Noble International Journal of Economics and Financial Research
ISSN(e): 2519-9730 ISSN(p): 2523-0565
Vol. 04, No. 08, pp: 76-82, 2019

Published by Noble Academic Publisher
URL: http://napublisher.org/?ic=journals&id=2

Open Access

THE ROLE OF CAPITAL CONTROLS IN THE PERIOD OF THE ECONOMIC CRISIS: HOW WAS THE GREEK TRADING CULTURE BEEN FORMED?

Panagiotis Liargovas[1], Athanasios Anastasiou[2*], Dimitrios Komninos[3], Zacharias Dermatis[4]

[1,2*,3,4]Department of Economics, University of Peloponnese, Greece

ABSTRACT: The implementation of the measure to restrict free movement of capital and cash for the first time in our country on 28th June 2015 is an interesting subject for research and further analysis. Also, with the introduction of plastic money in daily transactions, a new landscape is formed in the Greek trading culture. In particular, the use of e-banking in citizens' transactions as well as the use of POS (Point Of Sale) devices has increased considerably. Payments by electronic transactions have become part of everyday consumers[1]. This created a favorable environment for the transition from cash transactions to electronic card transactions, thus helping to reduce tax evasion and increase public revenues. The main points to be answered in this paper are:

> Why were capital restriction imposed in our country?
> What are the implications of capital controls for our daily lives?
> What is the experience of other European countries from the implementation of capital controls?
> What problems have been created by the implementation of capital controls?
> How did day-to-day transactions with capital controls change?

Keywords: Capital Controls, Electronic Payments, Tax Evasion, Collectability, VAT.

1. INTRODUCTION

Capital control refers to the economic measure that is taken by the Government or a central bank of a country to reduce inflows and outflows of funds into and from the domestic economy as recorded in the national accounts. It affects internal transactions as well as those that are in the direction of and towards the economy of a country[2]. Cases of capital controls are met in Iceland in 2008 (2008-14/3/2017), in Cyprus in 2013 (March 2013 - April 2016) and in our country in 2015 (June 2015 to date). In our country, according to Presidential Decree 96/1993, the Governor of the Bank of Greece is in charge of taking a decision to restrict the capital after informing the Minister of Finance. It is the duty of the latter to decide whether or not to implement the measure and, if the audit is deemed necessary, then inform the European Commission. The role of capital controls is to reduce the risks to a regulated economy, and in particular to our country, the liquidity risk it faced in its banking sector. And the results that these measures can bring vary according to the economic, social and political environment in which they apply.

The impact of capital controls is particularly evident both in companies operating in our country and in the environment outside it. Limits imposed on transactions and disbursements make it difficult for businesses, especially those operating abroad. The effects of capital controls showed industry-to-branch changes[3]. The tourism industry was more resistant to stable sales and the cancellation of tourists to below 10%. Still, the IT sector, which had the largest share of sufficient money outside the banking system, as

[1] Pursuant to Article 62 of Law 4446/16, a consumer means any natural person who acts for reasons outside his trade, business or profession

[2] Capital controls have been fully enforced with European acquisitions and become necessary in those cases where banking panic may prevail, making banks vulnerable to a wave of massive withdrawals.

[3] The existence of restrictions on capital movements creates distortions in business operations and is a brake on attracting new investment.

well as the chemical industry. By contrast, retail sales showed a 39% decrease in debt collection and had many cancellations of orders reaching 29%. A significant downturn was also made in the construction sector, with 33% of small and medium-sized infrastructure contractors stopping production, 35% reducing employment by layoffs or compulsory licenses, and only 6% having sufficient money outside the banking system.

2. THEORETICAL FRAMEWORK

2.1. A Brief History of Capital Controls in Greece

On June 28th, 2015, capital restrictions were imposed on Greek banks or, as they often refer to as their English term, capital controls.

In particular, capital controls have been imposed as a consequence of the financial crisis, which has been a major blow to the banks and the entire financial system, making many of them problematic and obliging them to take and implement measures to manage them.

Banks remained closed and banking transactions between individuals and businesses were very difficult, as well as foreign transactions in terms of imports and exports of goods and services. This negative climate appears to be reflected in the General Economic Climate Index, which declined from an average of 99.2 basis points in 2017 to 87.1 basis points in 2015, according to an IOBE report (2015). During the first months of 2016, the economy continued to be affected by capital constraints, as well as by the uncertain economic climate of protracted negotiations Bank of Greece (2016).

Finally, during the 4-year period (2015-2019), a total of 25 legislative decisions on capital stocks were issued in our country. Specifically 17 were issued in 2015, 3 were issued in 2016, 3 were issued in 2017 and 2 were issued in 2018.

2.2. Reasons That Capital Restrictions Have Been Imposed In Our Country

An organized and economically developed country chooses to apply restrictions on the movement of capital when it is under threat of crisis or when its financial staff provides for a risk that would damage its financial strength. At the end of June 2015, the Greek Government announced a referendum held on 5th July, while it was decided to impose severe restrictions on capital movements and payments, which in effect led to the closure of the banks, the so-called bank holiday.

Prior to the enforcement, a five-year course of implementation of two Memoranda had been carried out, which had an impact on the economy and more specifically on its contraction. In addition, the withdrawal of large amounts of deposits and the tightness of liquidity have been a source of fear for Grexit amid contradictions, frictions and conflicts with creditors and partners in an environment of social tension and uncertainty, high social and economic costs and unemployment, while also dominating the estimates markets and citizens, especially after the summer, the devaluation of the productive fabric and the national wealth.

All of this was the risk of Grexit and bailin deposits, creating a climate of uncertainty and insecurity, which was exacerbated when the prospect of a deal with creditors seemed far off. Therefore, the imposition of capital controls was imperative as this would be particularly damaging to our banking system, which was already facing severe liquidity problems. Political developments at the time had created a climate of uncertainty among depositors, with Grexit's potential scenarios growing. According to Mr. Karamouzis, Chairman of the Board of the Eurobank Group during October 2014-August 2015:

The country lost 43.4 billion € deposits from businesses and households, while cumulative losses from the start of the 2009 crisis exceeded € 116bn, or 65.2% of current GDP, which is probably the world's first.

Cash withdrawals from banks have reached an unpredictable level with total banknotes in circulation today exceeding € 50bn or 28% of GDP versus 10% of GDP. in the Eurozone, from € 30.4bn in October 2014 (+ € 20bn) and € 21.8bn at the end of 2009 (+ € 28bn)

Corporate deposits (non-financial corporations) decreased by € 25.6 billion to € 12.6 billion in July 2015, at 2001 levels, from € 38.2 billion in June 2009.

The international capital markets and interbank markets were gradually closed to Greece and the Euro system remained the only source of liquidity.

The tightness of liquidity in the economy has reached the suffocating limit, with an additional strict limitation by the ECB on the ability of Greek banks to finance the wider Public Sector, which has led the Government to use all the money held by the wider Public Sector and insurance funds (over € 7bn).

Over the same twelve-month period, the dependence of banks on the financing of the Euro system rose dramatically by around € 82bn, over € 125bn (70.7% of GDP) in July 2015

The ten-year government bond yields on the market climbed to 20% at the height of the crisis, at an astronomical heightened level compared to the rest of the Eurozone and liquidity weakened, while there was a significant decline after the agreement, close to 7.5% per annum. At the same time, the Greek stock market collapsed with FTSE 20 down 22.2% in the last ten months and 82.2% from the end of 2009

As noted by the Governor of the Bank of Greece, "capital controls have the status of a public good as they were not imposed by caprice but to stop the outflow of deposits[4]".

3. WHAT ARE THE IMPLICATIONS OF CAPITAL CONTROLS FOR OUR DAILY LIVES?

3.1. The Imposition of Capital Controls Led To A Small Revolution In The Greek Trading Culture.

According to a survey conducted by the Greek Confederation of Trade and Entrepreneurship, more than 1,000,000 cards (credit - debit - prepaid) were issued in the first month of capital control enforcement, while before the imposition of measures, approximately 100,000 cards were issued monthly. The increase in debit card transactions two weeks after capital controls was over 135%[5]. Even elderly, remote retired people, who are away from the nearest ATMs, rushed to make cards. The use of cards has therefore increased rapidly since the imposition of capital controls, since their use does not lie in some form of constraint (Liargovas *et al.*, 2018).

Therefore, the new fact of increasing the number of cards can significantly reduce branch transactions, resulting in lower bank operating costs and the creation of economies of scale[6].

3.2. Renewal of the Use of E-Banking

According to a survey conducted by the Hellenic Confederation of Trade and Entrepreneurship, the ethical practices of the Greeks have changed greatly and turned to services and uses in order not to affect their normal transactions and payments from new data.

There was a significant increase in both e-banking transactions and the intensity of these services as an increase of 30% compared to pre-capital controls was found. This move of citizens to electronic transactions was the reason for banks to step up their staff in the electronic system, thus making electronic channels the central banking network for banks.

3.3. Increase Electronic Transactions

According to a research by the Athens University of Economics and Business, the electronic banking system has helped overcome or resolve several problems that have arisen through the imposition of capital controls. In particular, the following digital services have grown considerably: 73% money transfer, 60% bill payments, 70% balance update, 32% public debt payments and 70% bill payments. These statistical results make it clear that e-banking services have helped Greek citizens overcome the significant problems they have and continue to have in the payment process.

3.4. Change in Buying Behavior

According to the same research by the Athens University of Economics and Business, the use of OnLine payments has changed substantially and the use of debit cards has been strengthened. On the contrary, the use of cash on delivery had a downward trend from 38% to 40%, a 10% decrease, while the use of PayPal, which was 35% to 40% previously, is now 4%.

[4] http://news.in.gr/economy/article/?aid=1500060101

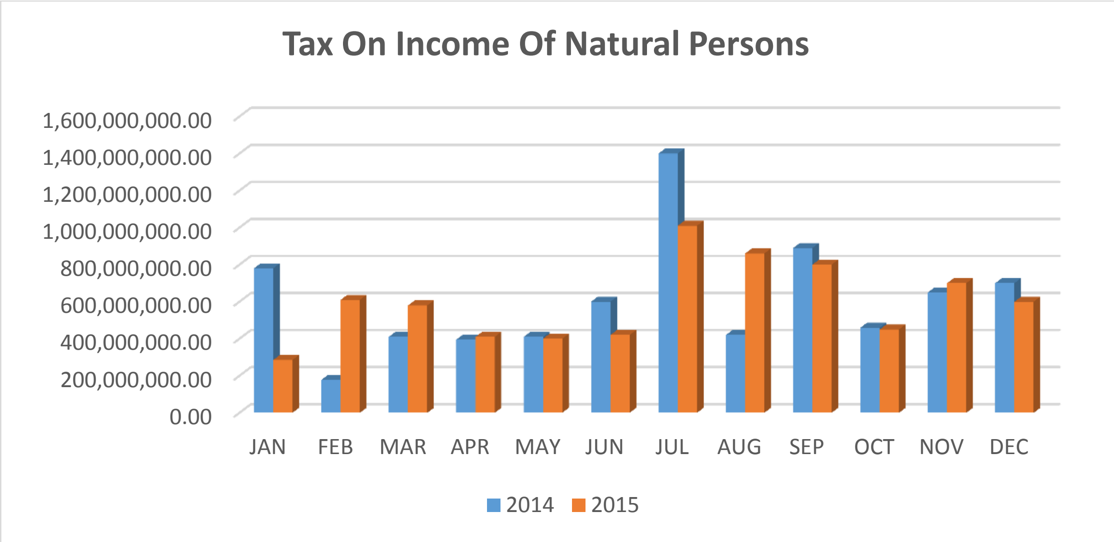
[5] According to the following reports: 'Capital controls increased the use of plastic money', Kathimerini (05.08.15) and 'In cash-footed Greece, plastic casts light into shadow economy', Bloomberg (04.08.15).

[6] http://www.eltrun.gr/wp-content/uploads/2015 /09/%CE%91%CE%BD%CE%B1%CE%BA%CE%BF%CE%B9%CE%BD%CF%89%CF%83%CE%B7.pdf

3.5. Increase in Tax Revenue

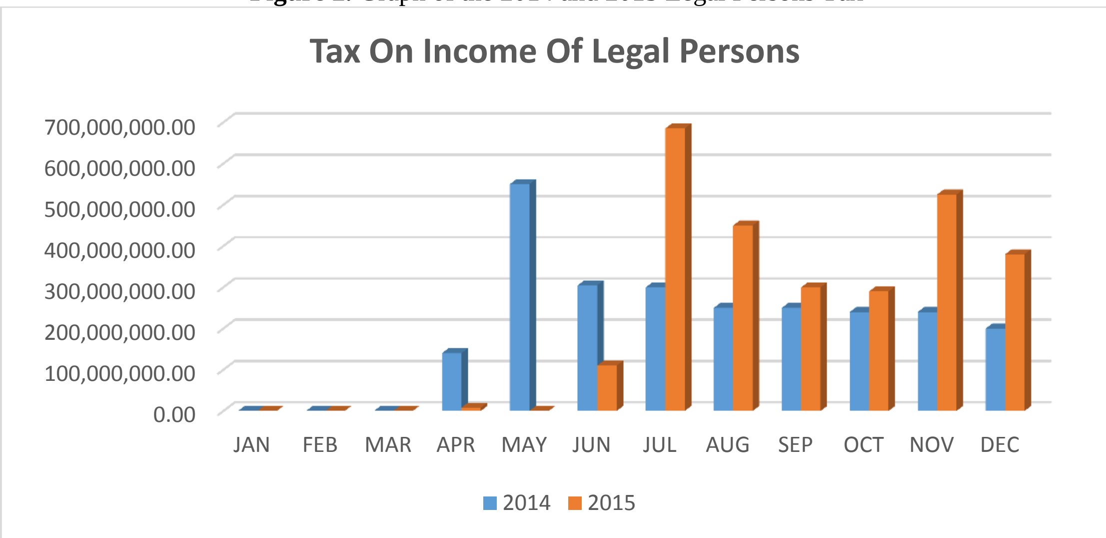
According to the GDD report (2016), it is noted that revenues show a significant increase from July 2015 onwards over the previous months, while in August and November they are higher than in 2014. It is justified by the fact that the first payment installment of this tax was postponed from 31 July to 31 August due to the imposition of capital controls for all or part of the time deposits was allowed.

Figure 1. Graph of the 2014 and 2015 Natural Persons Tax



Source: Treasury of the Republic of Greece

Figure 2. Graph of the 2014 and 2015 Legal Persons Tax

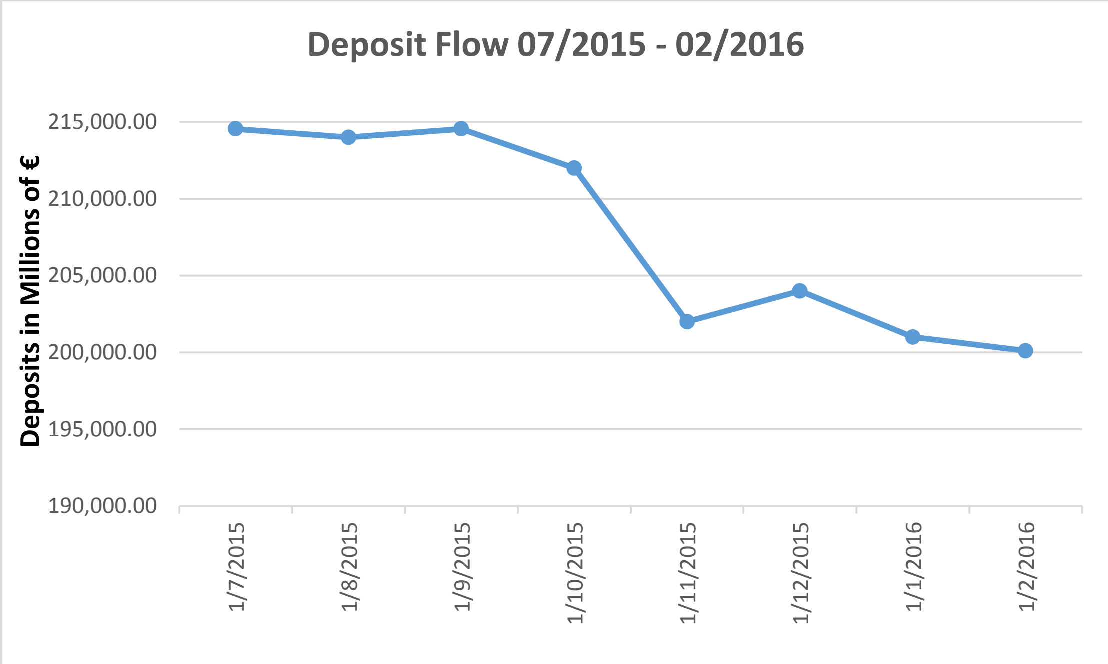


Source: Treasury of the Republic of Greece

3.6. Efficiency in the controlled flow of bank deposits

First of all, according to Bank of Greece data, we observe a controlled outflow of deposits from banks of our country of 13 billion euros during the period of application of capital controls (see Figure 3), when the period 7/2014 to 7/2015 was € 90 billion.

Figure 3. Graph of deposit flow for the period 2015-2016



Source: Bank of Greece (2016)

4. WHAT IS THE EXPERIENCE OF OTHER EUROPEAN COUNTRIES FROM THE IMPLEMENTATION OF CAPITAL CONTROLS?

4.1. Cyprus

It all started on March 16, 2013, when the Cyprus banks closed for 12 days. On 28th March 2013, under the capital controls regime, they began their reopening. All this trial lasted for 2 whole years. The controls in the case of Cyprus gradually relaxed with a deadline of 6th April 2015, when the last restrictions on capital movements were lifted. Specifically, the rescue plan agreed for the Cypriot economy included a 40% haircut of Cypriot deposits that were above € 100,000. When this plan came into force, the lack of liquidity of Cypriot banks made it imperative to apply capital control. That is, capital restrictions in the case of Cyprus were the result of the haircut of deposits and were applied to avoid a bank run (2016). The measures initially imposed were as follows:

- The amount of withdrawals from the accounts was set at € 300.
- Those of the citizens who traveled abroad were able to take 2,000 € with them.
- For foreign students the limit was 5,000 € per quarter.
- Currency export prohibited.
- Checks on sight deposits were only used for deposits in the name of the payee.
- Fixed-term deposits that expired in the next month of the restrictions were extended for at least one month and only a part of them could then be transferred to a sight account.
- A monthly ceiling was set for remittances of € 5,000. As a result, the economy shrank by 5.4% in 2013, after a 2.4% drop in 2012.

4.2. Iceland

At the end of 2008, when the Icelandic banking system experienced the absolute collapse, the Government of Iceland, in the context of capital controls, took the following measures:

1. 1.Restructuring of their banking institutions
2. 2.Adoption of domestic currency
3. Enforcement of foreign exchange controls not only to shield the competitiveness of the new currency but to prevent as much as possible the transfer of capital outside the country.

5. PROBLEMS CREATED BY THE APPLICATION OF CAPITAL CONTROLS

Restrictions on capital movements, bank closures, pervasive uncertainty and volatility have contributed decisively to shrinking production, cutting orders and cutting down the workforce.

As far as businesses - and especially those dealing with e-commerce - are concerned, they have suffered a heavy blow from capital controls, with 97% having problems with receipts and payments. According to a survey conducted by the E-Commerce Laboratory of the Athens University of Economics and Business, the main problems related to the inability to use payment methods such as Pay Pal, the payment of marketing partners such as Google and Facebook, payment of debts to suppliers as well as the use of credit and debit cards.

Also, according to BSE data, there were problems in production as there was a demand from suppliers for "cash" transactions, even for companies with international presence and established competitiveness. However, this has created serious problems for the liquidity of companies and difficulties in their trade relations with the outside world. Additionally, there was an impact on the distribution of products and services, as supplies were carried out with time-consuming and cost-intensive processes, creating security-enhancing needs.

Individuals faced a variety of problems during the bank holiday, as the cashout at the beginning was especially daily, leading to "queues" at the ATMs of all banks, while they were unable to trade with the outside.

Restoring citizens' confidence: Citizens' confidence in the State and the political and economic system must be restored immediately, according to the KEPE. As long as there is uncertainty in the social and economic environment and Greeks do not trust the proposed economic strategy, any attempt to reconstitute the Greek economy will not have a meaningful effect. Indeed, as the Bank of Greece study and the FITCH Assessment House quoted, the measures could relax if the political and operational environment is stable and Greece continues to implement the reforms envisaged in the economic adjustment program.

Confirmation of the trust of Greek depositors: The consolidation of Greek depositors' confidence in the Greek banking system is essential. This is reflected in the return (increase) of deposits. There cannot be a complete lifting of capital controls if it does not return about two-thirds of deposits withdrawn from the banking system between December 2014 and shortly before the restrictions (around 20 billion euros).

Effective management of non-performing loans. Banks need to carry out a wider range of restructurings of non-performing housing and non-performing business loans to small and medium-sized enterprises, with interest rate cuts, a grace period increase, and a longer repayment period. This will facilitate the financing of the real economy by the Banking System, supporting, according to a study by the Bank of Greece, the profitable and competitive businesses. As the President of the Greek Association of Banks, Mr. Katselis also points out, "To have an overview of the figures, let me remind you that the percentage of non-performing loans was only 4.5% of total loans in 2007 and it was now 42% . All banks have set up special management units to manage non-performing loans, have invested in infrastructure and human resources and offer a range of flexible and attractive regulatory products. A critical issue remains the efficient management of non-performing business loans, especially when more creditor banks are involved. The timely restructuring of these loans will allow the release of funds, which are currently committed to absorb any losses, to finance the real economy and to re-launch viable business units, "the chairman of the SCC adds.

The gradual relaxation and ultimately the lifting of restrictions on capital movements, which will be done by improving.

6. CONCLUSIONS

Capital restrictions may in most cases be considered imperative, under the threat of an upcoming bank run or the prevalence of banking panic, cases in which the relationship of trust between depositors and banks is broken, but they do not cease to bring a negative sign to the real the economy and growth.

These capital restrictions have affected both the public and the daily amount of their take-over, and generally their transactions, as well as businesses. Large companies have suffered from a lack of liquidity, with many of them closing down, making losses, or resorting to overseas. More negative at branch level was retail and construction. There has been an increase in unemployment, a decline in consumption and prosperity, and a failure of companies to meet their obligations, i.e. shrinking the economy. Some of them, in order to survive, moved their headquarters to other countries abroad. On the other hand, under the threat of an upcoming GREXIT, many borrowers rushed to repay their debt obligations, thus giving a small slack of liquidity to the banks.

REFERENCES

Bank of Greece (2016). Monetary policy. Interim report 2016 https://www.bankofgreece.gr›BogEkdoseis›Inter_NomPol2016

Liargovas, P., Anastasiou, A., Komninos, D., Dermatis, Z. and Kalamara, E. (2018). The benefits of use of plastic money in greece and the EU: Case study of use of plastic money from the elderly. *Theoretical Economics Letters, 8(5): 793-805*.