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THE ECONOMIC CRISIS IN GREECE AND POLICY FOR ITS OVERCOMING

KRYZYS GOSPODARCZY W GRECJI I POLITYKA JEGO PRZEZWYCIĘŻENIA

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Summary: The crisis of the euro area is undoubtedly a continuation of the global crisis that started on the real estate market in the USA, and from there spread to Europe, touching Greek economy the hardest. The purpose of this article is the analysis of causes of economic crisis in Greece and to determine high performance methods to its overcoming. To develop effective methods to combat the crisis and prevent future breakdowns changes must cover not only Greek economic policy, but also a mechanism for international cooperation. The crisis of the euro area turned out to be not only a crisis of the economies of member countries, but also of the mechanism of integration. It is especially about the economic policy carried out at the level of the EU institutions that affects the economic policies of individual member countries. Hence the article tries to find an answer to the question, what changes should be made in Greek economic policy as well as in the EU institutional framework to overcome the present crisis and to prevent its occurrence in the future. A permanent solution of the crisis can be only a transformation of Greek economy that was most acutely affected by a decline in production and an increase in unemployment.

Keywords: economic transformation, growth of export, unemployment in Greece, structural policy, public debt in Greece, budget deficit in Greece, banking reforms, proper policy mix between monetary policy and fiscal policy.

Streszczenie: Kryzys strefy euro jest kontynuacją globalnego kryzysu gospodarczego zapoczątkowanego na rynku nieruchomości w USA, skąd przeniósł się do Europy, dotykając pośród krajów UE najbardziej gospodarkę Grecji. Celem artykułu jest analiza przyczyn załamania gospodarczego Grecji i znalezienie najlepszych metod walki z kryzysem. Aby sformułować optymalne metody przezwyciężenia obecnego kryzysu i uniknąć podobnych załamań w przyszłości, zmiany muszą dotyczyć polityki gospodarczej Grecji, ale również mechanizmu międzynarodowej współpracy. Kryzys w strefie euro okazał się bowiem nie tylko kryzysem gospodarek krajów członkowskich, ale także kryzysem mechanizmu integracji europejskiej. Dlatego też artykuł próbuje znaleźć odpowiedź na pytanie, jakie reformy powinny nastąpić w polityce ekonomicznej Grecji, a jakie w strukturze instytucjonalnej UE, aby przezwyciężyć kryzys w strefie euro. Odpowiedzią na kryzys powinna być przede wszystkim transformacja gospodarki greckiej, która została najbardziej dotknięta spadkiem produkcji i wzrostem bezrobocia.

Słowa kluczowe: ekonomiczna transformacja, wzrost eksportu, bezrobocie w Grecji, polityka strukturalna, dług publiczny w Grecji, reforma bankowa, odpowiednia polityka monetarna i fiskalna.

1. Introduction

The crisis in Greece started in October 2009 when the reorganized new government published the real debt level and asked the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Union (EU) for help. After that Portugal, Italy, Ireland and Spain – hit countries − gradually joined the crisis. The crisis in Greek economy began with the high level of budgetary deficit and public debt. Like in many countries the Greek government relied on borrowed money to finance its budget spending. This internal disequilibrium was accompanied by external imbalances in the form of large deficit payments, which also had to be financed. The recession made this twin deficit harder to finance, because tax revenues were falling just as welfare payments started to rise. Budget deficit grew continuously because tax evasion was commonplace in Greece and pension rights used to be unusually generous. Because public debt, budget deficit and negative current account were growing, investors lost confidence in the Greek government's ability to serve their debts. They were demanding even higher rates of interest to compensate for the risk of not getting their money back. The higher borrowing costs were, the harder it was for the Greek economy to attain internal and external equilibrium and to grow itself.

The debt crisis in Greece began to spiral out of the control when credit rating agencies downgraded Greek government debt to "junk" status pushing the costs of borrowing so high that the country effectively had its international overdraft facility cancelled. The interest rates of Greek two-year bonds traded in the secondary market grew from 4.15% in 2009 to 9.73% in 2010, 26.27% in 2011, 177.37% in 2012 [Financial Times 2011]. The financial crisis in Greece moved after that on the real economy. During eight years 2008-2015 Greek economy passed by a great depression and in statistical terms its economy contracted by more than one quarter. As we can see in table 1 the deepest drop in GDP was noted in 2011 by 7.1% and in 2012 by 6.4%. Only in 2014, the Greek economy acquired a slight increase estimated at 0.5% of GDP, but in 2015 decrease was noticed again by 1.4 in spite of the growth on this small transitional positive number in 2014. The decline in GDP is projected also in 2016. Drop in production was mainly due to the decrease of private consumption by 25.6% and public consumption by 31.4% within five years except 2009 when public consumption grew by 4.8%. It was also due to the highly restrictive credit conditions. Gross capital formation decreased every year: in the years 2009--2013 by more than 80% and investment in equipment dropped by 69.7%. Slow recovery of macroeconomic balance influenced treatment to achieve the reduction in the interest on public debt. In 2015 10 year Greek Government bonds were accrue interest at a high level of 10.57%.

In the crisis period the Greek labor market was undergoing considerable adjustment. In 2008-2013 unemployment grew every year by about 2%, in total more than 10%. In the years 2014-2013 unemployment grew from 7.7% to 27.5%

Table 1. The main macroeconomic indicators for Greece in 2008-2016

	Annual percentage change								
	2008	2009	2010	2011	2012	2013	2014	2015	2016
GDP	-0.2	-3.2	-4.9	-7.1	-6.4	-4.0	0.5	-1.4x	-1.3x
Private consumption	4.0	-1.3	-6.2	-7.7	-9.1	-6.7	0.7	1.9x	
Public consumption	-2.1	4.8	-7.2	-8.5	-9.0	-4.9	-4.0	1.2x	
Gross fixed capital formation	-6.7	-15.2	-15.0	-19.6	-19.2	-5.9	0.8	8.4x	
of which equipment	1.3	-24.0	-8.2	-18.1	-17.3	-2.1	8.9	13x	
Export	3.0	-19.5	5.2	0.3	-2.4	1.8	4.1	5.2	
Import	3.3	-20.2	-6.2	-7.3	-13.8	-5.3	-1.2	2.2	
Contribution to GDP:									
Domestic demand	0.8	-3.4	-8.5	-9.0	-10.2	-6.5	-1.2	2.3	
Inventories	-0.5	-2.9	0.7	-0.4	0.0	0.3	0.0	0.1	
Net exports	-0.5	3.1	3.0	2.4	3.7	3.52	0.9	3.0	
Employment	0.8	-0.2	-2.6	-5.6	-8.3	-3.5	0.61	0.6	
Unemployment	7.7	9.5	12.6	17.7	24.3	27.5	26.6	25.8	25.7x
Unit labor costs whole economy	-7.1	-7.2	-0.1	-1.8	-6.2	-6.5	-1.9	0.2	
Real unit labor costs	2.2	4.3	-1.3	-2.9	-5.5	-4.9	-1.0	0.7x	
Savings rate of household	0.3	3.0	-3.0	-0.1	1.3	2.3			
Harmonized index of consumer prices	4.2	1.3	4.7	3.1	1.0	-0.9	0.8	0.5	
Terms of trade	-0.6	-3.4	1.8	-0.6	-1.0	0.2	-0.1	0.3	
Merchandise trade balance	-20.8	-16.2	-14.0	-11.3	-9.6	-8.7	-8.2		
Current account balance	-17.9	14.3	-12.8	-11.7	-5.3	-2.3	-2.0	1.3	0.3x
Net borrowing vis-à-vis ROW	-16.2	-13.3	-11.0	-9.8	-2.9	0.4	-0.1	0.2x	
General government balance	-9.8	-15.8	-10.7	-9.5	-9.0	-13.5	-2.5	-3.6	-4.6x
Cyclically adjusted budget balance	-10.6	-15.2	-8.4	-5.2	-3.2	-7.5	2.6	0.9x	
Structural budget balance	-9.7	-15.4	-8.9	-5.8	-1.0	-1.2	-1.9	-1.7x	
General government gross debt	113.0	129.3	148.3	170.3	156.9	176.2	176.3	194.8x	

Source: Eurostat GDP Growth (%), European Economic Forecast, Full forecasts for Greece, European Commission 5 November 2015; European Commission European Economy 7, 2013; J.V. Bordell, S. La Vella, *Key macro-economic indicators for Cyprus, Greece, Portugal and Ireland*, egov@ep.europa, 16 February 2015; Informator Ekonomiczny Ministerstwa Spraw Zagranicznych, Warszawa 2015.

and in 2014-2015 still remained above 25% of the total workforce. A profound contraction in economic activity reduced employment opportunities in the private sector. Employees laid off by private companies were not employed in the public sector, which showed an excess of employment. Rising unemployment brought of course downward pressure on wages. The cuts in public sector wages – in particular non-basic pay–concerned also the private sector. In the period 2010-2013 unit labor cost for the Greek economy decreased by 14.6%. In 2014 unit labor cost in the whole economy was reduced by 1.9%, but real labor costs by 1.0%. Labor costs were falling primarily as a result of the deterioration of the economic situation, but also wage setting reforms. Wage moderation was driven by firms moving towards more flexible working arrangements like part time employment or intermittent jobs. On the one hand the decline in wages increases firms profits on the other it entails reduced demand and further decline in production. In this way, there was a vicious circle in the Greek economy: the decline in production, expanded unemployment and put pressure on the continued decline in wages, demand and production.

Although reduced labor costs served also to recover competitiveness of firms, the sustainable growth export has grown only a little since 2011. In 2014 Greek export grew by 4.1% and in 2015 as it is predicted by 5.2%. In this context it should be noticed that the key indicator of economic activity is not only export but also investments and in Greece there were about 80% decrease of investments within 6 years. Because the participation of investments in Greek GDP has reached the lowest level for 50 years, investments constituted one of the main factors of changing the financial crisis into the economic one. Gross fixed capital formation decreased by 15.2% in 2009, by 15.0% in 2010, by 19.6% in 2011%, by 19.2% in 2012, and by 5.9% in 2013. Investments in equipment fell by about 70% in 2009-2013 (see Table 1). Furthermore due to pessimistic expectations the inflow of foreign direct investments to Greece had been nearly stopped with very lowest stock of 9% of FDI in GDP. The drop in FDI was connected with the balance of payment problems, an increase in unemployment and the decrease in competitiveness of the economy. It is worth adding that in 2012 Greece was ranked at the 100 position in World Bank Doing Business Report ranking after such countries as Romania, Bulgaria or Serbia [World Bank Doing Business Report 2012]. In 2014, followed by the lack of improvement in the investment climate, FDI grew only by 0.8% in Greece.

By 2015, production, investment, export and national income in Greece were still lower than in the pre-crisis period. Greek economy was still highly unbalanced with the budget deficit at –3.6 in 2015 and public debts at 194.8% in reference to GDP. Expected budgetary deficit will continue in 2016 (–4.6) and according prediction surplus may arise not till 2017 1.75% of GDP and 3.5% of GDP in 2018 (before taking into account the costs of debt service). Unemployment was more than one million, and import was higher than export by 9 billion euros. An economic recovery in the first nine months of 2014 turned to recession in the final quarter of 2014. At the beginning of 2015 the rate of annual growth grew a little by 0.8%. It was due to the growth of domestic public and private demand and export. Nevertheless economic growth in Greece was stuck in the middle of the year in connection with the organization of a referendum and difficulties in reaching an agreement with lenders (1.4% of GDP for the whole 2015). As it can be seen in Table 1 structural budget balance in Greece started to improve below the Maastricht figure in the last period. However, it does not reduce the level of public debt in Greece in relation to GDP. The persistent imbalance in public finances indicates the need for seeking further sources of budgetary income.

2. The causes of the economic crisis in Greece

Public spending in Greece has proved little responsibility in relation with structural and institutional reforms. Home and foreign borrowing financed public and private consumption rather than investments. The foreign debt services ration increased to 30% of foreign exchange receipts. The problem is that debt service was caused by low tax receipts. To pay off the debts one has to work out the budget surplus and seal the tax system. It is believed that in Greece, the tax avoidance was a daily practice that led to a huge loss of budget revenue. The governments' tax income has suffered in Greece, because of the constant tax evasion. In 2010 the estimated tax evasion cost for the Greek government amounted to well over 20 billion euro per year [*European Economic Forecast...* 2012, pp. 106-107]. The tax base was reduced by statutory exemptions for some groups (farmers) and inadequate enforcement of tax law for others (professionals). From many years the budgetary policy of Greece was characterized by the practice of permanent budget deficit. Greece was investing beyond their purchasing power and spending more capital than available before the 2004 Athens Olympic Games. Huge public imbalances developed also after that: in 2004-2009 period output increased in nominal terms by 40%, while central government primary expenditure increased by 87% against an increase of only 31% in tax revenue.

Although Greece had been accepted into the euro zone in the first group of member countries, in the past the country showed a constant structural imbalances, due to a large share of the state sector and flawed economic policy. Greek state controlled about a third of industrial output. The economy remained highly regulated with government monopolies in public utilities concerning air and rail transport. For a few decades flawed economic policy of Greece brought Greece to the brink of bankruptcy. The country lagged far behind in reforming its economic system, developing a non-productive public sector and inefficient regulatory framework in the economy. Populist politics vote buying brought about the growth of expenditure and an increase of the government deficit which played an important role in the creation of Greek crisis. Banks began to see Greece as a country unable to control the budget and they were concerned that perhaps it could not pay its debts. The Greek government was forced to reform and stated the aim to restore the fiscal balance of public budget due to implementing permanent real expenditure cuts. Since 2009 public expenditure was reduced progressively by –7.2% in 2009, –8.5% in 2010, –9.0% in 2011 and –4.9% in 2012. Moreover Greek government planned overall revenues would have grown by 31.5%, secured not only by new/higher taxes, but also by a major reform of the ineffective tax collection [*European Economic Forecast...* 2012, pp.106-107]. Despite the ambitious plan, the Greek government reached only a little increase in revenue, so the reduction of the budget deficit is due mainly by cut expenses.

In Greece tax receipts were consistently lower than the growing public expenditure and there are some doubts if Greek deficit reduction indicators are not only those data on paper. In connection with this doubts the Eurostat each year noted a reservation about the fiscal statistical numbers for Greece. To keep within the monetary union guidelines for many years the government of Greece had misreported the country's official statistics. After a couple of years often previously reported figures got revised to a somewhat worse figure. It was discovered that Greece had paid Goldman Sachs and others that hid the actual level of borrowing. Most notable is a cross currency swap, where billions worth of Greek debts and loans were converted into yen and dollars at a fictitious exchange rate by Goldman Sachs, thus hiding the true extent of Greek loans. The purpose of these deals made by several successive Greek governments was to enable them to continue spending, while hiding the actual deficit from the European Commission. The Greek flawed statistics making it impossible to predict accurate numbers for GDP growth, budget deficit and the public debts. Therefore the European Commission reported the need to restore trust among financial investors and to correct previous statistical methodological issues by making the national statistical service an independent legal entity that would improve the accuracy and reporting of fiscal statistics.

In a similar situation the imbalance in Greece in the past devaluation of drachma helped to gain external competitiveness and to revitalize the economy. EU assistance is aimed at restoring the balance and the normal functioning of the economy. The EU tries to reduce internal and external disequilibrium by foreign aids coupled with applying strict austerity measures. However, too demanding austerity program has not restored the confidence of the financial markets to Greece since the economic crisis even deepened. Despite the austerity program and foreign aids the crisis has stricken many sectors of the Greek economy and there is not a clear strategy of economic policy at the national and European level associated with the recovering of equilibrium. Neither consumers nor business nor specialized international analysts could predict with certainty the duration of austerity measures and domestic crisis in Greece.

The complexity of the crisis in Greece is related to the fact its economy was partly linked to the crisis of strategy of euro. The coexistence in the monetary union of countries with different levels of development like Greece on one hand and Germany on the other under the "roof" of euro led to very different rates of economic growth, investment, export and profitability. Firstly, in the initial period after euro introduction one could see the rapid development in the countries of periphery and the relative stagnation of the center. Higher growth rates in the countries of the periphery like Greece were accompanied by both a dramatic reduction in the costs of credits and cheap borrowing by consumers as well as by the states. Low ECB interest rates created speculative boom. A higher inflation rate in Greece than ECB interest-rate brought about excessive private as well public investment. The wrong investments in real estates, life on credit, excessive bank credit action and over-indebtedness of public and private sectors ended the financial crisis. Secondly, Greece does not have that mechanism of changing the currency rates as it is part of the euro area and does not dispose its own currency. An initial inflow of foreign capital served to set up conditions for balancing of financial transaction. However, euro rates fluctuations take into account changes in competitiveness and balance of payments statistics for all euro area members, not just the economy of Greece. As a result that the reduction in the exchange rate of euro was not large enough to stimulate the export of Greece, a significant trade deficit appeared: –17.9% in 2008, –14.3% in 2009, –12.8% in 2010, –11.7% in 2011, –2.3% in 2012, –5.3% in 2013, and –2.0% in 2014 (see Table 1). Balance of payments deficit deepened further outflow of capital from Greece.

After few months the financial crisis was transferred to the real economy, resulting in recession in Greece and high level of unemployment. Since 2009 Greece has been going through an economic and social crisis which was unprecedented in the EU history. To reduce the risk banks tightened their lending policies to Greek firms and citizens which worsened their situation because they could not have access to new resources. Tight liquidity and a rising share of non-performing loans put the strains on all Greek banking system. Credit to the private sector dried up as banks faced a drain of deposits forcing them to rely on "emergency liquidity assistance" controlled by ECB. The growth rate of credit to private sector remained negative and bank deposits flowed abroad looking for save locations in Switzerland, Germany or Belgium. Tight liquidity of course discouraged investments, export, production and job creation. The crisis has spread not only in the sphere of finance and private firms, but also took over the state and public sphere. A consistent problem is the lack of equilibrium in public finance and it does not refer only to the finance the central government but also to local budgets. A lot of local budgets are on the brink of bankruptcy. In general insolvency threatens many Greek firms, banks, central government and a lot of local governments. In view of close financial links now, there is a fear concerning spillover effects. The insolvency of some firms and institutions can entail inability to others.

3. Foreign aids for Greece

Facing a deep crisis with huge international consequences, the Greek government of course asked international in situations for economic aid. The aids came from three sources: the International Monetary Fund (IMF), the ECB and the members of the euro zone because Greek government could not take further loans on the financial markets. To avoid the potentially disastrous vicious circle European leaders agreed to a "firewall" to protect the rest of the euro area from a full-blown Greek default. In 2009 fearing bankruptcy Greece had to turn to the EU and the IMF for up to 110 billion euro this way paying back part of its debts. Help that Greece received from the euro area had mainly the form of loan guarantees based on a commercial basis, while at the same time the need for obtaining the consent of all members to assist. When at the beginning Greece objected to the official request for its help, it was evaluated that the amount needed to rescue its economy would increase to 25 billion. Soon this amount in fact doubled and increased to 45 billion euro, and it was supposed to be only the first tranche of the aid. Due to the continued crisis as in May 2010 the IMF granted Greece 15 billion euro, while the euro countries 30 billion euro under the Second Bailout Program. What is more, it was decided to reduce the Greek debt by 50% of 330 billion euro while private creditors of Greece agreed to its voluntary reduction to 100 billion euro. In 2015 the risk of a chaotic exit of Greece from the euro area was awarded by concluding a third bailout providing financing of as much as 86 billion euro. The aids will be spent in the period of three years. One of the key points of the negotiations was how to deal with loans outstanding in date Greece proposed the creation of a "bad Bank" (bank), which would take over the problematic credits. Since the aid was intergovernmental in character its conditions were approved by both the Greek Parliament and the parliaments of the other Member States of the euro area.

In addition Greek debt is kept by bank institutions that bought its government bonds and from where Greece received the loans. Bank credits and loans quarantines came from many countries, including first and foremost, the euro area countries: Germany at the rate of 69.5 billion euro, followed by France − 52.8 billion euro, Italy − 46.3 billion euro, Spain − 31.4 billion euro, the Netherlands −14.8 billion (see Table 2). In 2015 the main Greek institutional creditors included: European Financial Stability Facility (EFSF) – 130.9 billion euro, bilateral credit – 52.9 billion euro, ECB Target 2 − 41.5 billion euro, ECB SMP – 19.9 billion euro, IMF – 18.2 billion euro and the others – 49.3 billion euro. The total exposure of Germany, the largest creditor, to Greece, including the loans and other abilities, might be even higher than 69.6 billion. Standard and Poor's estimates it at 90.6 billion that includes EFSF loan financed by Germany − 38.2 billion euro, Target 2 interbank payment system balance – 29 billion euro, bilateral loans − 15.2 billion euro, Greek bonds held by the Bundesbank − 1.9 billion euro bonds [The Wall Street Journal 2015, p. 6]. Although Germany credited Greece in absolute terms the most, it seems that this country could absorb Greek losses without much trouble by its federal budget income and avoid triggering any noticeable tax or spending moves. While Germany is the largest creditor the other euro area countries like France, Italy, and Spain being owned more Greek public debts as a share of GDP might have had much more trouble in absorbing Greek failure.

Table 2. Eurozone countries credits and loans guarantees to Greece in billions of euro in 2015

Germany	− 69.5
France	− 52.8
Italy	− 46.3
Spain	− 31.4
Netherlands	– 14.8
Belgium	− 9.1
Austria	− 7.2
Finland	− 4.7
Portugal	− 2.7
Slovakia	− 2.1

Source: [The Wall Street Journal 2015].

In order to end the transformation in Greek economy successfully this country has to continue obtaining the foreign aid in future. Because Greece is undergoing the crisis that exceeds its capacity to its overcoming, and therefore is a huge challenge beyond its own resources, it depends in large degree on further support first and foremost from of the European Union. The total package of assistant source to Greece, including loans from the EU and financial institutions, write-downs on private sector debt holdings, and grants from the EU structural and other funds, far adds up to about 466 billion euro. This is equivalent to 175% of Greek GDP[1]. Help for Greece involves multiple transfers, which are designed for different purposes (see Table 3). It comes as a reduction in its debt-to-GDP ratio and the revival of economic growth. The First Economic Adjustment Program was launched in 2010 with a loan package of 110 billion euro, of which 73 billion euro was disbursed. The Second Economic Adjustment Program in 2012 had a loan package of 130 billion euro in addition to the amounts not disbursed from the first program. In 2014 to boost further demand and investment the European Investment Bank (EIB) was providing further support to local authorities in Greece. This was the second and final tranche of a 100 million euro framework facility that provided financing to local authorities in Greece. The third program of aids to Greece includes 86 billion euro and started in 2015. Greece received credit at 5%, which in subsequent tranches is to be reduced. Of paramount importance was not only financial support, but future successful negotiations of Greece with foreign investors on the possibility to reduce at least partly the debt of almost 200 billion euro. It is worth adding that European markets rallied on the improved prospects for the last-ditch deal to keep Greece in the euro under third bailout program, while Italian, Spanish and Portuguese bond yields fell.

[1] It is worth noting that this level of assistance is unprecedented in the post-war history of Europe. The US Marshall Plan for post-war reconstruction involved transfers equal to around 2.1% of GDP of recipient countries.

Table 3. EU and international support to Greece in recent years

Various forms of EU and international support – 466 billion euro
Financial assistance (loans) 240 billion euro
Private sector involvement (debt write-downs) 100 billion euro
EU funding for the period 2007-2013 (grants) 40 billion euro
including – 20 billion euro from EU structural funds
cohesion funds and 20 billion euro under the Common Agricultural Policy
• public debt –177% of Greek GDP
• 33 600 euro per Greek inhabitant
• total US Marshall plan 1948-1951:
– 13 billion American dollars (85% grants, 15% loans) – 5% of US GDP
– 2.1% of GDP of recipient countries
Credits under the third bailout program – 86 billion euro

Source: own source.

After the victory of SYRIZA in Greece in January 2015 the new Greek government suspended temporary talks with the Troika of requesting a further restructuring of its national debt. Moreover SYRIZA plans to increase taxes on the wealthiest Greeks, to take the fight against corruption, raise the minimum wage, reduce the gray area in the economy (about 25% of GDP). The Greek government opposed further reduction of pensions and played down suggestions that any compromise with Greece had to include erasing some of the debts it incurred in sum of about massive 240 billion euro [http://www.ft.com/...]. These new proposals of Greek government brought about further uncertainty in financial markets, and increased interest rate annual bond to more than 100%. As a result of failing talks with the EU, and organizing the referendum in Greece the ECB ended the Emergency Liquidity Assistance (ELA) to Greeks banks on 30 June 2015. During two weeks the government ordered all banks and the Stock Exchange to remain closed. The Greek citizens could withdraw from the banks the daily limits of 60 euros. The strict capital control stopped a father flight of money out of Greece. The number of "bad banks" is likely to rise, which is the natural consequence of forcing the Greeks to control capital flows. The Athens Stock Exchange opened after 5 weeks of the recorded declines in stock rate of 12.3%, including maximal banking sector drop by 30%.

The Greek crisis has also political implications beyond Greece, and stokes fears about the future of the single currency, which traded at an 11-year low versus dollar. A decision to end emergency lending made by the ECB's governing council might have pushed Greece out of euro, so only thanks to further ECB's financial supply Greece remains in the EMU. In response for the Greek referendum some of the EU partners were even in favor of leaving the euro zone by Greece. Germany's Finance Minister Wolfgang Schauble put forth a proposal for a temporary five year exclusion of Greece from the EMU. Janis Reirs − finance minister of Latvia, which endured his country's own austerity program owing to which Latvia has returned to the economic growth also said that his country would welcome a possible Greek departure. Latvia, Spain and Portugal have taken effective transformation programs to rescue their economies, but Greece failed to apply them In his opinion “if in a system there is an element that doesn’t work, the departure of this element won’t harm the system and in some cases may be positive” [International New York Times 2015, p. 4].

However, one can hardly imagine that the members of the current euro area would accept as a solution such a leap backwards by Greece changing its currency into drachma with completely free exchange rates. The cost of reintroducing a national currency seems to be much greater than leaving only a fixed exchange rate like Argentina did earlier. According to a group of 18 Greek economists, if Greece were to launch a new drachma and stop paying its debts, the country would go to autarky, public sector wages would plunge, and the financial market might be barred from the foreign debt market for years. Depositors would rush to pull their money out to protect their savings from being converted to drachma. The danger of bank withdrawals could lead to the long term imposition of capital control and breaking the rules of single market. Leaving the euro area could trigger hyperinflation, a decrease of investment, banks crashes and the bankruptcy of many firms due to euro debts. Inflation would strike not the people who have deposits in foreign banks, but mostly lower income depositors in Greek banks. Because Greece is far more integrated with the capital markets than for example Argentina was during its crisis, a Greek departure could be connected with negative externalities on the single market. If Greece left the euro area in a disorderly manner, that would cause contagion problems for the Spanish, Portugal and Italian banking systems [*Greece's agony...* 2011]. Daniel Gross shared the opinion that while Greece might ultimately require financial aids of about 400 billion euro, allowing Greece to abandon euro would cut its nominal GDP by at least half making debt equivalent to 400% of GDP [http://blogs.wsj.com/economics...].

The agreement was reached by Greece in August 2015 in compromise with creditors backing the latest package reforms, which were striking similar in terms of reforms Greece had rejected in a referendum organized in June 2015. This agreement may be a good lesson for other euro area partners ahead of the lure of the policy of “free riders”. In return for these credits Greece agreed to introduce tough reforms including tax increases, liberalization of regulated sectors in economy, an overhaul of the ailing pension system and privatization it had previously opposed. The third bailout accord provides far-reaching privatization in Greece: the accord expects 50 billion receipt to come from privatization managed from privatization funds. The new proposals include changes to the plan to sell the assets of land, port, state enterprises and improving corporate governance on public companies. The privatization process of public sectors is a move in the right direction which could bring improvements in the efficiency of national economy [http://biznes.interia.

pl/...]. A moot point was also a way to create the fund to which Greece would communicate the assets worth up to 50 billion euros for privatization. The management of this fund is to be carried out under the supervision of the international institutions. The money from the privatization of assets has hit to pay off debt and the recapitalization of banks. Further assistance for Greece is conditional on continuing further structural reforms by the Greek government.

4. The policy to overcome the crisis in Greece

A crisis of such magnitude calls for far-reaching change in the Greek economic policy, so that to recover new dynamics and overcome slowdown. Changes in policy should be implemented consistently and to recover the external and internal balance of economy. In the long run changes should also have a supply side character serving to improve the efficiency and economic competitiveness. The best response to the crisis in the euro area would be deep structural reforms that need to be carried out in many sectors of Greek economy. The first task is freeing business form administration obstacles to drive growth a major overhaul of the business environment and labor market reform is urgently needed, so that Greece becomes once again a place where domestic and foreign investors have confidence to invest and create jobs. Further supporting of Greece by foreign aids to recover the fiscal equilibrium and debt servicing is also a condition for the return of Greece on the path of growth.

Carrying out effective economic transformation in Greece depends largely on fiscal reform. At present the tax system in Greece is difficult to manage because of extensive exemptions and preferential regimes. A common practice in Greece is the hidden transaction (black market), and hence not paying taxes. The efficiency of taxes payments should be improved, because – as it is said every second Greek company cheats on taxes. The reduction of sizes of the tax base has made fiscal imbalances grow. Furthermore a lot of Greek businessmen registered their companies in tax havens and in effect high budgetary spending was not compensated by adequate revenues. The design of both direct and indirect taxes could be improved to support budget stability and economic growth. The reform of Greek tax system concerns all areas of direct and indirect taxation by broadening the tax bases, increasing personal income, corporate, VAT and property taxes, as well as employers' social contributions. The Greek government has been forced to take a harsh adjustment program which increased VAT from 19% to 23% on all products (except for groceries). Taxes rose in Greece on a wide range of goods that covered everything from sugar and cocoa, alcohol, tobacco and gasoline to taxis and funerals. Greek government insisted to increase also taxes in relation to people with the highest incomes. The new tax rates on income of natural persons (income from pensions or salaries) are: – 22% 0-25,000 euro, – 32% 25,001-42,000 euro, – 42% above 42,000 euro. Farmers pay in Greece only 13% income tax and receive special treatment for fuel and fertilizer expenses. The benefits of farmers are so substantial that thousands of Greek who live in rural areas but do not make a living from agriculture claim to be farmers. Greek creditors from the EU and IMF view the tax increase on farmer's income as one of the conditions for the dispersion of third bailout deal.

According to the agreement with creditors to get further financial aids Greece must also meet strict social insurance terms. Greek pension system had an opinion of generous, of which many Greeks benefited. In sum pension expenditure exceeded 17% of Greece GDP and before the crisis in Greece there were many 50-year old retire persons .The proposed changes to the Greek pension system includes reforms of the age of retirement and the level of benefits. The new regulations elaborated in reference with the third bailout program discourage from taking pensions as early as possible and reduce too high pensions in Greece. Greek citizens are eligible to retire at the earliest at the age of 62 with payments actually reduced unless they have contributed for 40 years. By 2023 minimum pension will be payable only at 67, the statutory retirement age. Reforms also include the program of decreasing high pension and the reduction in excessive bonus paid to officials. In Greece high pension expenditures were connected with an unprecedented rate of substitution, that is, the amount of the retirement pension in relation to past earnings, which before the crisis was 94%. In the case of the so-called burdensome work for full retirement The Greeks could retire after 25 years of work before 2009. Even hairdressers qualified to professions acquiring such entitlements. Overall the conditions of agreement with creditors have forced to reform the pension system in Greece: an increase in the retirement age to 67 years, the elimination of almost all privileges associated with the so-called burdensome work, lowering the highest retirees by up to 40%, a reduction in replacement rates to 54% [http://biznes.interia.pl/raport/...].

The Greek social security is now under deep reforms (started in 2010) and it is said that Greece has adopted one of the most ambitious pension reforms in the EU. However, taking into account the experience of previous austerity programs there are some doubts about the executions of social reforms. If they continue to be connected with additional social costs and increases in unemployment, reforms may be halted or evaded. The high cost of existing transformation proves the appropriateness of spreading the social costs of austerity program for a longer period. Unless these targets are softened the deal will weaken frail Greek economy, hence these efforts require long term perspective and solidarity from the rest of the EU [European Economic Forecast..., pp. 106-107]. At the time of social reform introduction it is important that Greece takes in parallel steps to reduce its budget deficit and adopt new fiscal and economic policies. Greece has already made progress in the substantial reduction of its budget deficit through cutting expenditure and new tax measures. Due to this progress Greek fiscal consolidation has been even above the fiscal efforts in the EU partner countries: Greece implemented namely consolidation measures with more than 16% of GDP in order to reduce the budget deficit from –15.8% in 2009 to –2.5 GDP in 2015. Although fiscal consolidation effort in Greece has been large, its effects do not have proven to be positive to produce economic growth and reduce unemployment. It seems that Greece cannot simply reduce the budget deficit too rapidly and reduce the level of its debt at the expense of further deepening of unemployment.

The central issue for overcoming the crisis in Greece is reducing the rate of unemployment, which surpassed any tolerable limits. The austerity policy pursued by the government brought dramatic growth of unemployment up to one quarter of labor force. Unemployment in Greece was increasing continuously, from month to month since 2008 and according to Greek government figures in June 2013, the unemployment rate stood at 27.9 percent of labor force. In sum there were 1.4 million people out of work in Greece, and 3.6 million employees. The Greeks lost their jobs, especially young people and women. In the age group 15-24 years unemployment rose to 58.8 percent and among women to 31.9 [Rzeczpospolita 2013]. One of the limiting factors to increase employment was also a high level of regulation of the labor market in Greece which has to be eliminated under the transformation program. If the transformation program was a success, Greece would need persistence and consistency, especially when it comes to the reform of labour market. Because Greece cannot devaluate its currency, it has to rely on internal progressive devaluation to improve external competitiveness. Greece expects competitiveness gains and benefits from the labor market reforms, which may result in the further adjustment in the production and export sectors.

Therefore as part of the transformation efforts of the Greek economy, measures were especially needed to foster a rapid adjustment of unit labor costs to restore international competitiveness. In 2008-2015 costs of the workforce in Greece fell on average by 30%. In addition the Greek labor market has to be also reformed to upgrade human capital and provide more and better employment opportunities due to the reform of the education system which contributes to having useful skills by the graduates. A more flexible labor market in Greece implies among others such actions as: the extension of employment for a trial period, the reorganization of the rules to carry out collective redundancies, facilitating part-time employment and implementing a better system of the identification of registered unemployment. In addition, the actions should include eliminating barriers to access certain professions (pharmacists, lawyers, engineers, architects, notaries). For many Greek firms the cost of the private employee's employment was relatively high in relation to its productivity. For this reason, the fight against unemployment in Greece has to rely rather on labor market liberalization than wage settings and combined salaries with performance.

Structural reforms in Greece to stimulate economic growth seem to be the best guarantee to increase employment as well as to keep budget deficit under Maastricht limit. The reform of the nurturing economic growth includes among others privatization, liberalization of the economy, decreasing public sector, reforms of financing. It is necessary for Greece to continue the reform of its inefficient public sector that employed too many workers, which generates a deficit and requires continuing government subsidies. For example, the Hellenic public railways have the revenues of 100 million euro, the wages of employees of the company are 400 million and the remaining cost is 300 million euro. Thus Greek government must finance state railways in the amount of 300 million euro every year [Newsweek 2013, p. 51]. In the past funds obtained from the sale of treasury securities were in turn spent on subsidizing unprofitable state-owned companies operating in declining industries. The privatization of such state-owned enterprises and freeing businesses from excessive administrative regulations seem to be a necessary factor for any economic transformation in Greece. It is worth noting that Greece has already agreed to sell 13 airports to a German investor. Structural reforms should limit the role of the state sector in Greece in order to develop more competitive industries and services composing mainly of private firms. Greece can build much of its strength on private enterprises in such sectors of the economy as shipping, tourism, services, ports, food processing and textiles. Greece has good universities and generally well-educated work force to develop new firms in industry and service sector. It can also use its location as a potential logistics and energy hub in the south-east of the EU [http://ec.europa.eu/economy_finance/...].

In the long run it may develop a strong financial sector for south-east regions, but now Greek banking system has suffered huge deposit outflows, hence banks need recapitalization. Greek banks were recapitalized once in 2012 to allow them to lend capacity to the real economy after the restructuring of Greek government debts [Firlej 2012, p. 9]. In 2013 the Greek banking sector and administration speeded up the disbursement of the 4 billion euro funding to help SMEs to get affordable loans. Taking into account the huge outflow of deposits from Greek banks during the crisis they have to be credited with new capital again and obtain urgently more capital (at least 10 billion euro) to finance local business given the poor state of their business clients. Transformation in Greece needs to remodel large parts of its central and regional public administration and to make the country an attractive place to do business. Planned transformation changes in the functioning of the public administration include among others the creation of supervisory institutions controlling the functioning of the administration at the level of spending and remuneration policy. It is also recommendable the transformation includes the reduction of the number of administration units at the local level. Greek tax administration has to be reformed with a view to executing effective long term regional policy and efforts to strengthen its capacity to collect taxes. Needs to be more effective and conducive to the development of business are becoming intensive. The aim of these measures is to increase the transparency of the functioning of administration, reduce corruption and improve relation of Greek administration with the European institutions.

One of the necessary methods to overcome the crisis in Greece is to carry out export development strategy. The growth of global export in Greece might be supported by structural reforms and labor costs reduction. The continuation of cuts in labor costs would help Greek firms to recover their external competitiveness especially in labor intensive industries. It should be taken into account that the Greek economy has traditionally been less open than many other similarly-sized economies. For example the Irish export has an important contribution to the GDP (100.8%), while in the case of Greece, it is three much smaller (34.1%) [http:Ec.europa/data/database 20.04.2015]. The current organization of export clearance and customs formalities in Greece deters many SME from exploring overseas markets. Exports clearance involves a lot of bureaucracy: paper-chase of unnecessary certificates and documents for selling their products and services abroad. The removal of unproductive documentary requirements can eliminate much of these administrative costs and improve competitiveness of Greek SME. Freeing Greek business from bureaucracy and corruption can unleash pent-up growth potential in such sectors as textile, tourism, port services, food processing, and sustainable energy. The reform in foreign exchange can be done by limiting the procedures for setting up a business engaged in export and reducing the scale of the licensed economic activities. At the same time there is a need in Greece for export development strategy to further improve the quality of products, nowadays only cut in labor costs. In comparison Ireland has much improved the technological level of products, while in Greece the process develops slowly. Due to structural reforms the external position of Ireland is rebalancing and unexpected current account surplus is recorded, export growth had a positive contribution to increase GDP as the household savings ratio fell. Ireland now enjoys a large surplus on its current account, much more than in other European countries. The growth resumed driven by an impressive resurgence in Irish exports by 12.7% in 2014, especially in the pharmaceutical and agro-food sector. Following this example in Greece efforts should in particular be focused on technological development and equipping new exporters to find opportunities both in single market and in promising third countries markets. The rapid growth of the partner economies, for example the Turkish economy, can be a convenient outlet for many Greek producers. Over the medium term this trend is expected to intensify with the growth being led by export while domestic demand will remain weak due to austerity programs**.**

If the structural reforms restore investor confidence, Greece will return to the international capital market, foreign investment will flow to boost production and export and unemployment will fall. It is estimated that the successful reform of product and service markets in Greece could add up to 13.5% to Greek GDP and reduce unemployment over the long term [Kryzys grecki... 2010]. On the other hand the structural reform in Greece must also include employment in public sector, because it is said that there are 700 thousand too many workers there. At present Greek administration is characterized by bureaucracy and too high employment, hence it is believed that the main source of crisis in Greece lies in the political system and its inefficient system of central and regional governing. Only after the accession to the EU Greece began to introduce modern regional policy, but this involved hiring too many unnecessary officials. In the past Greek government paid political clientele on the occasion of elections, but now it faces the need to reduce employment in public sector. Thus the plan provided for making 25 thousand persons redundant: in 2013 4 thousand officials lost their job, and in 2014 the next 11thousands. In addition, 12 thousand people were sent on forced leave. During the time of forced leave the workers received 75% of the salary. If within eight months they did not find employment in one of other state institutions, they were finally made redundant. The first employees who experienced these changes under the austerity programs were teachers and employees of the municipal police [Newsweek 2013, p. 51].

Traditionally close relationship between politics and business in Greece reduces efficiency and transparency in the functioning of the market economy. In future economic transformations in Greece have to make deep changes in the functioning of the government policy in economy. An important cause of the crisis was the organization of the Olympic Games in Athens and a number of costly orders addressed in connection with them to public institutions. For example an order was imposed on commercial banks to transfer funds to cover debt through the purchase of the Greek government debt instruments. This way the obligation of banks to the debt reduced domestic supply of loans to the private sector, and private projects were driven out by the inefficient loans for state-owned enterprises [Karnowski 2006]. Therefore the economic transformation in Greece should lead to lending the capacity of bank and increasing investments by private firms, increasing the efficiency of credit system and supporting the restructuring of real economy. The received foreign aids in the form of financial support thus far enable the Greek authorities to serve the debts, to pay foreign creditors, but not to invest in key factors to boost growth, sustainable energy development and to create employment by setting up new firms. However, foreign assistance from the EU should not concentrate on paying rates of credits to foreign banks, but also ought to bear long term fruit into building new infrastructure and increasing competitiveness in the Greek economy. Infrastructure constitutes an important obstacle to growth and among the priority projects for growth and employment identified by the Greek government there were numerous infrastructure projects in the field of transport, tourism, waste management or energy. The tourism sector accounts now for 15% of the Greek economy, so one may expect positive impact on the economic development coming into force from the projects of five motorway concessions (1,400 km of the Trans-European-Network accounted for €3.2 billion of national and EU expenditure). These investments are expected to create an estimated 30,000 direct and indirect jobs in the medium period. Furthermore, due to its location Greece has the opportunity to develop sustainable energy production(solar, wind, geothermal). Greece benefits from such a variety of renewable energy sources as abundant wind and sunshine: hydro, geothermal and biomass offer a lot of potential of transferring its economy to green electricity production. Experts suggest that further aid for Greece should include a combination of the new loan in development of infrastructure, sustainable regional production and business environment.

Every austerity program is only a temporary remedy, which results in a reduction of demand, production, investment, capital inflows and negative economic growth. Instead the debt restructuring the new austerity program demands that Greece cut again spending and raising taxes. That depressed the weak economy and drove up unemployment making the growth of Greek budgetary revenue restrained. It seems that Greece cannot take any more austerity as it will cause more social unrest. Any program for Greece must take into account its consequences for investments, international capital movement and export, production and consumption. It seems that under the third bailout program Greece was again left in a fragile position. Greek finance minister is right to insist on elements of growth stating that: "any solution priorities growth, a factor inexplicably absent from previous negotiations" [Financial Times 2015, p. 6]. Thus far austerity desired from Greece did not work and it did not really help the country to recover its growth. Past bailout sowed the poison seed of further bailouts to come. Previous rescue attempts provide a wrong example because under their protection Greece postponed structural reforms. The first reforms in 2010 allowed Greece no space for debt forgiveness: 200 billion euro was paid back to creditors owing to which Greece avoided financial default but its economy gained no relief. Because Greek public debt is too high, currently standing at 173% in relation to GDP, the basic premise to overcome the crisis is the reduction of the size of debt.

The creditors of Greece should have been aware of the fact what that too strict austerity program would bring to the economic growth. Greek economy was simply unable to come back on the path of growth under former too strict austerity programs. Forced fiscal and current account adjustments and the control of capital flows occurred not to be the solutions for the Greek crisis. The only way out of the crisis is to maintain aid to Greece towards the continuation of structural reforms, rather than debt service. Although fiscal austerity reduces debt, the example of Ireland and Spain shows that only structural reform can spur growth in the long run. It is also thought that the problem of paying debts would be made immeasurably worst if Greece were to leave the euro. The country would almost certainly reintroduce the drachma, that would devaluate dramatically and quickly making it even harder for Greece to repay its debts. A much better solution seems to be maintaining financial assistance for Greece contingent upon progress in the transformation program

To sum up the cures for Greece to overcome the crisis should include such actions as:

– national budget consolidation,
– reducing the public debts, structural reforms,
– privatization,
– growth of investment and productivity,
– restoring competitiveness,
– growth of export,
– reform of labor market and decrease of labor cost,

- reducing the inflation,
- decrease of unemployment,
- bank restructuring,
- reform of bank regulation,
- reform of bank supervision and resolution.

Thus far the Greeks have suffered the most in the euro area from the economic crisis. The EU is right to believe that financial contagion from the Greek crisis can be contained, so Greece departure from the euro would not necessarily destabilize other members of the euro zone or spread havoc on the global financial markets. So far the Greek crisis has had a limited impact on the financial markets. In the time of Greek referendum the euro area peripheral bonds remained at the low level with ten year Italian yield – 2.32% and ten year Spanish yield – 2.32% [Financial Times 2015]. Such a relatively muted reaction on the Greek crisis could be due to three reasons: 1. Financial market expects all the time a compromise to be found. 2. It was thought that the ECB would be able to prevent contagion to the other countries. 3. Small less open Greek economy does not carry important economic and political consequences for the rest of the euro area. Nevertheless the cost of Greek crisis for the euro zone lies first and foremost in the contravention of the rules of monetary integration and the creation of a precedent that the one member of the euro zone can leave. The cost of this is much greater than the same instance of Greece and is associated with the creation of the uncertainty of the functioning of the euro area. Greek departure from the euro area would upend one of fundamental principles of the EU policy. Political and economic costs of such a decision would be very high. Greece slips into economic chaos and could easily not only make the EMU hard to function but it could also infringe the rules of the single market. It would discredit the European projects and reverse the tendency to closer the union for ever if the EU leaders share the opinion that punishing Greece is in its interest to finance bailout programs and allow Greece to stay in the euro area.

As the past experiences have shown the imposed austerity program unfortunately did little to help Greece and its creditors. The austerity program imposed on Greece resembles the World Bank's "structural adjustment programme" which required from borrowing countries to limit the role of the government as well as cut budget spending, privatization and reduced regulations . In order to bring its country out of the economic crisis the Greeks must reach equally deep transformations of political and economic systems as required by the World Bank program. The only rational alternative for Greece is to take up courageous structural reforms. One of the main causes of the crisis was not related only to economics but to the faulty political system. The close relationship between politics and business in Greece reduced efficiency and transparency in the functioning of the market economy. The effects of this relationship was the preferential treatment of state-owned enterprises in comparison with private ones, where the state-owned sector was assisted by public subsidies. Widespread tax avoidance and political clienteles have brought budget deficit and huge public debt. All success stories with the World Bank adjustment structural programs show economies that applied that program consequently in combination with state intervention and gradual liberalization [Ha-Joon Chang 2014. pp. 95-96]. The program of restructuring the economy of Greece has to be also gradual and versatile, liberalization has to cover a lot of areas of the economy, and be consistently implemented over a period of years. Greece needs radical reforms of state institutions, and the austerity program has to be only part of the structural program and as such has to be correlated with the reform of labor market, tax system and pension, functioning of the economy towards the development of more productive sectors. The transformation programs in Greece with a view to overcome the crisis contain four main elements:

a) Fiscal consolidation

The Greek government has to take steps to restore the long term sustainability of public finances. The debts problems in Greece have been the consequences of long term twin deficits: budgetary deficit and deficit in balance of payments. The EU imposed the bailout program on Greece indicating the country has to absolutely restore budgetary balance, and even to obtain interim surplus. From the point of view of the economic growth, it is always better to restore fiscal sustainability by reducing expenditure rather than increasing taxes. However, servicing such a huge debt like in Greece requires additional sources of income: privatization, broadening the tax bases, the increase of personal income, corporate, VAT and property taxes and streamline tax execution. Deleveraging of public finances by increasing taxes and cut spending can of course worsen an economic situation in the short run. Because Greek financial markets remain segmented from European partners the government has to lower the level of budget deficit and public debt levels to recover the confidence of financial markets. Due to the consistent policy of fiscal consolidation Greece will able to debt financing at lower interest rates, easier finance private investment and return to the path of economic growth.

b) Structural reforms

Low competitiveness of Greek economy is a structural problem, which produces low recovery and tradeoff between internal and external balance. Greece should support the development of technologically advanced branches of production and reform labor market to improve its competitiveness and activation of the unemployed. What should be done in Greece to overcome the crisis now are supply side reforms that boost productivity, investments, output and employment. These actions should include: privatization, labor market flexibility, deregulating sectors and professions. Public sector in Greece has to get the "right size" after its disproportionate expansion fueled by cheap credits. Efforts are also aimed at encouraging more competition in sheltered sectors, such as gas and energy, the legal professions, thus bringing down costs and improve competitiveness. Wages reduction to the competitive level should include not only the public sectors, but also workers remuneration in private firms.

More workers ought to be employed in private innovative enterprises and fewer in public sectors. Policy should aim to reduce non-tradable prices to enable the depreciation of real exchange rate and boost international competitiveness. Greece should return on an export-driven path to the recovery based on highly productive branches and enterprises. For this purpose, Greece has to create favorable conditions to attract foreign capital. Ireland is an important lesson in the context of transformation economy for Greece, where the government was fighting against the crisis by using more flexible management and higher growth of export then traditional anti-crisis methods applied in Greece.

c) Banking sector reforms

Nowadays the society in Greece has to deal with the consequences of the imprudent and high risk of lending practices. In the conditions of huge differences in competitiveness between euro area partners "one-size-fits-all" euro led to an enormous imbalance in current account (at 10% of GDP in Greece before the crisis) that was entirely funded by the private European commercial banks. In the EU member countries a lot of regulatory provisions which were designed to protect the stability were either removed or relaxed. Banks in Greece had discretion to expand their operation with little regulatory oversight. They applied this freedom to exercise profit maximization and the majority of this expansion was property related. The exposure to toxic financial assets naturally went together with large capital outflows and current account negative position. The external imbalance of current account balances increased "bad investment" thanks to a negative real interest rate, greatly contributing to the banking crisis. Moreover, the sharp declines in property have exposed banks reckless lending practices and funding models across the banking systems. The example of Greece showed that banks were prone to periods of instability which had large and expensive consequences to the wider economy. First and foremost to overcome the crisis the capitalization of the domestic banks in Greece should be completed. The need to rescue the banks which were step away from disaster due to the rapidly increasing number of toxic loans becomes obvious for the Greeks. (In the first quarter of 2015 these loans accounted for 35% of the total loans issued by Greek banks). The financial regulations have to limit the probability of bank failure (minimum capital/ liquidity requirements) and protect the interests of bank customers, more from just inspecting compliance of rules to evaluating risk management systems. To get out from the crisis the banks must reach full capacity to support the recovery through new lending, including SMEs which play a key role in job creation. Bank mergers and deleveraging of bank balance sheet are also recommended in Greece.

d) Debt reduction

The crisis in Greece does not seem possible to be over quickly without significant reduction of Greek huge debt. As the debt crisis in Greece is getting worse an initial condition to combat the crisis is to reduce the public debt. The European partners and

IMF made an error in 2012 when they only minimally restructured Greek debts, a lot of which belonged to the European banks. Now there is a need for more important restructuring of Greek total debt of 368 billion euros to keep the country permanently in the euro area and the EU. It is rather unrealistic in the short term to reduce government debt in Greece significantly through obtaining the budgetary surplus. The scale of the problem is so huge that these debts can be never paid off, so they have to be restructured. It is possible to attain this goal by classic methods: a) debt restructuring, b) debt forgiveness, c) debt monetization, or d) privatization. Debt restructuring seems to be the most possible option but it has to be deep enough in conjunction with the undertaken structural reforms. In the case of debt forgiveness the mechanism of the Paris Club could be created to forgive part of the debts. Monetization of debt has a bad reputation because it often leads to galloping inflation. Moreover it is not possible to execute it in euro area because EBC cannot buy bonds on the primary market (only on the secondary market). The sale of public assets cannot bring only partial reduction of Greek debts at the level of 61.9%. It seems that any realistic strategy for dealing with the crisis in Greece has to involve massive write-downs (forgiveness) of Greek debts belonging to some other countries. The European Stability Mechanism could take over the Greek debt of the IMF and the ECB and commit to future debt relief tied to structural reforms. Only after a partial debt relief Greece would be able to service the remaining debt after structural reforms have been implemented.

5. Reforms of the EU and euro zone

The global financial crisis has changed the perception of risk and the euro area does not have a reputation as an area of stability and credibility. The crisis within the euro area is more costly than in the USA because of an ad hoc (rather than automatic) arrangement to extend credit, contagion and self-fulfilling panics, deeper economic recessions and mutual resentment between partners. The crisis in the euro zone will not be overcome permanently without solving the problem of external unequlibrum between partners. The high debt in Greece is an effect of not only default of internal economic policy but also the low rates of ECB interest rates and easy debt financing by the European banks. The chances of success in structural reforms and obtaining the permanent external and internal equilibrium in Greece are slim, if the euro area itself is not reformed. A lot of authors indicate that the crisis in the euro area is not only the crisis in such countries as Greece, but it is also a structural crisis of the European integration and its institutional framework. It seems that the economic crisis in Greece will be overcome permanently without reforms of the EU and the euro area. Without reforms, the EU itself will not guarantee that similar crises will occur in the future as a result of an inadequate rapid response on the part of the euro area. The EU "misbehaved" by itself because the area is an incomplete economic union, whose structural weaknesses is exposed especially in the time of external financial shock due to:

– lack of banking union,
– small resources accumulated in the EU budget,
– imbalance between single currency and multiple sovereign fiscal policies,
– lack of automatic stabilizers,
– absence of legal order and bankruptcy regime,
– low level of labor mobility.

The present crisis in the euro area revealed that monetary integration had crossed the Rubicon towards more harmonized economic policy. Monetary integration simply does not work without further fiscal integration among member states. The countries of the euro area fell into debt crises relatively easily despite Maastricht conversions criteria and Stability Pact. To escape from the current crisis and prevent the future one, there is no alternative, but to elaborate a proper policy mix between monetary policy and fiscal policy at the European level. There is a combination of decentralized national fiscal policy and centralized monetary policy in the euro area now. Budgetary policy in the euro area serves primarily as an absorption function at the national level, and less at establishing an optimal budgetary spending for entire EMU. The latest crises have showed that in the further transfers of national policy sovereignty from the member states to supranational organs is necessary, so that the monetary policy and fiscal policy may be better coordinated to be more effective in the proper functioning of the currency union.

A key reason why a single currency works in the US and does not work so efficiently in the EU is the insulation provided by the federal fiscal system. Managing a large monetary union in the EU should be straightforward like in a federal state. In a federal state like the US nobody linked the potential default of one state to the local currency functioning as a legal tender. For example, during a recent financial crisis the state of Illinois simply stopped paying 5 billion of its bills and California issued vouchers for wage payments. In both states there were cuts in public services. However, nobody envisaged a bail out financed solely by neither the other US states nor an exit from the monetary union. An analysis of the institutional manner in which the US deals with the crisis reveals federal country wide prudential rules for banks and Federal Reserve System as a lender of last resort. The central budget in the USA also helps the states by automatic stabilizers when an economic crisis begins, which is not in the EU mechanism of integration [Bleblavy, Cobhan, Odor 2011, pp. 341-343; Allegre 2011, pp.153-154]. In the case of the state of Michigan in the USA, which underwent an economic crisis like Greece in the EU, federal budget funds helped to get out from the crisis by a reduction in federal tax revenue and transfer of unemployment benefits for laid off workers. According to calculation made by Sachs and Salay Martin for every decline in every state income of 1 dollar the US federal budget was able to transfer back 40 cents [Sachs, Sala y Martin 1989].

The EU moved towards the EMU without giving it the ability to bail out public debts of partner countries and make transfers between them because of the prohibition of the Maastricht Treaty and limited size of its budget. Therefore it seems desirable that monetary union in the euro area should be accompanied by a tight coordination of the fiscal policies of its member states. It was easy to surrender monetary sovereignty among the states of the USA because the cost of losing the monetary instrument was overwhelmingly dominated by the benefit of belonging to the common fiscal area. Thus in the euro area there is a need for coordination of budgetary policy that arises from the growing economic integration and the likely spillover effects, when budgetary policies in one member states may have impact on the economies of other partner countries. On the one hand austerity programs and reduced budgetary expenditure of some countries can have negative externalities on the growth of trade partners, on the other more public spending in one or few countries may have positive impact by the growth of import from partners carrying out the policy of stabilization of their public finances.

The theory of fiscal federalism points out that fiscal responsibility can be divided between the UE and the members states in the same way as it is divided between national states and their regions. There are two main economic arguments in favor of fiscal federalism: 1. Spillover effects (negative externalities) if actions undertaken in one country lead to inefficient outcomes in the partner country. 2. Increasing returns to scale when for example an anti-cyclical policy is more efficient when carried out on a large scale [Baldwin, Wyplosz 2006, pp. 410-411]. Thus far we do not know precisely what the economic benefits and costs of closer economic union and coordinated economic policies are. Coordination commits partners to agreement on the actions needed to accomplish a coherent policy for the euro area. The basis for the coordination comes from the fact that in the euro area under the Maastricht Treaty (given the openness of the European economies), no member country alone has an incentive to expand demand issuing fiscal policy. If every country decides on its fiscal policy independently, taking into account only its own interest, the euro area fiscal policy would be on average deflationary. Today fiscal discipline and more belt-tightening in Greece, and the other partner countries increases the likelihood that the EU as a result of the euro crisis could face slow economic growth. A coordinated expansion by all member countries of the euro area would therefore have a much bigger positive impact on the growth and employment.

No institutional reforms in the EMU means the acceptance of internal fragility. However, so far the EU initiative to improve economic governance seems to be moderate and perhaps too late to take steps towards effective coordination. The EU propositions take into account the arguments to avoid and correct budget deficit and public debts in fiscal policies in the member states. Governments also put stress on political controls of EU institutions over deficit and debt development to be more strict and automatic. The fear of the loss of sovereignty with regard to this state of affairs comes from mingling two crucial aspects of fiscal policy: structural and stabilization. Structural tax policy is mainly microeconomic and can be decided upon at the national level. However, the income stabilization policy can be accomplished effectively at the supranational level in order to ensure an optimal level of expenditure in the EU as a whole. It seems that the fiscal policies of the euro area member states should be coordinated in the first place and the ECB may assume an active role to contain the debt crisis by buying the bonds of high indebted countries, and under the conditions to undertake the necessary reforms in highly indebted countries.

6. Conclusions

A crisis of such magnitude as in Greece calls for taking active domestic and international measures to overcome it. Although the austerity program carried out in Greece seems to be necessary, it can be used only if a balanced budget is restored simultaneously with the emergence of the economic growth. Greece has to reduce the budget deficit and public debt in order to be able to return to the financial market. However, any successful transformation is not only about increasing taxes and the budget in balance, as well as short term austerity programs, but above all about the deep structural reforms in order to change the economic structure towards the production of more products and services, especially technologically advanced. Structural policy in Greece has to include the public sector in the direction of slimming down and modernizing public administration. What should be done in Greece to overcome the crisis now are supply side reforms that boost productivity, investments, output and employment. These actions should include: privatization, labor market flexibility, deregulating professions, cutting the public sector, streamlining administration, simplifying the procedures to create new business, expending credits especially for SMEs, more investments in education and health sectors, reduction of unemployment.

Long-term effects of structural policy have to be comprehensive and consistent with the improvement of productivity and competitiveness of Greek economy. Overall the desired effect of structural reforms is to boost export and come back on the path of economic growth. The economic growth in Greece should be animated by changing the structure of economy towards increasing more technologically advanced production. Public investment and foreign aids should compensate the decline in demand and be directed to the development of infrastructure, new sectors of economy and sustainable energy. The reduction in production costs through internal devaluation and foreign capital inflow would serve to new investments and reduction of unemployment. The labor market should be liberalized to bring down labor costs. Structural policy in Greece has also to include financing to restore stability, to make this country an attractive place to invest and to do business. Greece has to deal with debt problems (substantial debt reduction seems to be recommended) so the public finance in Greece will be able to reach full capacity to support the recovery through new investments. The biggest change is to reform the Greek pension system. A lot of loopholes that let people retire early and avoid taxation must be closed. Financial reforms have to give banks the ability to channel resources to support country investment, greater credit for SMEs and the development of production and exports.

The reform of banking systems in Greece should be linked to the implementation of the banking union in the euro area. It seems that the actions taken by the Greek government are not enough to overcome the crisis in Greece. The activities undertaken by the partner countries and the EU are equally important. Although in the long run Greece needs essential structural reforms and debt reduction, to solve this crisis permanently and not let it repeat in the future changes need to be made also in the mechanism of the European integration. The banking union in the euro area should minimize the cost of potential bank failures and financial intervention to the citizens of member states. The banking union in the euro area would probably be unworkable unless accompanied by a fiscal union and at least partial debt reduction. All proposed steps against the crisis in the euro area are mutually collateral: monetary integration requires stricter fiscal integration, ECB bailout program provides partly the mutualisation of debts, fiscal integration requires banking union, and all of them require some form of stricter coordination between partners in the field of monetary and fiscal policy. Fiscal coordination in the euro area does not necessarily mean total unification of all national budgets into one supranational budget. The smooth functioning of the euro area requires coordinated fiscal policy between partners concerning public aids and optimal budgetary spending for the whole euro area. In the future it will only be under conditions of proper policy mix between the ECB monetary policy and fiscal policies in the member states if it is possible to run an effective mechanism to prevent and correct an economic downturn such as the one in Greece.

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