In Search for Effective Debt Crisis Management Strategies - Comparing Greece and China

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Abstract

With the rise of international institutions such as the EU and APEC, the nowadays global economic market is increasingly characteristic of the involvement of various nations. Domestic economies of those countries in turn, however, are heavily impacted by institutional changes.

In the wake of the currently unstable global economic pattern, Greece has been experiencing ongoing financial crisis whereas China is facing real-estate bubble as well as huge amounts of debts. Despite differences in the economy structure and the manifestation of the crisis, the two countries that together shaped the prototypes of Western and Eastern philosophy have been brought under the same spotlight again due to economic regression. In this paper, the author strives to analyse the potential institutional socioeconomic factors that induce crisis in both countries and how the Chinese crisis prevention and how both of the countries handle with these problems, see if the experience of Greece can help China see through its debt problem.

Through examining and comparing existing literature, the author first hopes to facilitate an understanding of the country's vulnerability facing the international financial crisis. Specifically, problems such as lax fiscal and monetary policies, social welfare, and institutional influences from the EU will be closely studied and compared with China's current situation.

The present study aims to summarize Greece's experience upon debt crisis and how China can learn from Greece's policy to prevent further debt problem, as well as provide the audience insights into tackling economic crisis under socioeconomic institutional influences within the global market.

Keywords: International Lending and Debt Problems; International Business Cycles; Financial Crises; Economic History: Financial Markets and Institutions
JEL Nr.: F34; F44; G01; N20

INTRODUCTION

Moody's Investors Service has downgraded China's long-term local currency and foreign currency issuer ratings to A1 from Aa3 and changed the outlook to stable from negative on 24 May 2017.

The downgrade reflects Moody's expectation that China's financial strength will erode somewhat over the coming years, with economy-wide debt continuing to rise as potential growth slows. While ongoing progress on reforms is likely to transform the

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economy and financial system over time, it is not likely to prevent a further material rise in economy-wide debt, and the consequent increase in contingent liabilities for the government.

A debt crisis happened since the summer of 2007 in the US and Europe as a result of excessive subprime bank lending. In March 2010, the European sovereign debt crisis started to unfold and forced European fiscal and monetary policy authorities (as well as the IMF) to bail-out governments in the Southern periphery of the European Union (EU).

The growing stock of gross government made the economists worried about china's economy. Some specialists and scholars even predicted that china would follow in Japan's steps, the economy would continue to decline and eventually stay in a low growth rate level, and the middle- income trap might loom.

Since Greece has rich experience upon debt problem, this paper aims to summarize Greece's experience upon debt crisis and how China can learn from Greece's policy to prevent further debt crisis, as well as provide the audience insights into tackling economic crisis under socioeconomic institutional influences within the global market.

DEBT CRISIS HAPPENED IN GREECE

Greece has undergone economic troubles since the 1980s. Its debt/GDP ratio rocketed from 35% in 1981 to over 100% in the 1990s. Greece's currency was also devalued, so in June 1994, the Greek Central Bank had made much efforts to stabilize the currency like force interest rates to 500 percent. It also cost much for the Bank of Greece to prop up the currency.

Being part of the Economic and Monetary Union(EMU) of the European Union in June 2000 fueled Greece accumulating more and more debt with its strong growth and access to cheap capital, hoping that its growing economy would be able to pay off its obligations in the future.

However, on December 8th,2009, Greece's debt rating was downgraded to the lowest level in the euro zone for the first time, the negative future economic outlook for Greece which signaled to the bond market that Greece would have an even harder time to meet is financial obligations, which caused the global market to panic.

Although both Greece and the European Union have done so many thing to setback the unstable economy, still, the future is unclear on if and when that will happen.

MISTAKES MADE AND LESSONS LEARNED

These aspects are the main reason of Greece's debt crisis according to Dr. N. Delener (2012), which are mismanagement of funds, taxes, European Economy Union membership & Greece's Weak, access to cheap capital, the euro, international confidence investors and lack of restoring, negative expected value, sovereign debt rules, rating agencies, solving debt by going more in-debt and accounting fraud.

Greece has a long history of being a pro-socialist country. Cutting government assistance and welfare programs was very hard for its leaders to do. Greece also had trouble collecting taxes from its citizens and the government failed to impose higher levels of scrutiny in forcing its populace to pay up.

Lacking the ability to innovate, Greece is a country that has had high inflation rates, low employment rates, high interest rates and high levels of corruption.

After Greece entered the European monetary bloc, creditors treated the country as if it was a triple-A rated country since they expected the other European countries to help out if there ever was a need. Unfortunately, the debt panic spreads all throughout the world.

Since Greek now uses euro as currency instead of its old currency- the drachma, it loses control of printing more. Devaluing the euro makes little sense as this would hurt all the other member nations of the euro zone. At the same time, using the same currency in different countries is bound to be problematic in different stock market strengths, GDP, labor force, welfare systems.

There are two parts of the international investor problem. Firstly, the vast majority of Greece's debt is held by international institutional investors and was bought through international bond markets, which can turn out to be dangerous. Secondly, many of the investors were European Banks which meant that a default in Greece was going to hurt everyone in Europe as well.

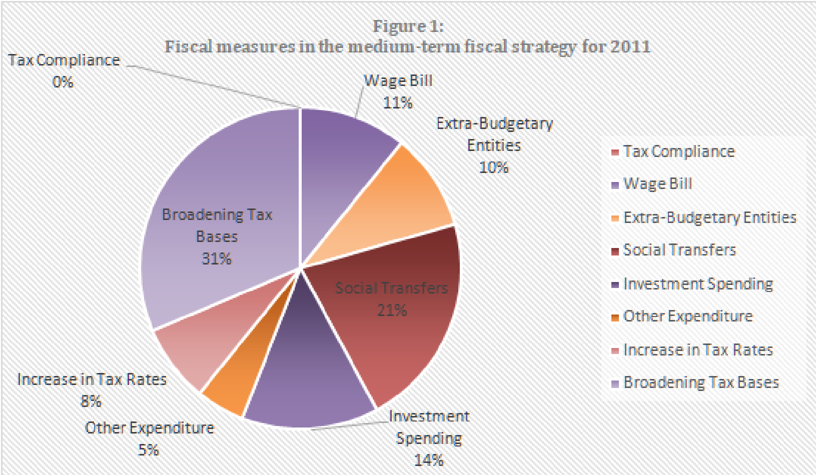
Another severe problem is that Greece borrow more to meet its current debt obligations, which sounds unreliable and ridiculous. It can only solve the short-term debt problem, and aggravate the further long-term debt crisis.

GREEK POLICY RESPONSES

The Greek government adopted sets of procedures to confront the crisis:

Fiscal Austerity

In October 2009, the Greek government has unveiled three separate packages of fiscal austerity measures aimed at bringing Greece's government deficit down from an estimated 13.6% of GDP in 2009 to below 3% by 2012. In total, the measures are worth an estimated €16 billion ($21.6 billion), or 6.4% of GDP. In March 2010, the parliament approved another austerity measures which aimed to increase revenues through a rise in the average value-added tax rate. On the expenditure side as shown in figure (1), most of the spending cuts announced focused on the civil service. The Greek social security system has been facing chronic and structural problems (George Hondroyiannis and Evangelia Papapetrou (2002), thus the government decided to reduce pension funds, cuts in pay and non-pay expenses, a substantial increase in prices for services offered by SOEs, and limits on subsidization. The government also announced to tighten public regulation and restructure Greece's public administration by consolidating local governance structures through reducing the levels of local administrative authorities.



Source: The Economic Adjustment Program for Greece (Spring 2011). European Economy Occasional Papers, Fourth Review 82

Long term structural reform

The government announced wide-ranging reforms to the pension and health care systems and to Greece's public administration, and boosting Greek economic competitiveness by enhancing employment and economic growth, fostering private sector development, and supporting research, technology, and innovation.

In spite of Greece's relatively drastic contractionary fiscal policies, and steps of the structural reform, the economic growth rate contracted by 4% in 2009, 1.1% in 2010 and by 3.7% in 2011, and registered unemployment reached 12.7% in 2010, as shown in the table (1).

In the table, despite of the increasing unemployment, real GDP growth is improving. Since the exports of goods and services grows steadily from 18.5% in 2003 to 31.9% in 2015, imports of goods and services remain ranging from 28.8% to 36.0%. Greece strives to solve the debt problem, and results are shown to them as well.

Table (1): Greece real GDP growth, unemployment rate, imports and exports (2003-2015)

	Real GDP Growth	Unemployment Rate	Imports of goods and services	Exports of goods and services
Unit	Annual growth %	% of labor force	% of GDP	% of GDP
2003	5.8	9.8	29.6	18.5
2004	5.1	10.6	29.1	20.7
2005	0.6	10.0	29.5	21.3
2006	5.7	9.0	31.7	21.2
2007	3.3	8.4	35.0	22.5
2008	-0.3	7.8	36.0	23.4
2009	-4.3	9.6	28.8	19.0
2010	-5.4	12.7	30.7	22.1
2011	-9.1	17.9	32.3	25.5
2012	-7.3	24.4	33.1	28.7
2013	-3.2	27.5	33.2	30.4
2014	0.4	26.5	34.9	32.5
2015	-0.2	24.9	31.8	31.9

Resources: OECD. Stat

CHINA'S SITUATION

The modern economy is a kind of debt economy. Since the market-oriented reform of China's economy, debt problem has been paid close attention to. In 1990s, a number of researchers studied the rising phenomenon of M2/GDP in China and the origin of debts. After 2009, in order to overcome the impact of the global financial and economic crisis, China implemented a large-scale expansionary fiscal policy, while the debt problem became the center of many problems in the political economy.

Three characteristics were highlighted: Firstly, Debt size and leverage have risen rapidly. During 2007 ~2015, total debt rose from $118.9 trillion to $168.5 trillion, social leverage (debt / GDP) rose from 1.7 to 2.5 times, and M2/GDP rose from 1.5 to 2.0 times, significantly more than many emerging market economies. The debt burden engulfed a large number of corporate profits. Secondly, as these debt accumulation periods overlap considerably with the situation of "the state advances as the private sector retreats", the debt is concentrated in large state-owned enterprises that are closely related to the government and the financial sector, Particularly the low operating industries such as metals, mining and petrochemical industries. Debt formation assets contribute less to growth and tend to decline, which forms systemic risks. Thirdly, Debt governance is difficult to resolve in the short term. In 2014~2015, China put forward the "deleveraging" policy at the level of monetary policy and financial supervision. At the beginning of 2016, the central economic work conference also proposed the recent reform goal of "decreasing capacity, decreasing inventory, decreasing leverage, lowering the cost, set "deleveraging"as a global economic policy and the important task of supply side structural reform. But up to the first half of 2016, there were no signs of a marked decline in debt size and leverage.

Through further analyzing, since China has more foreign exchange reserve and less foreign debts and the debt paying ratio, liability ratio and debt ratio of foreign debts are below their international alert standards by about 20%, 20% and 100%, the central government's sovereign debt is not very risky. Although affected by the expected RMB appreciation and interest rate policy, China's short-term external debt has risen. However, since China's foreign exchange reserve is above 9 times than short-term foreign debts, the liquidity risk of the central government's external debt is also not significant. On the other hand, the problem of local government debt in our country is quite severe. What is worrying is, especially in 2008, in response to the international financial crisis, the Chinese government has launched a 4 trillion bailout plan. In this instance, the number of local government investment and financing platforms has increased rapidly, and the total liabilities have also expanded rapidly.

CAUSES OF CHINA'S DEBT PROBLEM

Unequal rights and responsibilities. China implements the administrative system of separation of powers and fiscal rights between the central and local governments. The fiscal rights shift to the up side and the powers shift to the down side have resulted in unequal rights and responsibilities. China's fiscal revenue is mainly concentrated to the central government, while local governments rarely get much. However, the local governments bear most of the responsibility of the economic and social development, including infrastructure construction like education, health and medical and other infrastructure projects, supporting the development of local enterprises and the balance of local residents' income and so on. These responsibilities consume the governments big money. In the case of income less than expenditure, local government borrowing has become an inevitable choice.

Local governments pursuit GDP and performance projects. The performance evaluation of government officials is so narrow that GDP is usually used as a measure of achievement. This makes local governments more tempted to invest in increasing GDP. To achieve performance during his tenure, local government officials make blind or duplicated investments, borrow money, and do things to fulfil his achievements, rarely focusing on the analysis of economic benefits of the investments and financing costs. This distorts both the allocation of resources to the market and the waste of financial resources. Once the benefits of investment projects are poor, the repayment of loans will bring heavy burden to local governments.

The impact of the international financial crisis. On one hand, the international financial crisis setbacks China's real economy, declines enterprise efficiency, and reduces local government revenue at the same time. Because of its own strict funds, the relevant transfer payment to local government shrinks. On the other hand, China's central government has proposed an economic stimulus policy to maintain growth. The local government has done a lot of supporting investment for this purpose, so the international financial crisis has directly reduced local governments' revenue and increased expenditure. In this case, the scale of debts by local governments has also risen sharply.

The law does not allow local governments to issue bonds. At present, China's budget law does not allow local governments to issue bonds, local government formal financing channels is narrow, though in 2009 the Ministry of Finance approved for the local government to issue bonds, but the move is only temporary, not as conventional financing pattern of local government. The local governments try every means to avoid the direct control of law to lend money in order to provide money to the relevant units or projects in the form of guarantees. Investment and financing platform is produced in such a background, which also creates a stronger hidden for the local government debt.

Unreasonable economic development model. Although the country has repeatedly stressed the need to stimulate economic growth relying on consumption, but the contribution of the current investment in China's economic growth is still greater than consumption. The local economy is mostly stimulated by investment, not consumption or exports. Investments in all regions are more powerful. In addition, China's economic development presents regional imbalances. The eastern region develops rapidly, while the central and western regions develop slowly. It is reasonable for the central and western regions of the central and western regions with relatively weak economic foundation to scale up the investment in promoting economic development while the region is scrambling to increase investment.

COMPARISON BETWEEN GREEK'S DEBT PROBLEM AND CHINA'S DEBT PROBLEM

Similarity

Large credit scale. The European Central Bank had to lend a hand when the EU member countries were unable to borrow their debts. As in May 10, 2010, the European Union and the European Central Bank announced plans to provide euro zone countries with a bailout of 750 billion euros. In view of this, international financial institutions and their banks dare to lend to these governments. In our country, the central and local government classification system is implemented. When the local government appeared in the financial crisis, the central government had to rescue, and also made our banks provide a large amount of credit to the local government.

Opaque fiscal revenue and expenditure. Considering for the "election", the government used to make false accounting method to conceal public debt and fiscal deficit. Every new government has failed to take steps to improve its debt. When real data is disclosed, it causes market turbulence, social worries and crisis. But the local government in our country has a large amount of implicit debt due to the long-term debt guarantee of the local investment and financing platform. It is difficult to estimate the scale. Once these debts are realized, it will inevitably aggravate social panic.

Deferred liability. During the term of the euro zone countries, the governments of the euro area have invested heavily in their efforts to achieve good results, and these debts often have a longer cycle. When the government fails to pay its full debts, the responsibility is pushed to the next government. By the end of 2009, many of the debt payments made by the Greek government had been left over by the previous government. Similarly, many of our local government leaders in the term of political achievements, wantonly lending, debt repayment task is often pushed to the next government, lack of hedge power, local financial risks continue to accumulate.

Difference

Despite the most apparent difference of the figure of risks, they have 3 other differences.

Different debt nature. Greece's debt is mainly foreign debt, which is borrowed from other financial institutions, and the government is always in a passive position. In the event of crisis, international banks contracted business, and the financial situation of the government was greatly affected. While China's local debt is to the domestic bank debt, domestic debt is. The central government's policy has a big impact on banking. In view of the overall economic development of the country, the central government tends to give local government support in policy. There will be no rapid contraction of credit in the banking sector and the intensification of the local financial crisis.

Different debt investments. Greece's debt is largely spent on spending, maintaining welfare, and having a high level of welfare, variety and cost. The high welfare model makes the public and private sectors overburdened, weakens the economic competitiveness, and fails to increase its economic vitality, and cannot effectively cope with the impact of the international financial crisis. China's local government borrowing mainly for infrastructure investment, the recovery of the real economy and promote growth is of great significance, so that China has become a country in the international financial crisis after the rapid recovery of the country.

Different ability to prevent crisis. Although the euro zone countries have stability and growth pact, they require the proportion of the state budget deficit of the member countries. However, there is no political compulsion in the EU to ensure that Member States comply with and do not have punitive measures against violations, which have led to the violation of treaties by several Member States, triggering crises. And the central government of our country has the right of administrative command to local governments, and has strong enforcement power. It can correct the local government's major violations in time and prevent the local government from having more financial risks.

CONCLUSION

Through researching, since Greece and China have different kind of debt problem, it’s hard to find the same specific debt managements. However, following suggestions can be adopted.

a) Never cheat on one country’s financial statement. Lacking of responsibility may lead to global economic panic.
b) Reduce local corruption. Corruption slows down even prevents the development of a city even a country. As public characters and the governors of a country, thinking about oneself instead of from a global perspective is inadvisable.
c) The issuance of bonds should be subject to rigorous examination and approval.

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