THE EURO ZONE CRISIS:
A European contagious phenomenon or a problem of national economies?

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INTRODUCTION

Nowadays, the European Markets are in crisis while European economists, politicians and central bankers are in big confusion. At the same time, the economies of certain European countries are in complete disarray, a phenomenon which raises questions over the future of the Eurozone.

The Eurozone sovereign debt crisis started in 2009 when fears of an extended and unprecedented crisis made their appearance among investors mainly as a result of the increased private and government debt levels around the globe. Today, this financial crisis is still an ongoing problem that has made it extremely hard or even impossible for some weak Eurozone economies to re-finance their debts without the aid of third parties.

The citizens of Europe are angry and confused, asking themselves whether the crisis was built into the Eurozone system from the very start or not. In 1999, there existed the assumption that the common European currency would prevent catastrophic eruptions of local economies and harmonize existing economic differences. In theory, with the common European currency, the weaker nations could be pulled along by the stronger ones. In practice though, and since 2009 huge economic differences appeared forcing some countries to undergo radical reforms of their economies.

The unprecedented economic reforms and the rising debt levels across Europe created alarm in financial markets. This alarm started concerning the European area as a whole and not only the countries in which the crisis was severe. The phenomenon became more tense and the sovereign debt increases that had initially made their appearance in only a few Eurozone countries suddenly became a severe problem that characterised and affected the Euro area as a whole.

The Eurozone critical situation has demonstrated the necessity of a well-organized framework for management and prevention. New initiatives, efficient ideas and visions are absolutely crucial if we want to overcome the crisis and render European markets stable, viable and competitive again. Under these circumstances,
this thesis attempts to look at the historical roots of the problem since a lot of what we
read nowadays about the crisis is lacking historical analysis.

First of all it is necessary to analyze the historical background of the European
monetary integration process, starting from the early 1990s and culminating with the
actual launch of the common European currency in 1999. This historical background
analysis (chapter 1) focuses on three fundamental integration steps such as the Treaty
of Maastricht, the Stability and Growth pact and the creation of the Eurozone. The
analysis of these steps is significant as it offers important information for all those
who want to understand how the current crisis began and how it has evolved.

Chapter 2 addresses this thesis’ theoretical approach which is the
constructivist theory. The “logic of appropriateness”, a fundamental concept of
constructivism that is widely used during the thesis is presented and analyzed. The
aim of the chapter is to explain what constructivism is about, the theory’s main points
and ideas and what different concepts of constructivism can teach us about the current
Eurozone crisis.

The reason why constructivism occupies plenty of space in this thesis lies in
the fact that the theory “fits” the unique ongoing Eurozone crisis perfectly as its
assumptions, ideas and concepts can explain to a significantly large extent what the
Euro has gone through in the last critical years. As a matter of fact, constructivism can
provide the reader with useful crisis-related interpretations. Moreover, the theory can
play a particularly important role in rendering people able to understand deeply the
causes of the Euro Zone crisis and in defining the unique framework in which the
crisis has evolved.

After the theoretical explanations, the thesis attempts to analyze some of the
causes of the Eurozone crisis (chapter 3). The current critical situation has without
doubt been created by a combination of different and perplexed factors. These factors
concern the European integration steps mentioned before as well as global imbalances
and unsuccessful fiscal policy choices. This chapter is of significant importance as it
provides crucial details to all those who want to understand why and how the crisis
really emerged.
Chapter 4 focuses on how exactly the crisis evolved in certain European economies. The most affected economies were the Greek, Irish and Portuguese and this is the reason why these cases occupy a significant amount of space in this chapter. At the same time the thesis seeks to explain that the governments in crisis cannot solve the situation on their own and that they need international support and guidance to do so as they simply belong to the so-called “Euro framework”. The aim of chapter 4 is to explain why the crisis appeared in certain countries mostly in the south of Europe and what common characteristics these countries have.

After the reference to the worst affected nations, the term “financial contagion” is presented and analysed (chapter 5). This term refers to a scenario in which small economic shocks that initially affect just a particular region, spread to other healthy regions in a manner similar to the transmission of a medical disease. The “financial contagion” analysis is significant as it offers explanations on how the crisis has become a perceived problem for the Eurozone area as a whole.

In Chapter 6 the thesis attempts to analyze the solutions and responses that policy makers have promoted in order to tackle the Eurozone crisis. The responding initiatives have derived from national, European and global actors and this is the reason why the useful multilevel governance division is taken into account. The aim of the chapter is to provide the reader with information on how the crisis has been approached as well as on how it can be limited and eventually solved.

In the conclusion the thesis’ main research question is approached. After all the previous necessary analysis, the conclusion seeks to give an answer to whether the crisis was built within the Eurozone system from the very start or whether it is a problem of certain national economies. At the same time, it attempts to evaluate whether constructivism has indeed helped and made a contribution to a better and deeper understanding of the ongoing Eurozone crisis.

In more detail, the research question is a quest of whether the main responsible for the crisis are the inconsistent and inefficient European integration processes or the weak and misbehaving national economies. The answer to this question aims at shedding light to the historical roots of the problem as it puts the blame on specific European decisions and developments of the recent past. Therefore
it points out what the crucial mistakes have been and clarifies to a significant extent where exactly the Eurozone crisis has derived from.

Regarding the main thesis’ question, it is worth mentioning that in the last years a serious debate has emerged between those analysts who blame the European system and those who blame national economies. On the one hand, there are economists who underline that the crisis is a result of an incapable European system and that policy-makers were since the beginning aware of the unsurpassable obstacles. On the other hand, there are those economists who support that the crisis appeared because of certain countries’ economic misbehavior and that policy-makers were never in position to predict the upcoming crisis.

By analyzing the European integration’s historical background since 1993, the causes of the current crisis, the characteristics of this crisis in certain countries and the phenomenon of financial contagion this thesis attempts to enlighten the existing debate and subsequently give an answer to its main question which is whether the current crisis is a European phenomenon or a national one. The ultimate objective is the presentation of the two schools of thought, their comparison and the drawing of some conclusions regarding which is more accurate and why.

With regard to the methodology, the thesis is qualitative rather than quantitative, which means that it does not include in it tables and diagrams. It focuses mainly on literature review by presenting a coherent text without many references in numbers and percentages. Besides the books, a huge part of the sources derives from online documents and articles as the web research has been extended before as well as during this work. Given the fact that the Eurozone crisis is still an unfolding phenomenon, online references are considered of crucial importance as they depict perfectly the great developments and changes that are constantly and at a very fast pace taking place.
CHAPTER 1

EUROPEAN INTEGRATION: FROM MAASTRICHT TO THE EUROZONE

The European Union (EU) as we know it today is the outcome of a process of integration which started in 1950. The initial idea behind this process was the creation of an institutional framework of shared sovereignty in different sectors of the economy. The integration process has been based on treaties and agreements which have created a unique institutional framework. As a matter of fact, every single EU action is founded on treaties and agreements that have been approved by all EU member countries. These treaties and agreements are binding conventions between EU member states that set out EU objectives and EU institutions’ rules.¹

In no other part of the world apart from Europe have so many sovereign states bonded all together in order to voluntarily give up on big aspects of their sovereign control. In the EU this has been the case in the last decades when many different nations have relinquished important national jurisdictions to a number of supranational institutions. Therefore, the European uniqueness is obvious as it has created an unprecedented post-national citizenship within a transnational order.²

An EU treaty or agreement defines how decisions should be made and sets out the relationship between the EU and its member countries. During the last decades the EU treaties and agreements have been significantly amended in order to make the Union more efficient and transparent and in order to introduce new areas of cooperation. The treaty of Rome (1957) for instance, which created the European

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¹ EU treaties, European Union http://europa.eu/eu-law/treaties/index_en.htm
² Pioneers of European integration: Citizenship and Mobility in the EU (An Introduction pg 1) http://www.sscnet.ucla.edu/soc/faculty/favell/recchifavell.pdf
Economic Community, has been largely amended by latter treaties such as those of Maastricht (1992), Amsterdam (1997), Nice (2001) and Lisbon (2007).  

Out of all these fundamental EU treaties this thesis focuses on the treaty of Maastricht, which was signed in 1992 and came to force on 1st November 1993. The Treaty of Maastricht, together with several subsequent agreements, such as the Stability and Growth Pact (1997), is widely considered as the huge step that led to the creation of the Eurozone and the launch of the single European currency (1999).

1.1 THE TREATY OF MAASTRICHT

The Treaty of Maastricht (1993), also known as the Treaty of the European Union (TEU) marks a crucial milestone in the process of European integration and development. It modified to a large extent all the previous EU treaties and represented a new stage in European integration since it opened the way to broader forms of cooperation. First of all, the Treaty changed the official denomination of the European Economic Community as it introduced the name European Union the way we know it today. The new name marked a new stage in the process of creating an ever closer union among the peoples of Europe.  

Additionally, the Treaty of Maastricht created the so-called pillar structure of the EU, which brought unprecedented structural changes by creating a balance between supranational and intergovernmental principles. The three established pillars were: the European Community pillar, the Common Foreign and Security Policy (CFSP) pillar and the Justice and Home Affairs pillar (JHA). This pillar structure was abolished upon the entry into force of the Treaty of Lisbon (2009), when the EU became a consolidated legal entity. 

\[3\] EU treaties, European Union
\[4\] Why is the Maastricht Treaty considered to be so significant?, Andrei Rogobete, e-International Relations, February 26 2011
\[6\] Why is the Maastricht Treaty considered to be so significant?, Morgane Griveaud, e-International Relations, May 29 2011
The great step ahead, though, was neither the new denomination nor the new 
EU structure but the introduction of the common European currency, as the Treaty of 
Maastricht set out the terms and conditions for the creation of the Eurozone which 
was officially created some years later in 1999. According to the Treaty, the 
introduction of the common currency would take place through a three-phase scheme 
with three distinctive goals. The first goal would be the completely free circulation of 
capital; the second one would be the coordination of all EU member states’ economic 
policies in order for them to achieve certain financial and economic requirements, 
known as convergence criteria; the third and final goal would be the official launch of 
the single currency.  

The political rationale behind Maastricht has been of significant importance as 
the Treaty has been the evolution of the Single European Act (1986) and the 
outcome of the new international context created by the collapse of the Soviet Union 
as well as the reunification of Germany. A key player has undoubtedly been Jacques 
Delors who presented for the first time a concrete report on the steps to be taken 
towards an economic union in Europe. His actions, which have rendered him a 
leading figure of European integration, have sought to infuse the Commission with a 
renewed sense of purpose and to deepen political and economic integration in the EU. 

In addition to Jacques Delors, another politician who played a crucial role 
immediately after the end of the Cold War is Francois Mitterrand. His governments 
showed a great commitment to a rapid European economic integration as they 
believed that only by speeding integration can the community cope with the upcoming 
political and economic challenges. As a matter of fact, Francois Mitterrand is

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9 Jacques Delors: A French politician and economist as well as the first person to serve two full terms and two extra years as a European Commission’s President (1985 – 1994)  
10 Why is the Maastricht Treaty considered to be so significant?, Andrei Ragobete, E-International Relations, February 26 2011 [http://www.e-ir.info/2011/02/26/why-is-the-maastricht-treaty-considered-to-be-so-significant](http://www.e-ir.info/2011/02/26/why-is-the-maastricht-treaty-considered-to-be-so-significant)  
11 Francois Mitterrand: The longest-serving President of France (1981-1995)  
considered an influential EU integration proponent whose ideas have shaped the Union and led to the deep integration that European citizens experience nowadays.

The first goal of Maastricht was to a significant extent achieved during the 1990s as the general principle about free movement of capital was clearly defined in Article 63 of the Treaty and therefore respected by all Member states. This Article stipulated that all restrictions on the movement of capital among Member States and between Member States and third countries shall be prohibited.  

The second goal, though, needed a significant amount of time, as the coordination of all EU member states’ economic policies constituted since the beginning a very complicated procedure. After the Treaty, the EU countries needed to meet some specific objectives that would allow them to coordinate their economic standards and achieve the ultimate goal, meaning the adoption of the Euro. These requirements, the so-called convergence criteria, concerned the member states’ inflation rates, annual government deficits, government debts, exchange rates and long-term interest rates.

Regarding the inflation rates, the EU member states should have no more than 1.5 percentage points higher than the average of the three lower inflation members of the Union. Moreover, the ratio of the annual government deficit to gross domestic product (GDP) should not surpass 3% at the end of the examined fiscal year while the ratio of government debts to GDP should be less than 60% or at least declining towards it. With regard to the exchange rates, the member countries should have joined the exchange-rate mechanism (ERM) for two consecutive years without in the meanwhile devaluating their currency. Last but not least, the long-term interest rates should not be more than 2 percentage points higher than the rates of the three lowest inflation member states.

According to “Maastricht”, once these requirements were fulfilled, the Eurozone could be established and the common currency could officially enter into force. Despite the great difficulties of economic coordination deriving mainly from

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13 Provisions of the Treaty on the Functioning of the European Union (TFEU), The EU Single Market, European Commission
http://ec.europa.eu/internal_market/capital/framework/treaty/index_en.htm#general

14 The European Central Bank, Organisation, ECB, ESCB and the Eurosystem, Convergence criteria
the huge financial differences between the member states and the not promising financial state of some of them, the third goal of the Treaty was soon achieved as well. The velocity with which Maastricht’s objectives were reached as well as the Treaty’s lenient and sketchy criteria, have raised critiques regarding its efficiency.

Apart from the justified criticism, the historical TEU introduced as the main objective of the EU the economic cohesion among the countries of the Union. 15 The extremely important decisions that were taken in Maastricht led to a series of agreements that followed the Treaty itself. One agreement of significant importance signed in 1997 aimed at facilitating the Eurozone’s economic stability and coordination that Maastricht had introduced. This agreement is known as the Stability and Growth Pact (SGP).

1.2 THE STABILITY AND GROWTH PACT

The Stability and Growth Pact, a rule-based framework for the coordination of national fiscal policies in the Eurozone, was adopted two years before the official launching of the common European currency. Its main objective was to safeguard public finances, an important requirement for the Eurozone to function properly. The SGP consisted of fiscal monitoring of member states by the EU institutions and, after multiple warnings, sanctions against offending members. 16 This way fiscal discipline could be maintained and enforced.

The SGP referred to the member countries that had already met the convergence criteria. It took these criteria one step forward by ensuring that those members that have joined the Euro will continue to observe them for years to come. According to the SGP’s rules, which are completely in line with Maastricht’s convergence criteria, the Eurozone member countries should strictly observe and control their annual budget deficits and national debt. In more detail, the annual

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15 Why is the Maastricht Treaty considered to be so significant?, Andrei Ragobete, E-International Relations, February 26 2011
16 The Stability and Growth Pact: Experiences and Lessons to be learned for Europe and the World (Introduction), Andreas Exenberger, 2004
http://homepageuibk.ac.at/~c43207/die/papers/sgp.pdf
budget deficits should be no higher than 3% of GDP and the national debt lower than 60% of GDP or declining towards it.\(^{17}\)

Once the Euro was launched, many member states found it difficult to meet the SGP rules. If a country broke the rules, it was obliged to take measures to reduce its deficit. If it broke the rules three years in a row, the Commission could impose a fine of up to 0.5% of the country’s GDP. In 2003, large economies such as France and Germany broke the rules, which made the GSP look weak.\(^{18}\) The same happened with the UK, a member state that had previously decided not to use the Euro and which despite its derailments was never bound by the Pack’s penalties. For all these reasons the SGP’s weaknesses were visible since the very beginning. Therefore, the Council of the EU decided to suspend the agreement and reform it in 2005.\(^{19}\)

The new SGP form relaxed the rules as a response to criticisms of insufficient flexibility and in order to render the Pact more enforceable. The ceilings of 3% for budget deficits and 60% for public debt remained the same, but the decision to declare a state in excessive deficit could now rely on new more flexible parameters. In detail, the reformed pact discouraged governments from destabilising the Eurozone by borrowing money for election purposes thus encouraging them to think about long-term stability.\(^{20}\) The allowance for the deficit limit to be broken was an attempt to create economic growth.

In 2009, the Eurozone crisis sparked concern that even the more flexible SGP would be proved insufficient. This happened when certain countries’ augmenting public debts presented a great concern as they started to affect the stability of the common currency, creating speculations that the Euro would not survive the crisis. For this reason, in March 2011, a new second reform was adopted, named Euro Plus Pact (EPP) aiming at strengthening the previous ones. The new EPP was created as a

\(^{17}\) Stability and Growth Pact, Economic and Financial affairs, European Commission  
\(^{18}\) The Stability and Growth Pact: Crisis and Reform (pg 10-13), European Central Bank, Occasional Paper Series, no 129, September 2011  
http://www.ecb.int/pub/pdf/scpops/ecbocp129.pdf  
\(^{19}\) Stability and Growth Pact, Wil James and John Butters, CIVITAS Institute for the Study of Civil Society 2007, Last Update: Anna Sonny, 04/2012  
more stringent successor to the SGP and was aimed at reinforcing the Eurozone’s competitiveness, employment, sustainability of public finances and tax policies.  

The Stability and Growth Pact has been criticized by many economists as being insufficiently flexible. Some analysts remark that the Pact should be applied over the economic cycle rather than in any one year. Other analysts claim that the SGP has been applied inconsistently, as the Pact has failed to impose sanctions against Germany and France, while countries such as Portugal and Greece have been severely punished. Moreover, the last SGP’s version has too many exemptions that it is extremely difficult if not impossible to breach its regulations.  

The main reason why the Pacts have failed has been the significant lack of scrutiny of EU public budget plans. As a matter of fact, the SGP’s different versions have naively believed that the EU governments can always control their revenue and spending, and that they are able to put apart short-term political considerations in the interest of long-run fiscal stability. According to the Pacts’ visualisers, the violations, would be obvious to all and thus, swiftly punished something that unfortunately has been far from true.  

Despite its failure and the many arguments against it, the SGP remains the initiative that discourages governments from destabilizing the Eurozone by urging them to think about long-term stability. Moreover, it is responsible for keeping the Eurozone member states committed to the Euro. Undoubtedly, the Eurozone initiative, officially created in 1999, would not have been the same without the SGP’s rules and guidelines.

21 The Euro Plus Pact: A Plus but not a solution, Andrew Watt, Social Europe Journal 2011
22 The Stability and Growth Pact: Crisis and Reform, European Central Bank, Occasional Paper Series, no 129, September 2011
23 A credible Stability and Growth Pact: Raising the bar for budgetary transparency, Michael Burda, Stefan Gerlach, Research-based policy analysis and commentary from leading economists, 17 June 2010
1.3 THE CREATION OF THE EUROZONE

In 1999, the euro became a real currency, and a single monetary policy was introduced in the Union. A three-year transition period began before the official launch of euro notes and coins, but legally, the national currencies had already ceased to exist.

Five years after the Maastricht Treaty, eleven member countries had already managed to meet the convergence criteria allowing them to join the single currency. These countries were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. In these member states, the euro was launched (alongside national currencies) on 1 January 1999. Greece qualified in 2000 and was admitted on 1 January 2001, becoming the twelfth member of the group. In 2002 all twelve national currencies were replaced and physical euro notes and coins were officially introduced.

In 1999 Greece was covered by derogation as at that point the country was not allowed to use the Euro because of its inability to fulfill the convergence criteria. According to the formulated rules, at the request of the EU member concerned, a report by the Commission and the European Central Bank could evaluate whether the convergence criteria were met or not. Greece demanded that the derogation be repealed in March 2000. 24

A great number of economists have claimed that some of the countries that entered the Eurozone had never met the necessary requirements. On the one hand, these economists blame the EU evaluation system by supporting that the assessments carried out by the EU institutions were not based on precisely defined methodologies and procedures. On the other hand, they accuse the member countries by stating that certain states have presented false elements in order to join the common European currency.

A case of particular interest is the Greek one, as Greece met the convergence criteria two years later than the eleven member states mentioned before. In 2000, the EU considered that Greece had achieved a high level of sustainable convergence and

24 Greece’s membership in the single currency, Summaries of EU legislation
that at that point it fulfilled the requirements for the adoption of the Euro. Therefore, Greece’s derogation was finally repealed on 1 January 2001. 25

Despite its late qualification, the country was allowed in 2002 to join the Euro together with the other economies. That means that Greece had only one year of transition (2001-2002) while the rest of the countries had three (1999–2002). This unique case has raised questions about whether the country had really met the criteria and about whether its economy was prepared for the huge Eurozone step or not. 26 The reasons why Greece received such special treatment, explicitly presented and analysed below, are quite complex as instead of financial arguments they include moral and historical ones as well.

From 2007 onwards, five more EU member states joined the common European currency. Slovenia entered the Eurozone in 2007, Cyprus and Malta in 2008, Slovakia in 2009 and Estonia in 2011. With regard to the EU countries that have not joined the Euro, most of them, besides certain exceptions, are obliged to do so once they meet the necessary requirements. No state has ever left the Eurozone and there are no provisions for member countries to leave or to be expelled.

The countries that have decided not to become part of the Eurozone and thus not adopt the Euro as their national currency have been Denmark, Sweden and the UK. Regarding the Danish and the Swedish, the Treaty of Maastricht gave them the right to remain outside the common European currency, even when all convergence criteria are met. Therefore, after their opt-out from participating in the Eurozone, Denmark continued using the Danish Krone 27 and Sweden the Swedish Krona 28 as their national currencies. Their difference is that Sweden was obliged to join the common currency sometime in the future while Denmark was not.

In the UK, one of the EU’s largest economies, there are no plans to adopt the Euro in the near or distant future as the country did in 1993 negotiate an opt-out as

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25 Greece’s membership in the single currency, Summaries of EU legislation
26 Greece and the Euro (Introduction), Elias Dinopoulos and Iordanis Petsas, Department of Economics, University of Florida
http://bear.warrington.ufl.edu/dinopoulos/PDF/Greece.pdf
27 Danish Krone: the official currency in Denmark since 1875, subdivided into 100 øre.
28 Swedish Krona: the official currency in Sweden since 1873, subdivided into 100 öre.
well. In the UK, which uses the Pound Sterling as its currency, the public opinion has repeatedly in the recent past opposed joining the Eurozone. As a matter of fact, opinion polls keep showing the citizens’ increasing skepticism and opposition to the common currency something that proves that the UK is still far away from the monetary union.

It is worth mentioning though that the fact that Denmark, Sweden and the UK are not part of the Eurozone does not mean that their economies do not feel the ongoing Eurozone crisis. On the contrary, the interdependence among the EU states is so extended that even nations that do not use the Euro are significantly affected by the current financial downturn. In the UK for instance, even if the national policy makers pride themselves on their foresight in staying outside the Euro, the country has been without doubt hit by the crisis. As a matter of fact, the UK has been caught in the crosswinds of the Euro downturn and confronted by very pessimistic statistics and predictions. Therefore, the government has repeatedly acknowledged and expressed the need to jolt the economy out of its recession.  

Responsible for the monetary policy of the Eurozone is the European Central Bank (ECB). The ECB is managed by a president and a board of national central bankers and its principal task is to keep inflation under control. The Eurozone has no common governance or representation, some political control though takes place through the Eurogroup, which is composed of the finance ministers of Eurozone members and makes decisions regarding the common currency.

1.4 CONCLUSION

The analysis of the main EU integration steps of the 1990s can play an important role in understanding better the roots of the current Eurozone crisis as many

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29 Pound Sterling: the official currency in the UK. It is subdivided into 100 pence and it is the oldest currency still in use.  
31 Euro Group: the meeting of the finance ministers of the Eurozone and the political control over the common European currency.  
of the mistakes that have taken place in the recent past are inseparably connected with crucial EU decisions and developments. As a matter of fact, a very large part of the causes of the ongoing crisis can be traced in the unsuccessful recent EU integration process as well as the EU criteria, rules and requirements that have been hastily and sketchily formulated.

In 2009, when the current crisis actually emerged, the huge problems of some Eurozone economies made it impossible for the ECB and the Eurogroup to keep the situation under control. The crisis, resulted from a combination of several complex factors, hit the Eurozone hard and raised serious questions on whether the integration process from Maastricht onwards had been problematic or not. 33

The causes of the crisis are something that many analysts, and not only economists, have tried to approach. Various theories have emerged seeking to explain what exactly led to the current critical situation. Some theories focus on the globalization of finance, the international trade imbalances and the generally slow growth conditions of the global economy. Other theories blame the national fiscal policy choices related to government expenses.

The crisis though has proved that the causes and roots of the problem can be mainly traced in the historical decisions that have formed the EU itself. However, the majority of the existing theories over the causes of the phenomenon do not take into account the historical development of the EU and the fundamental integration steps that took place from 1993 onwards. For this reason, the above analysis, with the aid of a specific theoretical framework, can be proved a useful tool in approaching the European roots of the critical situation.

CHAPTER 2

CONSTRUCTIVISM AS A THEORETICAL APPROACH

Constructivism is a broad theory of knowledge that can be applied to several different scientific fields such as sociology, mathematics, psychology, architecture, international relations (IR) and many others. The theory claims that humans gain knowledge and derive meaning from a combination of their experiences and ideas. Of all the scientific fields that constructivism can be applied to, this paper is focusing on IR, as international relations’ constructivism, together with its numerous sub-theories and concepts, can provide meaningful interpretations on a range of issues of central concern to students of world politics, including the current Eurozone crisis.

2.1 CONSTRUCTIVISM IN INTERNATIONAL RELATIONS

Before attempting to connect international relations’ constructivism to certain events such as the Eurozone crisis I feel the need to clarify its origins and the reasons why it has been established as an important approach in IR.

With regard to international relations, constructivism has become one of the major schools of thought since the end of the Cold War when the dissolution of the Soviet Union rendered the international system much more open and fluid. The theorist who introduced constructivism in IR was Nicholas Onuf, who in 1989

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34 Constructivism: A short summary (pg 1-2), Patsy Ann Johnson, Professor: Slippery Rock University of Pennsylvania


http://e-edu.nbu.bg/pluginfile.php/147644/mod_resource/content/0/jackson_sorensen_Intro_in_IR_chap06.pdf

36 Nicholas Onuf: one of the primary figures among constructivists in IR well known for his constructivist book World of our making (University of South Carolina Press, 1989). Onuf’s theories are based on a continuum of rules and performative language.
claimed that states -much the same as individuals- are living in a world of “our making”. Onuf distinguished “social facts”, which are made by human action from “brute facts”, the existence of which does not depend on human action. 37

After the introduction of constructivism in IR in 1989, the international system was seen as an inter-subjective awareness among people and not as something “out there”, existing on its own. This international system was a human invention, a set of ideas and a system of norms arranged by certain people at a particular time and place. 38

IR constructivism (in shorthand: constructivism from now on) claims that significant aspects of international relations are historically and socially contingent, rather than just consequences of human nature. Constructivism does not constitute a separate theory of international relations but an approach to social inquiry that can be applied to many different IR theoretical frameworks. It focuses on human awareness and its place in world affairs while one of its basic assumptions is that the environment in which states and agents act is social. 39 This assumption emphasizes that material structures are given meaning only through the social context through which they are interpreted.

The constructivist approach was initially developed as a critique to several basic IR theories stemming from the works of notable philosophers. Firstly and most importantly, constructivism criticizes international relations’ (neo)realistic theory by claiming that this theory largely ignores the context and sources of state interests. Additionally, constructivism rejects the one-sided material focus of (neo)liberal theory by arguing that the most important aspects of international relations are social and not material, and by claiming that social reality is not objective or external to the observer of international affairs. 40

39 E-International Relations Constructivism: An introduction, Maysam Behravesh, February 3, 2011
From 2000 onwards, constructivism has developed two different strands. The first strand consists of widely accepted constructivist concepts while the second one includes more controversial concepts with radical arguments. All these concepts, from the most moderate to the most extreme ones, deal with a great variety of issues such as human behavior, state interests, norms and social construction.

Of all the existing constructivist concepts, this paper is focusing on the logic of appropriateness as this concept can make a significant contribution to the understanding of the current Eurozone crisis. However, before any attempt to prove this contribution, an analysis of what exactly the logic of appropriateness is seems more than necessary.

2.2 THE LOGIC OF APPROPRIATENESS

The logic of appropriateness is a constructivist concept that regards human decisions as driven by rules of appropriate and exemplary behavior. These rules are followed strictly as they are considered rightful, natural and legitimate. Man’s ultimate objective is to fulfill their obligations encapsulated in a role, an identity or a membership in a specified community. Embedded in a social collectivity, humans do what they think is appropriate for them in a specific type of situation. 41

Following rules of a role or identity is a complicated process involving thoughtful and reasonable behavior. This reasoning process, though, is rarely connected to the anticipation of future consequences as actors use criteria of similarity and congruence, rather than likelihood and value. 42 According to the logic of appropriateness, actors follow internalized prescriptions of what is socially defined as normal, good or right, without calculating the consequences and the utility of their actions.

41 The logic of appropriateness (Abstract), James G. March and Johan P. Olsen, Centre for European Studies, University of Oslo
42 Understanding Institutions and Logics of Appropriateness: Introduction Essay (Basic Ideas), Johan P. Olsen, University of Oslo, August 2007
A very important distinction that the logic of appropriateness introduces is the distinction between material and socio-political reasons. According to the logic of appropriateness, decisions are taken due to either material reasons or socio-political ones. Material reasons are based on facts and lead to “practical benefits” while sociopolitical reasons are based on solidarity and lead to “image benefits”.

The contribution of the logic of appropriateness can be seen as philosophical, political, sociological and economic at the same time as the concept’s assumptions can be applied and give explanations to a huge range of issues such as philosophical dilemmas, political uncertainties, sociological inquiries and economic crises. Regarding the current Eurozone crisis, these assumptions can provide very useful interpretations related to the origins of the phenomenon.

2.3 CONCLUSION

As a matter of fact, the logic of appropriateness can help European citizens understand why the European markets are in crisis and make them realize that new initiatives and ideas are needed in order to render European markets stable, viable and competitive again. The concept’s analysis can also play a particularly important role in rendering people able to understand deeply the causes of the Eurozone crisis and in defining the unique framework in which the crisis appeared and evolved. Last but not least, the logic of appropriateness can provide economists with ideas about how to avoid similar crises in the near future.

The concept’s distinction between material and sociopolitical reasons, for instance, can be applied to many European integration steps and decisions that are highly connected to the causes of the Eurozone crisis. An interesting question, concerning this distinction, is why countries such as Italy and Greece joined the Euro. Some claim that the decision to allow these countries in the Eurozone has been a material decision based on the fact that their economies had fulfilled the necessary criteria. Others support that Italy and Greece had never satisfied the requirements and that their allowance in the Eurozone has been a socio-political decision based on solidarity towards two countries with great historical value.
Another question is why the International Monetary Fund (IMF) decided to help the countries in need. On the one hand, there are economists who support that the decision was material, based on the fact that the weak Eurozone economies would really overcome the crisis with such a help. On the other hand, there are those economists who claim that the decision to offer money to certain member states was a socio-political one, aiming at strengthening the EU bonds as well as the union’s global image.

In a nutshell, the constructivist distinction between material and socio-political reasons as well as other constructivism’s assumptions like the exemplary and righteous behaviour can shed light on the historical roots of the existing crisis by giving an answer to the question whether the crisis was built into the Eurozone system or not. Without doubt all this theoretical background can provide explanations regarding the very controversial and multidimensional causes of the phenomenon.
CHAPTER 3

THE CAUSES OF THE EUROZONE CRISIS

The European economy is nowadays in the midst of the deepest recession since the 1930s, with real GDP shrinking by more than 4% in the late 2000s, the sharpest contraction in the history of the European Union. The governments struggle to agree on the best way out of this contraction, but are usually missing what actually caused it. As a matter of fact, the causes are numerous, complicated, highly intertwined and can be divided into three broad categories.

The first category approaches the causes globally by focusing on the global recession of the late 2000s when the global financial system faced unprecedented decline. The second category approaches the causes through the European integration processes of the 1990s and more specifically through the Maastricht Treaty and the Stability and Growth Pact. The third and last category approaches the causes nationally by focusing on certain Eurozone members’ fiscal policy choices.

The aforementioned division of the causes into three categories renders the Eurozone crisis less perplexed and more understandable. Moreover, such a division is significantly helpful in understanding deeply the historical roots of the phenomenon as well as in discovering crucial mistakes that have been made in the recent past.

3.1 GLOBAL CAUSES: SLOW GROWTH CONDITIONS

Since 2006 the global recession has marked universal economic decline and has resulted in slow growth conditions that have contributed to the European sovereign-debt crisis. In the last six years large financial institutions have been threatened with collapse, huge banks with bailouts and international stock markets...

Many areas worldwide have been suffering from evictions, foreclosures and prolonged unemployment. Financial leverage has been exceeding capital dangerously and financial markets have been dominant over the traditional agricultural and industrial economics in an unprecedented way.

Yanis Varoufakis has claimed that the global–and subsequently the European–recession of the late 2000s have very deep roots and that the real underlying issue is the way in which the current global economy is structured. According to him the roots of the problem are to be found in the main ingredients of the 1970s and the way in which these ingredients have created a major growth drive based on “controlled disintegration of the world economy”.

The main 1970s ingredients that Varoufakis considers the roots of today’s recession made their appearance when postwar American hegemony could no more depend on America’s deft recycling of its surpluses to Europe and Asia. This happened because US surpluses had at that time turned into huge deficits; the famous twin deficits (budget and balance of trade deficits). In the 1970s, US authorities instead of tackling their dangerous twin deficits, they decided to do the contrary and boost them. And who would pay for them rather than the rest of the world? And how? Inevitably through permanent capital transfers that rushed across the two great oceans to finance America’s unprecedented twin deficits.

The twin American deficits, thus, operated for many decades as a vacuum cleaner that absorbed different nations’ goods and capital. All this culminated in the great American turmoil of 2006, better known as the “American crisis of financialisation” which soon affected the whole universe and became a problem with global dimensions. The bursting of the American housing bubble created questions regarding bank solvency and had a large impact on the world’s stock markets, including European ones, where securities went through great losses during 2007 and

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44 The global minotaur: America, the true origins of the financial crisis and the future of the world economy (chapters 3 and 4), Yanis Varoufakis, Zed Books 2011
45 Yanis Varoufakis: a Greek political economist and author and a very active participant in debates on the global and Eurozone crisis.
46 Paul Volcker’s speech shortly after becoming the President of the Federal Reserve (Paul Volcker is an American economist, chairman of the Federal Reserve from 1979 to 1987. He is widely credited with ending the high levels of inflation seen in the USA in the 1970s)
47 Yanis Varoufakis interviewed on the Global Minotaur by naked capitalism (personal official blog) [http://yanisvaroufakis.eu/2012/02/14/the-global-minotaur-interviewed-by-naked-capitalism/](http://yanisvaroufakis.eu/2012/02/14/the-global-minotaur-interviewed-by-naked-capitalism/)
Economies all over the world slowed during that period, as international trade declined and credit tightened forcing governments and central banks to respond with fiscal stimulus and unprecedented institutional bailouts.

In 2007 the recession took an extremely sharp and dangerous turn. This took place when easy credit conditions started encouraging high-risk lending and borrowing practices especially concerning mortgages. On the top of that, finance started becoming extraordinarily globalized. The downward turn, characterized by plenty of different systemic imbalances affected the entire world economy, with more severe impact on some countries compared to others. The USA and China started experiencing a significant slowing of their growth when Eurozone member states saw their public debts rising dangerously.  

As a matter of fact, the American slow growth of the recent past is nowadays considered a problem that was spread to Europe and that played an important role in the development of the current Euro area crisis. This phenomenon demonstrated how swiftly contagion has been recently spreading around the world. The spread started when the American turmoil forced the nation’s panicked creditors to pull out their holdings. This damaged the underlying health of banks and subsequently the financial sanity of the entire country. In the interdependent global financial system of today in which national borders are extremely porous, Europe became the victim relatively soon.

The absence of global fruitful economic activity continued in 2008 and 2009 when many countries’ business cycles were permanently in a contraction phase with many consecutive quarters of negative GDP growth. At that particular time economies were characterized by an exorbitant rise in asset prices mainly due to inadequate regulation and oversight. Additionally, high unemployment levels remained and

   http://finmin.nic.in/workingpaper/euro_zone_crisis.pdf
50. The U.S. Financial Crisis Is Spreading to Europe, Mark Landler, The New York times, September 30 2008
   http://www.nytimes.com/2008/10/01/business/worldbusiness/01global.html?_r=0
increased even further, along with low consumer confidence, inflation and rising food and petroleum prices.

The prominent economist Paul Krugman\textsuperscript{51} has repeatedly stated that the economic maladies that caused the Great Depression back in the 1930s have nowadays made a comeback. According to Krugman the global recession can be traced in the failure of regulation to keep pace with an out-of-control financial system. “Nations rich in resources, talent, and knowledge – all the ingredients for prosperity and a decent standard of living for all- have failed and remain in a state of intense pain”. \textsuperscript{52}

Krugman’s argument about the failure of rich nations lies in the fact that western robust economies that in the recent past were growing fast, are nowadays in a huge financial mess. EU nations such as Portugal and Ireland that have been used to growing significantly in terms of GDP, today witness extremely high deficits. Additionally, countries such as Greece were used to seeing foreign capital flooding their economies but right now struggle to keep their imports as well as main industries at sustainable levels.

In 2010 many economies worldwide slightly or significantly recovered. The American business cycle for instance started showing signs of positive production and rapid economic growth. At the same time, the Chinese economy regained its lost status by becoming again one of the largest exporters and importers of goods in the world. This recovery though was not the rule everywhere as it did not reach some Eurozone member states which in 2010 instead of growing, started experiencing a great loss of confidence that led them to grave danger.

As a conclusion, the current critical situation of certain Eurozone economies has been to a large extent created by the last decades’ global recession. This recession though has not been the one and only cause as the crisis has undoubtedly been created by certain European integration steps’ weaknesses as well as certain member states’ fiscal misbehaviors.

\textsuperscript{51}Paul Krugman: an American economist who in 2008 won the Nobel Memorial Prize in Economic Sciences for his contribution to New Economic Geography and New Trade Theory. He is known for his work on international economics and currency crises.

\textsuperscript{52}End this depression now (Depression Economics), Paul Krugman, Merlose Road Partners, 2012.
3.2 EUROPEAN CAUSES: EUROPEAN INTEGRATION PROCESS

During the 1990s the European integration’s main goals were the complete circulation of capital within the EU as well as the coordination of all EU member states’ economic policies. The policy makers that worked in these directions took fundamental decisions, which without doubt ameliorated some things and made significant progress to others. In certain cases, though, these very same policy makers failed to predict what was about to come next.

3.2.1 THE FREE AND COMPLETE CIRCULATION OF CAPITAL

In 1993 the capital was already circulating within the European Union in an unprecedentedly free and complete way. The advantages of this complete and free circulation of capital were since the very beginning more than obvious as the circulation rendered the EU financial markets competitive, integrated, open and efficient. It also enabled European citizens to do operations abroad and companies to invest in other EU countries’ companies and participate actively in their management. 53

Despite its obvious advantages, though, the free and complete capital circulation, led to an unwanted result which was the culmination of structural biases within the EU. Sometime around the mid-1990s a sharp internal division between core and periphery emerged. This division took place because the wealthier EU member states –core- had more chances to conduct operations abroad compared to the poorer member states –periphery-, the international activity of which was limited. 54 As a result, certain member states’ economies started growing at the expense of others creating unequal growth conditions within the Union.

Nowadays, these unequal conditions that the Maastricht policy makers had failed to predict, have become an issue of great concern as the critical situation has rendered them deeper and undoubtedly much more dangerous compared to some years ago. They are without doubt considered one of the main causes of the current Eurozone crisis.

53 European Commission, The EU single market
http://ec.europa.eu/internal_market/capital/overview_en.htm#when
54 Economic Crisis in Europe: Causes, Consequences and Responses (Part I: Anatomy of the crisis), European Commission 2009
3.2.2 THE CONVERGENCE CRITERIA AND THE GREEK ENTRY

From 1993 to 1997 the EU policy makers’ main objective was the Union’s substantial preparation for the official launching of the common European currency. During those five years, the EU countries that were expected to adopt the Euro tried hard to coordinate their economic policies and meet the Maastricht’s convergence criteria which concerned the member state’s inflation rates, annual government deficits, government debts as well as exchange and long term interest rates.

The policy makers’ idea was quite simple. A member state could not become part of the Euro unless it had fulfilled the convergence criteria. In 1998 eleven member states had already met the criteria. One year later, these states started using the Euro along with their national currencies. In 2002, after a transition period of three years, the national currencies were abolished and the common currency officially launched. 55

The member state that had not fulfilled the convergence criteria in 1998 was Greece which qualified two years later. In 2001 the country started using the Euro along with the Drachma 56 and in 2002 it officially joined the Euro together with all the other economies. This means that Greece had only one year of transition instead of three.

The Greek Eurozone entry has in the last decade raised many questions. Firstly and most importantly, economists wonder whether Greece presented false elements in order to become part of the common currency. Secondly, the same economists ask themselves whether the country needed more than one year of Drachma and Euro coexistence in order to be properly prepared for the common European currency. 57

In November 2004 Greek policy makers admitted that the government’s deficit had never since 1999 been below 3%, as the convergence criteria required, which proves that the country did enter the Eurozone without respecting the necessary

55*End this depression now! (Eurodammerung), Paul Krugman, Merlose Road Partners, 2012.*
56*Drachma: the currency used in Greece before 2001. It was replaced by the Euro at the rate of 340.750 Drachma to the Euro.*
rules. Additionally, these same policy makers stated that from 2001 to 2002 and during the coexistence of Drachma and the Euro, the country’s economy did not have sufficient time to adjust to the new needs and get prepared for the huge Eurozone step.\textsuperscript{58}

Many analysts wonder why the EU policy makers allowed the Greek entry in the first place. Did Greece lie so successfully that the policy makers did not realize it? Or did the policy makers know about the Greek lies but decided not to pay attention to them? What actually happened is that the European policy makers knew about Greece’s economic abilities as well the country’s disrespect towards the criteria. Nevertheless, they let Greece in as they strongly believed that the country’s economy would improve and flourish soon in the Eurozone.\textsuperscript{59}

The main question is why these policy makers decided to allow Greece into the Eurozone even if they knew that the country was far beyond the convergence criteria’s standards. The decision has without doubt been a sociopolitical decision rather than a material one and the reasons, approached through a constructivist scope, are based more on solidarity rather than on practical benefits. In a few words, the Greek entry has been an act of positivity towards an EU member state with tremendous historical value as well as an act aimed at strengthening the EU bonds and the international image of the Union.

Today, it has been proved that the ongoing financial crisis can be traced back to the formulation of the convergence criteria which have been criticized as very lenient, negatively flexible and in some cases highly inapplicable. In 1993 the Maastricht policy makers failed to predict what was about to come next while in 2000 they failed to judge correctly Greece’s economic abilities. This happened because of the internal division of opinions between those who believed that Greece would prosper in the Eurozone and those who highly doubted it. All these failures and disagreements constitute one of the causes of the crisis as well.

\textsuperscript{58} Evidence mounts that Greece cooked the books, Edward Helmore, The week, 16 February 2010 http://www.theweek.co.uk/business/16599/evidence-mounts-greece-cooked-books
\textsuperscript{59} How Goldman Sachs helped mask Greece’s debt, Henry Richards, the Bureau of investigative journalism, 21 February 2012 http://www.thebureauinvestigates.com/2012/02/21/how-goldman-sachs-helped-mask-greeces-debt/
3.2.3 THE RIGID AND INCONSISTENT GSP

In 1997 hopes for a much better economically coordinated EU made their appearance and EU citizens started to believe strongly that economic stability was not anymore an untouchable dream. It was the year when a very crucial European integration agreement, the Growth and Stability Pact was agreed on.

After multiple calculations, the policy makers involved in the Growth and Stability Pact formulated some rules and criteria that were supposed to facilitate the discipline and stability in the Eurozone by taking into account the huge economic differences within it. The new rule-based framework though did not reach a high-level discipline and never managed to safeguard the Eurozone public finances effectively. Additionally it did not impose the predicted and necessary sanctions against the offending members.

With regard to the annual budget deficit, Germany –followed by France- was in 2003 the first country to disrespect the 3% limit. Italy became in 2005 one of the worst offenders as it started to break the same limit regularly while Spain followed the same example after the outburst of the global crisis in 2007. 61 Regarding the national debt, a great number of member states had already from the 1990s exceeded the 60% limit. Greece saw its public debt levels rising to the unprecedented 106% of the country’s GDP when Portugal’s debt was not lower than 86%. The high levels of national debt soon became the rule as almost all Eurozone countries were unable to meet the SGP’s strict criteria.

With regard to the sanctions, these were imposed inconsistently as the GSP failed to impose them to Germany and France but did impose them to Portugal and Greece. Additionally, the European Commission did not manage to impose the GDP’s 0,5% fine in many cases. 62

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The GSP’s sanctions system has been unsuccessful not because of miscalculations or wrong technicalities but mainly because of its selective character. In a few words, the system has been highly unenforceable towards those huge European economies that have played an important role during its creation. More specifically, German and French deficits, undoubtedly excessive compared to the Pact’s standards, were never punished. The reasons behind that has been the very influential role of these member states and especially their dominance in the Council of Ministers which is the body responsible for approving the sanctions.  

The fact that shortly after the adoption of the Euro very few Eurozone members managed to respect the GSP criteria in addition with the weak sanctions regime that the Pact introduced, proves that the GSP policy makers failed in their calculations and that the agreement had since the beginning huge underlying weaknesses. Nowadays, this rigid and inconsistent GSP constitutes one of the Eurozone causes as well.

As a conclusion, today it is widely accepted that the ongoing Eurozone crisis has been to a large extent created by crucial European mistakes that EU policy makers have made in the recent past. The rapid decision for free and complete circulation of capital within the EU, the Greek entry to the Eurozone together with all the other member states, the rigid rules of the GSP as well as the fact that the mobility of labor did not work as expected prove that a big part of the crisis has without doubt been created within the EU system.

3.3 NATIONAL CAUSES: FISCAL POLICY CHOICES

Alongside the crucial European causes though, the current crisis has emerged because of national weaknesses as well. These weaknesses have been wrong and hasty governmental decisions related to national fiscal policy choices. Successful fiscal policy choices manage to achieve economic objectives of price stability, full

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63 The tragedy of the Euro, Philipp Bagus, Ludwig von Mises Institute
http://mises.org/books/bagus_tragedy_of_euro.pdf

64 Fiscal policy: the use of government revenue collection (taxation) and expenditure (spending).
employment and economic growth. The ultimate objective of such choices is to keep a sane balance between revenue collection and expenditure.

In the last decade several Eurozone members’ governments have failed to follow such successful and sane fiscal policy choices. Especially the countries that have been hit hard by the crisis, such as Greece, Portugal and Ireland, have in the recent years proved to be largely incapable of keeping their fiscal policy under control. These countries’ greatest inability is the lack of balance between taxation and expenditure.

Such a lack of balance has great impacts on many variables of a country’s economy as it influences negatively the aggregate demand, the distribution of income, the pattern of resource allocation and the overall productivity of the economic activity. Furthermore, it leads to rapid rising of public debt levels, to huge loss of confidence and finally to severe economic decline. Greece, Portugal and Ireland constitute three cases in which this lack of balance has been very tense.

Greece is a characteristic example of a Eurozone member state that has in the late 2000s failed to use properly the government’s budget in order to influence positively economic activity. This started in the early years of the decade when the Greek government spent huge amounts of money in several different sectors. Until 2006 Greece had spent millions of Euros in education, culture, defense and military equipment. The country had also hosted the major but extremely expensive event of the Olympic Games.

The problem lies in the fact that all this expenditure has not been accompanied by sufficient collection of revenue, as one of the biggest problems of Greek economy has always been tax evasion. Since 2000 Greek individuals, trusts, corporations and

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65 Fiscal Policy and the great recession in the Euro area (fiscal policies during the crisis), European Central Bank, Occasional Paper Series, no 1429, March 2012

66 Research on Money and Finance: The Eurozone between austerity and default (A profusion of debt: If you cannot compete, keep borrowing)

67 Economic Crisis in Europe: Causes, Consequences and Responses (Part iii: Economic consequences of the crisis)

68 Greece’s Debt Crisis: Overview, Policy Responses, and Implications, Congressional Research Service, August 18 2011
other entities have –intentionally or not- failed to provide the state with the necessary taxes. As a result, this rampant tax evasion has starved the Greek government of funds.

The coexistence of extraordinarily high expenditure with very low revenue collection is by definition extremely harmful for any economy as it always leads to lack of public money, debts and economic decline. The consequences in Greece for instance have been catastrophic as in 2009 the country saw its public debt rising to unprecedented levels. Yanis Varoufakis once said “if Greek citizens were paying taxes, the Eurozone might be a different place”.

With regard to Portugal, before the emergence of the Eurozone crisis the Portuguese economy was growing and the country’s fiscal policy choices were successful leading Portugal to economic stability and discipline. In the late 2000s though this changed as the Portuguese government finances drastically deteriorated. The change took place on the back of falling tax revenue and rising social security expenditures. Since then and unlike in most European states, primary spending in Portugal has been procyclical.

The main problem of the Portuguese economy has not been much different than the Greek one as the recent Portuguese fiscal policy choices have encouraged over-expenditure as well as investment bubbles through unclear public-private partnerships. Additionally, the economy has been characterized by output stagnation due to the high and increasing levels of indebtedness and the low and decreasing levels of saving. All these have resulted in governance problems such as poor public budget, lack of transparency and accountability as well as loss of competitiveness.

In 2010 the ex-PM of Portugal Jose Socrates said that “Portugal needs to create new rules and implement fiscal reforms in order to achieve better economic efficiency”. According to him the Portuguese fiscal policy choices needed radical

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70 Procyclical Fiscal Policy: when spending goes up (taxes go down) in booms and spending goes down (taxes go up) in recessions.

71 The Fundamentals of the Portuguese Crisis (The Portuguese Output Stagnation)

72 Jose Socrates has been the Prime Minister of Portugal from 2005 to 2011 when he submitted his resignation after parliament rejected his government’s austerity measures aimed at tackling the crisis.
changes such as a steady increase of the number of taxpayers and a growth of the receipt amount from State taxation.

In Ireland, another member state that has been severely hit by the crisis, the case is slightly different as the country faced different problems compared to Greece and Portugal. The main Irish problem has not been bad fiscal policies or tax evasion but the country’s bank sector as the crisis there actually emerged when the country’s banks lost an estimated 110 billion euros, mainly related to defaulted loans. 73

To sum up the three cases, Greece, Portugal and Ireland have undoubtedly been three Eurozone members with great problems regarding their fiscal policies as all three states have been engaged in heavy borrowing in order to finance their numerous expenditures. That does not mean though that other Eurozone countries have not experienced similar difficulties.

Besides the countries that are currently experiencing the crisis very intensely, even member states whose economies are supposed to be healthy have in the recent past shown signs of unsuccessful fiscal policy choices. Germany for instance, a state with an extensive social welfare system has since 2000 been characterized by a high debt to GDP ratio. As a result Germany’s fiscal policy is nowadays facing challenges as well. These challenges, aimed at reviving the economic activity, are putting high pressure on the country’s fiscal deficit.

In 2012 Paul Krugman stated that the current Eurozone’s depression lies in the fact that almost all Eurozone member states –including the wealthiest ones- spend too much. According to Krugman “states need to be induced to spend less via high real interest rates while fiscal policies should not stop aggregate deleveraging but slow it down to a symmetric and accommodating pace”. 74

73 Resolving Ireland’s Banking Crisis (Introduction and summary), Patrick Honohan, Department of Economics and IIIS, Trinity College Dublin and CEPR http://www.irisheconomy.ie/Crisis/HonohanCrisis.pdf
3.4 CONCLUSION

The multidimensional and complex character of the ongoing Eurozone debt crisis makes it necessary to approach the causes of the phenomenon in a very multidimensional way as well. In this sense, the division between global, European and national causes renders the crisis a more understandable reality and makes the reader able to realise that the current Euro situation has its roots in different levels starting from global and culminating in regional and national weaknesses.

In an attempt to summarize the causes of the ongoing Eurozone crisis, someone realizes that the critical situation has indeed been created by global, European and national factors at the same time. Despite the fact that the European factors have been the most important ones, they all seem crucial as they have without doubt played a striking role in the emergence of the crisis. As a matter of fact, the global recession, the American crisis of financialisation, the efficiency of the Growth and Stability Pact, the tax evasion in Greece, the Portuguese over-expenditure and the banking crisis in Ireland are finally all pieces of the same puzzle.
In late 2009 the so-called Eurozone sovereign debt crisis emerged. The crisis started from certain weak economies but sooner or later affected all Eurozone member states, most of the EU’s countries as well as economies outside the Union such as Iceland, which experienced a huge banking collapse.

The most affected countries were those that already before 2009 had excessive national debt levels and low economic growth rates such as Greece, Ireland and Portugal. In these three Eurozone member states the situation soon became very tense as from 2010 onwards the Greek, Irish and Portuguese economies were not anymore able to re-finance their huge public debts without the international assistance of third parties.

4.1. GREECE

During the last weeks of 2009, Greece was unable to meet its public debt obligations due to the unprecedented increase in sovereign debt levels. Since then and until today the country has gone through a difficult period full of bailouts, austerity measures and desperate attempts for debt reduction and economic stabilization.

In order to understand how the Greek crisis appeared and evolved, we need to know that in the early 2000s the Greek economy was one of the fastest growing economies of the Eurozone with high living standards and large income from tourism and nautical sector. In specific numbers, Greece has recently grown at an annual rate

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75 Sovereign Debt Crisis: the term that explains the proliferation of massive public debt relative to tax revenues
76 The Austerity Measures in Greece and the Economic Crisis (page 6), Andreas Themistocleous, The GW Post Research Paper, February 2012
of 4.2% as foreign capital flooded the country. This growing economy together with the falling bond yields allowed the Greek government to run huge structural deficits and augment its expenditures. Prior to the current crisis, Greece had abundant access to cheap capital, fueled by flush capital markets and increased investor confidence.\textsuperscript{77}

Until the mid-2000s the developed Greek economy had spent vast amounts of money in several sectors in order to develop the country’s public infrastructures, defense and military equipment. In 2004 it also hosted the major but extremely expensive event of the Olympic Games with tremendous success. As a matter of fact, the games cost nearly $11 billion, double the initial budget proving once again that when it comes to overspending, Greece gets the gold medal.\textsuperscript{78}

The problem was that all these Greek public expenses were not accompanied by sufficient revenue collection. Therefore, the combination of over-expenditure and absence of revenue collection resulted in high public debt levels which since 2005 have been rising in an unprecedented way. As a result of the rising debt, the two most important Greek industries, shipping and tourism, became oversensitive to changes in the business cycle. In specific numbers, shipping and tourism, badly affected by the general economic downturn, saw their revenues falling by 15%. In order to see the gravity of the problem, it is worth mentioning that tourism accounted in Greece for almost 16 percent of GDP and one in five jobs in 2011. \textsuperscript{79}

In 2009 the crisis in Greece risked a conflagration on the financial markets and gained worldwide attention.\textsuperscript{80} The Greek public debt began to grow so rapidly that Greek policy makers immediately suggested as only solution harsh austerity measures. With extremely high debt levels and its main industries malfunctioning, Greece saw in early 2010 its credit grading being downgraded by the world’s leading

\textsuperscript{77} Greece’s Debt Crisis: Overview, Policy Responses, and Implications (The Build-Up to Greece’s Debt Crisis), Congressional Research Service, August 18, 2011, \url{http://www.fas.org/sgp/crs/row/R41167.pdf}
\textsuperscript{78} Greek Financial Crisis: Did 2004 Athens Olympics Spark Problems In Greece?, Derek Gatopoulos, Huff Post Business, 6 March 2010, \url{http://www.huffingtonpost.com/2010/06/03/greek-financial-crisis-olympics_n_598829.html}
\textsuperscript{79} Greek Airport Arrivals Fall as Crisis Hits Tourism Industry, Natalie Weeks, Bloomberg, October 12, 2012, \url{http://www.bloomberg.com/news/2012-10-12/greek-airport-arrivals-fall-as-crisis-hits-tourism-industry.html}
\textsuperscript{80} The Greek sovereign debt crisis and EMU: a failing state in a skewed regime pg 194, Kevin Featherstone, Journal of common market studies, 2011
rating agencies. Since then, the country’s sovereign debt has been repeatedly downgraded even further reaching dangerous junk territories by 2013.

At this point it is worth mentioning some of the domestic political problems that Greece has been facing in the recent decades. A close inspection of Greece’s political system proves that the country’s institutions have recently behaved in ways that either could not be foreseen or that were highly dysfunctional. As a result, the problematic political culture of the nation has played a significantly important role in the outburst of the Greek financial crisis.

In more detail, Greece has been a country with quite a number of striking paradoxes of governance. The most important of them is that while the executive government’s branch is very potent, the public administration is significantly lacking in strength. This paradox mainly derives from indigent intra-governmental productiveness, coordination and resources. It leads to rigid employment conditions and a particularly under-developed welfare system.

In February 2010 Prime Minister George Papandreou announced a round of tough austerity measures, including huge public sector pay cuts and a crackdown on Greece’s major problem of tax evasion. The measures, which prompted series of general strikes and protests, did not have the expected results and in May 2010 Greece signed an 110bn euros aid package deal with the EU, the ECB and the IMF. As a part of the deal, Papandreou announced a new round of even harsher and more stringent measures, which included new taxes and more salary cuts. The austerity measures demanded by Greece’s international lenders in return for the massive bailout help, opened holes in the Greek safety net and plunged the country into a recession of unprecedented dimensions.

In January 2011 European policy makers and international lenders said that Greek austerity had not gone far enough and that the state should speed up its reforms in order to get its finances back on track. From that moment onwards really intense

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81 The Greek sovereign debt crisis and EMU: a failing state in a skewed regime pg 194, Kevin Featherstone, Journal of common market studies, 2011
82 The Greek sovereign debt crisis and EMU: a failing state in a skewed regime pg 195, 197, Kevin Featherstone, Journal of common market studies, 2011
and violent protests started taking place with tens of thousands of protesters marching in Athens with the aim to oppose government efforts to agree on new austerity laws. Until 2013, the protesters have kept demonstrating extremely often and extremely violently amid a heavy police presence.  

When in 2011 the situation became even more critical, Greece started facing a complete loss of confidence, indicated by a great widening of bond yield spreads compared to most of the Eurozone countries. Right after that the Greek government debt was for the first time downgraded to junk bond status. In more detail, several credit rating agencies downgraded eight Greek banks due to concerns over Greece’s capabilities to pay back its debts.  

These concerning news immediately created alarms in financial markets all over Europe. As an answer to the deteriorating situation, in October 2011 Eurozone leaders decided a 50% write-off of Greece’s debt in return for more and stricter austerity measures. The agreement was reached after extraordinarily hard negotiations involving bankers, heads of state and the International Monetary Fund with its aim being the confrontation of the increasingly spiraling debt problems that threaten the European single currency project. The Greek write-off gave hopes for a significant reduction of the country’s sovereign debt. 

The hopes, though, did not last long as one month after the positive news, Prime Minister George Papandreou stunned European markets and leaders by calling a referendum with regard to whether Greek citizens wanted the European rescue packages or not. Faced with a heavy storm of criticism over his general inability of  

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84 Greece hit by new general strike over austerity, BBC News Europe, 18 October 2012  
http://www.bbc.co.uk/news/world-europe-19986804  
85 Junk Bond: Junk bond is a bond that is rated below investment rate and that has a high risk of default.  
86 Greece timeline: A chronology of key events, BBC news, page last updated at 11:50 GMT, Monday, 11 June 2012  
http://news.bbc.co.uk/2/hi/europe/country_profiles/1014812.stm  
87 Eurozone leaders agree to write off 50% of Greek debt, France 24 International News, Latest update: 31/10/2011  
dealing with the crisis, in November 2011 Papandreou withdrew his referendum and announced his resignation.  

From Papandreou’s resignation onwards, the crisis in Greece started having severe political implications instead of just financial ones. In November 2011 after long talks and negotiations a government of national unity was formed and a former central banker, Lucas Papademos was ushered in as new Prime Minister. Papademos would serve as Prime Minister until the next Greek parliamentary elections scheduled provisionally for the spring 2012.

The new interim Prime Minister, an acknowledged expert on financial matters, became immediately responsible for getting Greece back on track by cutting significantly the country’s deficit. In his first rather optimistic words, he underlined that Euro membership will lead to monetary stability and ensure that Greece will make the adjustments needed to restore economic growth. Eventually, Papademos’ deep knowledge of finance led to a slight amelioration and created a boost of confidence. Despite the improvements, though, European lenders still claimed that reforms were behind schedule and that delays were stalling recovery.

February 2012 has undoubtedly been the most crucial month as on 21 February and after all-night negotiations between Greek policy makers and European leaders, a new aid package deriving from the EU, the ECB and the IMF was agreed. This made Greece the first Eurozone country, so far, to have received a second bailout rescue package. The agreement of 130bn euros took place because of the country’s huge difficulties to reduce its deficit and is expected to bring the Greek sovereign debt back to sustainable levels in the next 5 years. Despite the bailout’s fundamental importance though, doubts made since the very beginning their appearance regarding

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88 Greece timeline: A chronology of key events, BBC news, page last updated at 11:50 GMT, Monday, 11 June 2012
89 Lucas Papademos: a Greek economist and Prime Minister of Greece from 11 November 2011 to 16 May 2012 during the wake of the country’s sovereign debt crisis.
90 Lucas Papademos appointed to form new Greek government, by Damien McElroy, Foreign Affairs Correspondent, The Telegraph, 10 November 2011
Greece’s ability to carry out the even harder necessary austerity measures or to manage the weakened economy.\textsuperscript{91}

The second bailout was clinched together with a deal on government cuts in return for the new rescue loans. These cuts were the harshest measures Greek citizens had ever seen and included 22\% off the minimum wage and 15\% off pensions. These measures were later on judged as economically unsuccessful as well as absolutely unsustainable for the vast majority of the Greek people. As a direct consequence, right after the measures’ enter into force Greece saw its unemployment rate rising to the new record of 21\%.\textsuperscript{92}

The extraordinarily high cuts in Greece combined with the dramatic unemployment’s increase led some parts of the population living at the risk of poverty and social exclusion. In the early parliamentary elections of May 2012 the attempts for a coalition government slumped mainly because of the increase in support for anti-austerity measures of certain parties. As a result of the inability to form a government, the Greek President Karolos Papoulias\textsuperscript{93} called fresh elections for 17 June. At that point the EU started facing a great political and economic upheaval as the failure of coalition talks in Greece prompted fears that the inevitable elections in the crisis-torn country would herald the start of the breakup of the Euro.\textsuperscript{94}

As a matter of fact, the critical situation in Greece during the period between the two electoral procedures sent ripples around the world. The crisis at that point was not only financial but also political as there was no elected government to lead Greece through the existing difficulties. At that exact period, extremely pessimistic speculations regarding the country’s future made their appearance.

\textsuperscript{92} The Austerity Measures in Greece and the Economic Crisis (conclusion), Andreas Themistocleous, The GW Post Research Paper, February 2012
\textsuperscript{93} Karolos Papoulias: the President of Greece from 12 March 2005 up to now as well as the Foreign Affairs Minister of several Greek governments during the 1990s.
\textsuperscript{94} Greece faces stark election choice – in or out of the euro, Larry Elliott and Helena Smith, The Guardian, Tuesday 15 May 2012 \newline http://www.guardian.co.uk/world/2012/may/15/greece-election-in-out-euro
Firstly, European policy makers started thinking seriously the possibility of further help by not ruling out a potential third rescue package. Secondly and most importantly, speculations appeared regarding a potential future Greek exit from the Eurozone. As a matter of fact, in mid-2012 a new word, the so-called Grexit was introduced in world business trading. Since then such a scenario has gained prominence as European bankers and finance ministers have repeatedly warned Greece that its departure from the Euro will be inevitable if it does not abide by the rules of its bail-out programme.

There have been several economists and policy makers who have recently adopted the radical Grexit approach as the only way to solve the crisis in Greece. According to the supporters of such a solution Greece’s only viable option is an exit from the Eurozone and an orderly default. A delay in organizing such a default will just continue hurting Greece and other weak Eurozone countries ceaselessly. According to the economist Costas Lapavitsas, a Greek default and exit would remove the pressure of debt and boost competitiveness. This would subsequently lift austerity for good and allow proper restructuring of the economy and society.

The Grexit theory is based on the idea that if Greece withdraws from the Eurozone by reintroducing its national currency at a debased rate, Greek exports and services will become more competitively priced globally. Imports will at the same time be more expensive leading to an augmentation of domestic production. This does not mean that a Grexit would be pretty for Greece. On the contrary, it would be brutal, destroy the savings of the middle class, and further strain the social fabric.

All the speculations with regard to a third bailout package or a potential Grexit scenario have so far been just theoretical assumptions. Even if the fears are

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95 Grexit: a combination of the words “Greek Euro Area Exit”, referring to the scenario that Greece could leave the Euro and adopt its former currency, the Drachma.  
96 The euro in crisis: Groping towards Grexit, The Economist, 15 May 2012  
http://www.economist.com/blogs/charlemagne/2012/05/euro-crisis  
97 Orderly Default: is a government’s failure to pay back a loan.  
98 Costas Lapavitsas: a Greek professor of economics at the School of Oriental and African Studies, University of London  
http://www.theweek.co.uk/eurozone/euro-debt-crisis/46910/grexit-what-happens-if-greece-leaves-euro  
100 Two dangerous Myths about a ‘Grexit’, Sebastian Dullien, Social Europe Journal, 18 May 2012  
http://www.social-europe.eu/2012/05/two-dangerous-myths-about-a-grexit/
reasonable, the radical scenarios they create do not seem feasible, at least so far. The reasons behind that are mainly three.

The first reason is the encouraging result of the Greek parliamentary elections of 17 June 2012 when Greece finally managed to form a coalition government and put an end to its brief but severe political crisis. The new three-party coalition government, led by Prime Minister Antonis Samaras\textsuperscript{101}, created an atmosphere of confidence in Europe and stabilized the Greek situation to a large extent. In his first words as new leader, Samaras stated that “the government’s goal is to get the country out of the crisis and to have the sacrifices people have made pay off”. He also ensured that he will lead a government of responsibility, a government that will make big changes.\textsuperscript{102}

The second reason lies in the fact that a potential Greek exit would without doubt undermine the EU process of integration. European policy makers and leaders have in numerous occasions stated that they cannot allow the Eurozone to disintegrate as the survival of the common currency is linked with the existence of the entire EU. This means that an expulsion of weak countries from the Euro does not constitute an option and that Grexit is nothing more than a measure of absolutely last resort.

The third and last reason is the so-called domino effect\textsuperscript{103} that a potential Grexit would cause. It is widely believed that if Greece abandons the common currency a huge effect of financial contagion would immediately affect the whole Eurozone’s economy. A Grexit might automatically lead to a loss of investors' confidence in Portuguese, Spanish and Italian capital markets. In that case rising interest rates could provoke sovereign defaults in these EU member states as well. Such fears make necessary for the Eurozone to keep Greece in its fold in order to avoid such a dangerous phenomenon.\textsuperscript{104}

\textsuperscript{101}Antonis Samaras: a Greek economist and politician, the current Prime Minister of Greece since 20 June 2012
\textsuperscript{102}Greek coalition government unveiled, Helena Smith, The Guardian, 21 June 2012
http://www.guardian.co.uk/world/2012/jun/21/greek-coalition-government-unveiled
\textsuperscript{103}Domino Effect: a chain reaction that happens when an economic change causes a similar economic change nearby, which will cause another one and so in sequence.
\textsuperscript{104}Domino effect of Grexit could cause global ‘wildfire’, Thomas Fischer and Thieß Petersen, Public Service Europe, 25 October 2012
After summer 2012 Greece has made small steps of stabilization and has clarified its objectives for the next five years. Since then, the country’s ultimate goal is a 2-year delay in the fiscal recovery policies, agreed with the lenders, which will offer time for more efficient reforms and measures. According to Greek policy makers, such a delay will allow Greece to reach a significant reduction of its debt and return to the markets relatively soon.

In 2013, Greece has implemented in a satisfactory manner a wide ranging set of reforms and has an ambitious medium term fiscal strategy for 2013-16. Therefore, the EU is praising the authorities for their demonstrated strong commitment to the adjustment programme and appreciates the efforts made by the Greek citizens. As a matter of fact, there is plenty of confidence and optimism that by the end of 2016, Greece can reach a debt-to-GDP of 175% and in 2020 of 124% of GDP with the ultimate goal being a debt-to-GDP ratio lower than 110% in 2022. 105

Despite the good climate though, the situation remains more than critical as Greece’s financial existence still depends on international lenders. Credible information says that if the country does not use wisely the last doses of the second bailout agreement the government will inevitably run out of money and face a default. This means that in the near future Greek citizens will have to tolerate more measures, do further sacrifices and be extremely patient until Greece becomes a competitive and developing economy once again.

4.2 IRELAND

Some years ago Ireland's economy was seen as one of the most successful in the world as the country enjoyed strong economic growth. Prior to the recession the Irish economy grew rapidly especially during the so-called Celtic Tiger years, which refer to the country’s period of rapid economic growth (1995-2007). During that period, Ireland’s GDP per capita rose significantly to exceed that of most western European states. In particular, the arrival of the EU single market made Ireland an

105 Eurogroup statement on Greece, 4 March 2013
an attractive location for inward investment and helped boost Irish exports. However, since 2007 the country has been among the hardest hit by the global financial crisis.  

In 2008 the coalition government of Ireland announced officially that the country had fallen into recession for the first time since 1983. Ireland was the first Eurozone state to enter severe recession and Irish citizens were the first ones to feel a sharp rise in unemployment, which in 2011 reached the highest levels since the 1960s (14.6%). While the current financial crisis has undoubtedly affected many economies to varying degrees, it has been especially severe in Ireland with a nominal GDP decline of 21 percent something, that automatically ranks Ireland among the worst-affected nations in terms of economic performance in the last years.  

The causes that led Ireland to such a reversal are mostly related to the country’s banking sector. In 2008 Irish banks found them over-exposed to the property market and came under unprecedented pressure due to the global financial crisis. It is estimated that the banks in Ireland lost 100bn euros, most of it related to defaulted loans. As a matter of fact, the way the banking crisis has unfolded in Ireland since the American collapse of Lehman Brothers in 2008 has sent the global economy into meltdown.  

A turning point was the moment that Finance Minister Brian Lenihan announced a sweeping guarantee of bank deposits and debt. This led to the risky step of guaranteeing all the debts of Ireland’s top six institutions and resulted in a series of banking misinterpretations and scandals that rendered the situation even more critical. The Irish government instead of guaranteeing bank deposits and letting private bondholders who had invested in the banks face their losses, borrowed foreign capital in order to pay the bondholders, shifting the debt and losses to its taxpayers. This was

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106 Ireland’s economic crisis: how did it happen and what is being done about it? , European Commission: Representation in Ireland  
107 Fine Gael/ Green Party coalition government under Brian Cowen, who served as Prime Minister of Ireland from 7 May 2008 to 9 March 2011.  
108 The Irish crisis, Philip R. Lane, The World Financial Review  
http://www.worldfinancialreview.com/?p=874  
109 Ireland’s banking crisis: timeline, The Telegraph, 31 March 2011  
http://www.telegraph.co.uk/finance/financialcrisis/8419616/Irelands-banking-crisis-timeline.html  
110 Brian Lenihan: Finance of Minister from 7 May 2008 to 9 March 2011, who unveiled three government budgets in fourteen months.
a serious mistake that led to the increase of government’s deficit, the closure of many businesses and the fall of the Irish stock Index.\textsuperscript{111}

In February 2009 Prime Minister Cowen announced 2 billion Euros of public-spending cuts. According to him the country “desperately needed to shore up its battered public finances”. Additionally, Ireland injected €7bn into Bank of Ireland and Allied Irish in return for guarantees on lending, executive pay and mortgage arrears. As a result, GDP contracted by 14% which led to the downgrade of Ireland’s credit rating by international financial services companies such as Fitch and Standard and Poor’s.\textsuperscript{112}

The consequences of this downgrade were so concerning that the Irish government created in late 2009 a body named National Asset Management Agency (NAMA). It was responsible for reducing the rising debt burden and reviving the weak growth outlook. Its main objective was the acquisition of property loans from banks of Ireland in return for public bonds. NAMA’s drastic creation was designed in order to help the major Irish banks restore their balance sheets following the crisis caused by the credit crunch.\textsuperscript{113}

The property development loans were supposed to create more available credit in the Irish economy and hopefully lead to the rebuilding of Ireland’s shattered banking system. None of these two things actually happened as NAMA failed to prevent further bank losses and assist in the general economic recovery.

NAMA’s failure made clear that the critical situation could not be solved without the assistance of third parties. As a matter of fact, in November 2010 the Irish government agreed on an 85bn euro rescue package with the IMF and the EU as an attempt to tackle the huge hole of the country’s public finance. The package was accompanied by an austerity programme entailing dramatic tax rises and spending cuts.\textsuperscript{114} The austerity programme created several notable protests as since late 2010 thousands of Irish citizens, with many students among them, have descended on

\textsuperscript{111}\textit{Irish Stock Index}: the only Irish stock exchange existing since 1793.
\textsuperscript{112}\textit{Ireland’s banking crisis: timeline}, The Telegraph, 31 March 2011
\textsuperscript{113}\textit{Republic approves creation of NAMA}, Symon Ross, Belfasttelegraph.co.uk, 13 November 2009
\textsuperscript{114}\textit{Ireland’s banking crisis: timeline}, The Telegraph, 31 March 2011
Dublin from all over Ireland and marched on the capital expressing their deep concerns and dissatisfaction about the tax rises and salaries’ cuts.\textsuperscript{115}

The unprecedented banking collapse in such a developed Western European country has proved once again the high inconsistencies of the national as well as the EU objectives. As a matter of fact, at a national level the crisis in Ireland has demonstrated a banking system with huge weaknesses. On the top of that, at an EU level, the Irish crisis has highlighted the costs of the incomplete institutional design of the monetary union and the importance of deep-level reforms both to reduce the probability of future crises and to increase the resilience of the European banking system in the event of a crisis.\textsuperscript{116}

The rescue package combined with the harsh austerity measures have without doubt resulted in a significant reduction of Ireland’s public debt and despite the intense citizens’ protests have provided Ireland with optimism and hope. Surveys have pointed to stronger consumer and business confidence by providing further evidence that the internal market has been moving towards stabilisation again.\textsuperscript{117} This does not mean, though, that the country has overcome the existing difficulties as Ireland is still a long way from solving completely its debt crisis.

Economists have claimed that the economy of Ireland will start growing rapidly again after 2013 and it is without doubt true that the country has made important steps towards this direction. In January 2012 Prime Minister Enda Kenny\textsuperscript{118} denied the possibility of a second Irish bailout but admitted that very demanding economic challenges were ahead. As long as the crisis is still an ongoing Eurozone issue, economies such as the Irish one must always continue their harsh measures and unavoidable sacrifices.

\textsuperscript{115}March for a better way: One of the most notable marches that led more than 50 thousand protesters into the streets of Dublin right after the Irish bailout agreement.

\textsuperscript{116}The Irish crisis, Philip R. Lane, The World Financial Review

\textsuperscript{117}Escape from recession not on the cards in 2013, Dan O’Brien, The Irish Times, 4 January 2013

\textsuperscript{118}Enda Kenny: the current Prime Minister of Ireland (since 11 March 2011).
4.3 PORTUGAL

Since the spring of 2010, a major economic and political crisis hit Portugal. The country was battered by the sovereign debt crisis that began in Greece and has spread across much of Europe’s periphery. Intense anxiety was born because of the excessive levels of debt and the generally underperforming Portuguese economy. In 2011 as the Eurozone debt crisis mounted, leading credit rating agencies downgraded Portugal’s public debt, thus undermining further the already lost confidence. \(^{119}\)

In order to understand how and why the crisis affected Portugal we have to travel back to 1974 when the “Carnation Revolution” initiated the “Third Portuguese Republic”\(^ {120}\) by changing the country’s regime from an authoritarian dictatorship into a democracy. It was a historical year as that led from monarchy to democracy: after the revolution the contemporary Portuguese political system became dynamic, democratic, durable and most importantly European. \(^ {121}\)

In economic terms, during the ongoing “Third Portuguese Republic” the governments of Portugal have repeatedly encouraged over-expenditure and investment bubbles through unclear and risky public-private partnerships. This means that the current financial crisis’ roots can be traced in the last four decades when ineffective and badly-targeted financial decisions were taken. The public Portuguese funding has for more than 30 years been characterized by complete absence of balance, by fast and risky decisions as well as huge miscalculations. For this reason Portugal requested assistance from the IMF (1977/78), in order to solve its urgent problems of public and external deficits as well as other serious macroeconomic imbalances such as sharp increases in unemployment, pressure from oil prices and a huge inflationary pressure. \(^ {122}\)


All this was the harbinger of what happened next as on December 7 2009 rating agencies Fitch and Standard and Poor’s lowered Portuguese economic ratings to negative. Right after that the government reported a much higher-than-expected budget deficit of GDP. These two incidents were the first ones to spark serious concerns all over Portugal. As a result, the heavy debt burden and rising interest rates, forced Portugal to enact three rounds of austerity measures that put its economy into real recession.

In 2010 bond spreads had already started widening sharply and public debt had reached very dangerously high levels. The Portuguese government put out a statement to reassure citizens and investors that it was committed to deficit reduction. In setting the new budget goals, the government announced that it would freeze public wages and significantly reduce payrolls. In March 2010 Prime Minister Jose Socrates said that Portugal needed a fast and successful privatization plan, caps on public wages and tax increases on high incomes. Right after Socrates’ announcement thousands of civil servants organized huge strikes in protests against the freezing plans.

The government first plans did not have the expected results and in April 2010 Fitch downgraded Portugal’s credit rating even more. At the same time it warned Socrates of the need of further cuts unless he changed the government’s fiscal course. As a matter of fact, on May 13 2010 the government passed a new series of the harshest austerity measures Portugal had ever seen in order to speed up the reduction of the existing budget deficit.

Despite the desperate attempts, in early 2011 the deficit was still far from reduced which meant that Portugal needed even harsher fiscal policy choices. This is when a bitter political fight over austerity measures led to the resignation of Jose Socrates’ government. The Prime Minister resigned after opposition parties rejected

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123 In 2008 the Portuguese forecast for 2009’s budget deficit was 5.9% of GDP. The forecast was far away from reality, though, as the actual 2009 budget deficit was proved to be 9.4% of GDP.
125 Jose Socrates: the Prime Minister of Portugal from 12 March 2005 to 21 June 2011 who resigned when parliament rejected his government’s austerity measures.
126 Portugal passes another austerity budget, BBC News Business, 27 November 2012
127 Timeline: Portugal, BBC News, Thursday 22 March 2012
http://www.bbc.co.uk/news/business-20513821
http://news.bbc.co.uk/2/hi/europe/country_profiles/1101811.stm
his last-ditch attempt to push through a fourth package of spending cuts and tax increases but had to stay on, leading a caretaker government for a short transitional period. The instability following the resignation made clear that a third party’s assistance was necessary if the country wanted to overcome the huge difficulties.

On April 6 2011 Portugal became the third Eurozone country, after Greece and Ireland, to ask for a financial bailout from the IMF and the EU. The agreed programme was a 78bn Euros aid package aimed at helping the country cope with its budget deficit. The bailout undoubtedly ameliorated Portugal’s weak fiscal position and gave hopes with regard to the country’s growth prospects.

Portugal’s credit rating has, even after the aid, been so low that the country might follow Greece in requesting a second bailout in order to save its economy. This scenario has so far been avoided as Portugal has since 2011 made small but steady steps of progress. As a matter of fact, in 2013 the economy of Portugal is expected to contract even more which means that the country has still a long way to go in order to completely overcome the crisis.

Despite that, the IMF has repeatedly expressed its strong belief that by 2014 Portugal will be able to return to medium or long-term debt sovereign markets. In a nutshell, the Fund has praised Portugal’s significant progress towards regaining access to international debt markets as part of an impressive reform under the country’s bailout agreement.

4.4 THE “EURO FRAMEWORK”

The three weakest Eurozone economies mentioned above have without doubt numerous and huge differences. Greece’s and Portugal’s problem for instance lies in the fact that the countries’ fiscal policy choices of the recent past have been highly unsuccessful. Ireland’s problem on the other hand has its origins on the country’s extremely weak and inefficient baking sector.

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129 Timeline: Portugal, BBC News, Thursday 22 March 2012
130 IMF praises Portugal’s reform progress, Peter Wise, Financial Times: EU economy, January 17 2013
http://www.ft.com/intl/cms/s/0/6e8150f8-6093-11e2-a31a-00144feab49a.html#axzz2N468i1VB
At the same time, despite the striking differences, these three economies share many common characteristics as they all face huge sovereign debt levels, high unemployment rates and negative growth prospects. These are results of the overall Eurozone crisis that has created similar circumstances and characteristics primarily to Greece, Ireland and Portugal and subsequently to several other Eurozone member states.

The fact that all Eurozone members share the same currency automatically creates a specific framework with not only similar economic circumstances but also with a small range of options for the member states. This means that those Eurozone countries that are hardly hit by the crisis have limited options in order to face the critical situation as they all belong to the same currency’s strict framework.

The small range of options that the Eurozone members have because of the restrictive framework they belong to makes the overtaking of the crisis a much more difficult task. This happens because in member states such as Greece, Ireland and Portugal the national policy makers cannot intervene in the countries’ economies the way they would if their states did not belong to the unique framework of the common currency.

The Greek case can prove what kind of restrictions the “Euro framework” imposes to the weak Eurozone member states. If Greece did not belong to the common currency’s family it would have a wide range of options that could help the country overcome the financial stalemate. Now, as a part of the “Euro framework” Greece has a limited range of options and few possible moves out of the crisis.

To make this argument clearer, under normal and complete sovereignty and without the restrictive Eurozone framework Greece would be able to weaken its currency in order to strengthen exports and render them more competitive in the global market. This way the country’s domestic production would increase leading progressively to more viable public debt levels. Within the “Euro framework” this option does not exist and Greece must find new alternative ways in order to achieve such goals.

The same limited options apply, maybe to a smaller extent, to the case of Portugal as the Portuguese state the same way as the Greek one cannot intervene
directly in its economy in order to create a surplus. With regard to Ireland, the country faces restrictions regarding to the way its banking crisis can be approached and solved.

This entire rigid framework that does not allow to weak Eurozone economies many ways out of the crisis can be seen as a strong flaw of the recent intense European integration steps. It is a result of the 1999s decision to introduce the same currency in countries with numerous different qualitative and quantitative characteristics. This proves that the causes of the current financial crisis lie mainly on the creation of the Eurozone in 1999. As a matter of fact, most of the financial problems that the EU countries are now facing can be traced back to the decision of creating the monetary union, which established the single European currency.

With the common currency, the huge differences among the Eurozone’s economies became even greater. As a result, the Eurozone was divided between a strong core and a weak periphery. Nowadays, this periphery cannot act unilaterally in order to overcome the difficulties as it coexists with rich partners in the same “Euro framework”. For this reason it is obliged to ask for bailout packages and international assistance instead of taking matters in its own hands.

The core-periphery dualism among the nations of the EU is a reality with special characteristics and great implications to the member states. It describes an economic superiority of the core nations that are geographically central to market centers compared to the peripheral countries which have obvious developmental disadvantages. The superior member states enjoy high technology industries, producer services, limited unemployment and overall development potential. The inferiority of the peripheral nations on the other hand stems from their locations and economic sizes related to transportation costs and industrial agglomeration. ¹³¹

4.5 CONCLUSION

The Eurozone crisis has without doubt emerged in a different way in each of the weak Euro economies. As a matter of fact and despite the common characteristics, it has been very different in Greece, Ireland and Portugal. This has taken place due to the diverse economic or political character of each of the aforementioned member states. Undoubtedly, the economic particularities as well as the different political cultures have rendered the crisis unique in each case.

In Greece for instance the crisis has had special characteristics that derive mainly from the nation’s unique political culture. The paradoxes of Greek governance that include several forms of corruption as well as political scandals have played an important role in the emergence of the severe Greek crisis. In Ireland the critical situation has had a unique character as well as it has its origins in the country’s weak banking system. As a matter of fact, the Irish bank debts mounted suddenly in 2008 sending the nation’s as well as Europe’s economy into meltdown. Last but not least, in Portugal the crisis has also had particular characteristics that derive mainly from the country’s unsuccessful fiscal policies. The lack of balance between the Portuguese public expenditures and tax revenue has played a major role in the apparition of the crisis there.

The differences have been significant but several common elements have been present as well. Greece, Ireland and Portugal as well as other weak member states have all experienced high sovereign debt levels and an incapability to pay their debts without the assistance of third international parties. They have also experience the feeling of coexisting in the same “Euro framework” with much more stable Eurozone member states.

This coexistence of richer and poorer countries in the same framework has created really high interdependence with positive and negative aspects. A positive aspect is the increased solidarity and mutual understanding between member states. Negative aspects, on the other hand, are the lack of possible one-sided options, as mentioned before, as well as the phenomenon of financial contagion which has plagued the Eurozone from 2009 onwards.
CHAPTER 5

THE EUROZONE CRISIS AND FINANCIAL CONTAGION

The sovereign debt increases that in the beginning of the Eurozone crisis were concerning only a few member states have in 2013 become a generalized problem for the common currency area as a whole. When in 2009 Greece and Portugal were facing high debt levels, nobody thought that their huge problems would spread so fast and that economies such as the Spanish and Italian one would face similar difficulties a few years later.

The spread of the huge sovereign debt levels and the low growth prospects from certain Eurozone economies to others has taken place because of the extremely high levels of interconnection and interdependence between the Eurozone member states. This spread is undoubtedly a characteristic example of financial contagion. Before analyzing why the current Eurozone crisis has become a contagious financial phenomenon, a definition of what exactly financial contagion is and an analysis of recent contagious financial examples seem more than necessary.

5.1 FINANCIAL CONTAGION

Financial contagion is an economic term which refers to the scenario during which economic shocks that initially affect only certain economies and regions, spread to other countries that were healthy before.\textsuperscript{132} This spread usually takes place through a manner similar to the transmittal of a contagious disease.

The study of financial contagion has recently grown significantly in importance as a result of the expanding global character of financial markets and the high economic interdependence of many international entities around the globe. Since

\textsuperscript{132}Financial Contagion: definition in Business dictionary

www.businessdictionary.com
1990 global economy has witnessed numerous phenomena of financial contagion as states and financial sectors are nowadays more interrelated than ever before. Globalization has created new frameworks of interconnected economies, which means that negative changes such as economic fluctuations that take place in national economies or in certain financial sectors usually affect significantly other economies or sectors as well.\textsuperscript{133}

The financial contagion can be domestic or international. At the domestic level, the contagion occurs between financial sectors of a certain economy while at the international level the contagious phenomenon takes place between different national economies.\textsuperscript{134} When either domestic or international financial contagious phenomena occur, instability and fragility are the results in most of the cases.

The American turmoil and the Irish banking crisis for instance are two phenomena that besides their international impact are mostly based on domestic financial contagion. The 1997 Asian financial downturn and the Eurozone sovereign debt crisis are on the other hand are clear examples of international financial contagion.

The turmoil in the American financial markets started with the failure of the financial service firm called Lehman Brothers. Before 2008 Lehman Brothers was one of the biggest American investment banks conducting business in a huge variety of sectors such as trading, investment banking and management as well as equity. In September 2008 the firm lost the biggest part of its clients, faced unprecedented stock losses and finally did not manage to avoid bankruptcy.\textsuperscript{135}

Lehman Brothers’ failure triggered a contagious financial transmission that undermined confidence in similar US investment banks and that caused significant changes in American asset prices. It was the largest bankruptcy in American history that affected not only the US financial sector but the global economy as well. Lehman

\textsuperscript{133} Financial Contagion (introduction), Franklin Allen and Douglas Gale, Financial Institutions Centre http://fic.wharton.upenn.edu/fic/papers/98/9831.pdf
\textsuperscript{134} Global crises and equity market contagion (empirical results), Geert Bekaert, Michael Ehrmann, Marcel Fratzscher and Arnaud Mehl, ECB’s working paper series, September 2011 http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1381.pdf
\textsuperscript{135} The Lehman Brothers Case: A Corporate governance failure, not a failure of financial markets, Professor Arturo Bris, May 2010 http://www.imd.org/research/challenges/upload/TC039-10PDF.pdf
Brother’s bankruptcy is considered to have played a significantly important role in the late 2000s global financial crisis’ emerging and unfolding.

The Irish banking crisis started with certain banks’ abilities and irregularities and culminated in a general downturn of all Irish financial institutions. In 2008 Anglo Irish Bank’s chairman admitted to have hidden 87mn Euros in loans from his bank. This revelation led to resignations of the bank’s executives and investigations over certain shares purchased in the bank.

In 2009 the Irish government was forced to nationalize the Anglo Irish bank in order to save it as recapitalization was not enough. Despite the efforts though, the bank was not finally saved as in 2011 it merged with another financial institution in order to form a new company, the Irish Bank Resolution Corporation.

The Anglo Irish Bank’s scandal and failure triggered chain reactions in the Irish banking system and resulted in a general lack of trust regarding the private affairs of the country’s banks. Several financial institutions started facing severe problems and feeling the need of government assistance. As a matter of fact, Ireland’s two biggest banks were in 2009 forced to accept 3.5bn Euros public bailouts in order to avoid bankruptcy.137

The Asian financial crisis started in Thailand and soon raised fears of a regional and worldwide economic downturn because of financial contagion. In 1997 the Thai government was forced to devalue the national currency 138 in order to face the high foreign debt levels. This action actually led the country to an effective bankruptcy before the upcoming collapse. The crisis spread fast to most of Southeast Asia and Japan. Several countries, including South Korea, Indonesia, Laos and Malaysia experienced slumped stock markets, asset prices and currencies as well as huge debt risings.139

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136 Anglo Irish Bank: the third biggest bank in Ireland functioning from 1964 until 2011 that dealt mostly with commercial banking and that operated internationally in Europe and the United States.
138 Thai Baht: the currency of Thailand, subdivided into 100 satang.
The economic crises in the USA, Ireland and Southeastern Asia are characteristic examples of how an initial economic shock can spread like a medical disease to several different financial sectors or national economies. This is what recently happened in the Eurozone as well.

5.2 FINANCIAL CONTAGION IN THE EUROZONE

The intense European integration processes of the last decades have resulted in strong interdependent relations among all EU member states. Especially those members that since 2002 use the common European currency, nowadays experience tight coexistence in an unprecedented interconnected framework.

The strong relations among the Eurozone member states and the interdependent framework these states belong to, have rendered the Eurozone an entity in which financial contagion has recently grown significantly in importance. This growth has taken place due to the free, fast and complete circulation of capital and services and the fact that a great number of sovereign states share the same currency. As a matter of fact, the Eurozone financial contagion has to do with the strong links between economically weaker and more powerful member states. The close financial ties are those responsible behind the “fast and furious” virus spread of the crisis from one member to another.  

The Eurozone crisis became a clear contagious phenomenon after 2010 when the critical situation spread from Greece, Ireland and Portugal to other member states. This is when the crisis started concerning the whole Eurozone entity and when grand economies of the European south such as the Spanish and Italian one started facing serious financial problems.  

140 Financial Contagion and the European Debt Crisis (Introduction), Sebastian Missio and Sebastian Watzka, August 2011  
http://www.sfm.vwl.uni-muenchen.de/forschung/aktuelle_papers/contagion_in_euro_area.pdf  
In 2009 when Greece and Portugal faced dangerously high debt levels and when Ireland had to deal with an extremely severe banking crisis, analysts could not predict that from 2011 onwards this would be the case for many more Eurozone economies. The crisis did indeed transform in two years’ time changing from a limited regional problem to a problem with more severe and much broader characteristics.

With regard to Greece and Portugal, when these two countries were unable to handle their debts, all the financial firms and banks that had lent them money were exposed to huge losses. This resulted in a severe deterioration of the relations between the countries in need and the lending firms. The deterioration had severe repercussions to third countries, mainly Spain and Italy that were supposed to be economically healthy before. 

Regarding Ireland, when in 2009 the country’s taxes reached ultra-low levels, the general Eurozone financial competitiveness was distorted. These levels made it necessary for Ireland to attract foreign investment with the two biggest creditors being Germany and the UK. The Ireland’s 2010 threat of banking collapse though had devastating results in the creditor countries which saw the Irish weaknesses spreading to their economies as well.

Experts on the unfolding Eurozone crisis suggest that the contagious phenomena mentioned above are without doubt present and concerning but still limited compared to what can happen in the near future. According to them, the financial contagion can be much more severe and catastrophic if potential scenarios concerning weak economies come true. Such a scenario is the potential Greek exit from the Eurozone.

The so-called Grexit is considered by many a scenario that would immediately trigger an unprecedented financial contagion in the Eurozone. It is widely believed that if Greece leaves the Euro in the near future a contagious domino effect will have

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142 Financial Contagion and the European Debt Crisis (introduction), Sebastian Missio and Sebastian Watzka, August 2011

143 European Economic Crisis: Ireland in Comparative Perspective (Domestic political institutions and economic policy), Sebastian Dellepiane Avellaneda and Niamh Hardiman, UCD School of Politics and International Relations

a significant impact on others such as Spain and Italy, which might be obliged to leave the common currency as well. This would lead to a situation out of control with terribly unpredictable consequences.

Greece’s future in the common currency is vague and the reason behind this is the uncertain performance of the country’s economy. If the evaluation of Greece’s reforms keeps being negative, foreign lenders will probably decide to suspend the financial support. Such a suspension, which undoubtedly constitutes a measure of last result, would lead Greece to sovereign default something that all European policy makers strive to avoid.

The reason why such a suspension is the worst case scenario lies in the fact that a potential Greek exit would cause a disastrous domino effect. A Grexit would lead into a huge loss of investors’ confidence in Italian and Spanish capital markets which would sooner or later provoke sovereign defaults in these states as well. The loss of confidence would not be limited only in Italy and Spain though as it would have more far-reaching economic repercussions.

The group of affected economies would not be just European, but would include the USA, Brazil, China and other global powers. The Grexit scenario would create severe international recession as by 2020 more than forty economies would reach 17,2 trillion losses in Euro. In the Eurozone for instance, France and Germany would lose 2,9 and 1,2 trillion Euro respectively feeling dramatic strains. To put it bluntly, the Grexit “chaotic scenario” would be disruptive and disorderly, pushing the Euro to around $1.15-1.10 against the dollar and causing a 2% drop in euro-zone gross domestic product.

Of course it is worth mentioning that the very pessimistic assumptions described above are not shared by all analysts as there are financial experts who argue that a Greek exit could be a controlled event. According to this point of view, in a

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144 Grexit: Who would pay for it? (pg 1), CEPS Thinking ahead of Europe, 23 May 2012
145 Economists React: What Happens If Greece Leaves Euro Zone?, Katie Martin and Laura Clarke, Real Time Economics, May 22 2012
http://blogs.wsj.com/economics/2012/05/22/economists-react-what-happens-if-greece-leaves-euro-zone/
potential Grexit, the effects would be devastating in Greece but controllable outside the country. Huge European banks would need to raise capital but the ECB which has insulated the banking system of Europe against the worst shocks, would save the situation with plenty of cash.

These optimistic counter arguments are based on the fact that Greece represents a small percentage of the Eurozone’s economic activity. According to them, unless someone is Greek –or a tourist in Greece who gets trapped without cash by a Greek default- a Grexit is no big deal. The German minister of finance Wolfgang Schäuble\textsuperscript{146} recently said that “Germany definitely wants Greece in the Euro but if attempts fail it is very well prepared”.\textsuperscript{147}

In any case, the risk that a Greek exit might turn into a wildfire spreading in Europe and all over the world is more than sufficient for the international community to make all possible efforts to keep Greece within the Euro and avoid the upcoming uncontrollable contagion. This is the reason why international lenders insist on aiding Greece and on providing the country with rescue packages.

The German Chancellor Angela Merkel together with the ex-French President Nicolas Sarkozy have stated several times in the recent past that they simply enough cannot allow the Eurozone to disintegrate and have associated the survival of the common currency with that of the EU as a whole.\textsuperscript{148} This has mainly taken place because of the direct involvement of their own banking sectors. Moreover, EU’s commissioners such as Joaquin Almunia have shared exactly the same view, arguing that expelling member states from the Eurozone is not an option: "Those who think that this hypothesis is possible just do not understand our process of integration".\textsuperscript{149}

The financial contagion will probably be catastrophic if Greece abandons the common currency but is a present and concerning phenomenon even now that the country is still an active and important member of the Eurozone. The main victims of this contagion have since 2011 been Spain and Italy.

\textsuperscript{146}Wolfgang Schäuble: a German politician of the Christian Democratic Union (CDU), currently serving as the Minister of Finance in the Second Cabinet of Chancelor Angela Merkel.
\textsuperscript{147}What would happen if Greece defaulted and left the euro?, posted on February 17, 2012 http://jubakpicks.com/2012/02/17/what-would-happen-if-greece-defaulted-and-left-the-euro/
\textsuperscript{148}EU risks being split apart, says Sarkozy, MacCormaic, Ruadhan, Irish Times, 9 December 2011 http://euobserver.com/economic/113568
\textsuperscript{149}Spanish commissioner lashes out at core eurozone states, Euobserver, 9 September 2011
5.3 FINANCIAL CONTAGION IN SPAIN AND ITALY

In 2013 Spanish and Italian economies are considered to be in a critical situation. Both Spain and Italy experience high sovereign debt levels that have forced their governments to follow harsh austerity measures. According to several Eurozone experts when Greece and Portugal sneezed, most of Europe had a cold. The crisis expanded like a virus and many countries are now at risk: especially Spain and Italy are perfect candidates for severe financial problems. 150

The question that concerns many European policy makers is whether Spain and Italy will ask for bailout aid packages following the negative examples of other Eurozone economies. This sounds scary as Spain and Italy are countries whose economies are huge which means that a potential international help would require enormous amounts of money. The Spanish and Italian qualitative characteristics are different from the Greek and Portuguese and make a different approach and management of the crisis necessary.

5.3.1 SPAIN

The Spanish economy has been facing evident difficulties in the last 40 years. From the 1970s onwards Spain has a huge trade deficit, inflation rates are extremely high compared to other EU countries and competitiveness is almost absent. Despite these difficulties though, Spain has been a driving EU economic power as well as a leading advocate of the European common currency.

The real economic problems in Spain started in 2008 and became even more intense after 2010 when the Eurozone sovereign debt crisis reached its peak. This is when the building market crashed and when major Spanish companies went bankrupt. In 2009 the Spanish GDP contracted for the first time after 15 years and Spain officially entered a recession period. In March 2012 unemployment in Spain had a significant increase raising to the unprecedented percentage of 24,5%. 151

150 Europe’s financial contagion, The Washington Post
151 The Spanish Crisis: Background and Policy Challenges (Chapter 2. Abrupt end of a long growth cycle pg 5), Javier Suarez, CEMFI and CEPR, December 2010
http://www.cemfi.es/~suarez/The_Spanish_Crisis_JSuarez.pdf
The austerity measures aimed at tackling the Spanish crisis have been extremely harsh in the last years. The citizens have reacted dynamically to the general recession through massive protests and manifestations. The 15-M movement for instance, which demanded radical changes in Spanish economics and politics became famous all over the world.

The protesters in Spain have shared one of the strongest rejections in Europe of welfare cuts and austerity measures and their intense reactions have revealed clearly their compassion for other European economies that struggle even more. The number one problem has been unemployment: since 2009 Spain has seen its unemployment rate increasing by 37%.

Especially after 2011 the country has been suffering the worst unemployment rates ever recorded becoming the European country with the most jobless citizens. In specific numbers, the 26% of Spanish people is in 2013 without a job, a shocking figure for a huge Western European economy like the Spanish one. This figure becomes even larger and the problem even more acute when it comes to the young part of the Spanish population. As a matter of fact, more than half of the 16-24 years old Spanish citizens, who have been irretrievably affected by the crisis, remain unemployed.

Unemployment though has not been the only concern as Spain’s banking system is in an unprecedented critical situation as well. From 2010 onwards several Spanish banks’ credit rankings have been downgraded to junk status and expressed the need of financial support either through nationalization or bailouts in order to cover their losses.

In June 2012 emergency discussions regarding the need of capital injection into the Spanish banks made their appearance. European policy makers announced that a help package of around 100 billion euros would be available aimed at the savior of the fragmented Spanish banking sector. After long and difficult negotiations an

152 **15-M Movement or the Indignants Movement**: series of ongoing protests in Spain which started on the 15th of May 2011. Their objective is the significant decrease of unemployment and political corruption as well as the reduction of influence of economic in politics.


154 **Bankia**: the fourth largest Spanish bank that went through nationalization in May 2012 and asked for a 23,5bn Euro aid to cover its losses.
initial package of 62 billion euros was agreed on. With this international aid the banks of Spain became subject of international control with stringent rules and requirements. The decision, which was taken after long and hard negotiations, made Spain the fourth and largest European country to agree to accept emergency international assistance as part of its continuing debt crisis.

The question is whether Spain will follow Greece, Ireland and Portugal and ask for a rescue bailout. This scenario has sparked concerns all over Europe with policy makers contemplating on whether it would be the best option for the fourth-largest economy of the Eurozone or not. Mariano Rajoy\(^ {155}\) has claimed that Spain’s international assistance will enhance “the credibility of the European project, the solidity of Europe’s financial system and the possibility that credit will flow again.” On the top of that, Luis De Guindos\(^ {156}\) has repeatedly said that Spain will not need an international help package similar to the Greek one.\(^ {157}\)

The sovereign debt levels though keep rising, the austerity cuts do not bring the wanted results and unemployment does not seem to be falling under 26%. All these make a future bailout agreement a very possible if not an inevitable option for Spain and only the near future can show and prove how far from reality such a bailout actually is.

5.3.2 ITALY

In 2010 Italy saw for the first time its economic growth decreasing dangerously and its public debt rising to 120% of the country’s GDP. Two years later the country’s economy had shrunk by 0.7%, underlining a deepening recession, as government austerity measures continued to affect all Italian financial activities.\(^ {158}\) Today the Italian economy which is the third Eurozone’s economy in terms of power is facing high borrowing costs that are threatening to be the main source of a new national crisis.

\(^ {155}\) Mariano Rajoy: the Prime Minister of Spain since 21 December 2011

\(^ {156}\) Luis De Guindos: the minister of Economy and Competitiveness of Spain since 21 December 2011.


\(^ {158}\) Italian economy contracts 0.7% in second quarter, BBC News Business, 7 August 2012

http://www.bbc.co.uk/news/business-19162772

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Economically, Italy has in the last decades been an EU country with a significant surplus in its budget, something that has always been excluding debt interest payments. Additionally, the Italian deficit to GDP has been one of the lowest in the EU proving that Italy has in the recent years been an example of an economically well-functioning member state. However, when the debt started reaching unsustainable levels, economists started regarding Italian bonds as risky investments instead of sure assets. According to speculations of these economists the debt of Italy, affected by the financial contagion that the Eurozone is facing, will keep growing needing refinancing in the near future.

Politically, Italy has gone through a period of great instability in the recent past especially during the Silvio Berlusconi\(^{159}\) governments. As a matter of fact, several Italian governments have since the 1990s been involved in controversies and numerous court cases are still pending related to corruption, tax evasion as well as other scandals. This has resulted in the degradation of Italy’s international reputation something that is visible nowadays along the course of the Eurozone crisis.

The government in Italy has since 2010 decided to adopt stringent austerity measures designed to avoid a potential bailout which would possibly destroy the Eurozone as a whole. Many analysts view the Italian economy as the endgame of an eventual collapse of the common currency as it is simply enough too big to fail. Neither the EU nor the IMF has sufficient cash at their disposal to rescue it. If the country defaults, that would probably mean the end of the euro.\(^{160}\)

The measures have included a sudden freeze on public sector salaries and an intense fight against tax evasion. Prime Minister Monti\(^{161}\) has in the last two years unveiled a radical and ambitious package of spending cuts and tax increases including unpopular decisions like augmenting the country’s retirement age. The aim has been

\(^{159}\) **Silvio Berlusconi**: an Italian politician who served three times as Prime Minister of Italy (1994-1995, 2001-2006, 2008-2011)

\(^{160}\) **Looking at Austerity in Italy**, Juan Carlos Hidalgo, Cato Institute, May 16 2012


\(^{161}\) **Mario Monti**: Italian economist that has served as Prime Minister of Italy from November 2011 to December 2012, as a leader of a government of technocrats during the peak of the Italian debt crisis.
the saving of billions of euros through a mixture of spending cuts and tax rises in order to reach a balanced budget by 2014.\textsuperscript{162}

The austerity measures have resulted in a feeling of discontent among the Italian society, which has since 2011 started largely immigrating because of the unemployment and the general financial insecurity. The main victim of the critical situation is the young population which has been forced to move abroad in hopes of a better life because of the lack of proper job opportunities.

New fears surface every day over the debt-burdened Italian economy as European policy makers struggle to prevent the escalation of the crisis in the Eurozone’s third largest economy. The Italian government tries to move decisively in order to get its finances in order and implement necessary regulatory reforms. Despite the efforts though, Italy’s economy unfortunately seems to be sliding much deeper into recession. Recently, the Italian business confidence has been constantly falling, as financial experts and company executives are increasingly pessimistic over the country’s economic prospects and expect the recession to worsen in the near future.\textsuperscript{163}

In a nutshell and despite the obvious problems, the Italian case seems a bit less crucial compared to the Irish or Spanish one. This happens for two reasons which mainly have to do with the Italian banks and industries. Firstly, one important element that has managed so far to save itself from the unprecedented mess is the Italian banking sector. As a matter of fact, the Italian banks have not been as badly affected by the sub-prime crisis as the banks in other weak Eurozone economies. Secondly, another element that makes significant difference is the developed productive industrial sector that Italy has at its disposal. Without doubt, Italian industries are very developed and competitive compared to the Spanish or Greek ones, characterised by high quality and craftsmanship and reinforced by a workforce of many million people.

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\textsuperscript{162}Italy's Leader Unveils Radical Austerity Measures, Rachel Donadio, The New York Times, December 4 2011


\textsuperscript{163}Italian economy contracts 0.7% in second quarter, BBC News Business, 7 August 2012

\textsuperscript{164}Italy Industry Sectors, Italy Industries, Economy Watch 24 March 2010

http://www.economywatch.com/world_economy/italy/industry-sector-industries.html
5.4 CONCLUSION

The negative financial occurrences in Greece, Ireland and Portugal have had severe impacts on other Eurozone members as well. The financial problems that started in certain economies in 2009 spread to others quickly and by 2011 had become a phenomenon that concerned the whole European continent. This made automatically the crisis a broader and more worrying reality that needed very well-coordinated initiatives in order to be eliminated. The Euro countries that first experienced the financial contagion were Spain and Italy which saw their economies being badly influenced by the general downturn.

At this point it is worth mentioning that in 2013 one more EU member state felt the extended financial contagion. This was Cyprus which suddenly started experiencing an acute crisis that mainly affected its banking sector. The question nowadays is whether Spain, Italy, Cyprus and all the member states that are plagued by contagion will find a way to face it. As a matter of fact, the European policy makers have many issues to solve as they should not care only about how Greece or Ireland will be saved but about how the crisis will not spread to more Eurozone economies as well. In this sense, responses and solutions with regard to why and how the crisis has emerged, evolved and spread are in 2013 more than necessary.
CHAPTER 6

RESPONSES AND SOLUTIONS TO THE EUROZONE CRISIS

Since 2010 numerous ambitious ideas and responses related to the overcome of the Eurozone crisis have made their appearance. They have been mainly expressed through innovative national or EU recovery and support plans as well as through new measures and regulations.

Regarding the national level, the weak Eurozone sovereign member states have in most of the cases responded to the crisis with strict public deficit reduction policies. These policies have been aimed at stabilizing national economic performances by bringing expenditures in line with revenues, thus diminishing the member states’ public debt.

Regarding the European level on the other hand, the EU as a supranational entity has mainly responded to the critical situation with ambitious initiatives such as the creation of economic stabilization mechanisms. These initiatives have been aimed at restoring confidence in the Eurozone as a whole as well as preventing the collapse of the entity’s national economies.

The European initiatives have not always been well coordinated as they have been the compromise results between many different member states’ opinions and priorities. As a matter of fact, the creation of the various anti-crisis EU bodies has taken place after hard “battles” among the member states, which have always tried to promote their own ideas and interests. Moreover and as explained below, the

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European initiatives aimed at tackling the crisis have been seen by many as too little and especially too late.

In spite of the critiques, the new ideas and responses, either national or European ones, have to some extent ameliorated the situation. Nevertheless, they need to be more swift and decisive, otherwise instead of successful and promising initiatives, they will just be desperate actions which will lead to undesirable results and even further economic deterioration. Without doubt, ambitious, bold and well-targeted actions are necessary if Europe wants to return to sane and prosperous economic conditions.

6.1 NATIONAL RESPONSES

The Eurozone member states and especially those fiercely hit by the sovereign debt crisis have since 2010 responded to the critical situation with measures and regulations aimed at a fast and urgent repair of their financing systems. The difficult task of this repair foresees the promotion of effective investment and employment programs as well as the implementation of realistic fiscal plans.

The responses to the crisis have in most of the cases been translated to a shift towards a new reality that includes stricter regulations combined with tighter fiscal policies. This new reality has raised questions and has been criticized as highly unable to lead to higher investment levels in the national markets that could boost problematic countries’ real economies. Nevertheless, at the moment it seems one of the few feasible ways out.

On the one hand, stricter regulations seem necessary when a weak economy wants to attract investments, remove its banks’ burden and protect itself against further shocks. On the other hand, tighter fiscal policies seem necessary as well as they augment public income thus reducing debts and leading to profitable economic activity. In this sense, the coexistence of strict regulations and tight policies looks like an inevitable situation for the countries that need significant amelioration through

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167 The case against austerity today (The political case for austerity today pg. 4-5) Simon Wren-Lewis, Discussion paper of the institute for public policy research, October 2011
radical economic reforms. As a matter of fact, the shift to such a situation has since 2010 been the case in all weak Eurozone economies.

In the in debt economies of the Eurozone entity for instance, the governments have in the recent past implemented austerity measures in order to regain their fiscal balance. In parallel, structural reforms have been made aimed at enforcing the effectiveness of regulations of the past and improving growth prospects, employment opportunities and competitiveness.\(^{168}\)

6.1.1. GREECE

In Greece, the reforms have been mainly translated into ambitious goals that could only be achieved through numerous optimistic plans. A huge project of privatizations, a fight against black market, tax evasion and generally corruption as well as innovative business plans are some parts of this ambitious planning ahead.

Regarding privatizations in Greece, this has been a wide ranging programme that has included numerous public holdings such as rail and road transport, ports, airports and real estate. The efforts have been mainly focused on public openings to strategic investors, on extended public-private partnerships and on the establishment of new private holding companies. In more specific terms, the aim has been a privatization package that would hopefully result in more sustainable debt levels by 2015. Within these privatizations’ optimistic aim all private creditors who had Greek public bonds in their possession were obliged to accept lower interest rates and significant face value losses.\(^{169}\)

Privatisations have been a key part of Greek efforts to pay down debt and return from the verge of bankruptcy. As a matter of fact, they have often created tension and led to fierce disagreements. The first tension was the one created between the national policy makers and Greece’s international lenders with regard to whether the implemented strategies would eventually work or not. The second one was the

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\(^{168}\) Economic crisis in Europe: Causes, Consequences and Responses (Part 2.4 Structural Policies pg. 71) European Commission’s Economic and Financial Affairs, Luxembourg, 2009

massive resistance from Greek citizens worried about selling off some the nation's most important assets.\(^\text{170}\)

The tension between Greece and its lenders has been a result of the lack of progress that mainly derives from the reluctance of Greek governments to sell and the political instability in the country. Under the terms of its bailout agreement, Greece was obliged to raise 19 billion Euros by the end of 2015 and around 50 billion euros by 2020 under its asset sale program. Despite the clear rules though, the country has already missed several revenue targets, having raised only about 1.6 billion euros in cash since 2010.\(^\text{171}\)

With regard to the black market’s problem, the Greek governments have recently made a huge effort to tackle tax evasion and improve the country’s ineffective taxing system. This effort has been of significant importance as Greece holds a negative record with regard to black market levels in Europe with approximately 20bn Euro of unpaid taxes every year. An effective tax collecting system has nowadays become a necessity but in spite of the efforts the increase in public revenues has not been rapidly and sufficiently implemented so far. There has been progress but the process is slow as Greeks keep avoiding taxes and underreport their earnings to a large extent.\(^\text{172}\)

Regarding general corruption, the governments have repeatedly in the last years tried to put an end to the bribery system that characterizes transactions and cash donations in Greece. Bribes have been traditionally taking place vastly, either by individuals or by companies towards public institutions with the aim of avoiding bureaucratic obligations or gaining certain benefits. Progress has been made in this field as well; the problem though is far from completely solved.

\(^{170}\) *Desperate Bid to Cut Deficit: Greek Privatization Plan Faces Massive Domestic Resistance*, Manfred Ertel, Spiegel Online International, 7 June 2011


\(^{171}\) *Greece prepares second wave of privatizations*, Reuters, October 16 2012

http://www.reuters.com/article/2012/10/16/us-greece-privatisations-idUSBRE89FOEC20121016


http://www.asecu.gr/Seeje/issue06/katsios.pdf
With regard to new business plans and ideas, Greece has since 2011 taken successful initiatives and shown significant improvement. The critical situation has indeed obliged the country to make a step forward by implementing regulatory business reforms in several different subfields. More specifically, the governments have implemented new regulations by introducing fresh ideas, elements and limitations. In 2011 for instance, George Papandreou’s government decided to significantly reduce limits with regard to the processes of construction permits by imposing new strict regulations regarding the permit applications. \(^{173}\)

This was just the first business alteration as one year later, the following Greek governments made even bigger steps. Firstly, they strengthened their relations with investors by protecting them through greater disclosure of all material transactions. Secondly, they increased their insolvency process by putting an end to the conciliation procedures of the recent past and replacing them with new rehabilitation ones.

6.1.2 IRELAND

In Ireland, the reforms have been mostly related to the banks as this is the sector in which the crisis in the country has been very severe. These reforms have included extended nationalization and capitalization plans, new agreements as well as creation of technical auxiliary bodies responsible for ameliorating the situation.

Regarding the nationalization plans, several different actions have taken place, the most important of them being the nationalization of the prominent bank named Anglo Irish Bank. This institution, which has since 2008 been badly affected by the crisis, remains even today associated with negative international references as well as with huge domestic failings. The nationalization took place in 2009 because of the serious and insolvable Anglo Irish Bank’s problems. The main one was actually the fact that the bank was heavily exposed to property lending with the biggest part of its loans belonging to property developers. This was catastrophic for the institution mainly due to the general downturn of the property market in Ireland. \(^{174}\)

\(^{173}\) The economic adjustment programme for Greece (Chapter 4.3: Growth enhancing structural reforms pg. 39-40, 42-43) European Commission’s Economic and Financial Affairs, Brussels, July 2011

\(^{174}\) Ireland’s banks get failing grades, David Enrich, The Wall Street journal, 1 April 2011

http://online.wsj.com/article/SB10001424052748703806304576234180828120692.html
With regard to the ambitious capitalization projects that occurred, in 2008 the Irish Ministry of finance decided to recapitalize the country’s biggest banks. These extended projects included cash injections to the banks through bailouts as part of the generous governmental capitalization aid packages. The banks that desperately needed capital injections were the Bank of Ireland (BoI) and the Allied Irish Bank (AIB). In specific numbers, BoI received an external recovery package of 5,2bn Euro while AIB a 3,5bn Euro aid. All these capitalization actions resulted in a slight amelioration of the banking sector of Ireland as after the government’s help, the banks are expected to return quite soon to profitability. 175

Regarding the implementation of new agreements, in 2010 the Irish government in collaboration with several public unions put into force the Croke Park Agreement (CPA) which took its name from the conference facilities in Dublin where the agreement was actually signed. Hopes for a new more flexible economy with increased productivity were immediately created. The CPA was signed because of the great discontent among Irish citizens deriving from the huge pay cuts mainly on public sector workers. With the agreement, the Irish state agreed not to impose further pay cuts while the public unions agreed to cooperate on public reforms without calling industrial action. The results were impressive as in 2010 signs of financial flexibility and efficiency did undoubtedly appear. 176

With regard to new auxiliary bodies, the main Irish government’s initiative was called NAMA. As already explained briefly in chapter four, this new body was a national response to the deteriorating financial crisis in Ireland aimed at improving the credit availability in the country’s economy. NAMA, which covered several Irish financial institutions including all those banks that were hardly hit by the crisis, was since the beginning an undoubtedly broad and rather controversial idea. As a matter of fact, it faced harsh critique based on the argument that the only thing the government

could accomplish with NAMA was to dissipate money without clear recovery strategy for the banks. 177

6.1.3 PORTUGAL

In Portugal, the reforms have primarily taken the form of horizontal austerity measures and radical structural alterations. During the critical years, the Portuguese governments have pushed through extended austerity packages as well as huge reforms in order to render companies competitive again and get their economy back on track.

Regarding the austerity measures, those started in 2009 through slight cuts in salaries and unemployment benefits but very soon became extremely harsh packages that included servants’ salary cuts and generous tax hikes. This happened when in 2010 Lisbon’s economy entered a period of deep recession and when the debt’s mountain grew dangerously.

With regard to structural reforms, in 2010 privatizations of state-owned enterprises started taking place as well. Portugal needed desperately to privatize public businesses in order to be able to comply with the goals set out with its bailout agreement. In details, the governments were forced to sell energy and electricity companies, the national airline called TAP as well as the public broadcaster and the railway enterprise. 178

6.1.4 DIFFERENT REACTIONS AND EXPECTATIONS

In general, all weak Eurozone economies have responded to the crisis with extended and ambitious plans which have created hopes that the current financial nightmare will soon belong to the past. As explained above, every case has without doubt been unique as each country has gone through different problems, has faced different obstacles and has seen much different results.

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177 The National Asset Management Agency: A brief guide, 30 March 2010

178 Portugal’s response to the Euro Area Crisis: fiscal consolidation and structural reform, Interview with Portugal’s Minister of Finance, Vitor Gaspar, Chatham House, 5 December 2011
http://www.chathamhouse.org/sites/default/files/public/Meetings/Meeting%20Transcripts/051211gaspar.pdf
Greece for instance has been forced to adjust to much more difficult changes compared to what has taken place in other weak Eurozone economies. The obstacles have been big and the sacrifices of Greek people even bigger. At the same time, the goals have been formed differently as well leading to both positive and negative reactions and expectations.

As a matter of fact, the results of all these efforts in Greece have primarily led to a strong international acknowledgment that the country has implemented in a satisfactory manner a wide ranging set of reforms. Especially after the defrayment of the last bailout’s disbursements, the international community has started being positive and optimistic towards Greece again. In specific terms, the ambitious expectations include firstly the target of a primary surplus of 4.5% of GDP by 2016 and secondly the aim of sustainable public debt levels of around 120% of GDP by the end of the decade. If Greece in the near future manages to fully comply with the further necessary requirements of the adjustment programme, all these objectives will sooner or later become true.  

Despite the positive reactions though, the Greek efforts have also provoked dissatisfaction as the progress has sometimes been slow and not enough. As a matter of fact, during the critical years many skirmishes have made their appearance resulting in hard relations and huge disagreements between Greece and its foreign lenders. It is worth mentioning for instance that the Troika has repeatedly in the recent past expressed its uncertainty with regard to Greece’s capability to keep to the deficit reduction plan agreed and thus ameliorate its situation.

The troika’s gloomy assessments over Greece’s performance during the crisis have raised fears over a potential Greek exit from the single currency as well as a growing rift between Athens and other European capitals. In more detail, many of the tripartite committee’s members have stated that Greece remains hugely off track and that the debt-sustainability analysis will keep being pretty terrible. This undoubtedly proves that the Greek reforms instead of acknowledgment and satisfaction have also caused disruption and unpleasantness.

179 Eurogroup statement on Greece, 27 November 2012. 

180 Ticking off by Troika heightens fears of Greek exit from Euro,
Ireland on the other hand, has gone through smoother changes which as mentioned above have mainly concerned its banking sector. These changes have in 2013 resulted in an unexpectedly fast recovery especially regarding the Irish exports which have brought back the competitiveness that was lost during the critical bubble years.

When Ireland was some years ago standing at the edge of a precipice, few analysts could imagine that confidence would return relatively soon. The enormous efforts that have been made have indeed resulted in a better functioning financial sector, a positive turnaround in investors’ sentiment and a significant return to growth. With the international partners’ solidarity and the implementation of more structural changes, Ireland can feel confident that will soon be able to leave recession behind. 181

Portugal finally, has been forced to face the necessity of harsh measures and structural changes as well. The well-coordinated Portuguese reform packages, though, are in 2013 expected to create job opportunities, balance the public budget and push growth by raising the country’s international competitiveness. In a few words, if Portugal continues the efforts, it will soon be in a good light and regain international trust once again.

To sum up the national responses, these have been swift and effective so far despite the existing difficulties mainly in Greece. They have created optimism even if the prospects for further growth remain limited due to the not so favorable global outlook. Throughout their entire course, these national responses have been accompanied by responses in a European level whose importance has been crucial as well.

http://www.guardian.co.uk/business/2012/jul/24/greek-exit-from-euro-fears-heighten

181 There’s light at the end of the tunnel for Ireland, Olli Rehn (Vice-President of the European Commission), 25 November 2012
6.2 EUROPEAN RESPONSES

The European Union has since the beginning of the crisis reacted with coordinated and decisive actions aimed at stimulating the confidence among its member states. Since the countries of the Eurozone have very few monetary policy choices, such supranational actions seem a necessity responsible for getting the whole entity’s economy back on track.

The fact for instance that the Eurozone economies are not in the position to print money in their own currencies in order to pay back their debt holders, means that initiatives in a European level are absolutely needful. These initiatives that since 2008 have been taking place at a fast pace, have created hopes for a future without instability, uncertainty and underproduction.

The European initiatives have mainly taken the form of new EU mechanisms and bodies as well as new regulations proposed mostly by the European Central Bank (ECB). Additionally, they have taken the form of more independent reactions that have led to various decisions and agreements along the course of the critical phenomenon. Regarding the new bodies and mechanisms responsible for tackling the crisis, these have been quite many so far. They started in 2008 with the “identifier” European Economic Recovery Plan (EERP) and continued with much more ambitious and complicated plans along the way.

The EERP was a European Commission’s proposal of 2008 responsible for reducing the catastrophic effects of the global financial crisis on the Eurozone economies. Its initial aim was the prevention of the economic slowdown through new policies and measures over a two years period. It combined short-term with longer-term plans. The first ones included efforts to bolster demand and save jobs as well as EU small and large businesses. The second ones included ambitious attempts of investments in new innovative strategic sectors aimed at restoring the lost prosperity.

It was the first initiative and it entered into force when the Eurozone crisis was still a limited phenomenon. This means that it was not strong enough to face the new much more severe and worrying dimensions of the crisis that emerged after 2009. As a matter of fact, it was a rather broad conception that never included a specific planning ahead with concrete projects and ideas. However, it remains a recovery plan of significant importance as it made a promising start that inspired the numerous European mechanisms that followed.

The European Financial Stability Facility (EFSF) was the next attempt aimed at ameliorating the Eurozone’s financial situation. It was a special body agreed on in May 2010 with the clear objective of providing financial help to all those Eurozone states in need. The EFSF was without doubt an innovative creation as its main function was the issue of bonds that could increase the capital needed to provide loans to the member states with financial difficulties.

The new special body’s capacity to publish debt instruments rendered it automatically able to buy sovereign debt and recapitalize banks. This created hopes that the EFSF could make a significant contribution to certain economies’ financial relief. It did indeed contribute to a large extent to the rescue packages offered to the countries in need as it offered 18bn Euros to Ireland and around 5bn Euros to Portugal. 183

In spite of its undoubtedly useful contribution, the EFSF had since the beginning fierce opponents as well. The critiques mainly came from member states which were initially reluctant to consign extended jurisdiction to supranational bodies. This happened because the idea of a European mechanism with tasks and responsibilities that were clearly intervening with national jurisdictions was something new. Thus, it created mistrust among the member states which started feeling that they were slightly losing a part of their sovereignty.

This mistrust went partly away in January 2011 when the European Financial Stabilization Mechanism (EFSM) came to complete and ameliorate the EFSF. At that point the weak Eurozone economies started realizing that the rendition of some

183 European Financial Stability Facility (EFSF) (Sections A, B, D, F, G), 27 November 2012
jurisdiction to new supranational entities was more than necessary. In this respect, the
EFSM is until today considered the initiative that changed Eurozone citizens’
perspective towards the necessary existence of international lending institutions.

The new mechanism was actually an EFSF’s sequel that corrected its
ancestor’s weaknesses. Its tasks and competences were not something new as it was
one more body with the capacity to provide loans with the funds it had in its
possession. The important difference though was laying in the fact that the EFSM’s
loans were more coordinated actions with much more specific and rational goals. 184

In more detail, the new European body has provided by 2013 Portugal with
loans of approximately 26bn Euros and Ireland with loans of something more than
22bn Euros until 2014. These loans have been activated under requests and after
agreements between the Commission and the member states based on strict
conditionality and concrete adjustment programs.

Despite the initial reluctance and mistrust, the two funding programs, EFSF
and EFSM have played an extremely important role in the confrontation of the crisis
as they keep providing necessary assistance to the countries in need. It is not an
exaggeration to say that they have created a wide safety net that has boosted
confidence and hope. Finally, in October 2012 they were both replaced by the
European Stability Mechanism (ESM), the most recent of the numerous EU bodies.

The ESM was an attempt to combine the ideas and objectives expressed
through all the previous initiatives. It created hopes that it would be the final outcome
of the EU’s continuous and difficult efforts to form a well-structured supranational
entity that could tackle the crisis. The new body encapsulated the EFSF’s and EFSM’s
powers in a more permanent resolution mechanism. This does not mean, though, that
the previous bodies ceased to exist as they have ongoing agreements and obligations
with member states until 2014.

In a few words, the ESM’s main task was once again the issue of bonds on the
financial markets aimed at raising the capital that could be provided as assistance to
the weak Eurozone member states. Its main difference from the previous bodies was

184 The European Financial Stabilization Mechanism (EFSM) [Chapters 1,2 pg. 2,4], Gavin Thompson,
the fact that it was based upon an already subscribed capital and not upon guarantees coming directly from the Eurozone members. This subscribed capital, available for immediate use, has been estimated in 500bn Euros. \textsuperscript{185}

The new mechanism is from 2012 onwards expected to be the one and only organization responsible for covering Eurozone member states’ bailout applications. It is also expected to monitor and provide guidance regarding the rescue packages that have already been agreed by the previous EU bodies. The ESM’s financial assistance can be activated only upon requests and is always provided subject to strict conditionality. This assistance has so far taken the form of loans to Euro area member states mostly for recapitalization reasons as well as the form of interventions in their debt markets.

Until today, the ESM is without doubt the most complete EU mechanism that offers substantial help and advantages to all participants. Its ability to react efficiently and fast in order to support financially the countries in difficulty lies primarily in two things; firstly in the fact that the mechanism possesses significantly robust resources and secondly in the fact that it rejoices an enhanced governance structure. \textsuperscript{186}

All the bodies created by the EU, starting from the general EERP and culminating in the well-targeted ESM have from 2008 onwards made a remarkable contribution to the confrontation of the critical situation. In this challenging objective, they have not been on their own, as besides the EU, the ECB has come forward with ambitious initiatives as well.

With regard to the ECB, it has since 2010 proposed regulations and taken measures aimed at fostering liquidity and limiting volatility. Its actions have been swift and on a large scale so far as it is an institution completely dependent on the existence of the common currency. In this sense, it has the incentive to act carefully but at the same time decisively and fast.

Some time ago, Mario Draghi, the President of the European Central Bank, has stated that the ECB is ready to do "whatever it takes" in order to protect the

\textsuperscript{185} The European Stability Mechanism (Chapter 2 pg 74-78) European Central Bank, Monthly Bulletin, July 2011 \url{http://www.ecb.int/pub/pdf/other/art2_mb201107en_pp71-84en.pdf}

\textsuperscript{186} The European Stability Mechanism (Abstract and Chapter 3 pg. 71,8) European Central Bank, Monthly Bulletin, July 2011
common currency from collapse and tackle the crisis even if this requires fighting against unreasonably high government borrowing costs. The President’s speech proves the Bank’s strong commitment as well as its fundamental role in the confrontation of the critical phenomenon. According to Draghi, the ECB has enough power to preserve the common currency which is highly irreversible. 187

In the beginning of the Eurozone crisis, the ECB commenced open market operations by purchasing both public and private debt. This way it reached a significant amount in capital which discharged some national economies. The fears of high inflation that were immediately created ceased to exist when the bank absorbed the same amount of its capital accumulation in order to prevent such an unwanted rise. 188

With the capital that the ECB has in its possession, it has provided European banks with funds, thus subsidizing them in an unprecedented way. It has also offered to the global financial markets additional liquidity aimed at putting an end to the crisis and supporting strongly the real economy. These have been ways of relieving the suffering banks and the vulnerable sovereign states.

In December 2011 the bank initiated the largest infusion of credit in the common currency’s history. It loaned 489bn Euro at a rate of only one percent to more than 500 banks mostly in Ireland, Greece, Spain and Italy. This way many banks found enough capital to pay off their own debts, something that allowed them to continue loaning to businesses and start operating healthily once again. 189

According to several analysts, the European Central Bank’s most ambitious and promising actions have been focused on Greece. Regarding the Greek case, the bank has changed some of its basic policies on the credit ratings that are necessary for loan deposits. Specifically, it has decided to accept all debt instruments issued by

187 Debt crisis: Mario Draghi pledges to do ‘whatever it takes’ to save euro, Jamie Dunclay, The Telegraph, 26 July 2012  

188 The role of the European Central Bank in the financial crash and the crisis of the Euro-zone (pg 4-5)  

189 Banks set to double crisis loans from ECB, Patrick Jenkins and David Oakley (London) and Ralph Atkins (Frankfurt), January 30 2012  
http://www.ft.com/intl/cms/s/0/09ab9542-4b6d-11e1-b980-00144feabdc0.html#axzz2ExhOAO9U
Greece, regardless the country’s problematic credit rating. This has removed some pressure from the Greek bonds which have in the recent years been repeatedly downgraded to junk status.

The ECB’s president Mario Draghi is considered the one who has put in motion most of the bank’s recent crisis-related actions. The newly expanded role that the institution has been recently playing must according to him continue expanding even more. In one of his most dynamic speeches, Draghi referred briefly but clearly to what the ECB has achieved so far and to which its future goals should be.190

The speech praised the decisions that the European Central Bank has taken so far in an attempt to prove the institution’s significant contribution and prepare the member states for more actions. In details, Mario Draghi highlighted that the bank has reduced the interest rate by 25 points and cut the reserve ratio’s minimum limit from 2% to 1%. He also referred to the future steps by announcing long-term operations that for the first time will last more than three years.

The ECB’s initiatives in general have completed perfectly all the mechanisms created by the EU itself. In spite of the critiques coming mostly from the huge Eurozone financiers, like Germany, these initiatives have significantly reduced the burden of most of the weak Eurozone economies and contributed to the Eurozone’s slight financial amelioration. They have been accompanied by some independent decisions and ideas as well, the most important of which have been the Greek government debt’s 50% write-off and the speculations over a possible Eurobonds introduction.191

Regarding the 50% write-off, in October 2011 in an emergency summit in Brussels, the European banks agreed to halve Greece’s debt. The agreement was followed by the private investors’ fierce reactions, who immediately expressed their huge dissatisfaction. Their dissatisfaction was eventually sweetened by the EU promise to provide them with 30bn Euros aimed at covering all their losses. This

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190 Interview between Mario Draghi, European Central Bank president, and Lionel Barber, Financial Times editor, and Ralph Atkins, Frankfurt bureau chief, December 18 2011 http://www.ft.com/intl/cms/s/0/25d553ec-2972-11e1-a066-00144feabdc0.html#axzz2ExhOAO9U
money came partly from the EFSF and partly from the Greek government’s privatization attempts.

The decision to cut Greece’s debt in the middle is so far considered one of the most decisive actions that will hopefully bring the country’s debt level back to viable levels, meaning less than 120% of GDP by 2020. EU Commission President Barroso has described it as a solid way forward that will put an end to the speculations over a Greek default and that will create growth prospects in Greece in the long-term perspective. 192

With regard to the Eurobonds, these were first suggested as a possible way out of the crisis in November 2011. They have been an innovative and challenging EU idea that promotes the introduction of bonds in Euro jointly issued by all Eurozone member states. According to their visualizers, the Eurobonds are investments of a specific amount of Euro loaned for an exact period of time to the Eurozone entity as a whole. Their aim is to be eventually forwarded to the governments in need. This way, these governments will be able to receive funds at much more preferable conditions compared to the recent past as they will backed by the ratings of the healthier economies. 193

The Eurobonds’ conception does undoubtedly sound as a very promising one but at the same time conceals unavoidable risks. As a matter of fact, it has raised unprecedented questions within the Eurozone related to whether it can really tackle the current critical situation. Its controversial nature lays mostly in the fact that it allows weak Eurozone nations to have access to cheap credit thanks to other more stable and powerful economies.

This has created two different strands in the Eurozone as the weak economies of the European south want the Eurobonds while the stronger economies of north Europe do not. Greece and Spain for instance have repeatedly tried to persuade the European policy makers to make steps forward while Germany and Finland have on

the other hand repeatedly expressed their intense skepticism. The near future will actually show if these differences will be eliminated or if the Eurobonds will never get adopted after all. 194

At this point it is worth mentioning the idea of an integrated European Banking Union (EBA). In 2012 the European Commission introduced a set of proposals aimed at strengthening the European Monetary Union and thus ending the crisis. These proposals cede powers for the supervision of all banks in the Eurozone to the ECB and national supervisory authorities. Their provisions foresee several steps starting from the so-called Single Supervisory Mechanism (SSM), continuing with the single rulebook and the common deposit protection and culminating in the complete banking union of the Euro area. 195

The EBA has been a proposal of fundamental importance in Brussels since 2012 as it is considered a remedy of the ongoing critical situation. It is expected to put an end to the great risks in the euro area mainly related to the cross-border spill-over effects during bank crises. According to most of the EU policy makers, a move to an integrated banking system is needful in order to stabilise the Euro and boost the weak Eurozone economies. 196 Despite the promising announcements though, the EBA’s implications are very often considered very worrying as well.

As a matter of fact, the banking union has created controversy as many reckon that the EU cannot rely on it in order to solve the crisis. The critiques claim that it is a very future-oriented proposal that cannot help the current banking Eurozone problems. 197 They also strongly support that a potential centralization of more than 6000 banks will heavily undermine national sovereignty. Regarding this problem, several member states have expressed different concerns as they do not agree on how

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the banking union should finally work. Germany for example does not want coverage of its savings, something that other countries would definitely consider unfair.  

In spite of the criticism though, the integrated banking union constitutes an important Commission’s proposal aimed at making sure that the single market rules are applied in a consistent manner. Its efficacy in tackling the crisis is something that has not been proved yet but its significance as the most recent EU integration attempt remains undoubtedly strong.

To put the European responses in a nutshell, these have been in most of the cases positive and well-coordinated actions. The EU, ECB and other initiatives have without doubt created hope even if there are still many fundamental steps to be made. In these efforts, they have not been on their own as besides the national initiatives explained above; they have been assisted by global initiatives as well. These have mainly originated from the International Monetary Fund.

**6.3 GLOBAL RESPONSES: THE IMF’s ACTIONS**

The current Eurozone crisis has not been a serious issue only for the badly affected member states of the Euro area or the EU itself. It has also been of significant importance for global organizations which have repeatedly in the recent past sought to put an end to the critical situation. Of these organisations, the most active one has without doubt been the historical International Monetary Fund.

The IMF was created in 1945 after the Bretton Woods Conference  with the aim to ensure financial stability, promote monetary cooperation, decrease poverty and lead to sustainable economic growth around the world. Its universal character and importance are indisputable as it is a supranational entity composed of 188 countries, almost all sovereign states of today’s international community.

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199 Bretton Woods Conference: a meeting that took place in New Hampshire, USA aimed at regulating the international financial and monetary order after World War II.

200 International Monetary Fund (official site): Overview: What we do, how we do it and membership - consulted on 15 December 2012- [http://www.imf.org/external/about/overview.htm](http://www.imf.org/external/about/overview.htm)
In its attempt to provide financial advice and assistance to countries with economic difficulties, the IMF has been involved in plenty of big or small financial crises around the globe. In 1973 it contributed to the confrontation of the unprecedented oil price shocks while in the 1980s it faced successfully the huge Latin American debt crisis. Additionally, in 1997 it managed to offer decisive help to the Eastern Asian countries that were almost devastated by the wave of financial crises there. 201

Until the eruption of the Eurozone crisis, the biggest part of the Fund’s rescue packages was focused on developing countries with limited influence in the global finance. In 2009 this changed as the crisis in the Euro area was a case that concerned western developed economies with bigger and potentially more dangerous impact on the world’s economy. It was something that the IMF had never faced before.

For this reason and in order to be able to adjust to the new reality and provide the Eurozone member states with the necessary financial resources, the Fund went through several reforms and augmented significantly its lending capacity to approximately $750bn. The requests mainly came from the in debt Eurozone member states such as Greece, Ireland and Portugal which since 2010 have asked the IMF for direct funds. In addition to that, Spain and Italy have recently demanded financial surveillance and monitoring. 202

Regarding Greece, the IMF has played an important role in the successful course of the country’s bailout programs. In 2010 the Fund initially asked for radical structural and fiscal changes in exchange for its funding. After that it became responsible for overseeing and monitoring the implementation of these necessary changes.

In more detail, in May 2010 the International Monetary Fund provided Greece with 30bn Euro, an amount that corresponded almost to 25% of the country’s first

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201 The International Monetary Fund and World Bank (pg 954-956), Ngaire Woods, International Relations Journal (volume 62)

bailout programme. In February 2012 it contributed to the second rescue package to Greece by offering approximately 28bn Euro, meaning more or less 20% of the package this time.

The Fund has repeatedly in the last years pushed the EU leaders to lighten the burden that the rescue packages have created in Greece. According to the IMF the Greek bailout programs must be lenient if they want to meet their targets and keep the country’s economy on track. As a part of this lenient approach, the IMF has pressed Greece’s international lenders to delete some of the debt that the country owes them. In this sense, the International Monetary Fund has been one of the main forwarders of the 50% writing off of the Greek debt that took place in October 2011.

The EU and especially those member states that are huge financiers have reacted intensely to the IMF’s lenient approach regarding the confrontation of the Greek crisis. The German government for instance has expressed its fierce objections as it has already lent billions of Euros to Greece that need to be taken back. These billions are the main reason why the Germans are so adamant regarding further concessions to Greece.

Additionally, the IMF has been one of the most optimistic entities with regard to whether the Greek debt will reach sustainable levels soon or not. The Fund’s current president, Christine Lagarde has expressed her conviction that the country’s debt will close to sustainable levels, meaning less than 129% of the GDP, by 2020. This conviction has created intense reactions as well.

The reactions have once again come from certain EU countries which disagree with the Fund and do not share the belief that Greece’s debt can return to sustainable

205 Eurozone leaders agree to write off 50% of Greek debt. France 24 International News, last updated: 31/10/2011
206 Christine Lagarde: the managing director of the IMF since July 2011. She has held many ministerial posts in the government of France such as Minister Agriculture and Fishing as well as Minister of Economic Affairs, Finances and Industry.
levels so soon. The disagreements between the EU and the IMF with regard to the Greek debt levels have created tensions and serious concerns during the course of the crisis. Since November 2012 though, the tensions have been tranquillized after an agreement which managed to set up a realistic goal; Greece should decrease its debt to a 124% of GDP in 2020 and to the sustainable levels of 110% by 2022.  

In general, the International Monetary Fund has been involved in the Greek sovereign debt crisis to a very large extent, significantly more than in any other country in the recent past. Apart from the fact that its dissension with the EU in many crucial questions related to the Greek case has led to temporary fears and stalemates, its fundamental role towards a more stable and viable Greek economy remains indisputable.

With regard to Ireland and Portugal, the IMF has offered support, guidance and help to these countries as well. As a matter of fact, its active participation in the Irish and Portuguese bailouts started in 2010 and has been translated into generous funding for both member states so far.

In Ireland, the Fund has boosted the country’s optimism as it has urged the Irish authorities to use their bailout funds properly in order to make direct investments in their international lenders. In terms of numbers, the IMF has offered Ireland 22.5bn Euro which has approximately been 25% of the country’s total rescue package. In Portugal, the Fund has in addition to its generous assistance, warned over the necessity of tough policy choices that will close the country’s large fiscal gap in the near future. In terms of numbers, it has provided Portugal with 26bn Euro, meaning one third of the country’s whole bailout funding.

The IMF’s involvement in Ireland and Portugal might not have been as extended as in Greece but still remains a considerably big intervention of significant importance. In both these weak Eurozone economies the Fund has through its

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surveillance, achieved to keep track of their financial health, alerting them to potential risks and providing them with extremely useful policy advice.

Regarding Spain and Italy, the International Monetary Fund has been involved in their economies as well but through an indirect and subtle supervision. It has not, at least not yet, intervened in terms of providing direct funding. The reasons why the Spanish and Italians have not received such funding are mainly two.

The first reason is the fact that Spain and Italy have not such an excessive deficit compared to Greece, Ireland and Portugal. The second one is that the IMF does not have the resources to offer funding to such big economies as the Spanish and Italian one. These two reasons have so far allowed the Spanish and Italians to focus only on their national reforms and measures in order to tackle the crisis and avoid the request for funding from international lenders.

There are fears and concerns, though, that firstly Spain and subsequently Italy will inevitably need to ask for funding relatively soon. This scenario has created alarms in the Eurozone and mostly in the IMF itself. Christine Lagarde has repeatedly stated in her recent speeches that the Fund will do whatever possible to help the Spanish and Italians avoid rescue packages. According to her, this is feasible through effective surveillance and strict monitoring of the two countries’ finances. 211

In the last three years, the International Monetary Fund has pledged more than 100bn Euro to Greece, Ireland and Portugal. This amount is much bigger than the funds the IMF offered to Latin America and Eastern Asia together some decades ago. As a result, its resources have since 2010 been significantly reduced making difficult for it to get involved in more rescue packages in the near future. Especially with cases such as the Spanish and Italian one, this difficulty becomes almost impossibility. 212

Spain is one of the biggest EU countries with a population around 50mn people as well as the fourth Eurozone economy in terms of GDP comparisons. According to speculations, the total amount of a Spanish rescue programme could reach the 300bn Euro. This proves how huge and devastating a bailout agreement with


212 The IMF and the euro crisis: Less cash, more impact, The Economist, 6 October 2012 (from the print edition) http://www.economist.com/node/21564254
Spain would be for the Eurozone as well as for the involved lenders. IMF spokesmen have recently pointed out that a Spanish rescue package could stretch the Fund’s resources to breaking point and raise serious questions and concerns about the future and the purpose of the Euro.  

Italy is an even more striking case as it is simply enough a country with an extremely high GDP per capita as well as a very developed financial infrastructure. It is considered a global economic power as it is member of the G8 industrialised nations. For these reasons, there is the shared belief in Europe that a potential Italian bailout would be a catastrophic initiative which would trigger the Eurozone’s end. According to IMF’s spokesmen neither the Fund itself, nor the Eurozone, could bear such a funding as the money is simply not there.

To sum up the International Monetary Fund’s actions aimed at assisting in the confrontation of the Eurozone crisis, these have since 2010 been unexpectedly intense and decisive. As a matter of fact, the Fund is in 2013 actively involved in the bailout packages of three Western European countries –Greece, Ireland and Portugal- as well as in the monitoring and overseeing of other two –Spain and Italy. Such a dynamic involvement is something that would have been completely unthinkable some years ago.

As a conclusion and in an attempt to have a complete overview of all the responses to the Eurozone crisis, either national, European or global ones, it is significantly important to state that all the efforts have been highly connected and intertwined. There has been an unprecedented level of coordination between the measures taken by the national governments, the initiatives of the EU and the ECB as well as the global IMF actions.

A characteristic example that proves this advanced and extended coordination is the term troika. This term was created in 2010 and describes the tripartite committee composed of the European Commission, the ECB and the IMF aimed at tackling the crisis. The troika encapsulates the biggest part of the actions aimed at

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http://online.wsj.com/article/SB10001424052702303552104577438362208356278.html
tackling the Euro crisis as it is charged with funding, monitoring and making recommendations on relative policies. Thus it wields a great amount of power.

6.4 CONCLUSION

To put the responses to the crisis in a nutshell, these demonstrate once again how perplexed the Eurozone crisis is. They also demonstrate the need of very well-coordinated and well-targeted actions that must derive from many different institutions in order to have the necessary effectiveness. National, European and global initiatives must be successful at the same time under a very strict and interdependent framework if they want to serve well the purpose they have been created for.

In general, the financial Euro crisis has demonstrated the need of a very well-coordinated and strong framework for crisis confrontation. Such a framework should include mechanisms able to avoid further damage and systemic defaults. Additionally, it should contain crisis resolution in order to lead the Eurozone’s weaknesses to an end while reducing the existing risks and securing the citizens’ protection. Last but not least, it should include crisis prevention in order to avoid a possible repeat in the near and distant future.
CONCLUSION

THE EUROZONE CRISIS AS A EUROPEAN PHENOMENON

All the above analysis, from chapter one to six, proves the complexity and uniqueness of the Eurozone crisis. The Treaty of Maastricht shows that the current recession has its roots back in the 1990s and that it is highly connected with some of the historical European integration steps. In addition to that, the analysis of the causes of the crisis proves that it is rather impossible to put the blame only on a certain nation as the critical phenomenon has emerged through a combination of global, European and national weaknesses. Last but not least, the possible solutions and responses to the current financial difficulties show that only a well-coordinated framework of actions and initiatives could get the Eurozone back on track.

On the top of all this, the previous six chapters give details on the significant and sometimes striking differences between the weak Eurozone member states by presenting separately how exactly the crisis emerged and evolved in their economies. Moreover, they offer clarifications regarding several crisis-related phenomena, such as the financial contagion which proves how interdependent the Eurozone countries have recently become. What these chapters do the most, though, is to provide the reader with a better understanding of how perplexed the current Euro crisis is and of how many different actors are involved in it.

These actors have been extremely diverse representing a very broad spectrum. It is not only national governments that have been involved in the Eurozone crisis but also plenty of European institutions and bodies as well as universal organizations. This proves that the crisis has undoubtedly been a multi-level phenomenon with national, European and global characteristics. In this sense, its causes as well as implications need to be examined through a broad and multi-level spectrum in order to make good and complete sense.
A crucial question that has emerged with regard to this multi-level examination of the Euro crisis is which of the three levels, national, European or global, is the most important one. Analysts have primarily sought to discover whether the characteristics of the crisis are more Greek and Portuguese or more European and universal. Additionally, they have tried to understand if the roots of the general recession can be traced more in national weaknesses rather than in European miscalculations. Finally, they have sought to find out whether the crisis’ implications are more dangerous for certain nations or for the broader European and global financial system. The answers are difficult as the limits are barely perceptible.

There have been theories that put the Eurozone crisis’ blame mainly in national economies and that consider the actions and decisions taken by certain Eurozone capitals as the primary causes of the general critical phenomenon. Some analysts claim that Greece must take almost full responsibility as it has cooked books and never really tried to reform its inefficient economy. The theories that accuse national entities focus on the processes of budget management and support that the public expenditures’ systems of certain economies lack the ability to track and assess the effectiveness of their spending.

Kevin Featherstone for instance has characterised Greece as a failing state that has been completely unable to overcome the huge endemic problems of low competitiveness, trade and investment imbalances as well as fiscal mismanagement. According to him, Greece’s political culture has been unique as the country has been unable to monitor its public expenditure and face the huge tax evasion. All this has created a state vulnerable to corruption with governments that have been accused in a series of scandals full of rent-seeking, clientelism and personal favors.

Other theories claim that the European Union is the responsible for maintaining and promoting a highly impossible system that cannot bear the real gravity of the unprecedented recession. The supporters of these theories blame the EU ineffective system and its structural mistakes of the recent past. All this has created an intense debate between those who simply enough believe that the crisis in Europe concerns only certain weak economies and those who think that it is a broader

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problem that derives directly from the EU’s inconsistencies. This thesis proves that the second point of view is more accurate as the historical roots and causes of the current situation lie mainly in European initiatives, decisions, expectations and mistakes.

In a few words, the ongoing Eurozone crisis is more a European phenomenon rather than a national one. This of course does not mean that the critical situation is necessarily and exclusively a European or a national phenomenon as it is too perplexed to be that easily categorized. As a matter of fact, the current crisis is a situation that combines many diverse characteristics including European and national ones.

The various different national particularities for instance have played a fundamental role in the development of the crisis. The unique banking difficulties in Ireland, the corruption problems in Greece and Portugal and the huge real estate bubble in Spain have without doubt formed the crisis as it is and constituted an important part of it. In this sense, the national sides of the crisis remain potent and indisputable even if they are of limited value compared to the European ones.

The European sides of the crisis can be traced in various stages of the Euro crisis’ evolution starting from the 1990s and culminating in the recent attempts to solve the phenomenon. Firstly it is the intense EU integration processes that from 1993 onwards have been the basis of what European citizens experience today. Secondly, it is the causes of the crisis as well as phenomena that occurred during its course. Lastly, it is the solving attempts that have been taking place at a very fast place in the last years.

7.1 UNSUCCESSFUL INTEGRATION

The intense integration processes and initiatives of the 1990s have changed the EU’s character significantly and led to the Union we know nowadays. Today’s highly interconnected EU framework, with its advantages and disadvantages, is a result of these processes which have always sought to create an extremely interdependent and multifunctional Union. In a few words, the treaties and agreements of the recent past
and the failure to respect them have been the main responsible for the numerous benefits as well as for the crucial problems that the EU citizens face nowadays.\footnote{Rethinking European Integration after the Debt Crisis, Professor Giandomenico Majone, European Institute, June 2012. http://www.ucl.ac.uk/european-institute/analysis-publications/publications/WP3.pdf}

In 2013 the EU citizens enjoy great benefits such as the free circulation of goods and services as well as the free movement within the Schengen area. These benefits are the positive results of the recent integration attempts to create a more livable and well-functioning EU.\footnote{Pioneers of European integration: Citizenship and Mobility in the EU (An Introduction): Economic and political rationales for freedom of movement, Adrian Favell and Ettore Recchi, Edward Elgard Publishing, 2009} The same citizens though experience huge difficulties especially after the eruption of the financial crisis in 2009. These difficulties are the negative outcomes of the huge integration efforts of the last decades.

The negative outcomes have created debates that try to give an answer to a crucial question. Do the problems and difficulties originate from the EU integration processes or do they derive from non-European factors, such as national weaknesses, where the EU system cannot intervene? Especially with regard to the current crisis, this question has recently taken large dimensions seeking to discover whether the Euro critical situation has its roots in national misbehaviors or in the ineffective EU integration system.

As explained above, the ongoing financial crisis’ origins can be traced in various levels including a global, European and national one. The fundamental importance of all these levels should not be underestimated as all of them have played a significant role in the outbreak and development of the crisis. However, the EU remains the number one responsible as the inadequate and badly targeted integration decisions of the 1990s are the first ones to be held accountable for the current financial mess.

The first milestone that proves the fact that the Eurozone critical situation is mainly a European problem is the Treaty of Maastricht which initiated an era of unprecedented interdependence and closeness among EU citizens and member states. The treaty introduced the common European currency, which constitutes the starting
point of the current economic stalemate. From 1993 when the Euro idea was first discussed until 1999 when the Eurozone was officially created, crucial mistakes did intentionally or not take place.

The ongoing Eurozone’s financial situation has proved that the ambitious common currency objective that Maastricht inserted needed more time as well as more thorough examination in order to be safely implemented. Simply enough, the three distinctive goals that the Treaty introduced, which were the free circulation of capital and goods, the complete coordination of EU economic policies and the launch of the Euro, could not be achieved in a seven years’ time framework.

The main problem was that the policy makers who came up with the three-phased scheme did not entirely respect it, as the desire to launch the Euro as soon as possible resulted in a catastrophic rush. The initial aim was that each phase of the scheme should start only after the successful outgrowth of the previous one. In this sense, the coordination of the EU’s economies should take place after the completion of an entirely free goods and services’ circulation. Respectively, the common European currency should be officially launched only after a successful financial coordination of all European Union’s members.

The aim was never reached as the economic coordination, expressed through the Convergence criteria, commenced before the completion of the free circulation. Additionally and more importantly, the official Euro introduction occurred prior to any successful alignment of the EU economies. These derailments from the initial objectives resulted in a scheme, the goals of which were never followed, respected, and hierarchised.

An extremely important part of the three-phased Maastricht’s ambitions were undoubtedly the Convergence Criteria, which were specified requirements that the EU member states needed to fulfill in order to coordinate their economies and subsequently adopt the Euro. The Criteria consisted of specific economic numbers.

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217 Why is the Maastricht treaty considered to be so significant? , Andrei Rogobete, E-International relations, February 26, 2011
http://www.e-ir.info/2011/02/26/why-is-the-maastricht-treaty-considered-to-be-so-significant/

218 Treaty of Maastricht: A positive step towards integration? (Introduction and Background pg 1-7), Shravan G Shenoy, Volume 2, Issue 1, August 2012
http://www.jsia.edu.in/JJIA/PDF/Sharavan-TreatyoMaastricht.pdf
that EU countries were obliged to reach in a limited time framework and through well targeted reforms.

Until 1999 many EU members were able to fulfill the obligations and reach the relevant economic figures. This proves that the Convergence Criteria were either very leniently formulated or that the vast majority of the EU economies was in the 1990s functioning almost perfectly.\(^{219}\) A close look at some of today’s Eurozone weak economies at that time convinces almost everybody that what really happened was a hasty, insufficient and extremely indulgent wording of the Criteria.

The creation of such lenient requirements at such crucial times demonstrates that the policy makers who formulated the Convergence Criteria set out inadequate sanction instruments without taking into account the urgency of the situation and the seriousness of the challenges. This resulted in a very easy and fast fulfillment of the requirements even from the mediocre at that time EU economies. Especially in the case of Greece, it was as if the EU pushed the country to meet the criteria in record time.

In 1997 EU policy makers decided to introduce a broad pact which would have a better and more complete understanding of the EU’s economic reality than the Convergence Criteria and which would create the appropriate conditions that could in the long term lead to complete financial coordination. The new pact was the famous Growth and Stability Pact that was applied only to the EU member states that had already met the Convergence Criteria.

The GSP was supposed to create a highly coordinated framework that would lead to a healthy financial system ready for the Euro, the biggest economic challenge the Union had faced until 1999. It was an advanced and optimistic initiative responsible for safeguarding the EU public finances and keeping the Union’s economy on track. It included mechanisms able to influence the members’ fiscal policies as well as a new sanction system. Its goals were never achieved as the

\(^{219}\) The Maastricht Convergence Criteria and Economic Growth in the EMU: Convergence criteria versus economic stabilization and economic growth, Slawomir I. Bukowski 
miscalculations that took place led to an unprecedented inability of several EU countries to follow and meet their new obligations.\textsuperscript{220}

What occurred with the GSP was the opposite of what took place with the Convergence Criteria. While the previous problem was leniency the new one was severeness and lack of flexibility. Even the economically healthy and robust EU countries found it in the beginning difficult to obey to the new strict and rigid pact. Many member states were initially obliged to abstain from the pact’s goals while others inevitably disrespected them or even ignored them. In the long term, the weaknesses of the GSP became even more obvious until the Pact was radically revised and eventually replaced.\textsuperscript{221}

Despite the integration attempts’ failure to coordinate efficiently the EU economic standards, the Euro was finally launched in 1999 following faithfully the timetable that was set up in Maastricht. The Treaty’s inconsistent goals, the defections of the Convergence Criteria and the rigidity of the SGP did not sensitise the responsible policy makers who failed to predict the mess that was about to come. As a matter of fact, the greatly unequal economic characteristics of the countries that were supposed to adopt the Euro did not urge anyone to propose alterations or perhaps to delay the decision to launch the common currency.

In general, the crucial integration mistakes that took place from 1993 to 1999 prove that primarily the current financial crisis is a European phenomenon that has its basis in the fast and sketchy integration steps of the last years. These mistakes shed light on the roots of the ongoing critical situation and outline the causes of the crisis which are undoubtedly multidimensional but first and foremost European.

\textsuperscript{220} \textit{The Stability and Growth Pact: Experiences and Lessons to be learned for Europe and the World} (The SGP and the political economy of the EU pg 5-8) Andreas Exenberger, 2004

\url{http://homepage.uibk.ac.at/~c43207/die/papers/sgp.pdf}

\textsuperscript{221} \textit{The Stability and Growth Pact: Crisis and Reform} (The first nine years of the Euro: Waisting the good times? & The crisis) European Central Bank, Occasional Paper Series, no 129, September 2011

\url{http://www.ecb.int/pub/pdf/scpops/ecbocp129.pdf}
7.2 EU WEAKNESSES AND INCONSISTENCIES

The causes of the Eurozone crisis can be firstly traced in global weaknesses that since 2000 have engendered the outburst of numerous financial inconveniences. Secondly, they can be found in inconsistencies of important Eurozone economies which have not been in the recent past able to grow financially and to avoid large deficits. Last and most importantly, they can be traced in EU badly targeted decisions and actions.

The European causes of the current crisis are highly related to the above analysis of the ineffective EU integration processes as they are part of the weak integration system of the recent past. In this sense, in order to fully understand the EU-related causes it is necessary to have a background of the last decades’ integration process as the causes have emerged through this process especially in the crucial period from 1993 to 1999. Starting with the Treaty of Maastricht and culminating in the Euro adoption, crucial EU realities emerged that were unheard before and that instead of bringing the Union closer created a strong and unprecedented skepticism.

The hasty and inadequate integration efforts of the 1990s had first of all a highly undesirable result within the European Union. This was an unprecedented structural division that was translated into a continuously increasing gap between core and periphery EU countries. The gap already existed in the 1980s when the EU failed to develop genuinely common policies to help new periphery members reduce their economic drawbacks compared with the Core. This has been largely responsible for the structural discrepancies that work against the process of European integration until now. 222

In the 1990s, the gap became larger as powerful member states increased their exports especially within the Eurozone by reducing workers’ wages and thus boosting their competitiveness compared with their partners. The core countries were characterised by high technology, large manufacturing and producer services while the periphery was specialized in agriculture, low manufacturing and standardised

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222 Core vs Periphery in the EU, Éric Toussaint, CADTM, 21 June 2011
http://cadtm.org/Core-vs-Periphery-in-the-EU
production. Today the structural division raises crucial questions and concerns as it has become more perceptible than ever before. As a matter of fact, after 2009 and the eruption of the crisis the division has culminated in an extremely worrying reality named core-periphery dualism. The weak EU economies have to face a growing trade deficit towards their richer partners as well as severe balance-of-payment deficits that reflect surpluses in the economies of the core.

In actual facts, the division started affecting seriously the EU member states after the complete free circulation of goods and services. In this sense, the Maastricht’s objectives to unify even further the EU by providing the Union’s members with privileges and freedoms they had never imagined before had negative results. Unfortunately, the desire for more economic closeness as well as the hopes for a Union with small economic differences among its member states did never become true. On the contrary, the great structural biases that made their appearance started dividing the EU instead of bringing it closer.

The economic gap was not taken properly into account during the crucial decision making processes of the 1990s as at that time the policy makers did not manage to realise that a huge internal division was about to unfold. No specific actions were taken aimed at tackling this phenomenon that was for the first time plaguing that severely the EU’s entity. The reason behind this inactivity was mainly the fact that the great economic partition was barely perceptible in 1993 as it was at the first stages of its unfolding. Of course this is not an excuse for ignoring a problem that has nowadays evolved into one of the main wounds of the European Union.

As a matter of fact, the 1990s inability to predict the dangerousness of the unfolding internal EU division is the reason why today the entity experiences an unprecedented deterioration of the relations between its wealthier and poorer states. Without doubt the negligence of such a crucial problem and the incapacity to face it at its early stages, has progressively led to uncomfortable and tepid relations between the EU’s north and south population. The negative current climate between Greeks

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223 Core Periphery analysis of the EU: A location quotient approach (pg 4), Richard S. Mack & David S. Jacobson, Central Washington University, Dublin City University

224 Core vs Periphery in the EU, Éric Toussaint, CADTM, 21 June 2011

225 Treaty of Maastricht: A positive step towards integration?, (Introduction and Background: pg 1-7), Shravan G Shenoy, Volume 2, Issue 1, August 2012
and Germans for instance, entirely initiated after the eruption of the ongoing financial crisis, has its roots in the above inactions and inabilities of the 1990s integration attempts.226

In spite of the aforementioned emerging division, the unsuccessful integration of the recent past has created a second problem, of great importance as well. Since the 1990s, most of the EU member states have the conviction that they can achieve significant success without real and substantive effort. This problem has its roots in the integration decisions taken in the 1990s and especially in the lenient requirements, standards and demands that EU policy makers set up in those years. First and foremost it was the very indulgently formulated Convergence Criteria that have been repeatedly criticised as unable to correspond to the challenges for which they were created.

The fact that such crucial requirements that were about to determine the adoption of the common currency and thus the future of the EU, were so hastily and leniently formed made the EU countries dangerously careless and negligent. The clement policy making procedures rendered the member states unable to realise that the integration’s intense goals such as the financial coordination and monetary unification needed big efforts and even bigger sacrifices. In the end of the 1990s, instead of diligent and hard-working members, the European Union consisted of countries that were taking their financial stability and health for granted.

The relatively easy fulfillment of the Convergence criteria had severe repercussions especially in the countries of the European south which were never famous for their financial health and discipline. Member states such as Italy, Greece and Spain entered the Eurozone much more easily than initially expected and did not really care about reaching and maintaining high national economic figures after their accession. It is worth mentioning that their easy entry took place despite the fierce opposition that was massively expressed against it. As a matter of fact, during the 1990s various EU member states expressed their skepticism. The Netherlands for example opposed the Italian entry while Germany and France objected to the Greek one. Regarding Italy for instance, the country was allowed in the Euro area anyway in

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226 Greek-German relations at new low as Eurozone crisis rumbles on Helena Smith, The Guardian, 15 February 2012
http://www.guardian.co.uk/business/2012/feb/15/greek-german-hostility-eurozone-crisis
spite of its flagrant violence of the criteria. When it comes to Greece, the way and rapidness that Greece entered the Eurozone constitutes the ultimate example of how tragically lenient and sometimes irresponsible the EU policy making has actually been.227

As a matter of fact, Greece’s entry in the Eurozone constitutes a landmark for the common currency as well as for the whole EU’s course in the 2000s. Intentionally or not many mistakes took place primarily with regard to the country’s performance and subsequently with regard to its substantial preparation to adopt the Euro. As explained in previous chapters, Greece firstly cooked its books to a significant extent and secondly went through a very limited transition period before entering the Euro community. The political elite in Greece as well as the EU policy makers that allowed such unjustifiable derailments should definitely feel guilty today.

It is absolutely normal and reasonable to wonder how and why the responsible policy makers considered that Greece had reached a high level of sustainable convergence and that it had met the necessary conditions for the adoption of the Euro. The reasons behind the indulgency of the strong Eurozone countries and the European policy makers towards Greece and other weak economies are several. Firstly, it is the logical argument that countries which have been founding members of the European Union, such as Italy, or countries with great historical and cultural value for Europe, such as Greece, should not be left outside the very important integration initiatives. Secondly, it is the belief that the Eurozone will eventually benefit from the important industries, such as shipping and tourism that can be found in Europe’s southern economies. Last but not least, it is another “logic of appropriateness” argument, the politically correct thinking which states that despite the existing hardships, the weak European economies will finally do what they are expected to.

What has actually been proved is that the EU “held its nose” and let Greece join the Euro in spite of the presentation of falsified public finance elements. On the top of that, it is without doubt bizarre that the Union allowed the Greeks in the Eurozone after only one year of national and Euro currency coexistence when all other acceding countries had three years of such transitional period.

227The Maastricht Convergence Criteria and Economic Growth in the EMU: Convergence criteria versus economic stabilization and economic growth, Slawomir I. Bukowski
For several different reasons, certain EU countries have become subject of special treatments, the negative results of which are more than obvious nowadays.\footnote{Greek Debt Crisis: How Goldman Sachs helped Greece to mask its true debt, Beat Balzli, Spiegel Online International, February 8 2010 \url{http://www.spiegel.de/international/europe/greek-debt-crisis-how-goldman-sachs-helped-greece-to-mask-its-true-debt-a-676634.html}} These reasons have mainly been historical or moral as Greece and Italy for instance are considered two countries with great historical value for the European architecture that cannot be absent from the big EU integration steps. To some extent though, the reasons have been financial as well as many of the weak nowadays Eurozone economies went through a long period of economic growth and prosperity in the 1990s. This made the European policy makers believe that the prosperous years would continue, something that was eventually proved completely wrong as from 2001 onwards this suddenly changed.

The very flexible and indulgent rules together with the favorable treatment of certain economies prove what has already been mentioned about the unjustified leniency and the negatively fast pace of the integration procedures. The only two arguments that could make sense regarding the lenient Convergence Criteria are the following; firstly, the strong EU’s desire to launch the common currency as soon as possible and secondly the long period of economic growth that the Union went through mainly in the 1990s. The rush though is in very rare cases the indicated solution as when actors hustle, the decisions are usually hasty and the substantial progress is hardly there.

What the EU attempted to do after the fast and not thoroughly organized adoption of the Euro was to set up some strict requirements that the Eurozone member states would have to fulfill after their Euro accession. This way the Union tried to fix the mistakes made by the lenient entry criteria by creating a new pact aimed at observing the Eurozone’s economic figures after the launch of the common currency. The new initiative, named Growth and Stability Pact, was supposed to put an end to the previous clemency and apply strict rules and expectations to the Euro economies in order to render them able to maintain their financial health during the crucial decade of the 2000s.\footnote{The Stability Pact: More than a minor nuisance? (Introduction), Barry Eichengreen & Charles Wyplosz, 1998 \url{http://eclab.berkeley.edu/~eichengr/research/stabilitypactnuisance.pdf}}
With the new pact, which was the first strict financial EU accordance, the clear goal was the observation of the Euro area’s economic figures in the long term with more stringent demands. On the one side, the long term perspective tried to correct the inefficient fastness of the previous years that had led to hasty and unsuccessful decisions. On the other side, the more stringent demands sought to extinguish the member states’ conviction that the integration objectives and challenges could be achieved without significant efforts.

As a matter of fact, the Convergence Criteria and the Growth and Stability Pact have been two ideas with similar objectives but significantly different characters and timelines. The common goals have been the coordination of EU economic standards as well the facilitation and maintenance of financial stability among the Union. The first distinction lies in the fact that the Convergence Criteria have been an urgent initiative that urged the member states to meet certain requirements in a certain amount of time. On the other hand, the GSP has been a lengthier pact that requested the same countries to observe their economies carefully without any deadline or time limitation. The second distinction concerns the strictness of the requirements that the initiatives introduced. As explained previously in the thesis, the Convergence Criteria have been clemently formulated in order to render the interested member states able to meet the requirements easily and relatively fast. On the other hand, the GSP has been put forward in much more rigorous terms in order to fix the previous mistakes and irregularities.

The aims of fewer leniencies and more time were to some extent reached but the internal problems of the GSP, which was massively replaced by new initiatives until 2010, did not allow that much progress to be made. As extensively described before, the new pact was broad, sometimes extremely strict, with an ineffective sanctions system and with rules that were hard to implement. Inevitably, the EU integration attempts replaced the problematic clemency and rapidness with other problematic and sometimes opposite terms such as inapplicable broadness and extreme severeness. It was like a sudden move from one end to the other without middle ground solutions and ideas.

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230 The Stability and Growth Pact: Crisis and Reform (The first nine years of the Euro: Wasting the good times? & The crisis), European Central Bank, Occasional Paper Series, no 129, September 2011
No middle ground means that almost all EU decisions of the recent past have been unrealistically ambitious. In general, the weaknesses and inconsistencies of the last decades, which constitute the most important causes of what the Eurozone is experiencing today, reveal the European roots and character of the financial crisis. Another thing that proves this character is the numerous attempts to solve and put an end to the ongoing deadlock.

7.3 NEW EUROPEAN REALITIES AND IDEAS

The proof that the ongoing financial crisis is mainly a European phenomenon derives not only from the historical roots and the causes of the crisis but also from situations that were created along the course of it. Without doubt, during the crisis realities that were never imagined before were formed and evolved. One such reality has been the unprecedented financial contagion in the Eurozone while another one has been the realization that the weak Euro economies cannot act on their own in order to improve their financial position.

As a matter of fact, the difficulties that the Eurozone started going through from 2009 onwards have created a financial contagion that had never made its appearance before in the European continent. This contagion has been the most striking aftermath of the extremely high interdependence that the Eurozone countries have been experiencing in the last decade. It demonstrates that the current crisis cannot be viewed as a phenomenon with only national isolated perspectives but as a much broader phenomenon with repercussions and prolongations that concern the whole continent.

By definition the financial contagion proves that the critical financial situation should be approached holistically and not selectively. First of all, it should have been predicted that the intense integration especially in sensitive sectors such as the monetary one would have an unavoidable consequence; the transmission of economic shocks from one country to the other. In this sense and after rational argumentation it
makes sense that the consecutive bailouts for Greece, Ireland and Portugal have since 2010 infected other economies such as the Spanish and Italian one. 231

Moreover, during the crucial decade of the 2000s mechanisms that would promote innovative anti-contagious ideas should have been created. At a national level, financial uncertainty is associated with a short maturity of outstanding debt as well as contingent public liabilities. Therefore, a better liability structure is something that could improve a weak economy’s liquidity and limit significantly its exposure to contagion. Moreover, mechanisms of prudential oversight for the financial system could also help render an economy more resistant to contagious financial shocks. Last but not least, international policy options, such as liquidity assistance, have proved that the effectiveness of rescue packages depends always on the contagion to which a certain economy is or can be exposed. 232

During the creation of the common currency no real attention was paid to the almost certain fact that a potential financial disruption somewhere in the Eurozone would be sooner or later dangerously disseminated. As a matter of fact, the Union’s liability structure could have been significantly improved in order to limit the phenomenon. Additionally, prudential oversight mechanisms could have undoubtedly assisted as well. On top of all that, the bailout packages could have been much better adjusted to the very fragile and prone economies of certain EU states. Global examples of the recent past such as the turmoil in global financial markets that started in Eastern Asia did not sensitisie the EU integration’s policy makers who could not predict that an intense financial contagion would soon be a very difficult reality for the Eurozone entity as well.

The very difficult contagious reality has become even more worrying because of another important element of the ongoing crisis which has previously been defined as the “Euro framework”. The interrelation between the Euro area’s member states has become so strong that one of its negative aspects is that the national economies are most of the times incapable of solving their problems alone. Greek and Portuguese

231 Financial Contagion (pg. 2-7), Franklin Allen & Douglas Gale, Financial Institutions Center http://fic.wharton.upenn.edu/fic/papers/98/9831.pdf
policy makers for instance have repeatedly stated that they would definitely prefer unilateral national anti-crisis measures rather than international measures such as bailouts and foreign surveillances. The problem though is that they do not have the privilege to choose.

To put it more bluntly, the common currency does not allow the states who share it to take the situation in their own hands especially during critical periods such as the one they are going through now. As analyzed before, the excessive debt, for example, is a problem that without the Euro could be successfully handled by the national economies. With the Euro though such a problem simply enough cannot be faced nationally but only through international agreements and compromises. In Greece experts have claimed that if the common currency was not present a devaluation aimed at strengthening the country’s exports would have been possible. Accordingly, the same thing could have taken place probably to a smaller extent in Portugal and Italy.

In fact, the extended financial contagion and the restrictive “Euro framework” prove that the Euro states belong to the same “family” and act in the same environment. Both terms demonstrate that the ongoing Eurozone crisis needs international initiatives and ideas such as new supranational mechanisms and authorities in order to be confined and confronted. These initiatives, extensively presented before, have been multidimensional once again as they have derived from national governments’ attempts, global institutions’ actions but first and foremost European efforts.

The most important responses and solutions aimed at tackling the crisis have been the European initiatives. This of course does not undermine the national reactions that have taken place in several countries neither the global IMF’s capital aid as without the assistance of such national and global actions the EU initiatives would have been too isolated. A crisis with European historical roots though that has been formed through various mistakes of the EU past needs primarily European reactions and ideas in order to be solved. Thus the dominance of the European solutions has been more than obvious.

First of all, the national initiatives in spite of their undoubtful boldness and importance have been of limited influence because of the aforementioned member
states’ inability to take crucial measures and decisions in their own hands. Without doubt, the austerity measures and the fight against tax evasion are worth mentioning national efforts but still as not as prominent as the European ones that have been mainly translated into supranational mechanisms and bodies. At a European level, the anti-crisis attempts deriving from the EU itself, did undoubtedly in the last decade take the form of tremendous changes and reforms that were absolutely unheard before.

Of course all the attempts to save the Eurozone, national, European and global ones have taken place simultaneously and through great coordination and cooperation. As a matter of fact, it is sometimes hard even to distinguish whether the initiatives have come from governmental, EU or global actors. The bailout agreements for instance aimed at rescuing the indebted Eurozone states have been composed of money deriving from both EU and universal sources. On top of that, the Troika’s actions, which were in the beginning clearly European, have progressively been so intensely mixed with national measures and reforms that the barriers are imperceptible. Moreover, the strong intergovernmental role of the European Council and the council of the EU has made it sometimes hard to distinguish whether the initiatives derive from the EU or the member states themselves.

Despite the hardly existing distinctions, the coordinated efforts have been primarily European as both in the bailouts as well as in Troika’s initiatives, the EU is without doubt the actor with the most gravity. As far as the bailouts are concerned, the largest part of the capital forwarded to Greece, Ireland and Portugal has come from European sources such as the EU itself as well as the European Central Bank. In specific terms and as previously in this thesis explained, the rescue packages for Greece have been around 80% European as most of the funds have derived from the Euro states and especially from the Eurozone’s bilateral loan commitments. Additionally, the same more or less can be said about Portugal as the two thirds of the country’s bailout deal is capital coming directly from EU mechanisms.

With regard to the Troika’s activity, this proves as well that the responses to the critical situation have been primarily European. As analysed previously in this thesis, the tripartite committee has been the body responsible for organizing the loans to the weak Euro economies as well as for monitoring their financial performances.
and potential comebacks. During its crucial operations and interventions in the European economic figures and performances, the Troika has demonstrated the EU’s great potency to substitute national authorities to an extent that was never imagined before.

In clearer terms, the Troika has since 2011 been taking on the executive functions and responsibilities of certain European governments by prescribing and implementing tasks and reforms that the national authorities should under normal circumstances implement on their own. 233 In Greece for instance the Committee showed since the very beginning its power as well as its determination to make crucial interventions in the country’s unsteady economy. Specifically, it sharpened the austerity and demanded the implementation of tight labor laws despite the mass strong opposition. In Portugal accordingly, it demonstrated its potent and influential role as well by requesting similar wages’ cuts and abolitions of certain counterproductive labor regulations.

The unprecedented Troika’s interference with certain Eurozone’s national authorities is a clear example of the large extent to which national jurisdictions have been ceded to international bodies. As a matter of fact, the intense financial crisis has rendered the weak Euro economies unable to survive without foreign assistance thus resulting in a painful concession of responsibilities which in a financially healthy period would have been entirely governmental. This new phenomenon has first of all created a feeling of great confusion and discontent among the Union’s citizens who witness the loss of some of their nations’ autonomies. Moreover, it has raised serious questions among analysts with regard to whether the EU should be intervening that much in its member states’ policies or not.

At this point it is worth mentioning that the ongoing financial crisis has resulted in a shift from an intergovernmental EU to a much more supranational one. In the last decades, the EU has been mainly functioning in a traditional intergovernmental way meaning that the European rules and decisions have not been having a very direct and strong impact on the member states and thereby on the EU citizens. Therefore, the cooperation among the EU countries has been taking place

through an interstate type of cooperation proving the potency and extended jurisdictions of the Union’s member states. Recently and especially after the emergence of the crisis this traditional EU’s function and cooperation has slightly changed.

As mentioned before, exceptions to the current supranational EU’s character are the European Council and the Council of the EU. These two institutions are still today considered intergovernmental bodies as they represent national executives and promote the member states’ interests. The rule though is that the critical situation has cut down the strong national powers as nowadays the EU rules and decisions are regarded much more influential and potent. In this sense, the cooperation in Europe has been progressively becoming more supranational enforcing the multi-national character of the EU where power is delegated to the Union’s authorities by all governments of member states. This means that the national governments are nowadays ceding some of their potencies while the EU’s supranational entity is gaining strength. The change has been accompanied by the sudden apparition of a very strong Euroscepticism, an acute characteristic of the ongoing Eurozone recession.

7.4 CONSTRUCTIVISM’S CONTRIBUTION

Constructivism is a theory that “fits” in the unique ongoing Eurozone crisis as its assumptions, ideas and sub-concepts can explain to a significantly large extent what the Euro has gone through in the last critical years. Starting from the most basic and fundamental constructivism’s thoughts and culminating in its most specific and detailed sub-theories, we can undoubtedly extract useful ideas that can make a strong contribution to a better and more complete understanding of the current crisis.

Regarding general constructivist assumptions, the distinction between “social” and “brute” facts for instance applies to the financial crisis and the argumentations around it as it differentiates the situations made by human action from those that do

234 Euroscepticism: the criticism of the European Union as well as the opposition to the idea of European integration. Its main argument is that the European integration weakens the European nation states.
not depend on humans. More specifically, this differentiation enlightens and gives answers to an important inquiry that has been concerning the various analysts of the crisis in the recent past. Is the crisis a non-human dependent and inevitable phenomenon or is it the result of human inappropriate actions and mistakes? In a few words and based on Onuf’s terms is it a “social” or a “brute” fact?

The analysis of this thesis has proved that what the Eurozone is currently experiencing is a “social” fact that has its roots in badly-targeted and hasty human decisions. In this sense, and with the aid of the clear constructivist distinction between human and non-human phenomena, the thesis provides arguments and support to the idea that the Eurozone critical situation is a European phenomenon deriving from ineffective human policy making. This awareness offers the chance to see the roots clearly, to seek productive solutions and avoid the repetition of similar mistakes in the future.

The social and human character of the ongoing crisis reminds strongly one of the most fundamental constructivism’s assumptions which states that the environment in which states and agents act is primarily social. As a matter of fact, the blame for the crisis lies first and foremost upon wrong policy makers’ decisions which proves once again that the human and social aspects have been dominant compared to statal or material ones. Constructivism claims that material structures have meaning and importance only when interpreted through social contexts. In this sense, the material facts and outcomes of the Eurozone crisis, such as the excessive debts or the very high unemployment rates must be viewed as consequences of social and human nature rather than just realities of their “own making”.

Regarding more specific constructivist concepts, the logic of appropriateness applies to the crisis as well providing this thesis’ readers with a better understanding of the framework in which the Euro financial crisis emerged and evolved. As a matter of fact, the logic of appropriateness sheds light on some of the most critical EU policy makers’ decisions as it analyses the reasoning process and objectives that lie behind them.

236 Constructivism: An Introduction, E-International Relations, Maysam Behravesh, February 3, 2011
First of all it considers human decisions and actions as driven by an exemplary behavior that always follows rightful and legitimate rules. This consideration “fits” to the European policy makers’ decision making of the 1990s when the main EU integration steps took place. The actions aimed at a more integrated Union were characterised by the strong conviction that they were appropriate and exemplary as well as by the certainty that they were driven by just and natural rules.

Secondly, the same logic regards the policy making’s ultimate objective as the fulfillment of obligations encapsulated in a concrete role or in a specified community’s membership. This regard “fits” to the 1990s EU integration processes as well as it provides explanations that concern the European policy makers’ goals and commitments. Without doubt, the responsible decision makers that introduced crucial integration ideas did consider themselves as representatives of a specific EU role and identity and even more as an integral part of the entity’s community.

Last but not least, the logic of appropriateness claims that decision making is a complex process which necessitates thoughtful and reasonable behavior. According to the concept, this process is rarely connected to the realization and anticipation of the upcoming consequences as the actors do not calculate the utility of their actions. As a matter of fact, what happened in Europe from 1993 onwards is an exact depiction of what the logic describes above as during the decision making the responsibles did not demonstrate thoughtfulness and rationality. Moreover, they did not manage to predict the future consequences as well as the serious upcoming dangers.237

At this point it is worth mentioning that the Eurozone entry of countries such as Greece and Italy can be explained through a “logic of appropriateness” point of view. As a matter of fact, the decisions to let unstable economies join the common currency lie mostly on social reasons rather than on material ones. This means that the problematic European economies were allowed to become part of the Euro because of the element of politically correct thinking. This constructivist element, that has been mentioned before as well, regards actions as exemplary and rightful ones and actors as very legitimate entities that will always do what they are expected to do. In this sense,

In spite of Greece’s and Italy’s non-promising economic figures, these countries have been expected to act carefully and wisely and that’s one of the main reasons why they were allowed in the Eurozone in the first place.

In a nutshell, it becomes clear that the appropriateness’ logic has been following this thesis’ argumentation along its course. All those who envisioned the common currency, created the convergence criteria and hoped in a more integrated and unified EU were finally pieces of the same constructivist puzzle that pursues a concrete rationale. Firstly is the belief that all integration oriented actions are appropriate and righteous. Secondly is the conviction that all integration policy makers have the same identity as they are members of the same community. Thirdly and most importantly is the absence of reasoning, the inability to predict and the inevitable catastrophic consequences.

In general, constructivism has provided this thesis with a solid theoretical background and has played a significantly important role in its conception, argumentation and outcomes. Undoubtedly, the logic of appropriateness is able to enlighten the readers with regard to fundamental events that have taken place before and during the ongoing financial crisis such as the decision to let Greece in the Eurozone, the controversial GSP as well as the famous bailout agreements. In a few words, the Eurozone crisis, when viewed under a constructivist perspective becomes a less perplexed and much more lucid phenomenon.

As an ultimate conclusion it is worth highlighting once again that one-dimensional approaches of the crisis and its roots will never lead to desirable and credible outcomes as the phenomenon has been a multi-dimensional reality created by many complicated factors. According to this thesis’ argumentation the crisis has mainly been a European phenomenon but this does not exclude other sides of it such as the huge national problems or the great global influences. As a matter of fact, the crisis involves an imbalanced and incomplete set of European rules –dating from Maastricht- together with failing states; a combination that has been proved dramatically explosive. 238

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