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Greece Crisis and EURO Currency - an Analysis

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Abstract: The world financial system is on the verge of breakdown, the current crisis had gone to an incredible extent. The extent of the crisis had become so severe that it had destroyed the trust in the banks and borrowers in all the major economies of the world. The European Union are slowly having problems one after the other starting from Greece. The current crisis in Greece is slowly spreading all over the European Union. Many economists and experts expressed that Greece have only one solution and that is to leave Euro and Default. The current Greece crisis puts a serious question on the survival of Euro – the currency of European Union (EU). The current crises in Europe are showing sign of Euro breakdown. This paper made an attempt to describe how the Greece Crisis had started, to what extent it had been reached and also attempts to explain the future of the EURO currency which is in jeopardy.

Keywords: Greece, Current Crisis, Euro, European Union.

1. Introduction

The world financial system is on the verge of breakdown, the currentcrisis had gone toan incredible extent.The extent of the crisis had become so severe that ithad destroyed the trust in the banks and borrowers in all the major economies of the world.The financial crisis had becomeGlobal financial crisis due to its severity. The current crisis is expected to have a double-dip recession in U.S. economy. As we all know, that present crisis was started in U.S.A. and slowly spread to Europe & rest of the world. Now, the financial crisis in Europe is slowly becoming severe than expected. The severity of European crisis is due to lack of proper policy making and coordination within the Euro region. The European Union are slowly having problems one after the other starting from Greece. The current crisis in Greece is slowly spreading all over the European Union. Before going further on Greece crisis, let us have a look on how Greece had entered into European Union.

2. Greece and European Union (EU)

Greece joined the European Economic Community, the predecessor name of the EU, in 1981 and also became a member of EU in 1999. In 2001, it had met all the requirements to become a member of the European Monetary Union, to use Euro as currency. The Euro came into circulation to Greece in 2002, replacing the drachma (Greece currency). The implementation of Euro provided the Greece with an access to competitive loan rates and also to low rates of the Eurobond market, which was a high inflation risk for the country under the old currency - drachma.

This showed more positive sign in the economic growth with an increase in consumer spending. Greece averaged 4 percent of Growth during 1997-2007 which is nearly twice of the EU average. Greece went into recession in 2009 with a contracted growth rate of 2 percent. This is due to world financial crisis, which had its impact on access to credit, world trade, and domestic consumption which are the engine of growth to Greece.

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3. Greece Crisis and Austerity Measures:

Any economy cannot sustainwith a low Interest rate for a long period of time& Greece is not an exceptional. It had a low interest rate along with major fiscal and structural weaknesses that lead to recession. During 2009, Greece had a high fiscal deficit (as per Eurostat it was 15.4% GDP from 13.6%) and public debt (126.8% of GDP).

Due to high deficit, public debt, market doubts and unsustainable cost Greece had lostmarket access in 2010. It had been forced to request emergency assistance programme from Euro countries and the International Monetary Fund (IMF). In early May, the Greek parliament, Euro leaders and IMF approved a three year € 110 billion (which is about $ 145 billion) adjustment programme to be monitored by the EU, European Central Bank (ECB) and IMF. Under this programme Greece has promised to take major fiscal consolidation and implement necessary structural reforms to place its debt on more sustainable and competitive manner. This, three year reform programme, includes the several austerity measures &Greece had committed to reduce its deficit to less than 3% of GDP (which is the ceiling under EU's Maastricht Treaty) by 2014.

Recently there was a severe protest in Greece against the Austerity Measures recommended by the ECB and IMF. ECB and IMF had asked Greece to take essential Austerity Measures before they claim out for the bail-out package. ECB watched Greece very closely on their decision on austerity measures.The Austerity measures are mainly classified into 2 parts, one is Tax Increase and other is slash in Public Spending. The Tax Increase includes the solidarity levy of 1% on income of € 12,000 to 4% on income of €100,000 or more. It also includes reduction in tax slab to € 8,000 from € 12,000. The Spending Cuts include reduction of 15% in wages and cut of 150,000 public sector jobs which would reduce the total bill to € 2 billion by 2015.

The current Greece crisis raised few questions like Whether the Greece will take the Austerity measures despite of the huge protest in the country? Whether it will default or will continue with Euro?

4. Why Greece can't &should leave Euro:

Many economists and experts expressed that Greece have only one solution and that is to leave Euro and Default. But leaving Euro is not easy and, unfortunately, not an option for Greece at this point of time. In 1998, the founding members of the euro-area agreed to lock their exchange rates at the then-prevailing levels. Leaving the Euro means breaking its commitment and the very motivation for leaving would be to change the parity. Leaving Euro will not only allow Greece to deal with sovereign debt crisis, but also it will be in the middle of a bank run, while everyone would be trying to avoid ending up with devalued drachma.

If Greece leaves, then the other countries like Ireland, Portugal and may be even Spain might also follow on the same line (because they are also looking for the bail-out package since their economy is also in tussle to pay off their debts). This will lead to banking crisis in all these countries, by holding their debts which might lead to banking crisis in UK and Germany (because they are the major creditors for these countries), which will put entire Europe in crisis. These are some major constraints and problems why Greece cannot leave Euro.

But, the economist and analyst who expressed their views, why Greece should leave Euro have their own reasons. If Greece does not leave Euro at this time, when the economy is already very weak, then there is a risk that the economy will spiral down further in crisis. It's a hard decision, which Greece had made, for Austerity measures but they did not have any other better option. The Crisis which, started in Greece, initially started spreading in a slow phase gained the momentum in such a way that even few developed countries in Europe are started feeling the heat.

5. Crisis Spreading – The Spillover Effect:

In economics there is a term called "Spillover Effect" which means the externalities of economic activity or processes of those which are not directly involved in it. Already, the crisis had started to spread to the other European Union countries. The countries like Portugal, Ireland, Spain and Italy are already suffering from the crisis. Italy, one of the major countries in European Union is already in crisis. Its deficit this year is expected to be just 4% of GDP; but, its overall debt mounds to 119% of GDP.Recently, the ECB had

purchased the bonds of Spain and Italy in order to avoid further crisis. Belgium is expected to follow as a victim of this Spillover effect.

6. Will Euro Survive?

The current Greece crisis puts a serious question on the survival of Euro – the currency of European Union (EU). The current crises in Europe are showing sign of Euro breakdown.

Many economists and analyst now feels that Euro may fail and soon it may get dissolved. But, Professor Milton Friedman, Nobel laureate and Famous Monetarist, had this view even before Euro came into operation. In his interview to ABC Australia on 17 July 1998 that

"In establishing the common currency area, the Euro, the separate countries are essentially throwing *away this adjustment mechanism. What will substitute for it?*

Perhaps they will be lucky. It may be that events, as they turn out in the next 10 or 20 years, will be common to all the countries; there will be no shocks, no economic developments that affect *the different parts of the Euro area asymmetrically. In that case, they'll get along fine and perhaps the separate countries will gradually loosen up their arrangements, get rid of some of their restrictions and open up so that they're more adaptable, more flexible."*

Friedman kept his view unchanged even in 2005, less than one year before he died (at age of 94 years). In an Interview with New Perspectives Quarterly Magazine, 2005, he said that

"*The euro is going to be a big source of problems, not a source of help. The euro has no precedent.* To *the best of my knowledge, there has never been a monetary union, putting out a fiat currency, composed of independent states. There have been unions based on gold or silver, but not on fiat money—money tempted to inflate—put out by politically independent entities.*"

Some economist felt that Friedman hadpessimistic view, and few said that Euro will not break-up or dissolve. They support their argument with the following stance that "Countries in the European member states are incredibly linked far beyond just sharing a common currency. The Borders of the countries have essentially been erased, the trade and even citizens can move freely between the Eurozone countries." It is true, that Prof. Milton Friedman's prediction is yet to come true, but it may happen sooner or later.

7. Conclusion:

The history of currency unions gives us more evidence on why Euro may not survive. For any Economy, the monetary integration along with the fiscal integration is far more important. If the monetary policy fails then the fiscal policy will support and vice-versa, but, European Unionfails to adopt this strategy. Secondly, the history shows that any currency unions become stronger during expansion or boom, but fails when there are contractions or slum. The best example for this is the 19thCenturies Latin Monetary Union and the Scandinavian Monetary Union, which is considered, has a Great success but forced to withdrawal when global conditions became unfavourable.

The Greece crisis, which is slowly spreading to the rest of European member countries, may eventually make the member economies to move to their own currency after certain period of time. But, still it's too early to say how things will take its shape.

I remember a famous line of Ludwig Von Mises in his book Human Action, which is as follows:

"*There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.*"

How true it is! "a voluntary abandonment ……… or later as a Final and Total Catastrophe of Currency System", even though he said this for credit expansion, this line is perfectly suitable for Greece.

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