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MAPPING ECONOMIC CRISIS IN SOUTH EUROPE: GREECE, PORTUGAL AND CYPRUS

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Abstract

The European crisis has been a subject of deep research for the past decade due to the extreme situations it has created in some countries. In this paper, we examine three of the countries that affected by the crisis: Greece, Portugal and Cyprus. The purpose of the paper is to try to understand the reasons some of these countries succeeded in overcoming the difficulties and the problems caused by the crisis while others could not find solutions easily.

Keywords: European economy, financial crisis, debt, Southern Europe

Jel codes: G01, G18

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1. Introduction

During the last decade, the European countries have shown some major changes- some of them severe enough to been examined thoroughly. Even though most of the countries in the European zone are part of the European Union not all of them are equal when it comes to their economies, the ability and the ways they solve their problems as well as how they treated by the other countries.

The greatest separation of the Eurozone is the Northern part on the contrary to the Southern. The countries of the North show some common characteristics that are not identifying in the countries of the South and related to the stability and the strength of their economies. The Southern countries have some common features as their Northern counterparts since they all belong in the European Union and the European Monetary Union. However, it is undeniable that the first have some specific features and institutional forms that grant them with "a different socio-political etiquette" (Rhodes, 1996). It was those imbalances- political and economic- within the Eurozone, which, along with the banking crisis, formed the European economic crisis and the 2008 financial meltdown (Hassel, 2014). However, it is not the Northern countries that we are interested in and we examine in this article but the Southern and more specifically, Portugal, Greece and Cyprus.

These three countries harshly affected by the economic crisis that hit Europe in 2008, each one in its time and severity. The way these countries chose to solve their economic problems and get through the crisis was different for each one of them. However, all of them are worth studying in order to be able to understand the importance of the political decisions and the alliances among the countries as well as the role of some Institutions and how they affect the economies of the countries. Can a country survive on its own? Is it possible that an economy of a country can solve the economic problems without the help of certain institutions? How important are the political relations of a country? These are the questions we will try answer through this paper.

2. The South European Crisis

From the very first moment that the countries of the Southern Europe (Greece, Italy, Spain and Portugal) applied for admission to the European Community in the 1970's, it caused concern to the "developed" Northern countries that viewed the South as a threat to the pace of their economic progress (Verney, 2009). In the 1990's, after Greece, Portugal and Spain had already entered the EC, the matter of the "developing" South was once again a hot topic. The unstable economies and monetary systems of Greece and Italy raised the fear that the South European countries would weaken the new currency that the European Union wanted to create and compete internationally. In order to secure the new currency and its strength, the European Union was prepared to launch it without the countries that did not meet the criteria of the Maastricht agreement, thus, the countries of the South Europe (Greece, Portugal, Italy and Spain).

Nonetheless, these countries managed to succeed and meet the expectations that the Northern countries had from them. Thus, in 1999, Italy, Spain and Portugal, became members of the EMU and, in 2001, Greece joined them. On January 1 2002, the euro became the official currency for the four countries, as well as, for the eight original Eurozone members.

2.1 *The breaking point*

With the new currency been released, the monetary policy that European Monetary Union released was one that was oriented to the Eurozone as a whole. The different pace of development and competitiveness from the countries of the South did not taken into consideration leading to major imbalances and increasing the vulnerability of these countries (Hassel, 2014; Scharpf, 2011). According to the monetary policy and the regulations of the Union, all countries had access to cheap credit. However, not all governments used the benefit of cheap credit for economic development but rather for consumption.

This was no news for the European Monetary Union and it did not come as a surprise when the problems emerged. The success story of the four countries was short. In 2004, it revealed that the Greek Eurozone admission based on some "particularly creative accounting" (Verney, 2009, p 2). Furthermore, 2008 was a breaking point for the future of the southern European countries. The collapse of the Lehman Brothers was the final hit before the complete downfall of the South Europe. The Southern Europe's growth was dependent in capital inflows, during the boom years and the countries of southern Europe had been recipients of cheap borrowing over the previous decades and, from that point, they had to deal with rapidly growing borrowing costs that would soon have dramatic consequences (Gros, 2012; Bosco and Verney, 2012).

Following the events of 2008, things were about to get worse for South Europe as in October of 2009, Spain and Greece put South Europe in the centre of worldwide attention. The recently elected Spanish government made the announcement that- unlike what their predecessors stated- the country's real budget deficit was in fact 12.7 percent and not 3.7 percent and the national debt was 112 percent of the GDP. Both these recalculated economic indicators were above the specified limits of the Eurozone.

Another event, which could be blaming for the contagion to the other states, took place in autumn 2010. This was the agreement signed by the German Chancellor and the French President. According to this agreement, future bailouts would include debt restructuring and the cost by the private sector. This, however, came in complete contrast with the original message for the rescue of Greece, which stated that the Eurozone would not let any of its members suffer a potential bankruptcy. Thus, it should be safe to invest –in Greece, firstly, as it's' been the country that the message targeted to and- in any member-state without the fear of future losses due to bankruptcy.

The downturn of the Greek banks shed light and drew attention on Cyprus, a country that had not shown any signs of imbalance in the earlier years. The Greek bond "haircut" which was planned could result to potential great losses of the banks in Cyprus given the exposure of these banks to Greek sovereign debt crisis. The IMF speculated the Republic of Cyprus to follow the plan of Greek help but in a twist of the events, the Cypriot government decided to get help from Russia and in December, an agreement signed between the two countries resulting in a €2.5 billion loan granted to Cyprus.

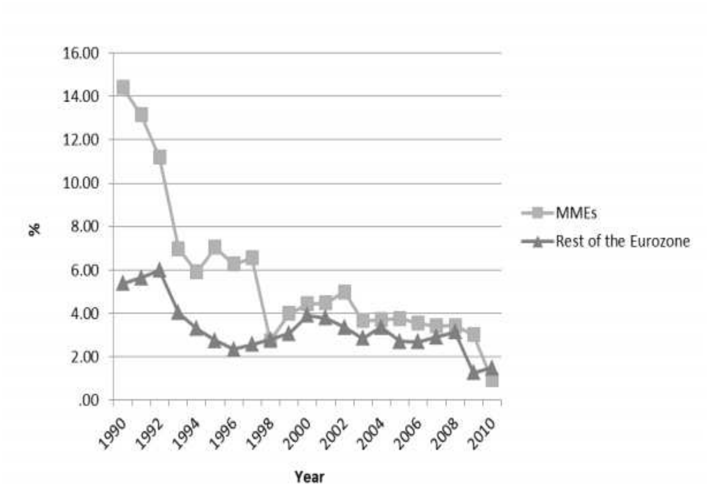
2.2 Two-speed economies

South European countries (Italy, Spain, Portugal and Greece) have been in the center of attention from the beginning of the Eurozone and have been the object of in-depth studies, especially during the last decade, since the financial crisis hit the European area. The Southern countries present some common features that could lead to the formation of a "southern type" or a "welfare model" and give us the opportunity to study them- the common features but, also, the differences through which some of them have managed in overcoming obstacles.

The countries of the European Union are of two-pace economies and separated in two different kinds of political economies: Coordinated Market Economies (CMEs), which consist of Germany, the Netherlands, Belgium, Austria and Finland and form the core of the Eurozone. On the other hand are the Mixed Market Economies (MMEs) (Greece, Italy, Spain, Portugal and Cyprus). MMEs were the late- comers both politically and economically.

When the MMEs became members of the Eurozone and the Monetary Union they had to reach countries such as Germany and France whose economies were already strong enough. The difficulties were many and the start was harsh but all these changed when the monetary system turned to Euro. Figures 1 and 2 present two macro- economic indicators that can show how the economies of the MMEs changed through the years and managed to cope with the economies of the CMEs. As seen is the figure 1 below, even though the wages in the MMEs were more sensitive and decreased faster in the beginning of 1990s whereas those of the rest of the Eurozone seemed to rise, the differences seemed to be diminished after the Euro was introduced in the 2000s.

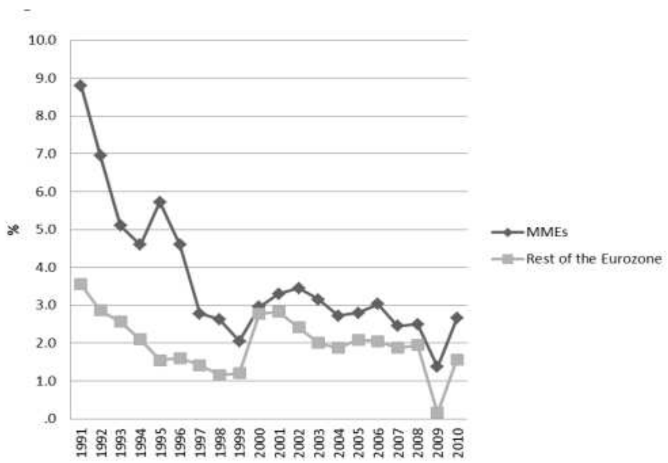
Figure 1: Nominal wages in MMEs and the rest of the Eurozone



Source: Hassel, 2014: 22

Figure 2, presents inflation as one more indicator of how MMEs succeeded in overcoming economic obstacles and reach the economies of the CMES. Prior to the 2000s, the differences were greater and the MMEs had higher inflation than the Eurozone average, whereas, after 2000, the inflation differential was much smaller.

Figure 2: Inflation in the MMEs and the rest of the Eurozone



However, none of these seemed to matter when the economic crisis hit the Eurozone. The separation of the countries was more visible than ever and had an important impact on them; both in the way they coped with the problems but also in the way they were treated. The way they coped with the problems they encountered during the economic crisis was an aftereffect of the political and economic decisions they had taken the previous years. In political terms, it was the public overspending by the governments, which took the opportunity of their EMU memberships and low interest rates, which caused inconvenience to the countries. When bail- outs and austerity measures were the solutions proposed in order to save the economies, the MMEs governments had a hard time coping with them.

Besides the macroeconomic indicators of the previous years were no warning was given, there were tremendous economic imbalances- deficits/ surpluses in the economies of the MMEs and CMEs- within the Eurozone that led to suffocation of the weaker countries once the crisis had hit.

3. Greece, Portugal and Cyprus

The case study Southern countries are Greece, Portugal and Cyprus. Its worth mentioned here that when we talk and examine Cyprus, it is the Southern part of the country (Republic of Cyprus). Taking into consideration this division, we examine the way that the Northern part of the island reacted in 2008 and the financial turmoil.

The Turkish Republic of Northern Cyprus (TRNC) is highly dependent on Turkey and, thus, it follows the economic trends of Turkey and not these of the Southern Cyprus. In the period of 2010-2011, Turkey showed high growth rates that must be mentioning. The same pattern followed by TRNC, which is actually a “branch” of Turkey. Even when the country showed high levels of budget deficit, not consider this since the economy financed by the Turkish banks. The difference here, however, is the fact that the financial transfers from Turkey are, actually, loans that not expected of paying back. In other words, TRNC is not an autonomous case to be examining for this paper.

3.1 One union but national variations

Even though Greece, Portugal and Cyprus belong to the same union, the differences and the imbalances among them were many:

Starting point: The first feature is the starting point of the recession of each country. Portugal and Greece affected by the crisis in the first years whereas Cyprus saw her economy being at risk during 2011.

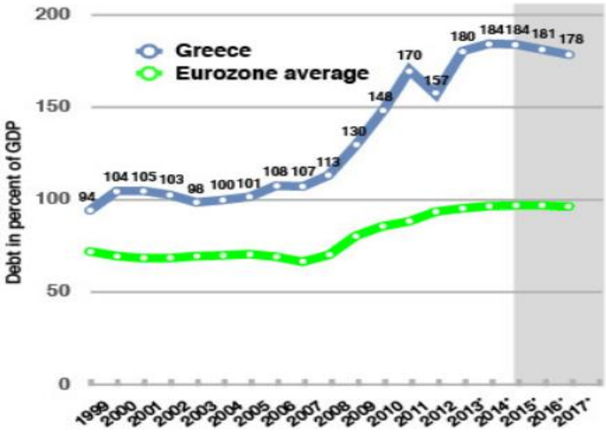
Greece had seen its economy growing rapidly the previous years and until the 2008 economic crisis. Despite the high rates of growth and the reduction of unemployment that the country showed, its economy was damaged by the fiscal deficit and the chronic public debt while responsible for these was the political class and the incapability to reform along with the extensive tax evasion. However, what made matters worse was the revelation of the real state of the country’s economy in 2009 that led to the country’s sovereign debt repeatedly downgraded and driving Greece towards an inevitable bailout.

Unlike Greece, though, *Portugal’s* economy has been weak and on slow growth since 2002. The constantly- rising unemployment and the fiscal imbalances led the country’s government to impose austerity measures and reforms. However, this decision happened placed right before the 2008 financial turmoil, causing further problems and difficulties to the already suffering economy. Due to the slow progress of the economy from the existing austerity measures, it was inevitable for the government to avoid implementing new and even stricter austerity measures, causing further suffocation and leading to a new and worse than before recession.

On the other hand, the *Republic of Cyprus* was a completely different case and did not follow the same path as Greece and Portugal. Its GDP was the least affected of the three countries examined, with its contraction being the smallest among them and the unemployment rates kept low. The period, though, when Cyprus’s economy put into risk was during 2011 and was a direct consequence of the write-off of the Greek public debt.

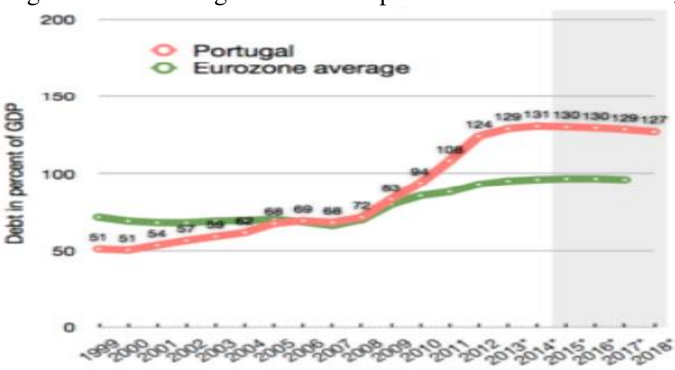
Figures 3, 4 and 5 present a comparison between these three countries. For Greece and Portugal, the downturn took place in 2008 that means that they first affected by the crisis in Europe. Greece’s economy has been and still is in a worse position than this of Portugal and Cyprus’s. The Greek debt- compared to the Eurozone’s- has always been much higher and according to the statistics and the predictions for the next years, it will remain in high levels. The Portuguese debt was not like the Greek. In the first years of the 2000s, the levels of the Portuguese debt were only a little higher to these of the Eurozone’s average. Even after the crisis affected Portugal, the country’s debt did not excess the Eurozone’s a lot, like the case of Greece. The reason behind this is the fact that the Portuguese economy has always been weak and with no industry to support or strengthen it. The Cypriot debt, on the other hand, was not like the Greek or the Portuguese. The country’s economic statistics were better and the debt of the country was under the Eurozone’s average for years. Only after the events of 2011, the Cypriot economy took a downturn and the country faced with a debt, which, however, was only a few units above the Eurozone.

Figure 3: The Greek debt compared to the Eurozone average



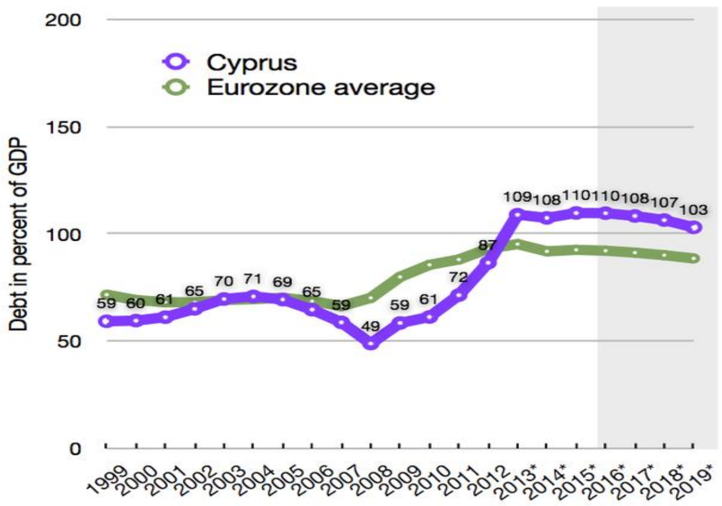
Source:http://www.principalandprosper.co.uk/Greece_Finaly_does_a_deal_but_so_what%253F

Figure 4: The Portuguese debt compared to the Eurozone average



Source: https://daytradingacademy.com/time-greece-leave-euro/

Figure 5: The Cypriot debt compared to the Eurozone average

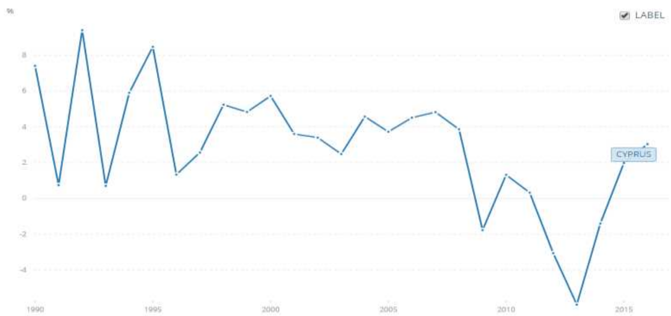


Source:https://commons.wikimedia.org/wiki/File:Cypriot_debt_and_EU_average.png

3.2 Time span

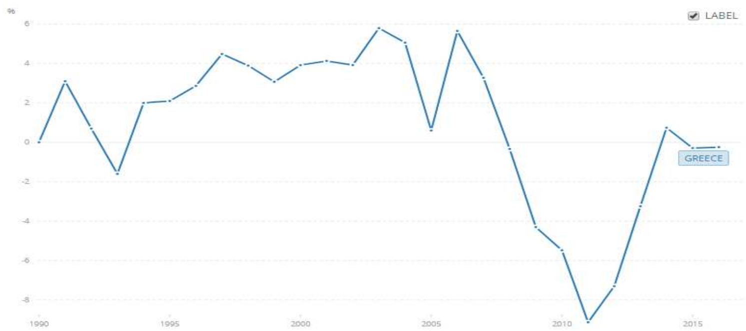
One more variation between the three countries is the time duration of the recession: for Cyprus, things were easier since its recession lasted less than the two other countries. The country's GDP became worryingly negative in 2010 but lasted for two years (figure 6). On the other hand, Greece was in a worse position. As shown in figure 7, 2014 was the first year that the country's GDP was not negative. However, in 2015, it became negative again but the situation was not as difficult or bad as before. For Portugal, things were different because the country fell into recession in 2007 with the country's GDP dropping and remaining low for two years, then showing signs of recovery (figure 8).

Figure 6: The Cypriot GDP prior, during and after the European crisis



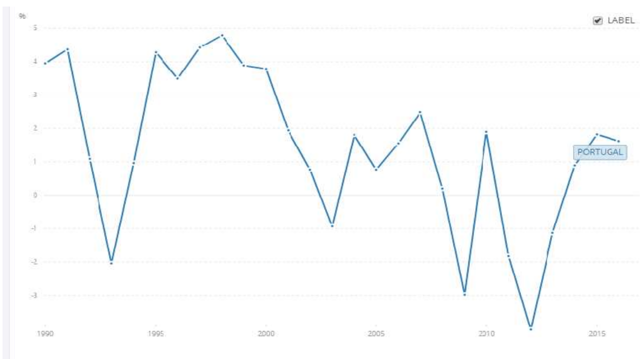
Source:https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2016&locations=CY&start=1990&view=chart

Figure 7: The Greek GDP prior, during and after the European crisis



Source:https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2016&locations=GR&start=1990&view=chart

Figure 8: The Portuguese GDP prior, during and after the
European crisis



Source: https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2016&locations=PT&start=1990&view=chart

4. Bailout programs and the role of the Institutions

In order to survive from the harsh economic situation, Cyprus, Greece and Portugal turned to the EU for help and adopted the rescue programs implemented on them by the EU and the IMF. Although all these three countries were in need for help, the background of each one was different and this affected their progress as well.

Greece had seen its economy growing rapidly the previous years and until the 2008 economic crisis. Despite the high rates of growth and the reduction of unemployment that the country showed, its economy was damaged by the fiscal deficit and the chronic public debt while responsible for these was the political class and the incapability to reform along with the extensive tax evasion. However, what made matters worse was the revelation of the real state of the country's economy in 2009 that led to the country's sovereign debt and driving Greece towards an inevitable bailout.

In April 2010, Greece was the first country- member of the Eurozone to have its sovereign credit rating seriously downgraded after becoming clear that the country's public finances were unsustainable. Since May 2010, the decisions for the future of the countries decided form the EU, the European Central Bank and the IMF in common starting with the case of Greece where a bailout package was decided which involved a € 110 billion loan and the adoption and implementation of austerity policies for the region.

Unlike Greece, Portugal's economy has been weak and on slow growth since 2002. The constantly-rising unemployment and the fiscal imbalances led the country's government to impose austerity measures and reforms. However, this decision put into action right before the 2008 financial turmoil, causing further problems and difficulties to the already suffering economy. Due to the slow progress of the economy from the existing austerity measures, it was inevitable for the government to avoid implementing new and even stricter austerity measures, causing further suffocation and leading to a new and worse than before recession. On the other hand, Cyprus was the last country that affected by the unstable economic environment of the Eurozone. The downturn of the Cypriot economy was a consequence of the Greek unstable and problematic economy.

With the governments of the three countries having liquidity problems within their banking systems, the rescue came from the ECB and the IMF. The technocratic governments that rose to leadership at this period along with the intervention of the Troika in regulating the government budgets of the countries have raised concern over the general strategy for the Eurozone's strategy.

At this point raises the question of whether the institutions- IMF, ECB and Troika- have really offered a solution to the governments and the economic asphyxiation of the countries. Alternatively, if the plans offered, did not take into consideration each case separately and with respect to the particularities of each economy. In addition, the extent at which the governments of these countries intervened with the institutions and the solutions offered is one more thing that should examined.

Once the Greek and Portuguese governments confronted with bankruptcy and the banking systems were unable to help, the two countries had to accept extremely tough commitments imposed on them by the institutions. These commitments- fiscal retrenchment and policy reforms – would form a new model of fiscal supervision in the Eurozone (Scharpf, 2011).

National governments would turn into actions involving the introduction of austerity programs, as well as monetary policies involving deposit guarantees, liquidity injections and recapitalization of the banks in order to solve the problems that appeared when the economic crisis hit the Eurozone (Bartlett and Prica, 2012). However, for both of these countries the budget balances deteriorated and the great deficits that they encountered, eventually, led them to a deadlock where no solution was feasible. At this point, it is more than obvious that the two countries would need the help of external partners and, thus, turned to the IMF and the Troika for assistance.

The immediate priority of the institutions was to offer help to these countries in order to avoid bankruptcy. The means to do that was trough guarantees offered by the ECB, direct loans from the IMF and stability funds by the EMU members. Yet, there were more sacrifices that needed by Greece and Portugal in order to restore the viability of their economies and these involved some strict conditions and measures imposed on them. Cuts of public-sector wages, pensions and public investments and expenditures and, at the same time, increases in the taxes and the VAT were the measures imposed on the countries, first place.

Strict as they might be, the measures and policies that proposed to Greece and Portugal accepted by the governments and not strictly and arbitrarily imposed on them. Before the Lisbon Treaty, the country members of the EMU did not have the option to neither reject the policies imposed from the EU and the IMF nor leave the EMU (Athanassiou, 2009). On the contrary, once an EMU member had applied for help and protection, the government was under "receivership". That meant that the IMF and the European authorities, in collaboration with the Commission, were responsible for the examination of the economic problems and the solutions, the policies and the ways to get through the crisis, the monitoring of the process and, finally, the evaluation of the program. The ideal way to do the above was with the agreement and collaboration of the national authorities; in any other case, the national governments had minimal power against the institutions and the only option that they have is this of the bankruptcy.

When it comes to Cyprus, things are more perplexed than with the other two countries. Cyprus has a banking system that is relatively large compared to its economy: total assets of 896% of the GDP in 2010, whereas, for the Eurozone and the European Union were 334% and 357% respectively (Stephanou, 2011). The decade prior to the crisis of the Cypriot banks, the national authorities planned to make the banking systems of the country international financial centers and they succeeded in doing so until recently that the crisis interrupted their growth.

After years of uninterrupted growth, in May 2011, the country cut—off from international markets. One year later, in June 2012, the government applied to the Troika (IMF- EC- ECB) for economic help. However, Cyprus's case perplexed the members of the Troika as to what would be the best solution for the country. The president of the country, Mr Christofias, blamed the banking system for the crisis. On the other hand, the ex- Governor of the Central Bank, Mr Orphanides, put the blame on the government and public finances, as well as, the Greek haircut. And this is, exactly, the peculiarity of the Cypriot crisis: it was a conjuction of "sovereign debt and banking crisis together with debt overhang of business and households and a severe decline of competitiveness" (Zenios, 2013). Cyprus has created an external debt so large that it cannot repaid; no matter how strict austerity measures imposed on the country.

On March 2013, an agreement finally settled for the Cypriot case. Euro group along with the IMF, the European Central Bank and the government of Cyprus reached an agreement, revolutionary for the terms of the Eurozone. A €10 billion bailout assistance, as well as, a €5.8 billion bail-in for the Cypriot banks. The bail-in was, in fact, the recapitalization of the banks through deposits. Depositors of the two major Cypriot banks saw their deposits being cut even more than 80%, whilst, capital controls were imposed. This caused the shrinkage of the banking sector from 700% to 350% of the GDP creating additional problems to the financial service sector and on the economy by affecting funds and pensions. The imposition of capital controls, however, was already familiar to the Cypriots and their government. In the years prior to the growth of the bloom of the country's economy, capital controls used as a form of securing and supporting the economy of the Island.

5. Conclusion

All the three countries share one common feature: they faced the economic crisis of 2008. The governments of these countries witnessed the failure of the banking systems and for all of them the solution was difficult to found within their borders.

The Troika was Deus Ex Machina for all of them, offering a saving through liquidity shots. However, along with the help, it demanded from these governments the fulfillment of some prerequisites. Nevertheless, not all countries where in the same situation; for some of them things were easier, whereas others would need greater effort and more time to regain their well-being.

Austerity measures, strict policies, fiscal changes and banking recapitalization were the common factors that the Troika brought along with the help. Even though the three countries had a common resultant, the outcome was not the same and the time needed for the consolidation was different. Three reasons were responsible for that: First of all, the strength of the governments as well as their negotiation abilities and foreign policies. In case the country's economy is in such a bad condition that is impossible for the government to provide the necessary help, it should be capable of finding and providing a solution that would in favor of the country and the common good.

The Cypriot government succeeded in doing so; the governments of the island had been strong and resilient the last decades and they remained so though the crisis. The determination of the government to provide the best solution maintained the public confidence in the strength of the system and consumer confidence in the economy. The decisive actions of the country reduced the impact of the financial crisis and helped speed up the recovery.

Unlike Cypriot, the Greek government did not seem to be capable of taking strong actions when needed. Even though the governments changed throughout the years of the crisis, none of them was strong enough to maintain public confidence and reassure the Greek people that a solution found. On the contrary, people lost their faith in the governments and, as a result, they acted in ways that caused further damage and deepened the existing crisis.

Portugal, on the other hand, took drastic actions and changed the way of its economy. After the elections of 2015, a new government formed and succeeded in helping the Portuguese economy recover and meeting the conditions set by the Troika.

To sum up, the challenge that the Eurozone faced from the very beginning was the difference in the pace and the competitiveness of each economy. However, this not taken into consideration from the policy makers who decided a "one-size-fits-all" monetary policy. The target of this policy oriented at the Eurozone as a whole rather than seeing each case separately and respectively. This led to governments misusing the benefits of the Union and its policies by using the cheap credit they had accessed for consumption rather than development and even misleading the Eurozone on the progress, they had made (the case of Greece).

The European Commission, the European Central Bank and the IMF offered the help when they asked to but with the terms and conditions, they demanded from the governments. After experiencing the austerity measures and policies they had to adopt, the two of the countries studied which had the strongest governments- Cyprus and Portugal- managed in overcoming the hardest part of the crisis and are now heading for a recovery and meeting their targets within the next years. Their return to the markets is a fact and faith is regained for them. Unfortunately, the same does not apply for Greece that is still in deep recession. Having had a stronger government that would have gained and maintained the trust of the people as well as the trust of the EC, ECB and the IMF, would have made easier for them to come out of the bad place that they are now.

One lesson that the financial crisis can teach the governments worldwide is that in times of deep crisis, the normal fiscal and monetary policies are insufficient in stabilizing an economy. The only way out of a crisis is through the collaboration of the governments, the central banks and the international institutions with respect to the needs of the country each time. A crisis will followed by an upturn, eventually, which in some cases might take more time and effort. It is this period that a government should take advantage and allocate the resources to the sectors that are more productive.

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