The Euro Crisis

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Some EU Statistics – Population, Income and Employment

Map of the European Union

EU Population in 2011 (thousands)

EU-27 Population	502,477	Sweden (SE)	9,415.6
Germany (DE)	81,751.6	Austria (AT)	8,404.3
France (FR)	65,048.4	Bulgaria (BG)	7,504.9
United Kingdom (UK)	62,435.7	Denmark (DK)	5,560.6
Italy (IT)	60,626.4	Slovakia (SK)	5,435.3
Spain (ES)	46,152.9	Finland (FI)	5,375.3
Poland (PL)	38,200.0	Ireland (IE)	4,480.9
Romania (RO)	21,413.8	Lithuania (LT)	3,244.6
Netherlands (NL)	16,655.8	Latvia (LV)	2,229.6
Greece (EL)	11,309.9	Slovenia (SI)	2,050.2
Belgium (BE)	10,951.7	Estonia (EE)	1,340.2
Portugal (PT)	10,637.0	Cyprus (CY)	804.4
Czech Republic (CZ)	10,532.8	Luxembourg (LU)	511.8
Hungary (HU)	9,985.7	Malta (MT)	417.6

Source: http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tps00001&language=en

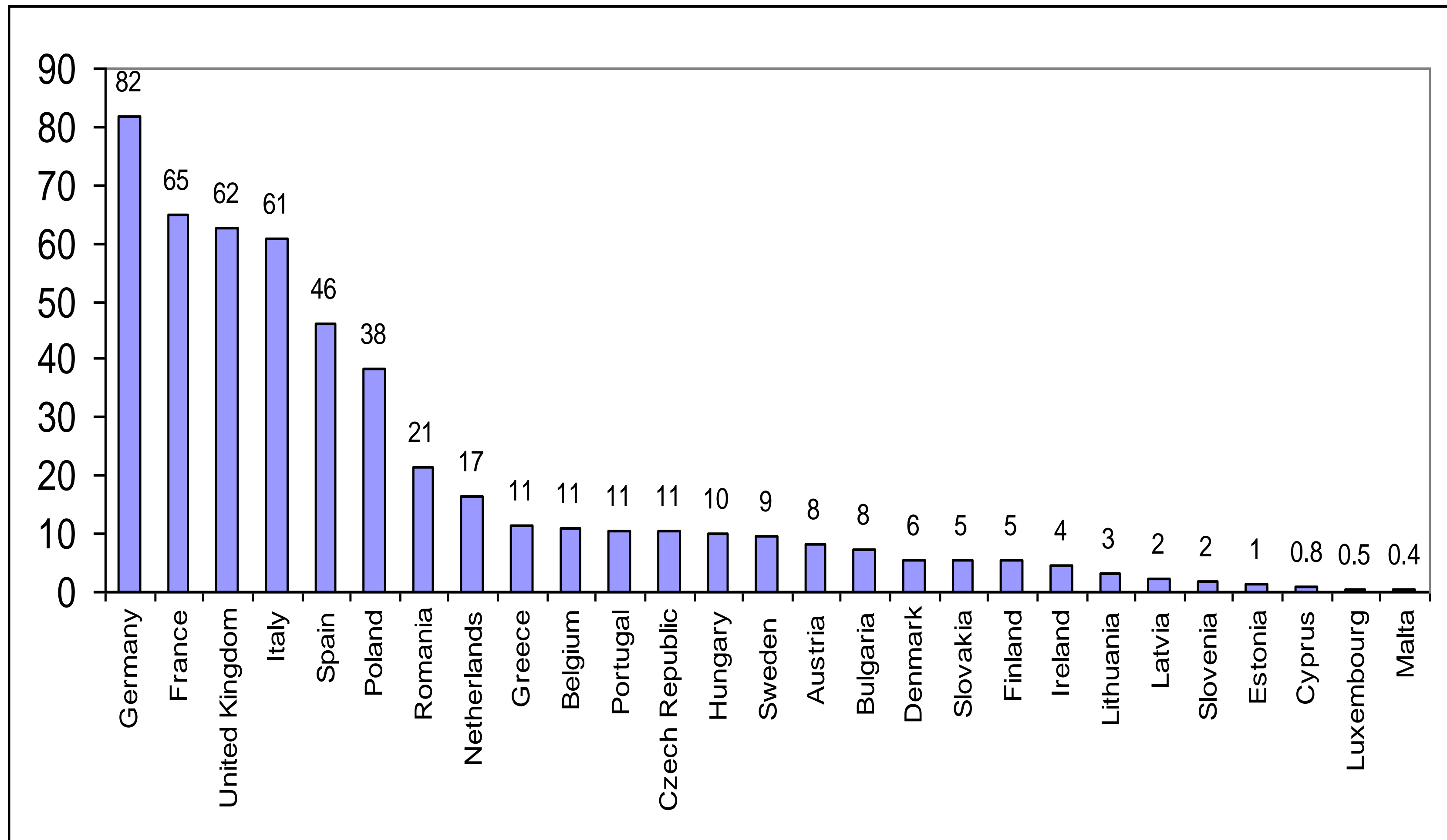
EU Population in 2011 (possible enlargements)

Acceding country	
Croatia	4,412
Candidate Countries	84,152
Turkey	73,723
Serbia	7,435
Macedonia, FYR	2,057
Montenegro	618
Iceland	319

Potential Candidates	9,062
Boznia/Herzegovina	3,843
Albania	3,149
Kosovo	2,070

Source: http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tps00001&language=en

EU Population (Millions in 2011)



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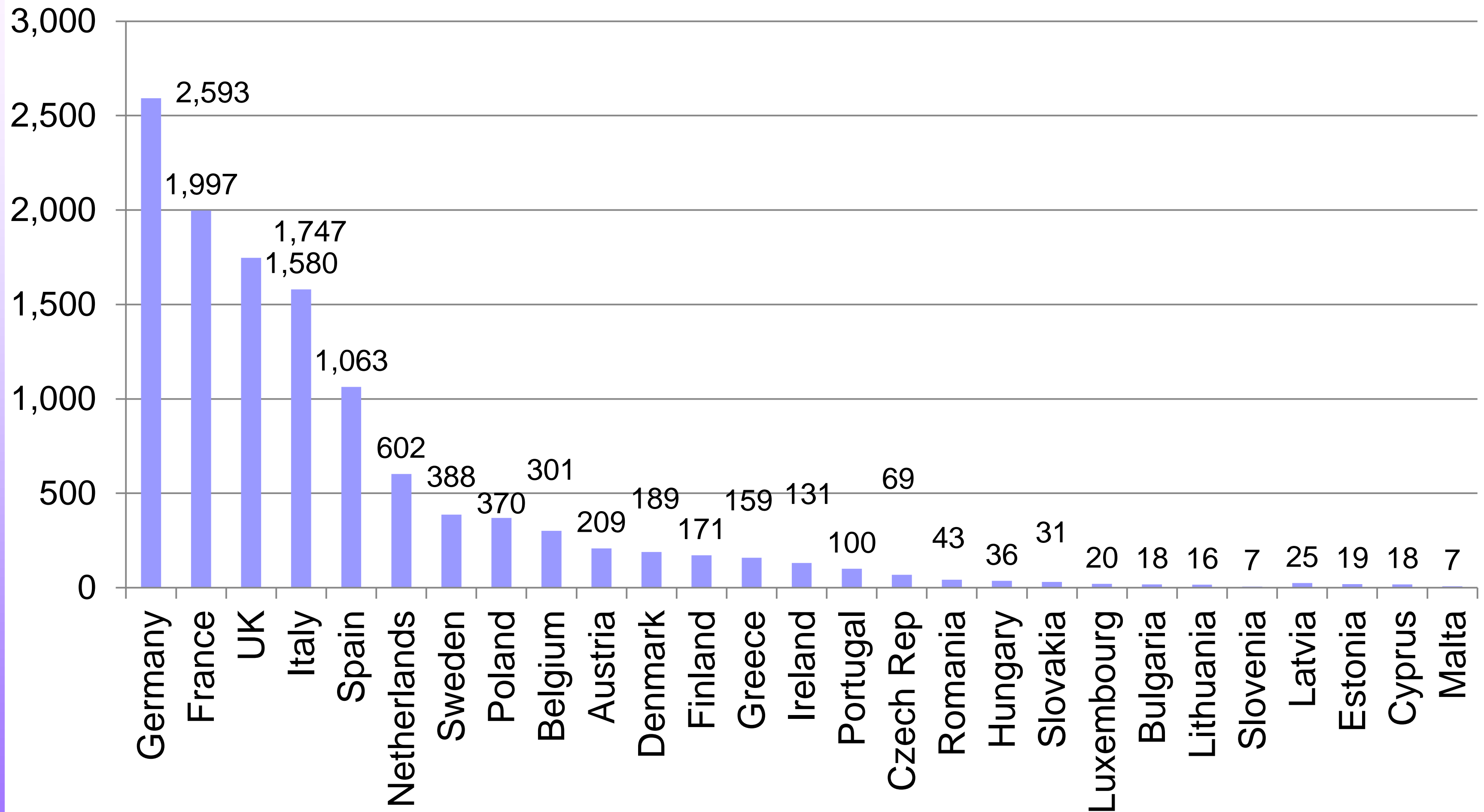
Total GDP (Billion Euro in 2011)



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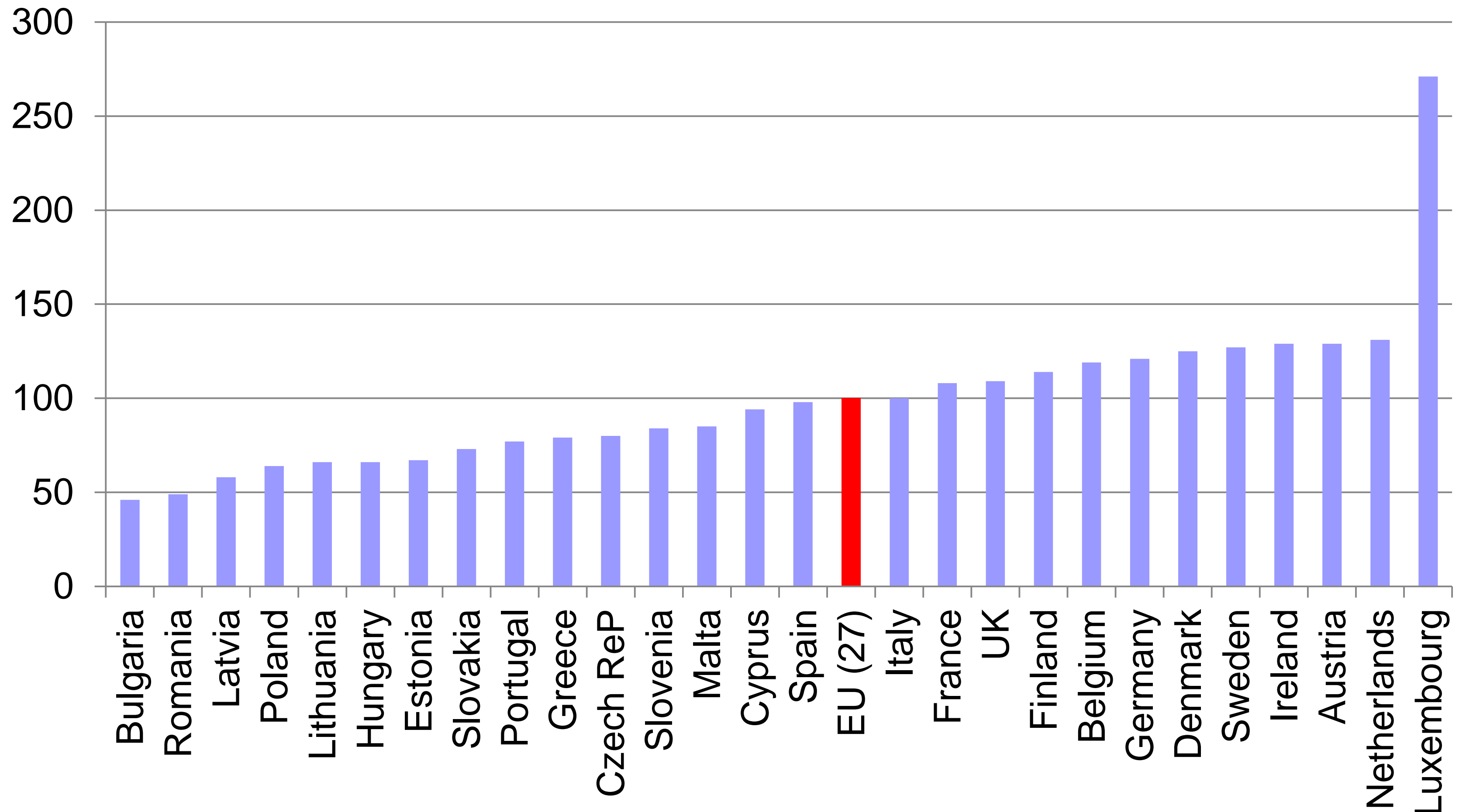
GDP Per Capita (PPS) 2011
EU AVERAGE = 100



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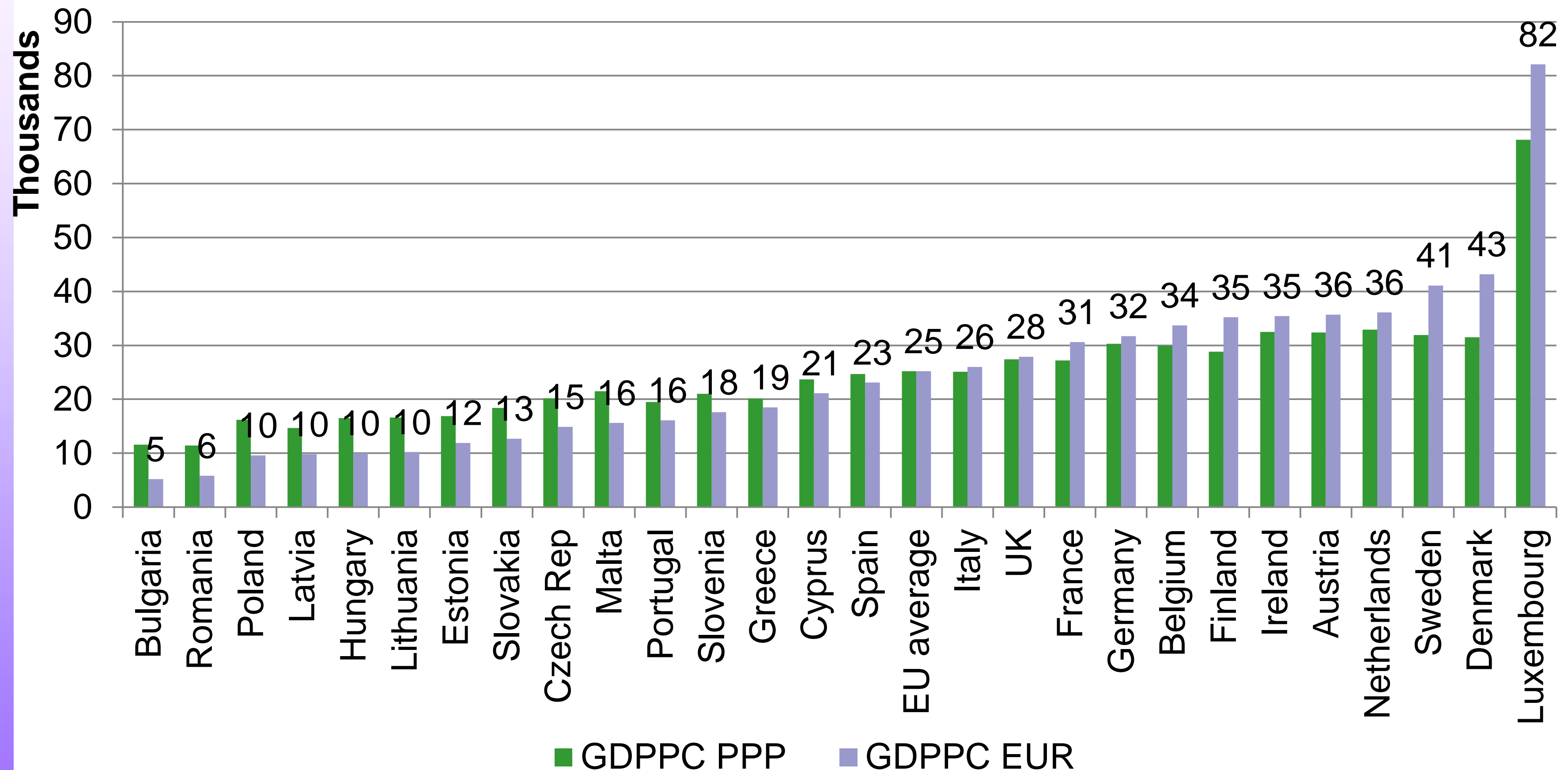
GDP Per Capita (thousand Euro in 2011)



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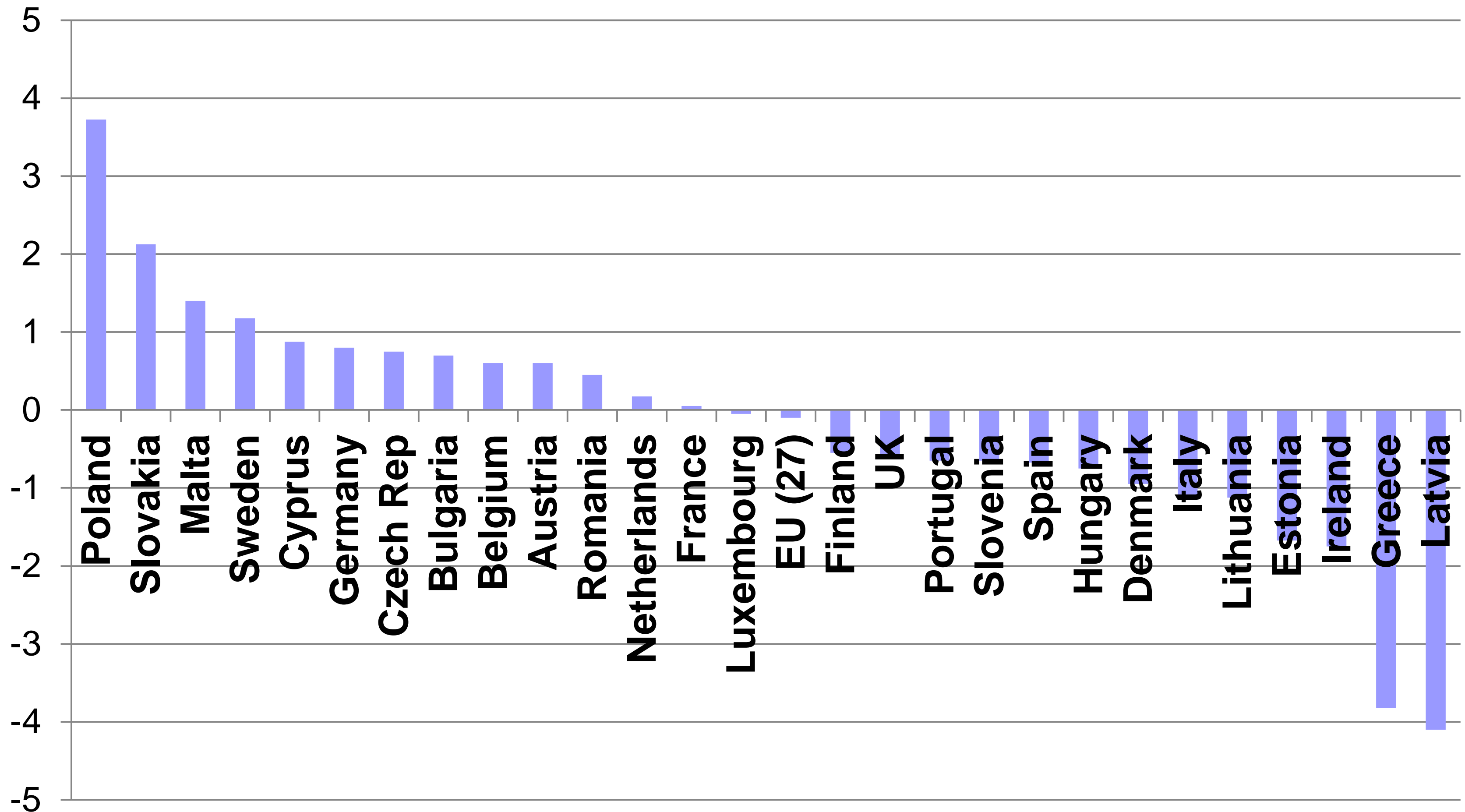
Real GDP Average Annual Growth Rate (%) 2008-2011



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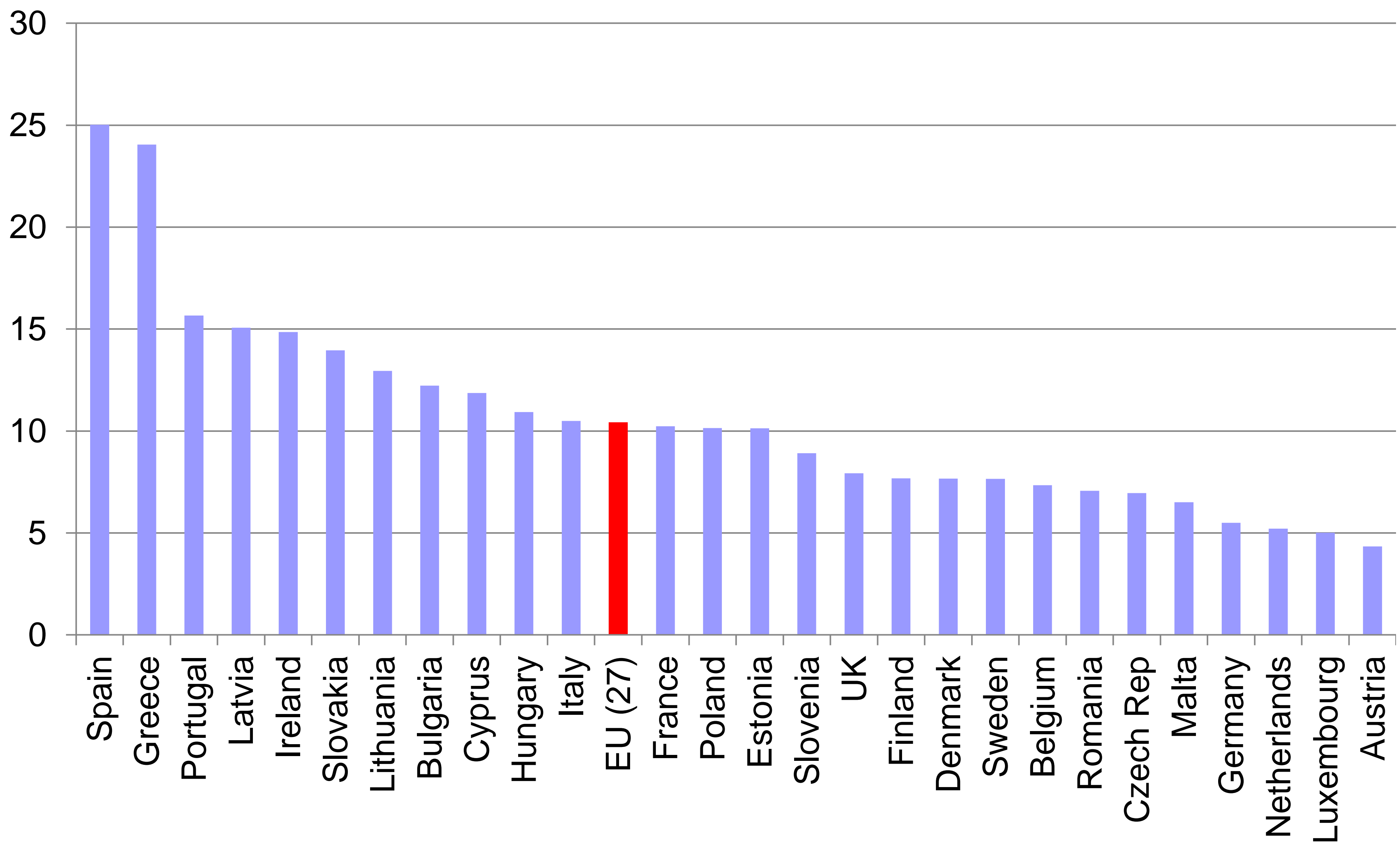
Unemployment Rates (%) 2012



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EU History and Institutions

The Beginnings of the EU

- In May 1950 French Foreign Minister Robert Schuman presented a plan for deeper cooperation between Germany and France and the European Coal and Steel Community was set up.
- European countries began to unite economically and politically in order to secure lasting peace in Europe.
- In line with the Schuman plan, six countries signed a treaty to place their coal and steel industries under a common management. The six founding members were Belgium, France, Germany, Italy, Luxembourg and the Netherlands.
- In 1953, the six member states removed custom duties and quantitative restrictions on steel and coal.

1957 to 2010 – From the EC to the EU

- 1957, Germany, France, Italy, Belgium, Netherlands and Luxembourg signed the Treaty of Rome.
- 1973: Denmark, Ireland and the UK joined the EC
- 1981: Greece
- 1986: Spain and Portugal
- 1995: Austria, Finland and Sweden
- 2004: Eight central and eastern European countries — the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and Slovakia and two were Mediterranean island states, namely Cyprus and Malta.
- 2007: Bulgaria, Romania
- Currently Croatia is an <u>acceding</u> country
- Iceland , Macedonia (Former Yugoslav Republic of), Montenegro, Serbia and Turkey are <u>candidate</u> countries.
- Albania, Bosnia and Herzegovina and Kosovo are <u>potential</u> candidate countries.

The Main EU Institutions

- European Parliament
- European Council
- Council of the European Union
- European Commission
- Court of Justice of the European Union
- European Central Bank
- Court of Auditors

The Main EU Institutions

- The European Parliament represents the people and its members are elected directly by the people in each member state. The European Parliament shares legislative and budgetary power with the EU Council of Ministers.
- The European Council refers to the meetings of the Heads of State (summit), as well as the President of the European Commission and the President of the European Council. Following the ratification of the Lisbon Treaty in December 2009, was made into a formal EU institution.
- The Council of the European Union is the EU's main decision-taking body. It represents all member states.
- The European Commission is the executive body of the EU. Amongst other things, it takes steps to ensure that EU policies are properly implemented in the member countries. It has the right to propose legislation.

Other EU Institutions

- The Court of Justice, located in Luxembourg, ensures that EU law is upheld.
- The European Central Bank in located in Frankfurt and its remit is to manages monetary policy and the euro.
- The European Court of Auditors is located in Luxembourg to ensure that money is spent appropriately.

Other Institutions:

- The Eurogroup is a meeting of the finance ministers of the eurozone. It is the political control over the euro currency and related aspects of the EU's monetary union such as the Stability and Growth Pact. Its current President is Jean-Claude Juncker.
- The Economic and Financial Affairs Council (Ecofin) of the Council of the European Union. This represents all 27 member states.

Directives and Regulations

- A regulation has general application and is binding in all Member States. As such, regulations are powerful forms of European Union law. When a regulation comes into force it overrides all national laws dealing with the same subject.
- A directive is also binding in all Member States regarding the results to be achieved, but leaves it to the national authorities as to the choice of form and methods. Directives are only binding on the member states to whom they are addressed, which can be just one member state or a group of them. In practice however directives are addressed to all member states.

The Lisbon Treaty

- The Treaty of Lisbon was signed in Lisbon on 13 December 2007 by the representatives of the twenty-seven Member States. It entered into force on 1 December 2009, after being ratified by all the Member States.
- The Lisbon Treaty is the latest of the Treaties which, have amended previous Treaties such as the Teaty of Rome (1957), Single European Act (1986), the Treaty on European Union (Maastricht Treaty) (1992), the Amsterdam Treaty (1997) and the Treaty of Nice (2001).
- The signing of the Lisbon Treaty led to the renaming of the Treaty of Rome as the Treaty on the Functioning of the European Union (TFEU).

Major Changes associated with the Lisbon Treaty

Major changes of the Lisbon treaty include:

- More qualified majority voting in the Council of Ministers, increased involvement of the European Parliament in the legislative process through extended co-decision with the Council of Ministers
- The creation of a President of the European Council with a term of two and a half years and
- A High Representative of the Union for Foreign Affairs and Security Policy to present a united position on EU policies.
- The Treaty of Lisbon will also make the Union's human rights charter, the Charter of Fundamental Rights, legally binding

Further Treaty Changes

- During the European Council meeting of 23 October 2011 it became evident that there is the need to strengthen economic convergence, improve fiscal discipline and deepen the economic union.

- The need is being felt to reduce further the member countries' sovereignty with regard to government finances. This was resisted by Britain in Brussels in March 2012, but the treaty was still signed without Britain the the Czech Republic.

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European Monetary Union

Economic and Monetary Union

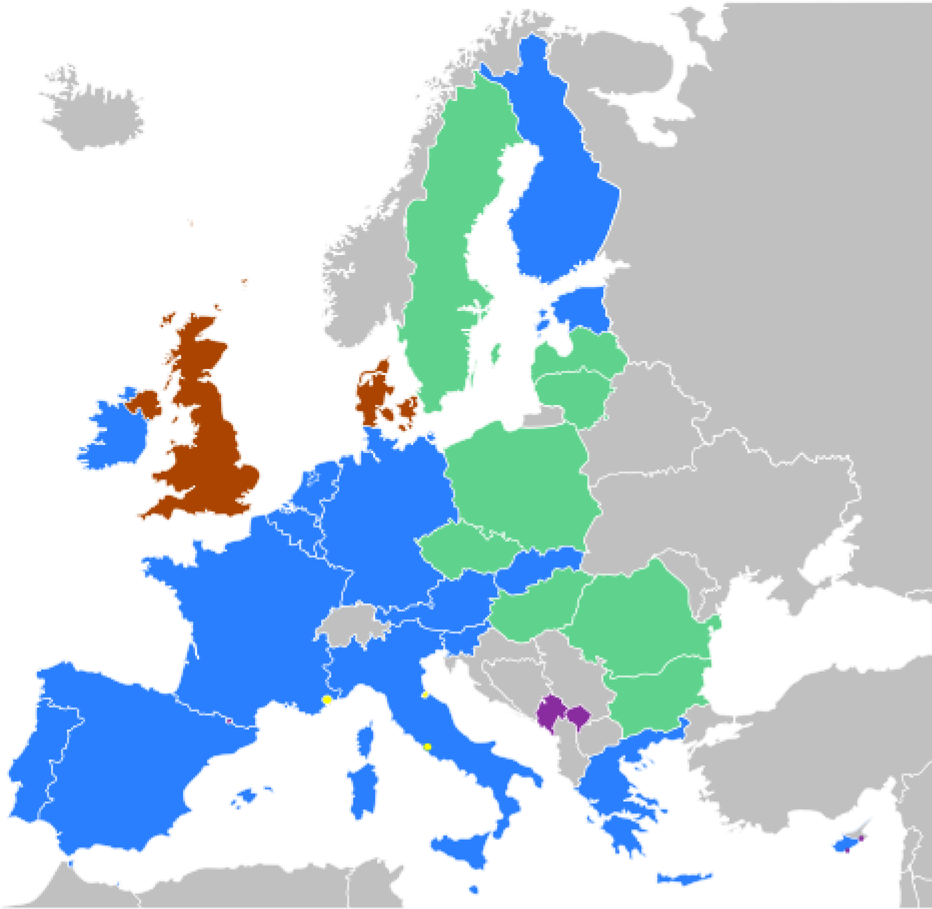
- European Economic and Monetary Union is aimed at coordinating economic policy, achieving economic convergence and adoption of a single currency (the euro)
- All member states of the European Union are expected to participate in the EMU, although eligibility to adopt the Euro is conditional on satisfying the so called Maastricht criteria.
- All member states, except Denmark and the United Kingdom are bound by treaty to join EMU.

Economic and Monetary Union

- Seventeen member states of the European Union have adopted the euro as their currency.
- Ten EU members use their own currencies: Denmark, Latvia, and Lithuania are currently participants the exchange rate mechanism, tying their currencies to the Euro as fixed rates or within a band.
- Of the pre-2004 members, the United Kingdom and Sweden* have not joined ERM II.
- Five states who acceded post 2004 have yet to achieve sufficient convergence to participate.

* According to the 1995 accession treaty, Sweden must convert to the euro at some point. By choosing to stay outside the ERM II, the Swedish government avoids the theoretical requirement of adopting the euro

Economic and Monetary Union



Blue:
EU Eurozone (17)
Green:
EU states obliged to join the Eurozone (8)
Brown :
EU states with an opt-out on Eurozone participation (2)
Purple:
Other non-EU users of euro (4) Andorra, Kosovo, Montenegro, Monaco, San Marino, and the Vatican City

First steps: European Monetary System

- The system of fixed exchange rates, under the Bretton Woods arrangement, ended in 1971.
- The member states of the European Community decided to take steps to reduce exchange fluctuations of more between their currencies by means of an intervention in currency markets. This led to the creation of the European monetary system (EMS) in March 1979.
- The EMS involved, amongst other things, the creation of a reference currency called the ECU composed of a basket of the currencies of all the member states. Each currency had an exchange rate linked to the ECU; bilateral exchange rates were allowed to fluctuate within a band of 2.25 %.

Economic and Monetary Union;: First Steps

- In August 1993, the EMS countries decided to temporarily widen the bands to 15 %.
- Meanwhile, to prevent wide currency fluctuations among EU currencies and to eliminate competitive devaluations, EU governments had decided to re-launch the drive to full monetary union and to introduce a single currency.
- At the European Council in Madrid in June 1989, EU leaders adopted a three-stage plan for economic and monetary union (EMU).
- This plan became part of the Maastricht Treaty on European Union adopted by the European Council in December 1991.

EMU in Stages

- The EMU's first stage (which began 1 July 1990) involved the abolition of exchange controls. The second stage (which began on 1 January 1994) provided for establishing the European Monetary Institute (EMI) in Frankfurt, with representatives of the governors of the central banks of the EU countries
- The third stage was the introduction of the euro (which began in January 1999). Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain adopted the Euro for non-cash transactions. Greece joined them on 1 January 2001.
- From this point onwards, the European Central Bank took over from the EMI and became responsible for the monetary policy of the EU. Euro notes and coins were issued on 1 January 2002 in these 12 euro-area countries. National currencies were withdrawn from circulation.

Adoption of the Euro

- In 2002, the 12 countries that adopted the euro extended its use for all payments, including cash. For this purpose euro notes and coins were issued on 1 January 2002 in the 12 euro-area countries. National currencies were withdrawn from circulation two months later.
- Three countries (Denmark, Sweden and the UK) did not participate in this arrangement.
- Following the 2004 enlargement, Slovenia (2007) Malta and Cyprus (2008) Slovakia (2009) and Estonia (2011) also adopted the euro. Bulgaria, Czech Republic, Hungary, Romania and Poland will adopt the euro when they are ready to do so in line with the Maastricht criteria.
- Andorra, Kosovo, Montenegro, Monaco, San Marino, and the Vatican City are not EU members but use the euro as their currencies

Euro Notes and Coins

- Coins have one common face, indicating their value, while the other side carries a national emblem. Coins circulate freely. Maltese coins can be used in Italy and French coins can be used in Slovenia.
- Notes are the same throughout the Euro area. There are denominations of 5, 10, 20, 50, 100, 200 and 500 euro and the notes increase in size as the denomination rises.

The Convergence (Maastricht) Criteria

An EU country must meet the five convergence criteria in order to adopt the euro. These criteria are:

- price stability: the rate of inflation not to exceed the average rates of inflation of the three member states with the lowest inflation by more than 1.5 %;
- inflation: long-term interest rates not to vary by more than 2 % in relation to the average interest rates of the three member states with the lowest inflation;
- deficits: national budget deficits to be below 3 % of GDP;
- public debt: not to exceed 60 % of GDP;
- exchange rate stability: exchange rates must have remained within the authorised margin of fluctuation for the previous two years.

The Exchange Rate Mechanism

- The European Exchange Rate Mechanism, ERM, was a system introduced by the European Community in March 1979, as part of the European Monetary System (EMS), to reduce exchange rate variability and achieve monetary stability in Europe, in preparation for Economic and Monetary Union and the introduction of a single currency, the euro, which took place on 1 January 1999.
- The second Exchange Rate Mechanism (ERM II) was set up on 1 January 1999 as a successor to ERM to ensure that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market.
- The convergence criterion on exchange rate stability requires participation in ERM II.

How ERM II Works

- A central exchange rate between the euro and the country's currency is agreed. The currency is then allowed to fluctuate by up to 15% above or below this central rate.
- When necessary, the currency is supported by intervention (buying or selling) coordinated by the ECB and the central bank of the non-euro area country.
- Non-euro area Member States within ERM II can decide to maintain a narrower fluctuation band.
- The ECB monitors the operation of ERM II and ensures co-ordination of monetary- and exchange-rate policies.

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The Stability and Growth Pact

The Stability and Growth Pact

- The Stability and Growth Pact is a political agreement reached at the European Council in December 1996, aimed at imposing discipline in the government finances of member states. It built on the Maastricht criteria and binds all members of the euro area to implement the so-called excessive deficit procedure if they do not meet the provisions of the pact, particularly that the budget deficit should be below 3% of GDP and total government should be below 60% of GDP.
- In theory, before 2012, action could have been taken in cases of serious breach of the Pact. There were however instances when countries broke the Pact provisions and the Commission closed one eye. When the euro was doing well, such laxity did not have major repercussions, but the Greek crises occurred in a very difficult period of the world economy.

The Six-Pack Reform

- As a reaction to the euro crisis, on 28 September 2011, the European Parliament passed a series of six budget laws - called six-pack - to impose stricter implementation of the Stability and Growth Pact, which is a rule-based framework for the coordination of national fiscal policies in the economic and monetary union and limits public debt and deficits to 60% and 3% of GDP respectively in the eurozone.
- The new rules include more automatic procedures to issue warnings and sanctions against debt offenders, an annual national budget assessment procedure by the European Commission, empowerment of the Commission to conduct spot checks at national level and a find for fraudulent statistics on government finances and greater independence of statistical bodies.

The Stability and Growth Pact – New Developments

- The “European Semester” of 2012was the first piece of legislation in force from the so-called six-pack of legislation so that fiscal and macro-economic imbalances of Member States could be identified and tackled at an early stage. As a result EU and the eurozone will be expected to coordinate their budgetary and economic policies, in line with both the Stability and Growth Pact and the Europe 2020 strategy.
- The rules of the Stability and Growth Pact will not be changed but there will be increased monitoring of national budgetary and economic policies will make its implementation more effective, however. In practice this also means that a member state’s budget are examined and assessed in Brussels first, before they are adopted by that state. This will allow ex-ante economic coordination at EU level while national budgets are still under preparation.

5

The Euro Crisis

Origins of the Crisis

- Fears that the global financial system, including the euro system could be on shaky grounds started in 2008, much before the Greek problem emerged in its fullest.
- In February 2009 European members of the G20 group, which represents the world's largest economies, met in Berlin and agreed on the need for a common approach to combat the financial crisis and restore trust in the common market
- In April 2009 the G20 Summit in London agreed to channel €832 billion into the IMF and other institutions and to tighten the rules on financial markets.
- Within the euro area, it was obvious that economic governance differed markedly between member states. Even before 2010, it was already known that the Greek government did not say the whole truth regarding its public finances when it applied to join the euro area.

Causes of the Crisis

The European sovereign debt crisis has resulted from a combination of complex factors, including the

- The globalization process leading to increased possibilities of contagion – for example, a Greek default could lead to many banks facing major problems and through contagion, this can be spread to all the euro area.;
- Lack of regulation on credit conditions, encouraging high-risk lending and borrowing, as was the case of Ireland;
- Real-estate speculation leading to bubbles, as was the case in Ireland;
- Slow economic growth and recessions in 2008-2009, as was the case of Italy and Portugal;
- Lack of fiscal prudence as was the case of Greece;
- Circumventing of rules and hiding deficits and debt levels, as was the case of Greece and Italy.

Origins of the Crisis

- In May 2011, when the possibility of a Greek default started to be taken more seriously, the crises started to unfold in an alarming manner.
- Although Greece is a small country and its share of the euro area economy is less than 3%, many banks are exposed to the Greek sovereign debt.

Why is the Greek Crisis a Major Problem

- The EU leaders consider it very important that the EU rescues Greece for several reasons.
- Firstly, there are many European Banks that hold Greek bonds, and if Greece defaults it could trigger a chain reaction of bank downgrading and possibly defaults, as well as runs on banks in Greece itself and in other countries. So it was in the interest of the EU, even for countries which are not in the eurozone, to help Greece if only for this reason.
- Secondly Greece is a member of the eurozone, where fiscal discipline was supposed to take centre stage. It was therefore important to bring Greece back into the fold and use this incident to put in place more discipline in fiscal matters throughout the eurozone.

The PIIGS

- Other Euro area members also faced problems, although not as worrying as the Greek case. Portugal and Ireland are relatively small countries, and also had a high debt to GDP ratio. These are still considered as being at risk, but the situation would seem to be improving
- Spain and Italy are also facing problems, although their large economy puts them in a relatively strong position and both are potentially solvent.
- The five countries facing problems are labelled PIIGS, an acronym formed from the first letter of the five countries.
- The latest country to be in trouble was Cyprus, as a result of its exposure to Greek banks.

The European Financial Stability Facility (EFSF)

- In early May 2010 the eurozone leaders approved a rescue package worth €750 billion aimed at ensuring financial stability across Europe by creating the European Financial Stability Facility. In October 2011 and February 2012, the eurozone leaders agreed to increase the EFSF to about €1 trillion, in terms of leveraged firepower.
- The EFSF can issue bonds or other debt instruments on the market with the support of the German Debt Management Office to raise the funds needed to provide loans to eurozone countries in financial troubles, recapitalize banks or buy sovereign debt. Emissions of bonds are backed by guarantees given by the euro area member states in proportion to their share in the paid-up capital of the European Central Bank.

Rescuing Greece

- In March 2010 Euro members (together with the IMF and the European Central Bank) agreed to help Greece combat its financial problems to allow a €110 billion loan for Greece, conditional on the implementation of severe austerity measures.
- A second bailout of €140 billion was agreed upon in July 2011. The second bailout carried a lower interest rate than the first, but had more complicated elements.
- Greece also managed to negotiate a 53.5% reduction in its debt burden to private creditors, while any profits made by eurozone central banks on their holdings of Greek debt will be returned to Greece.
- Greece agreed that a team of monitors, based in Athens, will oversee the process to ensure that agreed reforms are implemented.

The EU comes to the Rescue

- Similar, but lower levels of, assistance was agreed with regard to Ireland and Portugal in 2010. Such bailout arrangements were agreed for countries in risk of default to save the eurozone from collapse.
- Bailing out countries in danger of default was a U-turn on the EU treaties which rule out any bail out of a euro member in order to encourage them to manage their finances better.

Greek Austerity Measures

- Public sector limit of annual bonuses.
- Cut in wages for public sector utilities employees.
- Limitations on payments to high earning pensioners.
- A special tax on high pensions.
- Limitations on overtime pay.
- Special taxes on company profits.
- Increases in VAT and increases in on alcohol, cigarettes, and fuel.
- Scaling of pension age to life expectancy changes.
- retirement age for public sector workers has increased
- Public-owned companies to be reduced.
- In the second bailout, the European Commission, the ECB and the IMF also requested Greece to take measures to render its economy more competitive.

Not 100% it will work

- The aim is to reduced the Greek government's debt from 160% of GDP to 120% of GDP by 2020. It still be a high debt ratio. In addition the austerity measures may slow down growth.
- The is why the EU authorities insist on improvement sof competitiveness, by lowering wage rates and rendering Greece attractive for FDI.

Italy and Spain

- Italy and Spain pose much larger problems than Greece should they default on their debt.
- For this purpose the eurozone leaders agreed to increase the so-called "firepower" of their €440 billion fund to preempt dangers originating from the bigger economies in danger. This was done by leveraging arrangements to boost the European Financial Stability Facility (EFSF) to one trillion euros without increasing guarantees provided by governments.
- The EFSF is modeled like an insurance that will guarantee a portion of the debts of Italy and Spain (the two countries on which attention is focused now).
- The fund has already been used for Portugal and Ireland, and for the Greek bailout.

Economic and Social Implications of Austerity

- Greece and the other PIIGS were forced to impose austerity measures. These have the desirable aim of reigning in fiscal imbalances and generating confidence in government finances and in the euro area.
- However there are drawbacks associated with bailouts:
  - They may have a negative effects on economic growth and therefore may be counter-productive in that the tax base will be reduced
  - They generate hardship among families leading to social unrest, resulting in the government diverting its attention from solving the economic problems
  - Bailouts require bailers, and these are more often than not the 'fiscally-prudent' governments and their people. This could generate political problems in the donor countries.
  - Bailing profligate countries may encourage moral hazard.

6

Recent Developments

Treaty on Stability, Coordination and Governance

- In early March 2012, 25 of the 27 EU heads of government (exceptions were Britain and Czech republic) signed the new **fiscal Compact** (Treaty on Stability, Coordination and Governance) aimed at resolving the debt crisis by setting constitutional limits on national debt levels and budget deficits.

- This effectively empowers the European Commission and the European Court of Justice to impose compliance with the Stability and Growth Pact by levying large fines on fiscal misbehaviour.

- The countries that signed the treaty are expected to enter relevant provisions into their constitution.

- This type of arrangement is also likely to lead to Fiscal Federalism

The European Stability Mechanism (ESM)

- The EFSF (described earlier) is set to expire in 2013, running one year parallel to the permanent €500 billion rescue funding program called the European Stability Mechanism (ESM), which started operations in October 2012.
- In January 2011, a parallel arrangement was the European Financial Stabilisation Mechanism (EFSM), an emergency funding programme which could raise funds on the financial markets and guaranteed by the European Commission. Like the EFSF, the EFSM was also replaced by the permanent rescue funding programme ESM.

The European Stability Mechanism

- The European Stability Mechanism (ESM) is a permanent structure as an intergovernmental organisation under public international law and is located in Luxembourg.
- It has the function of a "financial firewall‟ so as to limit financial contagion by one member state.
- From 2014 the ESM will have up to € 500bn euros to help countries in difficulty.
- The rescue fund is available to the 17 eurozone countries - but loans will only be granted under strict conditions, demanding that countries in trouble undertake budget reforms.

Vision for the Eurozone

On 28 November 2012 the EU unveiled a vision for euro zone's integration involving a fundamental overhaul of how the euro zone is structured, including the prospect of setting up a common budget for the single currency area and issuing joint debt in the years ahead. This will result in a deeper integration of the 17 members of the Eurozone, effectively meaning a two-speed Europe, leading to a stronger monetary union by 2018.

One major idea is the joint issuance of bonds by euro zone countries, a process that would effectively involve the 17 member states underwriting one another's obligations.

Most recent: Spain’s Bank bailout

- The European Commission approved a payment of € 37 billion from the euro zone bailout fund to four Spanish banks on the condition that they lay off thousands of employees and close offices.
- The money approved on 28 November 2012 will come from the European Stability Mechanism, the rescue fund for the euro zone, discussed below

Recent re Greece: Rescuing Greece

- On 27 November 2012, Greece's international lenders agreed on a package of measures to reduce Greek debt by €40 billion, cutting it to 124 per cent of gross domestic product by 2020, amid calls for assurances by the IMF, and protests by Germany that such bailouts lead to moral hazard.
- It was thought by the Eurozone leaders that the agreement was not just about money, but a promise of a better future for the Greek people and for the euro area as a whole, a break from the era of missed targets and loose implementation towards a new paradigm of steadfast reform momentum, declining debt ratios and a return to growth.

7

Conclusion

The Story is not finished yet.

In mid-December 2013 EU finance ministers agreed on a single euro-area bank supervisor thereby expanding the European Central Bank oversight role. By March 2014 the new supervisor is due to be fully functional.

The idea is to break the connection between banking problems and sovereign-debt crises.

The Story is not finished yet.

- The Euro market seems to have calmed down. The interest spread on government bonds in Italy and other countries in trouble would seem to have narrowed.
- Many EU banks that were experienced liquidity problems would seem to have healthier balances now, as evidenced by early repayment of the 3-year loans they took from the ECB.
- Also the European Central Bank, erstwhile focusing exclusively on price stability would seem to be also considering promoting economic growth in its remit –In a recent statement, the ECB president, Mario Draghi, said that governments should not overdo austerity measures and if they are to cut expenditure this should be done on operations and not on investment, particularly in the infrastructure.

Advanced countries can also misbehave!!

- One reality that has emerged from the recent euro crisis is that indiscipline and defaults can also happen in advanced countries.
- In the "old days" we used to think that defaults only happen in poor countries
- The euro crisis has served to expose countries that behave badly by living beyond their means. It may yet serve as a catalyst for a more unified Europe.

THANK YOU FOR YOUR ATTENTION!