The economic crisis: Greece and Albania

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Abstract

This paper presents and critically discusses the origins and causes of the Greek financial crisis and its implications for the euro currency as well as the Albania economy. In the aftermath of the 2007-2009 financial crisis the enormous increase in sovereign debt has emerged as an important negative outcome, since public debt was dramatically increased in an effort by the US and the European governments to reduce the accumulated growth of private debt in the years preceding the recent financial turmoil. Although Greece is the country member of the eurozone that has been in the middle of this ongoing debt crisis, since November 2009 when it was made clear that its budget deficit and mainly its public debt were not sustainable, Greece's fiscal crisis is not directly linked to the 2007 US subprime mortgage loan market crisis. As a result of this negative downturn the Greek government happily accepted a rescue plan of 110 billion euros designed and financed by the European Union and the IMF. A lengthy austerity programme and a fiscal consolidation plan have been put forward and are to be implemented in the next three years.

As for the Albanian economy, being connected to the Greek economy hasn't put it seriously in danger yet, but there do exist several signs of a future crisis.

Key words: Sovereign risk, Debt crisis, Bonds market, Expectations, Remittances, Euro zone

1 Introduction

In December 2008, the NBER[1] stated that the US economy, the world's largest economy, had been in recession since December 2007, exactly a year ago.

By definition, an economy is said to be in a recession, if there is negative economic growth for at least two consecutive fiscal quarters. Anyway, there are also some different thoughts of defining an economic recession period.

In this chapter you will find some detailed information about the causes that produced this economic downturn, his domino effect on the global economy and especially the Euro zone. Lastly, you will learn more about the impact that the global economic crisis has had already over the Albanian economy and its way towards integrating in the European economic zone.

As mentioned above, the US economy has officially entered in a recession period since December 2007, but only now there were enough data to prove that. That's primarily because an economic recession was already being suggested by some important economic indicators.

High commodity prices

During the last decade, we've experienced a boom in the commodities sector, which brought their prices up and up even more. One important product of the category is certainly oil, crude oil. So, only during 2008, we've all seen how the oil prices got high, so high that they caused real economic damage.

In January 2008, a barrel would be sold for as much as $100 a piece, which was a price level never seen for a long time. It would be soon surpassed by other price levels, reaching their highest peak during July 2008, as high as $147 a barrel. Soon after this time, oil prices and commodity prices generally began to fall.

The high oil prices led automatically to a chain reaction, which brought high food prices[2] and the aggregate price level to a higher level. This simply means global inflation.

Inflation

By the beginning of 2008, there were data showing that the global inflation was at its historic levels, reaching the highest peaks of the last decades in many of the countries worldwide. We've already mentioned that commodities is one reason for that, while others may be the excess money supply around the globe and the rising

1 National Bureau of Economic Research.

2 This may be seen in two different angles: the first refers to the strong dependence of the food production on oil, the second is related to the usage of different food products as alternative energy sources to petroleum.

demand for food in the fast growing markets.

Therefore, inflation was highest in the oil-exporting countries, but it was also growing in the no-exporting ones, especially the developing countries, cause of the rise in food prices[3]. Inflation was also increasing in the developed countries, but lower than the ones mentioned earlier.

Unemployment

At this point we'll have to deal with a so called vicious circle. The economic crisis at the beginning was inducted by the increase in unemployment, which led to a lower demand for goods, which led again to more people losing their everyday jobs. So, according to ILO[4], at least 20 million jobs will have been lost by the end of 2009 due to the crisis, where the biggest "contribution" is shared between the construction, real estate, financial services and, of course, the automobile sector. This fact will bring the world unemployment level above 200 million people for the first time in history, probably the worst news for everyone.

Credit crisis

This is a consequence of different factors, one of whom is the ability to create new lines of credit. This factor draws lots of cash flows from individuals and lowered dramatically the ability to sell or buy assets. The latter was a big punch for the financial institutions in general, which began to use their reserve cash, restricting the credit and ability to make new loans.

These facts led to the harsh bankruptcy process for many large, well-established investment banks, and also many other commercial banks in different countries around the globe. You will see some frightening cases later in this chapter.

Another factor to be mentioned would be the so called cheap credit. People could now buy a house in the easiest way possible and this led to notable speculation. More money was around, but it was to be spent on the same thing. That brought increased demand, and therefore inflation again.

These were the main factors that were suggested to be the causes of the economic recession in the economic system worldwide. As you could already have seen, they were strongly interrelated with each other. After all, it's just economy. It is all related to one another.

2 The Greek financial crisis – the history behind it

From one of the fastest growing economies in the Euro zone in the beginning of the millennium, Greece fell from grace as the country dragging the Euro zone economy down. The Greek debt crisis dates back to its entry into the EU.

3 IMF.

4 International Labor Organization.

November 2004. Greece admits that its government lied about its deficit in order to get into the EU.

The EU requires its member nations to have deficits below 3 percent - but Greece's deficit was always above 3 percent, since 1999.

March 2005. Greece suffers from the huge costs incurred as the host of the 2004 Olympics. The new government plans to impose an austerity budget to cut the country's deficit. **2006.** Greece's GDP is up 4.1 percent. The measures seemed to have worked.

November 2009. The Greek economy suffers from the 2008 global financial crisis. National debt rose to 262 billion euro from 168 billion euro in 2004 - the 2009 budget deficit reached 12.7 percent of GDP, more than twice the previously published figure.

December 2009. Fitch cuts Greek debt rating from A- to BBB+, the first time in a decade the country is rated below investment grade. PM George Papandreou announced tough rules to cut down government spending.

January 2010. The Greek government announces a second round of tough austerity measures; which include lowering government wages, fuel increases, and a crackdown on tax evasion. These measures prompted a series of strikes and protest that continue for months.

May 2010. The Greek government receives a US$145 billion (110 billion euro) rescue package from the Euro zone members and IMF. This follows another round of more stringent austerity measures implemented by PM Papandreou. This move also results in a 48 hour strike.

July 2010. Greek parliament passes the pension reform; a key requirement of the EU/IMF rescue package deal. This move limits early retirement, and forced millions to re-enter the workforce. The retirement age for women is also increased from 60 to 65.

January 2011. Greece receives 'junk' status from all three rating agencies, Fitch, S&P and Moody's.

May 2011. Finance Minister George Papaconstantinou rules out debt restructuring, but hopes that EU and IMF will extend bailout loan repayments. The Greece government urges for budget cuts and privatizations to overcome its debt crisis.

June 2011. Greece begins talks with international creditors for a possible second bailout package, which is roughly equal to its first rescue package, to prevent country from default. PM Papandreou also proposes new and stricter austerity laws which prompts tens of thousands of people to protest against the new measures.

2.1 The main causes of the Greek financial crisis

A number of factors have contributed to the financial crisis that Greece has been experiencing since October 2009. Some of these factors are endogenous, having to do with the structure of the Greek economy itself, the prolonged macroeconomic imbalances that the Greek economy faces and the credibility problem of macroeconomic policy. Other factors are exogenous and have to do with the implications of the recent financial turmoil and the timing of the response of Europe to the Greek fiscal crisis. We will briefly review all these factors in the following sections.

2.2 Endogenous causes of the Greek financial crisis

There is no doubt that running widening public deficits in conjunction with declining external competitiveness played a decisive role on the deteriorating fiscal stance of the Greek economy. Increased public expenditure in recent years led to dramatic increase in borrowing requirements and high levels of accumulated public debt. The debt-to-GDP ratio will continue to increase in coming years because of the € 110 billion EU rescue package, most likely getting above 150 percent by 2020.

The lack of the necessary fiscal consolidation during the past ten years, when Greece was experiencing high growth rates, in relation to the continuous false reporting of fiscal data[5], have undermined the Greece's government credibility. On top of that, the decline in competitiveness since EMU entry (Malliaropoulos, 2010) led to a persistent deficit in the current account. Increased "twin deficits" together with the lack of structural reforms in home forced Greece to issue new bonds at short maturity periods and at higher interest rates compared to the "anchor" of the EMU, Germany.

2.3 Exogenous causes of the Greek financial crisis

The Euro zone governments failed to give a clear signal indicating their readiness to support Greece, while the Greek crisis was deepening. Legal skepticism and questions like "are bailouts illegal?" were raised, mostly by Germany, for an issue which was partly political. However, there is nothing in the Maastricht Treaty that prevents a Member State or all EU Member States from helping a country in financial difficulty, individually or with the support of an outside body (IMF, EBRD, EIB, World Bank etc.). While Euro zone policy makers were debating whether bailouts are illegal, at the same time there were some ambiguities about ECB's collateral eligibility criteria that is the ECB's policy to accept or refuse the downgraded Greek government bonds as collateral in liquidity provision presented. These ambiguities created problems for financial institutions holding Greek government bonds.

Another exogenous factor that contributed to the instability of the Greek economy was the lack of solidarity funds at an EU level. EU is a monetary union not an economic one with a Federal Budget. EU has a common monetary policy set at a

5 In mid-October 2009, the newly elected government announced the budget deficit for 2009 was estimated to be 12.7 percent of GDP while the previous government was arguing in September 2009 that deficit would not be higher than 6.5 percent of GDP..

supranational level but economic policy is still in the hands of national policy makers. Whenever a crisis occurs at the EU periphery, there is no adjustment mechanism in place to deal with such a crisis at a supranational level. The lack of European solidarity was inevitably mirrored in widening Greek spreads to German Bund. Eventually, the EU leaders agreed on 25 March 2010 an €110 billion 3-year rescue package for Greece.

On the other hand, Greece and its major trading partners in the Balkans were also hit by the 2007 global crisis, but with a time lag (Vlamis and Karousos, 2010). Nevertheless, recession may have hit Greece somewhat less badly than other countries because a relatively small manufacturing sector and of the large share of the shadow economy.

3 Economic crisis in Albania

Foreign investments and remittances are the only two elements that can bring the global economic crisis closer to the Albanian economic reality. According to several experts, it has been generally admitted that our country and its fragile economy isn't totally immune from the regional developments.

3.1 Current situation

The situation for the first quarter of 2012 follows the same trends of the end of 2011, where the real budget revenues continued to decline, along with private consumption and investments. Investments dropped by nearly 52 percent, while public expenditure dropped by 3 percent.

The overall situation shows the continuous deterioration of nominal budget revenues, which in the last period show stagnant or even declining values, therefore bringing a slower economy for the near future.

3.2 The possible impact over the Albanian economy

As we stated earlier, the two main factors that can bring economical consequences in Albania due to the global economic crisis are the FDI[6] and the remittances. But these two factors are able to produce a chain reaction and expand the crisis' impact over the Albanian economy.

According to that, some of the possible ways the global crisis can affect our economy are:

- The reduction of the immigrants' cash flows (remittances). This means that less money will be around. People won't have the ability to buy some things the bought before and the total sales may go deep down.

6 Foreign Direct Investments.

Bank savings will also decline and the possibility to invest somewhere will be lower. This will bring a chain reaction to the whole economy of Albania, even if it's just one factor making the whole mess.

- The reduction of FDI. This can be easily justified with the fear that different countries have in extending their trade relations in periods of big crisis. Economies tend to be less expansive, especially those that are fragile. In the case of Albania, FDI-s are a real development tool and if this tool is missing, then the economy will have its own decline period.
- High food prices. This is just the result of the high commodity prices worldwide, that affect the production of food among other products. This can bring higher price levels and lead to inflation, that might rise in an uncontrolled way.
- Lower exchange rates. This means that the ALL will be stronger compared with the foreign currencies, such as Euro or the USD. This automatically means less exports, less regional trade and a lower GDP.
- Restricted access to bank loans. This means that it will be more difficult to get a loan from a common bank, because of the restricted possibilities of the banks to credit their clients.
- Worse trade balance. This is related to some of the above impacts and means simply that the ratio imports/exports will rise on the imports side. It is stimulated by the combination of several economic developments stated above.
- Weakening the house market
- Reduction of interest rates depending on the exchange rates

4 Implications of the Greek financial crisis for Greece, the Euro zone and Albania

Let us denote first that it is not in the interest of any country to let one member of the EMU to run away from its debt obligations, as the associated political and economic costs would be substantial for everyone. There will be a general confidence loss in ability of EU to deal with its fiscal and wider economic challenges. If Greece is let/forced to default, contagion to other Euro zone bond markets and Euro zone financial institutions, that hold significant part of the Greek bonds, is a strong possibility. Debt crisis in one member country of the Euro zone might trigger a more general crisis involving other Euro zone countries perceived to be "fragile" and have similar budgetary problems (like Spain, Ireland and Portugal). Spillover from Greece into Balkans might be possible too via trade and, more importantly, via financial links. Financial links via Greek banks are widespread, since Greek banks have a considerable market share in Balkans and the south-eastern European economies and they are among the more aggressive lenders in these countries. Moreover, if Greece is let/forced to default, Greek commercial banks which hold government debt will be in trouble too.

By all means, credibility of the euro is currently at stake but too much political capital has been invested in it throughout the years to let it die. At the moment there is no consensus among the EU member states to move towards political union but, it is absolutely imperative to design and implement an institutional budgetary framework for supporting financially countries that face fiscal difficulties. There is a need for a "close and increasingly binding coordination of national economic policies, combining incentives and sanctions, coupled with effective surveillance and conditional assistance" (Tsoukalis, 2010). However, at this moment it is clear that there is no consensus within Euro zone member states to move forward into a more coherent political union that would allow the transferring of budgetary and tax responsibilities to supranational authorities (De Grauwe 2010d, 2010e).

4.1 Relationship between Greek financial crisis and the Albanian economy

The Albanian economy is inter-connected to the Greek economy in different ways. There were three main channels through which the two economies were linked: Albanian immigrants' remittances coming from Greece, Greece being Albania's second-biggest trade partner and three Greek banks operating in Albania, which comprise one-fifth of the Albanian financial market.

The Greek debt crisis could have an impact on Albania's foreign trade, remittances from 650,000 Albanians living there and the cost of lending by Greek banks. Remittances, which have been a driving force for the Albanian economy for the last 20 years, have shown a declining trend in the last couple of years.

Greece is our second-biggest trade partner, but this is much more relevant to imports than exports. Exports to Greece cover 12 to 15 percent of overall Albanian exports, adding that although this was not insignificant, most of the exports were basic minerals and low value-added goods, which are less sensitive and might even have a positive elasticity in the Greek crisis.

Thus, the Albanian economy has been hurt by the Greek crisis, but not as much as had been thought. As the Greek economy strives to recover from its debt crisis, neighboring Albania has been performing well economically. Experts say that although remaining unaffected by the Greek crisis would be impossible, its impact has not been severe.

The deteriorating economic conditions in Greece during 2010 and 2011 are in stark contrast to the relatively stable economic conditions which prevailed in Albania during the same period. The Albanian economy experienced reduced levels of economic expansion during 2010 and 2011. However, Albania's levels of economic expansion for 2010 and 2011 are, with the exception of Kosovo, the highest growth figures in the Balkan region (World Bank 2011).

Table 5.1 — *Annual percentage of GDP - Greece, Albania. Source: World Bank, November 2011.*

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Greece	1.2%	1%	-2%	-4-8%	-5%
Albania	6%	7.7%	3.3%	3.5%	3%

The deterioration of the Greek labour market in 2010 and 2011 is also in direct contrast to the conditions which prevailed in the Albanian labour market during the same period. While unemployment level in Greece during between 2008 and 2011 more than doubled, the unemployment levels in Albania during the same period have remained relatively constant.

Table 5.2 — *Unemployment percentage - Greece, Albania Source: World Bank, November 2011.*

Year	**2008**	**2009**	**2010**	**2011**
Greece	7.7%	9.5%	12.6%	17%
Albania	13.1%	13.5%	12.5%	12.1%

These are some other indicators that the impact of the Greek financial crisis isn't yet as severe as thought, but, as in the case of other regional economies, there might as well exist a time lag.

On the other hand, despite hardships endured by businesses established in the regions near the Greek border, experts say the crisis has caused some Albanian businesses to expand relations with other western European countries.

In the current situation, Albania has a lot to gamble on its future as related to the regional economic environment, and, more important, related to the EU zone. This means that the economic crisis that has affected most parts of the world actually will seriously be a way to measure our country's economic capabilities to face such situations in the near future.

We all know that we have a fragile economy, partly because of the long and annoying transition process that our country has been going through for the last 18 years. Meanwhile, other countries of the same region, that have only 18 years of existence, are now proud to be closer than ever to the EU, just a few years away from being part of it.

The economic crisis certainly will affect the integration process and will slow it down in a way that will leave us hopeless, but that's not the case. The important thing is to create the right economic environment so as to maintain the required macroeconomic stability for integrating in the higher economic and political organizations.

5 Recommendations

- The economic crisis is still going on and its primary target is the personal income of the individuals, especially those coming from the low-income levels. There should be made several decisions in order to help these people pass this critical moment.
- The government should focus its investments in the public services, by building new national roads, railways, new schools and also new healthcare systems.
- Politicians or experts should continuously monitor the activity going on in the banking sector carefully and be prepared to take into account external support, not only on currencies, but also on the banking systems
- Developing countries, and even the most developed countries should not be following a protectionist policy, if they are in the middle of the crisis, because that would only make things worse
- The countries' governments should invest as much as possible to invest in minimizing the gap between the high demand and the low offer and they should also strongly encourage new efficient ways in order to keep the balance between the offer and the demand for goods
- The economic crisis brought in many cases higher imports than exports. To reduce this gap created, and to be finally independent from the import of food products, several countries with unused agricultural capacities, should try to implement programs that raise the agricultural productivity and R&D in the agricultural sector. Related with this is also the expansion of the rural road system, very important for the development of the rural zones.
- There is high risk that the economic crisis could bring a food crisis. To prevent this, governments worldwide should take some precautions, such as putting off export barriers with their neighbours, assuring sustainable financing for the local agencies that deliver food and also they should improve the coordination with other countries in getting the right information anytime, anywhere about the global food reserves

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