The development of European integration in the light of the Greek economic crisis

Zexi Liu

The School of Russian Language, Beijing Foreign Studies University, Beijing, 100089, China

18030032@bfsu.edu.cn

Abstract. This article uses the Greek debt crisis in the context of European integration, elaborating the process of its outbreak, analyzing the domestic and international contributing factors of the crisis, and researching the role of various countries as a member of EU in the process of its resolution, in an attempt to draw a conclusion about its further influence of on EU. The EU took a length of more than 50 years to evolve into an enormous association with well-established economic systems. For many years, EU seemed successful, as the euro stimulated the integration of capital market and trade development. However, with the Greek financial crisis beginning, it seems that Eurozone members can no longer be seemed to be insulated from the financial collapses. The Greek crisis was mainly caused by the unbalanced economic structure of Greece, together with other external factors such as inherent flaws in the institutional design of the Eurozone, incongruity between the economies of member states in the Eurozone caused by their structural differences, etc. Countries within EU reacted in various ways, and by comparing these positions and elaborating how they reached agreements, we can conclude that the crisis make these countries rethink and amend the monetary system of EU, especially about how to response to economic crisis, which is of positive significance for EU, despite the huge economic losses caused by the crisis.

Keywords: Greek economic crisis, European integration, construction of EMU

1 Introduction

The Greek economic turmoil began in 2010 and subsequently turned into a prolonged destructive disorder for both the economy and the society of the country. Since the sharp phase of the crisis ended in 2013, the country still seemed to be unable to return to a state of sustained growth. Analysis of these complex phenomena requires a political economy prospective that acknowledges the connection of the economic crisis and its social and political context.

This study starts by pointing out that the Greek crisis occurred in the context of European integration process, which resulted in distinguishable regional economic development as well as growing economic imbalances within the region. Further, the paper shows the reasons of the crisis, two main ones of these are unbalanced economic

H. Mallick et al. (Eds.): ICEMCI 2022, AEBMR 231, pp. 606–614, 2023.
https://doi.org/10.2991/978-94-6463-098-5_69

structure of Greece itself, and incongruity between the economies of member states in the Eurozone caused by their structural differences, together with inherent flaws in the institutional design of the Eurozone. Finally, we aim to analyze how did the crisis influenced the construction of EU, which is an unexpected benefit.

2 Background information: European integration process

The Greek crisis occurred in the context of European integration, and is a typical example of obstacles and challenges for the integration process. So, to start with, I'd like to give a brief introduction towards the background of European integration and the establishment of Economic and Monetary Union (EMU), in order to help us better understand the crisis.

There are 3 vital stages for the Greek crisis. In the first stage, the prototype of EU alliance was established, characterizing the Hague congress of 1948 and the Treaty of Rome. The Hague congress was held in May 1948 with 750 delegates participating from around Europe. It's the first milestone in the history of European integration, as it led to the founding of the Council of Europe, which is the very first institution that is able to bring the sovereign nations of Europe together. Then, about ten years later, two treaties were signed in 1957, and the European Economic Community (EEC) and the European Atomic Energy Community (EAEC) were established according to them respectively. The EEC and the EAEC, together with the European Coal and Steel Community (ECSC), were later brought together under the collective name of the European Community, when six nations signed the Treaty of Brussels on April 8, 1965. From then on, Europe started its way to become a union, wanting to integrate the labor, capital and techniques together. More and more countries would find it beneficial and submit applications, including Greece.

In the second stage, the whole Europe experienced the process of founding a monetary union, from EMS to EMU, and finally EU, together with euro and ECB, which we will elaborate in the third stage. In 1969, at a summit meeting in Hague, heads of State or Government decided that it's necessary to create an economic and monetary union step by step. An initiative in 1969, which attach great importance to the need for "greater co-ordination of economic policies and monetary cooperation" can be viewed as the first real endeavor to forge an economic and monetary union between the members of the European Communities. Then, in 1979, the President of the European Commission initiated European Monetary System (EMS) as an agreement among members of the EEC to foster monetary policy co-operation among their Central Banks, which can better manage inter-community exchange rates and finance exchange market interventions, especially when the exchange rate of the dollar is unstable. The EMS lasted from 1979 to 1999 and was succeeded by EU.

In 1989 the Delors report showed the world a concrete plan to establish EMU in three stages, with a design of institutions like the European System of Central Banks (ESCB). The decision to form an Economic and Monetary Union was taken by the European Council in December 1991, and was later enshrined in the Treaty on European Union (the Maastricht Treaty). In general, EMU is not an institution with specific frame, but a system which involves the coordination of economic and fiscal policies, a common monetary policy, and even a common currency in the future. EMU acts as a catalyzer that boosts European integration mainly from the political and economic aspects, and represents a major step in the integration of EU economies.[1]

The monetary union brings the benefits of greater size, internal efficiency and robustness to the economy of Europe as a whole, offers opportunities for economic stability, higher growth and more employment and helped countries understand the advantage of an integrated economic system, so European countries were becoming more willing to have a single currency. However, during the process, political interest was gaining in importance[2], and the union pushed the currency establishment too fast, leaving not fully qualified countries space to join in. Greece, for instance, was suspected of covering financial deficit when it joined in 1981. With its further enlargement including the former communist states of Central and Eastern Europe, the expansion of the EMU introduced a new level of complexity and discord, and the Greek crisis is just an example of this.

The third stage consists of the founding of EU and the implementation of Euro. In 1986, the Single European Act was signed, which empowered the European Community to establish a single market by the end of 1992 (as it anticipated the 1992 Maastricht Treaty), and to run the European Union's Common Foreign and Security Policy (CFSP) in the future, in order to help codify European Political Co-operation (EPC) among ‘the Twelve’. With cooperation between the great powers becoming closer, on 1 November 1993, the European Union was formally established, which is an extremely important milestone in the process of European integration.

Political and economic cooperation are intertwined. During 1990-1991, when the founding of EU was under discussion, European Central bank (ECB) was established – it is the central bank of 19 European countries which thereafter would use the euro, and the main goal is to keep the price steady. Then the European Single Market was created by a trade agreement, which worked as an economic powerhouse that could compete globally more effectively than its component nations could on their own. It was the preparation stage for the later usage of euro currency. After a decade of preparations, the euro was launched on 1st January 1999, but at the beginning of three years it acted as an 'invisible' currency, only used for accounting and electronic payments. Then, on 1st January 2002, coins and banknotes were launched. From this moment on, the biggest cash changeover of 12 EU countries in history took place. With the euro becoming the most used currency, countries using it can’t use monetary policies to tackle economic problems, thus the possibility of economic crises increased, to which Greece is a victim.

All in all, these institutions and measures such as EMU, ECB, the same currency and sharing policies, have linked and connected the EU member states closer, which can further improve resource allocation between them and therefore develop a more

1 https://economy-finance.ec.europa.eu/economic-and-monetary-union/what-economic-and-monetary-union-emu_en

2 “Economic and monetary union was the offspring of the Franco-German couple, President Mitterrand and Chancellor Kohl to be precise. It was about high politics and peace on the continent, much less so about economics” (Loukas Tsoukalis 2010)

balanced economy. However, these can also lead to some kinds of economic problems due to existing imperfections, and this hidden drawback was ignored until crises broke.

3 The Greek debt crisis

3.1 Overview

Greece joined EU in 1981. From the moment of its joining, there existed debates about whether Greece meet all qualifications to be accepted or not. Later, on October 2009 the new prime minister of Greece announced that the fiscal deficit of the government was 14.5% of its GDP and the was highly above the Maastricht criteria, which serves as the access criteria for EMU – fiscal deficit should be no more than 3% of GDP and national public debt no more than 60%. [1] From then on, fear of default widened the bond market, and the yield on the Greek 10-year government bond soared to an astonishing high level of 6.7%. Then the Greek government found that, Greece will need around €9 billion to service its maturing debt by 19 May 2010 to survive the crisis. Ultimately the Greek economy system collapsed.

Greece found that it can't solve the problem itself and they searched for help from other countries using euro. This means that other countries had to face an altercation: should they bail Greece out or not. They didn't want to pay for Greece; but if Greece had bankrupted, the euro, which carries Greece's credibility, would also be devalued, and many countries in the monetary union would be in the similar economic situation as Greece. Due to the high contagion risk, it's probable that other bond markets in the Eurozone and financial institutions that own a sizable portion of Greek bonds may be impacted, if Greece is let or forced to default. To put it in another way, a debt crisis in one member country of the Eurozone could lead to a wider crisis involving other members, especially those who are perceived as "fragile" and have similar fiscal issues (for instance, Spain, Ireland, Portugal). This domino effect worried most people and finally, member states of EU decided it's a problem at European level and they had to offer help. By analyzing other countries' reactions during the process of reaching an agreement, we can learn how the crisis influenced the integration process: the crisis put significant pressure on the euro as well as the governance structures of the Eurozone, demonstrating that all countries in the Eurozone are strongly connected to one another. It also made clear that budget decisions and economic crisis in the smallest economies of the euro zone could have big implications for all countries that share the same currency. [2]

3.2 Reasons: external and internal

The outbreak of the crisis has its internal as well as external reasons. Fundamentally, the crisis was caused by Greece's own homogeneous economic structure in conjunction with declining external competitiveness [3], together with excessive external dependence, unreasonably high welfare and widening public deficits. Its economy relied too much on tourism, shipping and gaming industries and can't resist challenges caused by the American economic crisis in 2008. Meanwhile, Greece made excessive fiscal expenditure on social security, such as Old Age Security pension, paid leave and so on. Furthermore, the high level of debt is another factor that may contribute to the severity of the Greek crisis. In 2007, Greece's net foreign assets were 99.9% of GDP, its government debt -103.1%, and its private sector debt - 92.4%. [4] There is a significant risk that high debt ratios can lead to a tight financial chain, and could result in irreparable damage if other problems suddenly occur.

Besides, inherent flaws in the institutional design of the Eurozone and incongruity between the economies of member states in the eurozone caused by structural imbalances also have something to do with the crisis. EMU is to be blame for the contradiction between a unified monetary policy and decentralized fiscal policies. Because the unified monetary policy depended to a large extent on the economic situation of the core countries, and the shocks had an asymmetric impact on member states, so that the economic situation of some countries deteriorated more severely than others: they can’t take some monetary policies in response to the coming crisis, and finally struggled more than anyone could have anticipated. Nevertheless, based on the erroneous assumption that governments' irresponsible behavior is the only threat to EMU, the Stability and Growth Pact (SGP) and EMU were imprudently designed, failing to account for the effects of private excessive borrowing and lending, associated moral hazard, and deficient corporate governance, which makes the danger of a crisis higher than anticipated. [5]

Moreover, it could even be concluded that the sovereign debt crisis is not the result of accidental government mismanagement, but an inevitable consequence of imposing a single currency on several countries with extremely different economies. Europe pushed for the creation and expansion of the monetary union for political purposes while member states did not have the corresponding economic conditions, which was the root cause of these problems. Different nations have different economic conditions, and all member states must make adjustments in order to maintain consistency with the whole economy, otherwise governments’ decisions will lead to an increase in fiscal deficits and a rise in debt. From this point of view, the emphasis lies on that the euro, as a single currency in the region, is at odds with economic diversity as well as labor productivity differences, which have contributed to the debt crisis. However, we need to pay attention on the fact that regional imbalances within a country is fine and doesn’t cause such extreme crisis, but economic imbalances among member states caused severe problems in the Eurozone. By carefully investigating into this question, a resolution addressing debt crises can possibly be found. Additionally, international credit rating agencies added fuel to the fire, together with the lack of bailouts and policy-making mistakes. [6]

It is obvious that, in addition to endogenous structural problems of Greece, the functioning of the Eurozone itself may be another possible explanation the current issue. The Eurozone is in great need of a group of mechanisms at a supranational level that can prevent similar crises in the future. The discussion about that will be in the following section. In a nutshell, it's important to create a mechanism that can promote convergence in the competitive positions of EU countries and prevent further development of trade imbalances. [7]

4 Divergence in problem solving: slowing down integration

By focusing on how Greece and other countries using euro reacted to the Greek debt crisis, the characteristics of relationships between them can be found, which can help draw a conclusion about the crisis's further influence of on EU.

4.1 Greece

After many rounds of difficult negotiations, Greece was guaranteed with help under the condition that it had to assign documents about reforming and implementing austerity, including reforming bank system and Social Security System, increasing tax and reducing welfare, selling state-owned assets to repay debts and so on. Because of these items, some people thought that they were ceding the sovereignty for aid, which is the main reason why they were reluctant.

In addition, the crisis' proximate cause was that the Greek economy is not so competitive in the Eurozone. However, instead of bailing it out, the policies imposed by the lenders primarily for the stability of the Eurozone, have had disastrous effects on both economy and society. [8]

4.2 A bloc leading by Germany and its reluctant partners

As for many member states who didn't want to offer help, Germany may seem to be the leader. They didn't want to spend money for Greece and they were discontent with excessively high welfare benefits which Greek people enjoyed, but they had to think about the consequences: if Greece had really collapsed, Russia would take advantage of the situation in Balkans and threaten their national security. So, Germany decided that, if Greece can figure out the reform plan and accept the rule, which means that the Eurozone wouldn't become a "transfer union" at the expense of German people, they can help.

Besides, it's possible that German government could gain benefit through interfering in the event. Regardless of how we specify the counterfactual, savings of approximately 100 billion Euros is probably a low bound of the benefits the debt crisis will bring to the German government. These gains outweigh the Greece's total debt owed by Germany (estimated by most accounts at 90 billion Euros). That is, the German central government alone would have gained from the Greek crisis, even if Greece defaulted on all its debt. [9]

Although German decided to help, actually, there are countries who insisted objecting the aid project, such as new members of Central and Eastern Europe – they are mainly "mall countries" without big power. They had just experienced painful structural reforms and austerity, and they didn't understand why the Greek government is strongly opposed to reforms; meanwhile, they found it hard to accept that they have to help Greece, a relatively rich country. What's more, they were indignant about filling the "bottomless pit" again and strongly skeptical about Greece's ability to honor the agreement. Yet the fact is that somehow, they had to follow the big power – Germany. And here is a problem of democracy at the level of the Eurozone in terms of the big power's dominant roles.

4.3 France

There existed a country who are willing to help: France. The reason why France was willing the pay is that France wanted to avoid the Germanization of the Eurozone. It thought that once Greece is forced out of the Eurozone, there will be a 'chilling effect', and other member states may more consciously comply with the German-led rules of the Eurozone, which means they are likely to be closer to Germany, and the German-led rules (such as austerity and structural reform policies) will be more thoroughly implemented with France's space in the Eurozone being greatly reduced. So, for France, defending Greece is in fact defending France's future position in the Eurozone and fighting for a voice equal to that of Germany.

4.4 Implications for EMU

About EMU, we need to think about how can national debates influence the process of European integration, and what will it lead to: a nationalist revival, which is a threat, or a further balance between economic development and political cooperation. The answer depends on how would EMU react to it: will it break rules (give money to countries in crisis without reform plan, austerity or any other change), or will it strengthen discipline and protect the reputation of euro in a better way. The crisis stirred up conflicts between countries but if EMU can learn something from it, such as how can countries cope with economic crisis, I think maybe it can still be seen as a winner.

The reason why Greek crisis is dragging on, is partly because that EU was overly optimistic in estimating the cost of bailing out Greece and repeatedly delayed its intervention. While the Greek fiscal crisis was escalating, the governments of the Eurozone failed to send a strong message that they were prepared to help Greece. When it finally found that it had to help, it delayed again because it wanted to protect other vulnerable members of the Eurozone, trying to buy time for them to cope with the shock. Worse still, during the process, the Greek government didn't understand the importance of unanimity to change the status quo in the EU, and did everything it could to prevent unanimity among the other nations, which further delayed the process. [10]

On the one hand, the crisis did cause unfavorable impact on European integration process – stirred up conflicts between countries. On the other hand, more importantly, from the crisis EU realized that it need to perfect itself by various measures: designing more practical access criteria; establishing and strengthening financial policy coordination mechanisms, financial monitoring mechanisms, and crisis relief mechanisms; improving the internal structure of the EU; balancing the relationship between large and small countries within the EU, and figuring out to what extent should sovereignty be ceded, to whom these rights are accountable and who should check them, etc. Currently there is no consensus among the EU member states to move it towards political union, but it is crucial to design and carry out an institutional budgetary framework to provide financial aid to those who are experiencing 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". [11] If EU can solve these problems, or at least accumulate experience to solve these problems in the future, the crisis can be seen as a valuable one.

5 Conclusion

In conclusion, through investigating the Greek economic crisis in the context of European integration, it's evident that its origin root is the economic system of Greece, including widening public deficits, excessive external dependence and unreasonably high welfare. External environment also has negative impacts, such as inherent flaws in the construction of the Eurozone, incongruity between the economies of member states caused by their structural imbalances, inflexible policies, etc. As Germany, France, and other countries hold different opinions about its resolution, it's obvious that there is still room for improvement for EU and its monetary system. Countries need to establish and strength policy coordination mechanisms as well as crisis relief mechanisms, meanwhile balance all kinds of interests within EU, in order to remove the shadow over European integration casted by the Greek crisis.

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