



## THE FISCAL POLICY OF GREECE AND ITS MACROECONOMIC PERFORMANCE WITHIN THE FRAMEWORK OF THE EUROPEAN ECONOMIC UNION

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### **Abstract:**

This study aims to approach Greece's fiscal policy and its macroeconomic performance within the framework of the European Economic Union. In economics and political science fiscal and monetary policy are the basic tools used by the government and the central bank of a country respectively for the effective exercise of power, the promotion of economic goals, and the economic development of the country. The methodology followed was the review of international and domestic literature and the econometric analysis in the form of multiple linear regression between the GDP as a dependent variable and the remaining fundamental macroeconomic variables as independent variables for Greece for the period 1995-2022. The results can contribute to drawing useful conclusions about the effect of the main macroeconomic variables in particular inflation, unemployment, public debt, government expenditure, and total tax revenues on the Greek GDP.

**JEL:** E62; H5; H6; O11; O23

**Keywords:** fiscal policy, public debt, macroeconomic performance, fundamental macroeconomic variables, Greek GDP

### **1. Introduction**

Fiscal policy refers to the use of either government spending or tax policies or, in rare cases, the use of both tools by the government in order to change the economic conditions and in particular the macroeconomic conditions of a country including the overall demand for goods and services, the employment, inflation and economic growth. Fiscal policy is mainly based on the ideas of the British economist John Maynard Keynes who

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argued that governments can stabilize the business cycle and regulate economic production (Hayes, 2021).

The three stances of fiscal policy are neutral fiscal policy, expansionary fiscal policy, and contractionary fiscal policy.

Neutral fiscal policy is usually used when an economy is neither in economic downturn nor in recovery. The amount of government spending on the deficit, that is, the surplus not financed by tax revenues, is about the same as it has been on average over time, so there are no changes that will affect the level of economic activity.

Expansionary fiscal policy is implemented by the government during an economic downturn with the goal of reducing tax rates to increase aggregate demand and achieve economic growth. This means that consumers pay lower taxes, and have more income and savings to spend or invest resulting in higher demand. This high demand leads businesses to hire labor reducing unemployment and increasing the level of employment thereby raising wages and giving consumers more income to spend and invest. Instead of reducing taxes, the government can achieve the same result by increasing government spending without corresponding tax increases (Hayes, 2021).

Contractionary fiscal policy is seen during periods of excessive recovery accompanied by rising inflation to keep the economy in balance. It was essentially the reverse process of expansionary fiscal policy (Hayes, 2021). The government practices contractionary fiscal policy by raising taxes, reducing government spending as well as reducing public sector wages or jobs. Contractionary fiscal policy is rarely used as it is not particularly popular politically (Hayes, 2021).

The results of each fiscal policy are not the same for everyone and are usually shaped by the goals of policymakers. An expansionary fiscal policy that mandates tax cuts or government spending increases could only affect the middle class, which is usually the largest economic group. Conversely, a contractionary fiscal policy that involves increasing taxation or reducing government spending mainly affects the upper economic group. This means that when a government decides to implement fiscal policy then its policy will only affect a certain group of people (Kramer, 2021). It is worth mentioning that it is commonly accepted that a degree of government intervention is necessary in the economy to maintain the balance in the economy on which the economic and social welfare of the population depends (Kramer, 2021).

## **2. Literature Review**

### **2.1 The Greek Fiscal Framework**

Even though the Greek economy achieved high growth rates throughout the last decade, fiscal imbalances were never brought under control. The main weaknesses of the fiscal framework in Greece are the lack of transparency, the lack of a medium-term fiscal framework, the lack of a program for budget planning, the weak budget process, and the lack of accountability as well as organizational weaknesses (Kaplanoglou and Rapanos, 2011).

The lack of transparency is mainly due to the drafting of two separate budgets (the ordinary and the investment budget) with overlapping expenditure categories, the existence of significant extra-budgetary transactions, and the lack of coherent reporting of the finances of non-budgeted general government organizations (i.e. local authorities, social security funds and hospitals).

The lack of a medium-term budgetary framework is because the budget is drawn up every November for the following calendar year. Most tax measures have fiscal implications that last beyond the annual fiscal cycle. Therefore, a one-year perspective provides a poor basis for fiscal planning.

International practice has shown that public funds are used more effectively within a budget system with an emphasis on policy objectives related to the quality of spending and program reviews. In Greece the expenditure control and accountability framework are characterized by unreliability and multiple expenditure controls tend towards compliance and legitimacy resulting in the lack of program for budget planning. The weak budget process and lack of accountability happen because ministries enjoy a high degree of freedom to propose expenditures that are approved in a timely manner by the highest levels of government. The Ministry of Finance intervenes in all stages of the budget process at a very detailed level reducing their accountability and incentives to improve the management of public funds.

Organizational weaknesses are because the General Accounting Office, which oversees the budget, does not have a coherent information system to overview total public revenues and expenditures at any time. Local information systems are not in direct contact with the General Accounting Office, thus making the collection of information on both income and expenditure even more difficult.

The recommendations for the reform of the budget (Kaplanoglou and Rapanos, 2011) that are proposed are the merger of the public and the investment budget with an emphasis on the autonomy of the General Accounting Office for easier and more efficient management, the introduction of a new accounting system compatible with the International Accounting Standards and improving the timeliness and reliability of the budget reports. The General Accounting Office should produce monthly reports that will track all expenditures by the central government, local authorities, and the public sector. Furthermore, it is necessary to introduce a new effective internal control system where controls should not be limited to checking compliance with procedures but should also control the quality of expenditures based on total quality management. In addition, the introduction of stronger top-down budgeting, i.e. top-down decision-making on overall expenditures with the ultimate goal of cost containment, the introduction of a budget planning program to give greater attention to the objectives and quality of expenditures as well as the introduction of national tax rules which must be transparent and include all fiscal activities. It is also necessary to introduce a medium-term fiscal framework integrating the strategic goals and objectives of the government. Such estimates could be the basis for budget limits. Finally, the introduction of "accrual accounting" is proposed. "Accrual accounting" means that revenues are recorded when they are received while

expenses are recorded when they are incurred. Such a system could enhance transparency in the allocation of public resources and improve progress in decision-making.

## 2.2 Effects of Greek Fiscal Policy on Greek Economic Activity

The effects of fiscal policy on economic activity are shown in Table 1 below both in the short-run and the long-run (Tagkalakis, 2013):

**Table 1** The effects of fiscal policy on the growth rate of real per capita GDP (partitioned regression results)

Regressors	SR	LR	Regressors	SR	LR
Change in real government spending	0.104 (2.24)**	0.145 (2.04)**	Change in real government net taxes	-0.026 (-0.66)	-0.026 (-0.67)
Change in real government consumption spending	0.196 (3.30)***	0.222 (3.24)***	Change in real government net taxes	-0.059 (-1.82)*	-0.052 (-2.01)**
Change in real government gross fixed capital formation	-0.028 (-1.24)	-0.053 (-1.12)	Change in real government net taxes	-0.007 (-0.17)	-0.018 (-0.17)
Change in real government net transfers	0.148 (1.71)*	0.204 (1.65)	Change in real government net taxes	-0.027 (-0.73)	-0.049 (-0.80)
Change in real government compensation of employees	0.137 (1.91)*	0.166 (1.95)*	Change in real government net taxes	-0.028 (-0.72)	-0.029 (-0.76)
Change in real government current taxes on income and wealth	-0.111 (-1.78)*	-0.102 (-1.44)	Change in real government spending	0.106 (2.21)**	0.140 (1.83)*
Change in real VAT	-0.162 (-2.37)**	-0.121 (-3.40)***	Change in real government spending	0.139 (3.21)***	0.134 (3.29)***

The table reports the estimated partial effects of each variable on the respective dependent variable, i.e., the "pure" marginal effects of the regressor on the dependent variable, having partialled out the linear effect of the rest of controls from both the dependent and the explanatory variable. The R<sup>2</sup> and the other reported statistics refer to the multiple correlation coefficient of the original regression specification

\*\*\*, \*\*, \* Significance at 1, 5 and 10 % level of significance, respectively. Robust t-statistics are reported in parenthesis

The variables that appear to be statistically significant are real government spending in the short-run and the long-run at a 5% statistical significance level, real government consumption spending in the short-run and the long-run at a 1% statistical significance level, real government net transfers in the short-run at 10% statistical significance level, real government compensation of employees at 10% statistical significance level in the short-run and the long-run, real government current taxes on income and wealth at 10% statistical significance level in the short-run, real value-added tax at 5% statistical significance level in the short run and at a statistical significance level of 1% in the long-run and real government net taxes in the short-run and the long-run at a statistical significance level of 10% and 5% respectively.

More specifically, an increase in real government spending, real government consumer spending, real government net transfers, and real government compensation of employees increases the rate of economic activity. On the other hand, an increase in

real government current taxes on income and wealth, real value-added tax, and real government net taxes reduces the rate of economic activity.

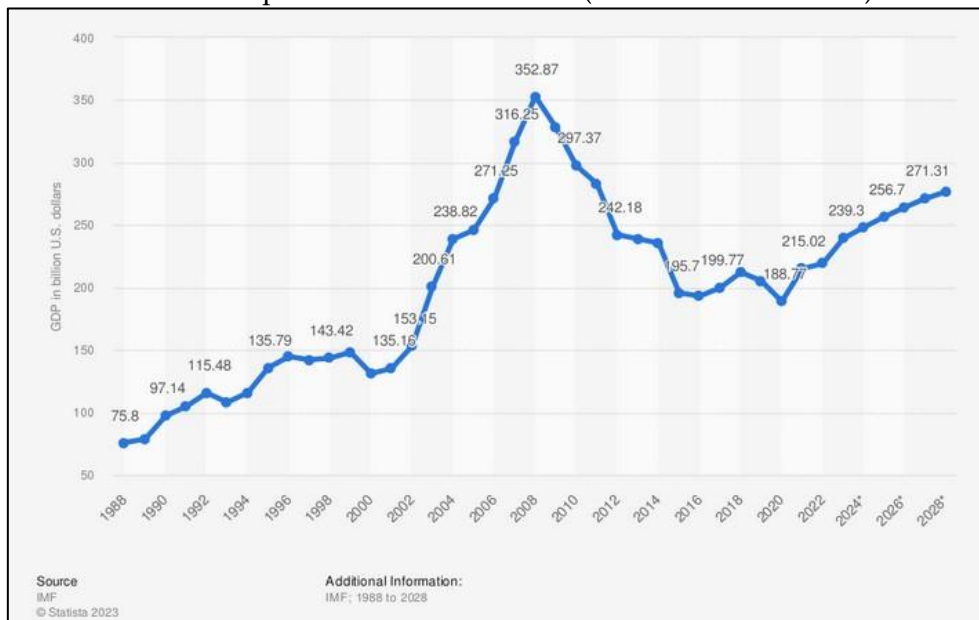
### 2.3 The Factors That Led Greece to Financial Aid

The reasons that led Greece to decide to request financial aid were low competitiveness due to the low productivity and high labor costs leading to a reduction in investment resulting in a reduction of part of the government revenues through which public deficits are financed (Kostarakos and Kotsios, 2017). In addition, rigid labor and rigid markets for goods and services did not help in the immediate absorption of macroeconomic shocks and automatic stabilization resulting in the shocks accumulating and worsening the economic condition of the country. Finally, the persistent large external and fiscal deficits led the country to be unable to borrow from the international markets and as a result, the only solution was to turn to the European Union for financial support (Gonçalves, 2016).

### 2.4 The Greek Gross Domestic Product (GDP)

Figure 1 below shows the Greek debt during the period 1988-2028 (International Monetary Fund, 2023):

**Figure 1:** Greece: Gross domestic product (GDP)  
in current prices from 1988 to 2028 (in billion U.S. dollars)



Greece was affected by the crisis in the first years when the global economic downturn broke out in 2008. This contributed significantly to the evolution and course of GDP (Vousinas, 2020). According to the above figure (1) the Greek GDP showed growth rates during the period 1988-2008 with a maximum growth rate in 2005 (Dimitriou and Metaxas, 2018). But with the outbreak of the global economic downturn, the Greek GDP started to decline (Lenoël, Macchiarelli, and Young, 2020). 2014 was the first year showing

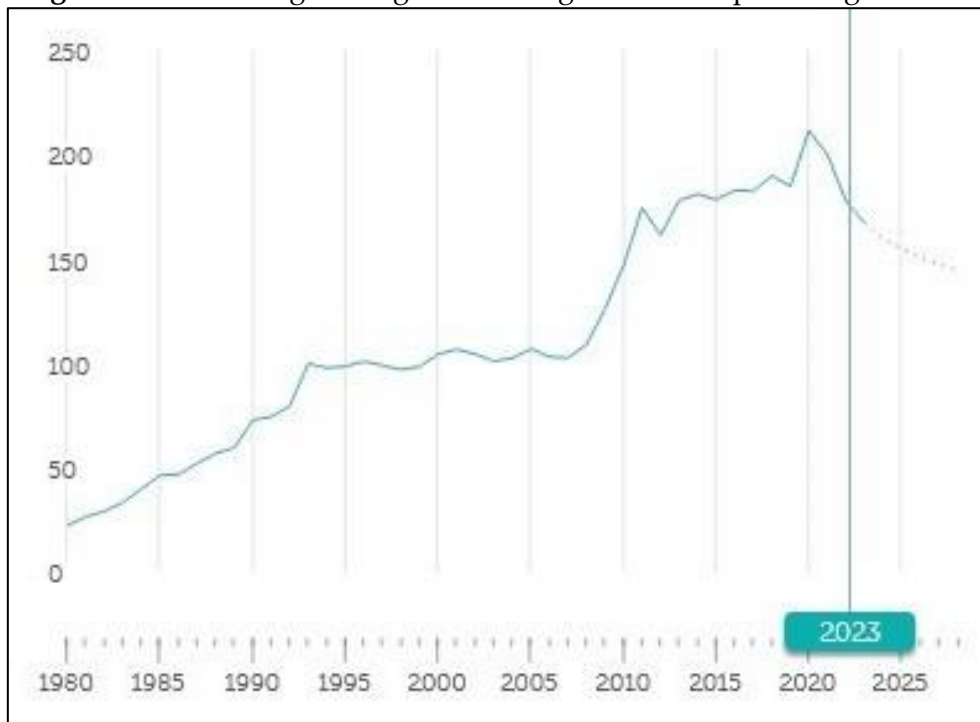
an increase (Gonçalves, 2016). After the global financial crisis, Greece was affected by the COVID-19 pandemic crisis in 2020. According to the above figure (1) the Greek GDP decreased during the period 2020-2022 due to the pandemic crisis.

According to the statistics, the forecasts for the Greek GDP for the coming years support that it will start increasing.

## 2.5 The Greek Debt

Figure 2 below shows the Greek general government's gross debt in percentage of GDP during the period 1980-2023 (International Monetary Fund, 2023):

**Figure 2:** The Greek general government gross debt in percentage of GDP



**Source:** IMF Data Mapper.

According to above Figure 2, in 1980 the Greek debt started to increase reaching 100% of GDP in 1990 where it remained stable for a decade. With the outbreak of the global financial crisis, the Greek debt began to increase even more, reaching 170% of GDP, where it remained until 2019.

However, with the outbreak of the COVID-19 pandemic crisis in 2020, the Greek debt began to increase, reaching 200% of GDP. Afterward, it started to decrease and today is reaching 150% of GDP.

We notice that the Greek debt increased at a greater rate during the outbreak of the global economic crisis than during the outbreak of the COVID-19 pandemic crisis.

### 3. Material and Methods

#### 3.1 Method

The method used in this research is the quantitative analysis and more specifically the econometric analysis of the main macroeconomic parameters of Greece.

#### 3.2 Purpose

The purpose of this research was to study how the fundamental macroeconomic variables of Greece affect the Greek GDP and to what extent.

#### 3.3 Sample

For the purposes of this research, a sample of 6 variables was used over 23 years. More specifically, the variables were the basic macroeconomic variables of Greece during the period 1995-2022.

#### 3.4 Data analysis

In this research the main variables are a) the GDP rate as a dependent variable, b) the inflation rate as an independent variable, c) the unemployment rate as an independent variable, d) the public debt as a percentage of GDP as an independent variable, e) government spending as a percentage of GDP as an independent variable and f) total tax revenues as a percentage of GDP as an independent variable. More specifically, the data are described by the linear relation:

$$GDP_i = \beta_0 + \beta_1 inf + \beta_2 unem + \beta_3 debt + \beta_4 exp + \beta_5 rev + u_i \quad (1)$$

These data are collected for Greece during the period 1995-2022. These variables have an essential role in the present research and through the quantitative analysis carried out, important conclusions are drawn for the economy of Greece.

### 4. Results and Discussion

#### 4.1 Results

In this section, the results of the quantitative analysis carried out in this research are presented in detail. More specifically, are presented the OLS estimators obtained from the multiple linear regression of the relation:

$$GDP_i = \beta_0 + \beta_1 inf + \beta_2 unem + \beta_3 debt + \beta_4 exp + \beta_5 rev + u_i \quad (1)$$

for Greece.

The OLS estimators are given by the relation:

$$\widehat{GDP} = \widehat{\beta}_0 + \widehat{\beta}_1 inf + \widehat{\beta}_2 unem + \widehat{\beta}_3 debt + \widehat{\beta}_4 exp + \widehat{\beta}_5 rev \quad (2)$$

## 4.2 Results for Greece

From the multiple linear regression, it follows that at a statistical significance level of 1% the OLS estimators as well as the corresponding standard errors for Greece are given by the linear relation:

$$\widehat{GDP} = 47,54 - 0,82 \text{ inf} + 0,09 \text{ unem} - 0,06 \text{ debt} - 0,67 \text{ exp} - 0,13 \text{ rev} \quad (3)$$

(6,7)    (0,4)    (0,28)    (0,03)    (0,15)    (0,17)

Additionally, it turns out that:

$$R^2 = 0,78, SER = 2,13 \text{ και } n = 24.$$

From the multiple linear regression, it follows that at a statistical significance level of 5% the OLS estimators as well as the corresponding standard errors for Greece are given by the linear relation:

$$\widehat{GDP} = 47,54 - 0,82 \text{ inf} + 0,09 \text{ unem} - 0,06 \text{ debt} - 0,67 \text{ exp} - 0,13 \text{ rev} \quad (3)$$

(6,7)    (0,4)    (0,28)    (0,03)    (0,15)    (0,17)

Furthermore, it turns out that:

$$R^2 = 0,78, SER = 2,13 \text{ και } n = 24.$$

We note that the regression results for the 5% statistical significance level are the same as the results for the 1% statistical significance level except for the confidence intervals of the OLS estimators.

From the multiple linear regression, it follows that at a statistical significance level of 10% the OLS estimators as well as the corresponding standard errors for Greece are given by the linear relation:

$$\widehat{GDP} = 47,54 - 0,82 \text{ inf} + 0,09 \text{ unem} - 0,06 \text{ debt} - 0,67 \text{ exp} - 0,13 \text{ rev} \quad (3)$$

(6,7)    (0,4)    (0,28)    (0,03)    (0,15)    (0,17)

Also, it turns out that:

$$R^2 = 0,78, SER = 2,13 \text{ και } n = 24.$$

We note that the regression results for the 10% statistical significance level are the same as the results for the 1% and 5% statistical significance levels except for the confidence intervals of the OLS estimators.

Table 2 below shows the results of statistical significance for Greece at 1%, 5%, and 10% levels. More specifically, from the table below, important conclusions are drawn about the effect of the main macroeconomic variables and in particular inflation,



unemployment, public debt, government expenditure and total tax revenues on the Greek GDP:

**Table 2: Regression for Greece**

Dependent variable: GDP growth (1)	
Independent variables	
<b>cons</b>	47,544 (6,708)***
<b>inf</b>	-0,823 (0,409)*
<b>unem</b>	0,097 (0,286)
<b>debt</b>	-0,065 (0,036)
<b>exp</b>	-0,677 (0,1599)***
<b>rev</b>	-0,139 (0,178)

\*\*\*, \*\*, \* Significance at 1,5 and 10% level of significance respectively. Robust t-statistics are reported in parenthesis.

According to the statistical significance table (2) above, we find out that the variables that are statistically significant for the Greek GDP and directly affect it are inflation at a statistical significance level of 10%, and government expenditures which are statistically significant at a level of 1%, 5% and at the 10% level. Additionally, the effect of the constant appears to be statistically significant at the 1%, 5%, and 10% levels. The remaining variables more specifically unemployment, public debt, and total tax revenues do not seem to be statistically significant, which means that they do not directly affect the Greek GDP and have a secondary role.

Finally, according to the statistical significance table (2) above an increase in inflation will reduce economic activity, and specifically, a 1 unit increase in inflation reduces Greek GDP by approximately 0.823 units. Accordingly, an increase in government spending will reduce economic activity, and more specifically a 1 unit increase in government spending reduces Greek GDP by about 0.677 units.

### 4.3 Discussion of the Results

From the results, important conclusions are drawn about the effect of the main macroeconomic variables in particular inflation, unemployment, public debt, government expenditure, and total tax revenues on the Greek GDP.

According to the above statistical significance Table 2, we find out that the variables that are statistically significant for the Greek GDP and directly affect it are inflation at a statistical significance level of 10% and government spending which is statistically significant at a 1%, 5%, and 10% levels. Additionally, the effect of the constant at the 1%, 5%, and 10% levels seems to be statistically significant. The remaining variables more specifically unemployment, public debt, and total tax revenues do not seem to be

statistically significant, which means that they do not directly affect the Greek GDP and have a secondary role. More specifically, an increase in inflation will reduce economic activity, and specifically a 1 unit increase in inflation reduces Greek GDP by approximately 0.823 units. Accordingly, an increase in government spending will reduce economic activity, and more specifically a 1 unit increase in government spending reduces Greek GDP by about 0.677 units.

From this, we observe that the Greek economy seems to be strongly affected by the level of inflation. This strong effect of the level of inflation on the Greek GDP is also confirmed by the course of the Greek economy so far, which managed to achieve high growth rates after the Second World War and the civil war until the period before the outbreak of the global economic downturn of 2008 with the budget deficit and public debt decreasing (Kaplanoglou and Rapanos, 2011). This resulted in high growth rates and great economic activity, high GDP, a reduction in inflation, stabilization of public debt in relation to GDP, and a particularly low unemployment rate (Alogoskoufis, 2012). However, the fiscal situation remained precarious as the underlying fiscal problems persisted and accumulated throughout the growth of the Greek economy. This combined with the outbreak of the global economic crisis of 2008 and the weak quality of Greek institutions led to an increase in the level of inflation, the budget deficit, and public debt resulting in the reduction of Greek GDP. For the same reason, the fiscal expansion and money supply expansion that was chosen by the Greek government in order to mitigate the pandemic's consequences in 2020 led to inflation and a lower GDP (Apostolopoulos et al., 2022). This fact confirms that a high GDP for the Greek economy is accompanied by low inflation, while, on the contrary, a low GDP for the Greek economy is accompanied by high inflation. So, the Greek GDP and the inflation rate seem to be related to each other with a negative relationship. And, this is because in periods of economic downturn Greece seems to follow an expansionary fiscal policy in order to stimulate domestic demand and reduce the general level of prices of goods and services which seems to increase considerably in periods of economic crisis and therefore drive the country's economy in recovery gaining higher growth rates but lower inflation levels.

The same seems to be the case with government spending. More specifically, until the period before the outbreak of the global economic crisis in 2008, the Greek economy was characterized by high growth rates with the budget deficit decreasing and stabilizing at low levels due to reduced government spending (Kaplanoglou and Rapanos, 2011). However, with the outbreak of the global economic downturn of 2008, the deficit soared to high levels and government spending increased due to wasteful government spending and lack of quality control over government spending (Kaplanoglou and Rapanos, 2011). This led to the reduction of the Greek GDP during the crisis period, a fact that was further burdened by the accumulated macroeconomic imbalances of the previous years. Furthermore, the fiscal expansion and money supply expansion that was chosen by the Greek government in order to mitigate the pandemic's consequences in 2020 increased government spending as increased aggregate demand using fiscal multipliers while the GDP was decreasing (Apostolopoulos et al., 2022). This means that government spending

decreases as GDP increases and increases as GDP decreases. So, Greek GDP and government spending seem to be related to each other with a negative relationship.

Regarding the unemployment rate, public debt and total tax revenues appear to be non-statistically significant variables which means that they do not directly affect the Greek GDP and have a secondary role and effect on the Greek economic activity.

The unemployment rate seems to have remained at a relatively low level within the permissible limits imposed by the Eurozone without showing many fluctuations, which confirms why unemployment is not a statistically significant figure for the Greek GDP and does not have a direct effect on the Greek economic activity (Athanasidou, 2009). However, it was one of the variables that were significantly not affected by the outbreak of the global economic downturn in 2008 and during the pandemic crisis in 2020 as the unemployment rate didn't change a lot but showed fluctuations without, however, significantly affecting Greek economic activity (Apostolopoulos et al., 2022). Additionally, in June 2007 the European Union announced that the Greek fiscal deficit had been reduced below 3% of GDP and was therefore sustainable, ending the excessive deficit process (Kaplanoglou and Rapanos, 2011). However, the Greek fiscal budget deficit began to increase due to the accumulated macroeconomic imbalances of previous periods and the outbreak of the global economic crisis of 2008 as government expenditures increased and public revenues decreased resulting in its default and stabilization at quite high levels (Athanasidou, 2009). This resulted in the deficit gradually accumulating, being integrated into the deficit of the previous years and thus turning into public debt. Thus, the public debt of Greece increased over time due to the accumulated macroeconomic imbalances despite the rapid growth of the Greek economy, with the result that the global economic downturn of 2008 burdened it even more and stabilized at 100% of the Greek GDP which it also makes it the second highest public debt in the eurozone (Athanasidou, 2009). During the pandemic crisis in 2020, the Greek public debt was reduced to a very small extent (Apostolopoulos et al., 2022). This stabilization of the Greek public debt because of the stabilization of the Greek fiscal deficit also justifies the fact that the public debt is not statistically significant for the Greek GDP as it remained stable at particularly high levels. Finally, the total tax revenues of Greece seem to be at quite low levels in relation to the high public debt, thus becoming insufficient to cover the Greek public debt. This large discrepancy between total tax revenue and Greek public debt makes government revenue statistically insignificant to Greek GDP.

## **5. Recommendations**

### **5.1 Limitations of the Present Research**

In the present study, there were limitations related to the sample size and the methodology used. More specifically, the sample size was relatively limited due to the variety of variables used for the present study but also due to the availability of data and limited access to this data.

Additionally, the quantitative approach was the only approach that could be followed as fundamental macroeconomic variables can be analyzed mainly quantitatively in order to derive clear, unbiased, and consistent results and conclusions as otherwise the results could be more arbitrary.

## **5.2 Suggestions for Future Research**

As far as future researchers are concerned, it is suggested to investigate more extensive quantitative research on the impact of macroeconomic fundamentals in Greece. In addition, the research could target a larger sample of data for more years as well as more variables that seem to significantly affect the country.

## **6. Conclusion**

In conclusion, this research deals with the issue of Greece's fiscal policy and its macroeconomic performance within the framework of the European Economic Union. First, the concept of fiscal policy and its basic stances are presented. Furthermore, the Greek fiscal framework is analyzed which seems to present weaknesses as well as the effects of the Greek fiscal policy which seems to directly affect the economic activity of the country. In addition, the factors that led Greece to financial aid are mentioned, while the Greek debt and the Greek GDP are presented. Moving on to the empirical part of this paper, the methodology used in this research is mentioned which was the quantitative analysis and in particular the econometric analysis in the form of the multiple linear regression between the GDP as a dependent variable and the rest of the fundamental macroeconomic variables as independent variables for Greece during the period 1995-2022. Finally, the empirical data of the research are presented in detail, followed by the analysis of the results. The variables that are statistically significant for Greek GDP are inflation, government spending, and the effect of the constant.

## **Conflict of Interest Statement**

The author declares no conflicts of interest.

## **About the Author**

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