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Planning to Fail: The Eurozone, its Sovereign Debt Crisis, and the Future of the Union

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The Eurozone, its Sovereign Debt Crisis, and the Future of the Union

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Abstract:

The European Union has been one of the greatest accomplishments of modern history. Through economic and political integration has ended centuries of warfare on the continent while producing the worlds largest trading bloc. Despite the initial success of the monetary union and its single currency, the Union has been bogged down economic troubles in the form of a debt crisis among several of the member states. The recovery period of the crisis has produced growth that is slow and uneven. Countries such as Germany has assumed the role of the economic powerhouse of Europe and therefore a political leader in the Union, all while Greece faced dangerously high debt and unemployment. In this paper I aimed to examine why the European Union has been subject to asymmetric shocks in its monetary union and why growth has been difficult to achieve. I argue that this is due to design flaws of the EU and EMU to form the institutional and political capacity to ensure proper convergence of the member states. By basing the assessment on the theory of Optimum Currency Areas by Robert Mundell as well as monetary and fiscal theory, I have found the design of the monetary union and single currency to be rushed and formed more by political ideology rather than economic theory. Consequently, attempts at the recovery of the Greek recovery have also been subject to the same policies based on ideology as the creation of the euro.

Introduction

For decades Europe was seen as the most stable and boring part of the world. Economic integration, fostered by the European project, tamed a continent ravaged by seemingly endless warfare. From its inception with the European Coal and Steel Community (ECSC), the European experiment has always been economic in practice with political motivations. (Stiglitz 2016, Burgess 2000) In his book *Federalism and the European Union: The building of Europe*, 1950-2000, author Michael Burgess discusses how the creation of the ECSC, though economic in practice, left the door open for political possibilities. Burgess writes: “The ECSC not only solved a past and seemingly intractable problem but it also heralded colossal possibilities for the future, a future which would be built upon many of the novel political ideas and assumptions inherent in the ECSC.”[1] Burgess also notes that the way in which the ECSC came about would act as a model for further integration projects. “The approach to federations, which Monnet called

[1] Burgess, Micheal . 2000. Federalism and the European Union: The Building of Europe, 1950-2000. 1st ed. London , UK: Routledge. pp 66

the 'ECSC method' of establishing 'the greatest solidarity among people', implied that 'gradually' other tasks and other people would become subject to the same common rules and institutions — or perhaps to new institutions — and this experience would 'gradually spread by osmosis'."[2]

However, the gradual acceptance and adherence to these same common rules and institutions have only worked when the economic and political arenas are performing at optimal conditions. In the case where such performance has declined, producing asymmetric shocks across the eurozone, is met with a lack of understanding of the problem at hand and the best course of action to address the issue. If anything has been shown by the first few generations of EU leaders it is that the appearance of solidarity far outweighs the commitment to ever reforming and redesigning for a better performing union and economic entity. What the Greek debt crisis, and more broadly the Sovereign debt crisis, has demonstrated is that the EU leadership are extremely reluctant to push through meaningful reforms to the institutions while they are still young and have yet to fully solidify, because of unwillingness driven by political calculations and engrained ideologies. Because of this any sort of recovery within the EU will remain slow and uneven, resulting in deeper political divisions.

These political motivations and aspirations have taken importance over the economic needs and realities for a monetary union to properly function. Not only that, but political aspiration combined with market ideology has led to the creation of economic institutions that are incapable of performing. *In this paper I argue that the European*

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[2] Burgess IBID pp 35

project failed to produce the policy and institutional capacity needed to ensure that the member state economies would converge in a manner to better form a monetary union, and because of this the EU, along with the ECB, have pursued monetary and deflationary fiscal policies that have been unable to properly assist the crisis countries to produce sustained growth. Nobel Prize winning economist Joseph Stiglitz echoes this sentiment writing: “The eurozone embedded many of these neoliberal ideas into the currency’s “constitutions”— without providing for enough flexibility to respond to changing circumstances or review understanding of how economies function.”[3] This adherence to neoliberal ideology in both its founding and policy choices will help to account for gaps within the design of the EMU and the self correcting nature of the market will help mitigate any economic issues that arise.

The modern European Union was established in February 1992 with the signing of the Treaty on European Union (TEU) also known as the Maastricht Treaty and became effective in November 1993. The TEU established policy and institutional domains such as social, foreign, and security policy oversight. It also established the Economic and Monetary Union (EMU). The goal of the TEU was to successfully create a European economy amongst the member states that operated under a monetary union and single currency. What was developed was the European Monetary Union which aimed to merge the member state economies into a single European market where they would operate under the watch of a central bank which monitors the performance of the eurozone as a

[3] Stiglitz, Joseph E. 2018. The euro: how a common currency threatens the future of Europe. New York: W.W. Norton & Company. pp 25

whole and its member states and the European Union which who provides assessments and targets for the countries to reach.

With the creation of the Economic and Monetary Union, a core piece to its functioning has been the Stability and Growth Pact (SGP), which has held a central role in the design and function of the EMU and the single currency. The SGP is a set of laws that regulates the amount of debt and deficits a member state can hold. The purpose of the SGP was to force the member states to coordinate tighter fiscal policies and not build their economies around excessive spending and borrowing. According to the SGP, member state governments may not run a deficit greater than 3% of its GDP while debt may not exceed 60% of the GDP.[4] These restraints only work when countries have enough economic growth and production where government spending is able to either kept to a low or can be financed mainly through tax revenue.

No other country has experienced the effects from these design flaws of the EMU than Greece. Since the first bailout was implemented in 2010, the Greek economy continues to underperform swinging between recession and depression. As of 2016 the debt to GDP ratio for Greece remains at an unstable 182%.[5] The Greek economy continues to be propped up by loans through the International Monetary Fund and the European Central Bank in exchange for austerity measures. The series of loans, the first

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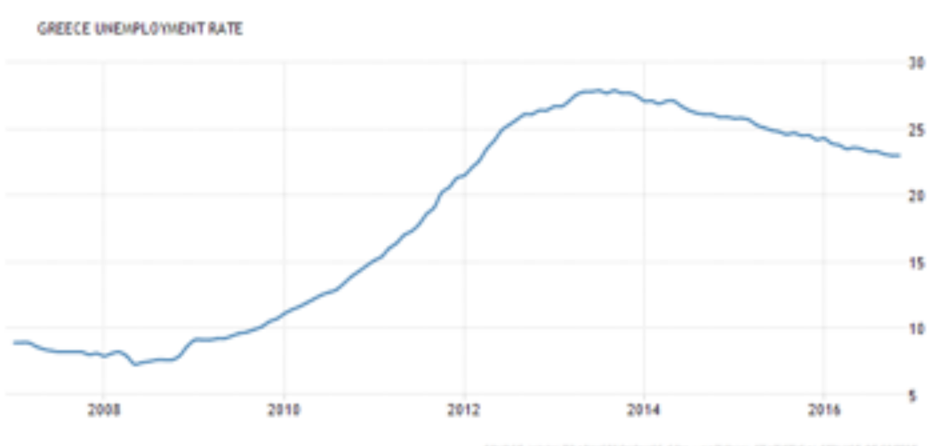
[4] “Stability and Growth Pact.” 2017. *European Commission - European Commission*. http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm (March 12, 2018).

[5] “Economic performance by country.” 2018. *European Commission - European Commission*. http://ec.europa.eu/economy_finance/eu/countries/greece_en.htm (March 13, 2018).

in 2010 for 110 billion euros was soon followed by further assistance with 130 billion in 2012 and 86 billion in 2015. However, despite sizable loans and reforms touted to bring back growth, Greece still experiences high unemployment and social unrest along with emigration as young people and skilled workers leave to find work elsewhere in the EU. As the charts below show that while the unemployment rates for both Greece and the EU as a whole have run along the same path since 2011, Greece still continues to battle a much higher unemployment rate despite the large influx of bailout funds.

Greece and the Eurozone have followed similar paths. While unemployment continues to slowly drop, both remained at dangerous levels for prolonged periods of time. (see charts 1 and 2) With Greece continuing to have an average unemployment of over 20% while the larger Eurozone deals with a rate more than half of Greece's, it seems only a matter of time before drastic measures will have to be made to save Europe, Greece, or both.

Chart 1: Greek Unemployment Rate



[6]

Chart 2: EU Unemployment Rate

[7]

Since then, the Eurozone has been unable to make a full recovery with most of the peripheral countries still experiencing economic troubles all while Greece continues to teeter on complete collapse. With the European Union seemingly unable to spur growth across the continent, economists and policy makers have started to question the viability of the EMU and its single currency. The inability for the Greek economy to grow and move beyond this crisis has shown the ineffectiveness of the Economic and Monetary Union in both design and practice.

This paper will attempt to answer two central themes to understanding not only the Eurocrisis but also Europe's economic institutions and future. The first question I will

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6 "Greece Unemployment Rate 1998-2018 | Data | Chart | Calendar | Forecast." *Greece Unemployment Rate | 1998-2018 | Data | Chart | Calendar | Forecast*. https://tradingeconomics.com/greece/unemployment-rate (March 12, 2018).

7 "Euro Area Unemployment Rate 1995-2018 | Data | Chart | Calendar." *Euro Area Unemployment Rate | 1995-2018 | Data | Chart | Calendar*. https://tradingeconomics.com/euro-area/unemployment-rate (March 12, 2018).

demonstrate how and why the Economic and Monetary Union was flawed from its failure to achieve Optimum Currency Area status due to various economic and political oversights. Second, I will show that a Greek, and in a larger context European, recovery will remain uneven and temporary. This paper will demonstrat that the founders and current leadership of the European project were and continue to be driven by ideological rigidity and grand visions for the EU while failing to develop the solidarity, institutional capacity, and flexibility for member states to recover from economic distress quickly.

The first section focuses on theory, which will help to establish a foundation on which the thesis and evidence can be analyzed and evaluated. This section details two main theoretical concepts. First, I explore how countries or economic blocs are able to establish a monetary union, including a single currency. This part relies heavily on the theory of Optimum Currency Areas (OCA) developed by Robert Mundell. The purpose is to show whether or not the Eurozone would be considered a prime example of an OCA leading up to and past the creation of the euro. If the evidence shows that the Eurozone failed to properly design itself as an OCA then that would help support the argument that the monetary union was flawed from its inception and offers little hope for a full and lasting recovery. The section also examines the ‘convergence criteria’ of the EMU using the theory of Optimum Currency Areas to show that the eurozone was not ready for the single currency and has done more damage in the process of releasing it too soon.

The second part of the first section will then move to the political and economic theory behind recovering a nations economy. This part outlines the differences between fiscal and monetary policies and how each one can affect economic performance in crisis situations. When discussing these differences I highlight the political philosophies that tend to push one side more than the other. By understanding what these policies are and who would be a proponent of them will help to better see what ideologies are prevalent during the creation of the euro and the crisis as well. This part will help to analyze the EU response to the sovereign debt crisis and how Greece has been used a test case for future crises.

The second section of the paper reviews the history and data surrounding the development of the single market leading up to the creation of the euro and its performance since. This part examines each stage of the process, focusing on who was involved at the time, what their motivations could have been, as well as the problems it was trying to address, and the issues that arose following its implementation. I focus on two key reports in the decades long lead up to the EMU, the Werner (1970) and Cockfield (1985) reports, to show at different points in time which issues were thought to be the most important for the success of the European Community. In this section, I discuss the framework of the Economic and Monetary Union, reviewing its initial design versus any changes that have been made as an attempt fix any issues that were presented.

Finally, the third section will focus how the SGP prevents member states, and in particular Greece, from pursuing alternative economic avenues. It will also examine how the SGP forces the European Central Bank and the EU towards a maco-monetary policy when dealing with member states that focuses more on a stable currency and low deficits than allowing countries to pursue policies that can help to spur consumer spending and increasing demand. This section will explore each bailout package the Greek government has received to examine which policies were relied upon. Finally, this section will show that the conditions given to the Greeks in exchange for rescue funds had less to do with growth and job creation and more to do with neoliberal fiscal ideology.

The implications for the Eurocrisis lies beyond simple economics. Since the political institutions of the EU have revolved heavily around the single currency and monetary union, making the economic health of the member states directly factor into the political legitimacy of the EU. The rise in right-wing parties across Europe has only added to the stress that the EU is already under. Many of these parties, such as UKIP and the National Front, already hold an anti-EU position, with the United Kingdom in the process of leaving the union. Grzegorz Ekiert, a Laurence A. Tisch Professor of Government and the director of the Center for European Studies at Harvard notes on the state of the EU and its dealing with multiple problems, speaking to the Harvard Gazette: "Europe's lingering economic and banking woes, questions about fundamental European institutions — including the entire EU project itself — are swirling about just as the radical right political parties are rising in nearly every country."[8] As the chart below demonstrates, the favorability of the EU has been decreasing across the member states. To little surprise, Greece holds the lowest favorability for the union with it reaching 27% in 2016. Even France and Germany, the founding members to the European project, are at 50% or less for the EU.

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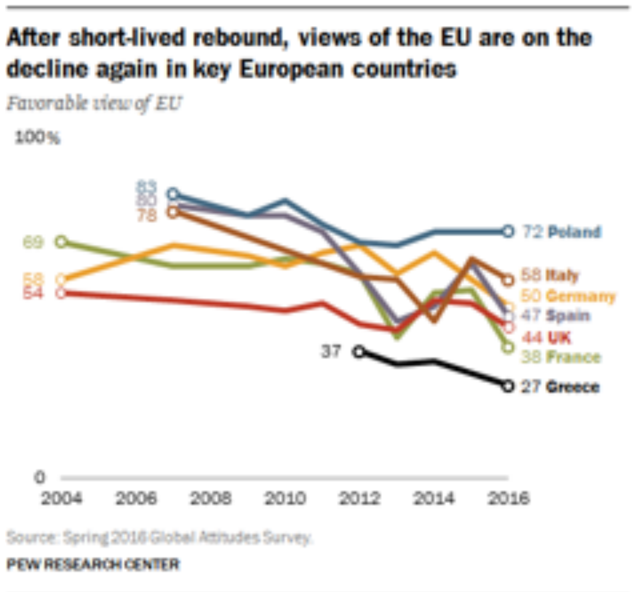
8 Pazzanese, Christina. 2017. "In Europe, nationalism rising." *Harvard Gazette*. http://news.harvard.edu/gazette/story/2017/02/in-europe-nationalisms-rising/?utm_source=facebook&utm_medium=social&utm_campaign=hu-facebook-general (March 13, 2018).

Chart 3: Favorability Views on the EU by Country



[9]

Reasons for this continual decrease in the favorability of the EU stem from a series of crisis situations and political developments that the EU leadership has been unable to properly handle. The first one is the European sovereign debt crisis. While many of the eurozone countries have come out of recession, growth still lags. As stated before unemployment remains high across the continent. While the European project has spanned over 50 years, the union itself remains young. Understanding the design flaws behind one of its central tenets allow for adjustments to be made before these errors become permanent and continue to drag down the Eurozone.

Part 1: Theory

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[9] Stokes, Bruce, Richard Wike, and Dorothy Manevich. 2017. "Post-Brexit, Europeans More Favorable Toward EU." *Pew Research Center's Global Attitudes Project*. http://www.pewglobal.org/2017/06/15/post-brexit-europeans-more-favorable-toward-eu/ (March 12, 2018).

Optimum currency areas (OCA) refers to a geographic region where conditions have been met to allow for a single currency to be used. Barry Eichengreen defines it writing: "An optimum currency area (OCA) is an economic unit composed of regions affected symmetrically by disturbances and between which labour and other factors of production flow freely."[10] These currency zones range from countries such as the United States and Canada to regional economic blocs like the EU. When a country or regional bloc becomes too integrated and large the introduction of a single currency is the logical next step in keeping a well functioning economy. Eichengreen writes: "A common currency, like permanently fixed exchange rates, encourages flows of commodities, capital and labour between states by eliminating exchange rate uncertainty and reducing transaction costs."[11] According to the theory and research on OCA, economic imbalances such as asymmetric shocks or varying exchange rates that would hinder a region's ability to operate under a single currency would be kept in balance by the coordination of economic activity amongst those involved.

In his work '*A Theory of Optimum Currency Areas*,' author Robert Mundell theorized how and when a currency union could and should form. Mundell put forth conditions in which regions could operate under a single currency. In the paper he proposes four main requirements that would allow a currency union to operate at an optimum level. These requirements are: labor mobility, capital mobility, a risk sharing system, and a coordinated business cycle. The central question then becomes, with the

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10 EichengreenEichengreen, Barry J. 2017. European Monetary Unification: Theory, Practice, and Analysis. Cambridge, MA: The MIT Press. pp 51

11 Eichengreen IBID pp 13

European Union undertaking something that has never been attempted on such a scale, has the EMU been constructed in a way where it is an OCA and can operate as such?

For a region to operate under a single currency, Mundell argues that the first requirement is that labor must be able to freely move about. While discussing the need for labor mobility, Mundell outlines two scenarios between nations in Western Europe. The first, as argued by J. E. Meade, who suggests that Western Europe lacks the needed conditions, such as labor to be mobile, to install a single currency and favors the continued use of national currencies to promote internal stability within the common market.[12] The second scenario sees a common currency as a tool to better benefit other areas to provide stability for the region argues; Tibor Scitovsky. Scitovsky believes that with the instillation of a single currency capital is more free to move around the region and force political institutions to promote greater mobility of labor.[13]

In either case Mundell believes labor mobility must be present in the creation of an optimum currency area. Writing: “neither writer disputes that the optimum currency area is the region—defined in terms of internal factor mobility and external factor immobility—but there is an implicit difference in views on the precise degree of factor mobility required to delineate a region.”[14] Nations or economic blocs that operate under an OCA theoretically would be able to use labor mobility as a safe guard to maintain low unemployment. For instance, if one area of the region is experiencing an increase in

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[12] Mundell, Robert A. 1961. “A Theory of Optimum Currency Areas.” *The American Economic Review*. http://www.jstor.org/stable/1812792 (March 22, 2018). pp 661

[13] Mundell IBID pp 661

[14] Mundell IBID pp 661-662

unemployment, skilled and unskilled workers will be able to freely move to other areas where employment is more available. Similarly, if an area is experiencing a shortage of skilled workers, then the various local and regional institutions along with the business community can work to attract people from outside the national borders to fill the employment gaps without worry of political restrictions. One of the core components of the European Union is its freedom of movement. This allows EU citizens to freely move throughout the member states in search of work or whatever reason a person sees fit without the need for a travel or work visa.

Like labor, capital mobility allows a region to better facilitate monetary transactions. Mundell argues that if a region increases in size, both geographically and economically, then the use of multiple currencies becomes illogical. In the case of the EU, without the euro in place the single market would have to operate under 27 separate currencies each with separate exchange rates. Mundell writes: "money in its role of medium of exchange is less useful if there are many currencies; although the costs of currency conversion are always present, they loom exceptionally large under inconvertibility or flexible exchange rates."[15]

In regard to both labor and capital mobility, Mundell sees national boarders and sovereignty as both a help and a hindrance to regions. While borders and sovereignty can help to protect a nation by granting control over inflows and outflows, the problems and solutions must then operate within a closed system. As shown with labor and how open borders can help to control unemployment across a region, capital can work in a similar

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[15] Mundell IBID pp 662

fashion. In areas where labor is abundant but capital is scarce, outside businesses would be able to invest more in setting up production facilities by taking advantage of the abundance of cheap labor. Since its inception, the European project has been about the integration of nations through economic means. The creation of economic community within Europe meant that capital would need to be mobile to help drive integration. It would seem that as far as the first two criteria for establishing and maintaining an OCA, the eurozone has allowed for both labor and capital to move freely about.

A key component for establishing and operating as an OCA is developing a system where any asymmetric shocks are minimized and spread out around the region. Under a risk sharing system countries or areas within an economic region can better coordinate policies to produce a convergence of economies. In the event of an area under economic duress, areas that are doing better will be able to lend assistance. This is what is referred to commonly as a transfer union Stiglitz offers the best definition, writing: "an economic grouping in which one country transfers resources to another, even temporarily in a time of need."[16]

With the development of this transfer union, the need for all of the areas to perform at optimum levels would compel better performing areas to help raise the stability of less performing ones. Mundell writes: "unemployment could be avoided in the world economy if central banks agreed that the burden of international adjustment should fall on surplus countries, which would then inflate until employment in deficit

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[16] Stiglitz IBID pp 22

countries is eliminated."[17] This argument has been a point of disagreement within the European economy. Because of this the ECB has been forced into assuming the role of a quasi-transfer union. Under its QE program, funds have been able to directly allocated to the affected countries. However, as it will be shown in later sections, these relief funds have been more about starving off default along with pushing crisis countries into pursuing different economic agendas than it has assuring that the affected members states would rebound in a quick and sustainable manner.

If the eurozone were to operate completely under Mundell's theory, Germany would be forced to take a much greater burden of the debt crisis in order to remove pressure from the afflicted countries and allow them to recover faster. However, as this paper will demonstrate, Germany has little incentive to agree to this arrangement due to the fact that they have benefited more than any other country within the EMU during the euro crisis. In fact, Annamaria Simonazzi, Andrea Ginzberg, and Gianluigi Nocella find in their paper *Economic relations between German and southern Europe: "*Germany has been able to run an economy with chronically weak demand and large external surpluses because other economies have been the polar opposite."[18]

Because of this advantage Germany holds over much of the other eurozone economies, economic solidarity remains a distant and lofty, albeit needed goal for the single currency and monetary union to operate efficiently. This situation where Germany

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[17] Mundell IBID pp 659

[18] Annamaria Simonazzi, Andrea Ginzburg, Gianluigi Nocella; Economic relations between Germany and southern Europe, *Cambridge Journal of Economics*, Volume 37, Issue 3, 1 May 2013, Pages 653–675, https://doi.org/10.1093/cje/bet010 pp 654

is in an optimum position to exploit the weak economies of the other member states to gain economic and political leverage only work to ensure the eurozone will struggle to achieve OCA status.

The final requirement for a region to operate as an OCA is a coordinated economic and business cycle. With better coordination, growth and downturns are more evenly distributed across the region, allowing for central banks to best push policy for the region as a whole. Eric Helleiner writes in John Ravenhill's *Global Political Economy*: "If selected countries experience similar external shocks, for example, the theory notes that they are more likely to be good candidates for monetary union, since they will have less of a need for an independent exchange rate."[19] Similarly Jamie Dannhauser notes the essay '*The Euro - The Story of a Suboptimal Currency Area*': "With a 'one size fits all' monetary policy, the cost of joining a monetary union will partly depend on the severity of asymmetric shocks but also on the extent to which common shocks have an asymmetric impact on activity and employment."[20] The EMU has been designed in such a way where the prevailing ideology of its creators saw a monetary union as possessing seemingly unlimited growth potential. The structure was set up to only deal with economic growth or small downturns to the whole economy. What has been shown to be the case though, is without a proper budgetary union, to ensure each member state is operating each economy accordingly, and transfer union, where in the event of

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[19] Ravenhill, John. 2017. *Global Political Economy*. Oxford, United Kingdom: Oxford University Press. Helleiner pp 193

[20] Dannhauser, Jamie. 2013. "The Euro- The Story of a Suboptimal Currency Area ." In *The Euo- the Beginning, the Middle... and the End?* , London , UK: Institute of Economic Affairs. essay. pp 58

asymmetric shocks or localized down turns funds can distributed more effective, the EMU will continue to experience uneven growth that will result in political and economic instabilities.

According to Mundell's theory and the criteria in which countries can be considered and operate under a monetary union, the eurozone and EMU project is incomplete. While the EU has made great work in ensuring that both labor and capital are able to freely move, the work in being a complete union has been lacking. As shown the EU fails to do what is necessary to prevent asymmetric shocks or even pursue growth policies that will help recession and depression ridden countries pull out quicker. The lack of political and economic solidarity coupled with ideological restraints, will ensure that the EU will never operate under OCA status.

When economies need assistance with spurring growth, governments have certain policy options at their disposal. They can implement monetary policy that deals with the money supply in the economy, fiscal policy which controls taxation and government spending, or a combination of both. Monetary policy, which typically falls under the oversight of a central bank, allows for greater supervision and control over how fast the economy increases or decreases. This section looks at the theory and practices of both and assesses the usefulness of each based on studies and historical events.

What is monetary policy?

Monetary policy is a set of tools used by central banks to either increase or decrease the money supply in the national or regional economy. Peter Bofinger writes: "the main aim of monetary policy is a control of the financial targets of the economic process (price stability, real growth, full employment), which have been set in such a way as to maximize the ultimate goal of social welfare."[21] Similarly, the Federal Reserve of the United States notes: "The goals of monetary policy are to promote maximum employment, stable prices and moderate long-term interest rates. By implementing effective monetary policy, the Fed can maintain stable prices, thereby supporting conditions for long-term economic growth and maximum employment."[22]

Under normal circumstances, central banks have control over the money supply to manage the economy within a sovereign nation. However, since it operates as a monetary union the member states of the EU must operate under the watch and authority of a central bank for the eurozone, the European Central Bank (ECB). This loss of economic sovereignty creates then a cost-benefit approach to those either looking to join the currency or have already been participating. For countries looking to join the single currency the loss of a large component of economic sovereignty would mean drastic changes to the way they are able to control their economies. Paul De Grauwe explains in his book *Economics of Monetary Union*: "in a full monetary union the national central bank either ceases to exist or will have no real power. This implies that a nation joining a monetary union will no longer be able to change the price of its currency (by devaluations and revaluations), to determine the quantity of the national money in

[21] Bofinger, Peter, Julian Reischle, Andrea Schächter, and Andrea Schächter. 2010. *Monetary Policy Goals, Institutions, Strategies, and Instruments*. Oxford: Oxford University Press. pp 125

[22] "Monetary Policy Basics ." *Federal Reserve Education* . https://www.federalreserveeducation.org/about-the-fed/structure-and-functions/monetary-policy.

circulation, or to change the short-term interest rate."[23] If a monetary union is experiencing an overall sound economy, then countries are more inclined to join and central banks will pull back and let the markets run while keeping a close watch. However, if a monetary union is not designed properly, as we have seen is the case with the EMU, asymmetric shocks to individual economies put recovery and recovery options at risk.

According to Michael Joyce et al. in their article *Quantitative Easing and Unconventional Monetary Policy,* the focus and application of monetary policy has changed from before and after the financial crisis. They write in pre-crisis time: "The aim of monetary policy was to achieve low and stable inflation, the policy framework was inflation targeting, the instrument was a short-term interest rate at which the central bank provided funds to banks or the interbank market and the impact of this official rate on market rates and the wider economy was reliably quantified." Joyce et al. notes how the financial crisis shifted the focus of central banks writing: "Central banks now have a much greater focus on financial stability in addition to targeting inflation." They continue. "The aim of these policies is to achieve financial stability and prevent or at least moderate asset market bubbles."[24]

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[23] GRAUWE, PAUL DE. 2018. *ECONOMICS OF MONETARY UNION*. Oxford : OXFORD UNIV PRESS. pp 3

[24] Joyce, Michael, David Miles, Andrew Scott, and Dimitri Vayanos. 2012. "Quantitative Easing and Unconventional Monetary Policy - an Introduction*." *The Economic Journal* 122(564). https://pdfs.semanticscholar.org/ebce/ee0b46de5ae81d271f0cd9f41f9bde7a0aa5.pdf.

Price stability is maintained through the controlling of inflation. Inflation refers to the increase of the price of goods over a period of time. If inflation rises too rapidly then the value of the currency decreases. Which could result in hyper inflation, rendering a currency worthless. In regard to the EMU, hyperinflation has been a large worried for those who helped to create the Eurozone particularly Germany. This scenario will play a prominent role when discussing the how the eurozone is structured and why was built in such a way. A central bank would work to control inflation through increasing or decreasing the money supply within the economy.

When economies experience downturns, institutions in charge of monetary policy have several options to help spur growth. As stated before, central banks have authority over the money supply within an economy. If in the event of a recession or depression, one of the tools central banks can use is what is known as monetary easing (quantitative easing or QE). Monetary easing is a process by which central bank purchases government debt from smaller banks to make them more stable and with the hopes of those banks will be more open to lending money again.

QE is a monetary option in which central banks are able to pump money back into the economy. It is a method which was used by both the American and British central banks to help fend off more damaging effects of the financial crisis. QE works by central banks create more money which is then used to purchase government and corporate bonds from financial institutions. This in-turn reduces the interest rates, making it easing for individuals and businesses to take out larger loans. With more money in the hands of private citizens and institutions, this would produce an increase in spending and also help to create jobs.

While QE has help to fend off the most serious effects of the financial crisis of 2008 in most western economies, some argue that continued use of QE has made economies too dependent on the inflow of money. Lord Macpherson, who was a former Treasury secretary of the United Kingdom, linked the use of QE to an addictive substance. He noted: “QE like heroin: need ever increasing fixes to create a high. Meanwhile, negative side effects increase.”[25] However, the QE problem is just let latest in a series of issues the promoters of greater European integration have had to deal with since its inception.

The desire to unify the member states under a single currency would stand as the logical goal for nations continually working to integrate their economies. Before the introduction of the euro, capital and goods would have to deal with multiple exchange rates when crossing borders. These exchange rates, tied to the national currency, presented an economic barrier at odds with the dream of economic integration. A multi decade attempt to tackle the exchange rate problem resulted in different attempts of trial and error.

One way the member state countries attempted to address the exchange rate issue was in 1972 to create a common exchange rate and tie it to the US-dollar, but with the ability to move up or down within a set of narrow margins. This practice would be referred to as ‘the snake in the tunnel’. “ Thrown off course by the oil crises, the

[25] “ECB Chief Draghi: QE Has Made Economies More Resilient.” 2017. *BBC News*. http://www.bbc.com/news/business-41021422 (March 22, 2018).

weakness of the dollar and differences in economic policy, the ‘snake’ lost most of its members in less than two years and was finally reduced to a ‘mark area’ comprising Germany, the Benelux countries and Denmark.”[26] The series of economic troubles in the world put a halt to snake and any progress made towards further integration.

While issues like the exchange rates acted as a hindrance towards greater market openness, the ability for a nation to better control the value of its currency is a powerful tool that allows it to better respond to economic downturns. For example, if we are to imagine the Greek debt crisis with Greece operating under its former currency, the way in which the Greeks responded would have looked very different from what we have seen under the EU. Under this scenario, Greece would have the ability to increase or decrease the value of its currency. With this option the Greek government could then implement measures to devalue its currency. A weakened currency would, in theory, make the country more attractive to tourists and foreign investors, seeing as they could get more for their money. The increase in revenue would then theoretically lead to an increase in jobs, wages, government revenue, and help to improve the trade balance as well.

Under this form of monetary policy, a national currency that is tied to a central bank would allow the country the ability to gain better control over the crisis situation. As it will be demonstrated later in this paper, a problem with the EU is because of the structure of its political and economic institutions, an over-reliance on monetary policy to

[26] “Fact Sheets on the European Union.” *The citizens of the Union and their rights | EU fact sheets | European Parliament*. http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_4.1.1.html (March 22, 2018).

ease crisis situations is extremely difficult when there are 27 individual economies with varying degrees of stability.

What is fiscal policy?

Fiscal policy consists of instruments, mainly controlled by national governments, that can help to increase or decrease demand or spending. Such instruments include the ability to tax, increase or decrease government spending, or create jobs provided by the government or with help from private institutions. When working together, both sound fiscal and monetary policy area able to address economic issues both at the macro and micro levels in order to help facilitate are faster recovery.

Fiscal policy can be broken down into two main types: expansionary and contractionary. The purpose of expansionary fiscal policy is to help reduce unemployment. It does this through tax decreases and increased spending. However, if there is too much expansionary policy, inflation can rise. Contractionary fiscal policy works to help keep inflation low through spending decreases and tax increases. The continual work of fiscal policy is a balance of trying to keep both inflation and unemployment low.

The increasing of short-term government spending, is meant to push capital back into a troubled economy to help increase confidence from citizens and businesses to spend their own capital to help create demand and promote job growth. The downside is that increased spending by government will increase the deficit and can add to the overall debt of the country. If economic growth fails to return in a substantial manner, or reckless spending continues after the crisis has left, then the increased debt burden will add to a worse situation once the economy turns.

However, despite the risks associated with implementing debt-financed fiscal stimulus, the benefits still outweigh the negative impacts on a nations finances, provided political leaders are able to make the necessary corrections once the crisis is over. According to Battaglini and Coate, the imbalance between the public and private sectors where government assumes most of the burden, in times of economic hardship is needed because it allows for the private sector to regain footing and help to lower unemployment, resulting in higher wages and an increase in tax revenue.[27]

How has ideology affected or pushed these policy tools?

The debate surrounding what is the most effective way for governments to overcome a declining economic conditions is one with proponents on both sides heavily invested in pushing their ideology further into the policy arena. Within the context of the EU this debate continues to play out. However, because some member state economies perform better than others, the agenda that is pursued is dependent on the ideology of those who hold the better bargaining positions in both the design process and how future policy is pushed.

At the beginning of the post-war era, Europe began to rethink its economic and social arrangements between the government and its citizenry. Initially, the West was operating under the Bretton-Woods system of international economic development, while

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27 Battaglini, Marco, and Stephen Coate. 2015. "A Political Economy Theory Of Fiscal Policy And Unemployment." *Journal of the European Economic Association* 14(2): 303–37. https://coate.economics.cornell.edu/docs/recentpublications/fpu20rev.pdf. pp 2

the Western European nations were implementing economic policies inspired by the work of British economist John Maynard Keynes. Kenynes's work, *The General Theory of Employment, Interest and Money*, developed the idea that governments have and should use more influence over their national economies in order to maintain a more healthy equilibrium. The idea that Keynes put forth was simple; if the economy is declining, then government should decrease taxes and raise spending to push money back into the economy, and when growth has resumed then the government can work to get its financial house in order by tax increases and spending cuts.

While many European countries operate with high degrees of redistributive economic policies and large social safety nets, the economic policies each country pushed on a national vs EU level can be quite different. In public, the EU has always worked to maintain a sense that it favors a robust social policy for its member states, and in many ways it has pushed for such, the economic make up of the EMU favors more heavily on a different set of economic principles. Neoliberalism, or market fundamentalism, have been a guiding force for many in the European leadership on how the EU economy should be designed and functions. The neoliberal school of thought advocates for a more unrestrictive form of capitalism. Unlike Keynesianism, which sees a role for government in the health and well being of the economy, neoliberalism believes that the best way for an economy to trend upward is to let the market self-correct. By allowing the market to rid itself of any bad and undesirable elements without government interference, it is able to better restore itself to an economic equilibrium.

Part 2: History and Structure of the EMU:

Since the signing of the Treaty of Rome, a single market has been a desire for the European project. Following the success of the Treaty of Rome, the 1960s saw a greater push towards European cooperation. During this time the customs union was set into place and Europe was seeing economic progress from the post-war rebuilding along with the increased intra-european trade. By the 1970s progress would be stalled due to the collapse of Bretton-Woods and a slow down in the global economy. These factors helped to push inflation and unemployment up in Europe and forcing member states to adopt more protectionist policies.[28] While this was a minor setback for the project, European leaders pushed forward with a series of papers that would help to outline the future and direction of the European community.

The first, known as the Werner Report, published in 1970 resulted out of a disagreement between EEC leaders on how to proceed in creating the monetary union. The debate focused on which area should be pushed first, either by building an economic union to coordinate economic policy or a monetary union by starting with a single currency. McCormick and Olso write: "Following agreement on the principle of economic and monetary union (EMU) at a 1969 summit of EEC leaders at the Hague, it was decided to move on the economic and monetary fronts at the same time, with the achievement of fixed exchange rates in states by 1980."[29] The report focused on how the agreement would best be achieved. The best path for a successful union meant the convergency of policy and pooling of sovereignty.

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[28] Olsen, Jonathan, and John McCormick. 2017. *The European Union: Politics and Policies*. Boulder , CO: Westview press. pp 69

[29] McCormick IBID pp 67

"To ensure the cohesion of economic and monetary union, transfers of responsibility from the national to the Community plan will be essential. These transfers will be kept within the limits necessary for the effective operation of the Community and will concern essentially the whole body of policies determining the realization of general equilibrium. In addition, it will be necessary for the instruments of economic policy to be harmonized in the various sectors."[30]

Under the TEU Treaty, the European Central Bank (ECB) holds the authority to develop and implement monetary policy over the eurozone countries. Within the EC Treaty lies the Protocol on the Statue of the European System of Central Banks and of the European Central Bank which details the functions and authorities of the ECB and central banks of all the member states. Under such protocol the ECB is granted authority over monetary policy within both the EU itself and the individual member states.[31] Other duties include: conducting foreign-exchange operations, holding and managing the official reserves of the member states, and promoting the smooth operation of payment systems.[32] As laid out, the primary focus for the ECB is price stability. Article 2 of the protocol explains:

"In accordance with Article 105(1) of this Treaty, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the

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30 Werner , Pierre. 1970. "Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in the Community ." *Council - Commission of the European Communities* . http://aei.pitt.edu/1002/1/monetary_werner_final.pdf. pp 10

31 "EUR-Lex Access to European Union Law." *EUR-Lex - ec0015 - EN - EUR-Lex*. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:ec0015 (March 22, 2018).

32 "PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK." https://www.ecb.europa.eu/ecb/legal/pdf/en_statute_2.pdf (March 22, 2018). article 3.1

Community as laid down in Article 2 of this Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4 of this Treaty."[33]

With the price stability as the main objective of the ECB and other member state banks, no attention is given to employment or the social and economic welfare of European citizens as oppose to the Federal Reserve which is designed to keep both unemployment and inflation down. The Council on Foreign Relations notes that the focus on price stability and monetary policy would work to hinder the potential and impact the EMU. The report notes:

" At the creation of the EMU in the late 1980s, lingering concerns over inflation and fears of an uncompetitive EU begat a firm agreement on the need for a strong, stable currency based on the Deutsche mark. Sober central bankers in Frankfurt would run EMU and the euro with a single focus—price stability —and with a series of rules—the Growth and Stability Pact—that would clamp down on fiscal prolificacy and instill confidence in the euro (the fact that it was always known as the stability pact symbolizes the lack of attention to the growth side of the equation)."[34]

This oversight limits the scope of how the ECB can be used to promote growth within troubled member states by allowing for fiscal tools that can help promote growth. While fiscal policy in the EU remains at the national level of member state governments, the EU, most notably the Commission, have set in place guidelines, laws, and annual directives for how member states can conduct spending practices.

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33 "PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK." https://www.ecb.europa.eu/ecb/legal/pdf/en_statute_2.pdf (March 22, 2018). article 2

34 "The Eurocrisis and the Uncertain Future of European Integration." *Council on Foreign Relations*. https://www.cfr.org/report/eurocrisis-and-uncertain-future-european-integration (March 22, 2018).

The strict limitations on fiscal spending stem from Germany's fear of inflation and debt. The hyperinflation during the interwar period of the early 20th century has rooted itself in the german political psyche, resulting in a fairly conservative ideology when it comes to fiscal matters. This fear was implemented into the design process of the EMU where there are strict rules on how much a member state government can spend. Leading up to the introduction of the monetary union, countries seeking to create a single economic zone were dealing with high levels of debt and deficits such as Italy whose deficits hit 10% of GDP in the run up to Maastricht.[35] The Stability and Growth Pact was put into place as a way to counteract reckless fiscal practices. According to the guidelines of the SGP, member states would have to adhere to two main criteria on how to manage their budgets, the first being that a countries deficit cannot exceed 3% of the national GDP and the second setting a debt limit of 60% to GDP. Despite having strict guidelines over fiscal policy the SGP, which as an attempt to better coordinate fiscal policy and promote convergence of the member states, lacked proper and timely enforcement.

> *"The Pact's Achilles heel was its weak enforcement provisions (ECB, 2008; Schuknecht, 2005). First, the Commission, as the institution initiating proceedings, had to get the backing from Commissioners before any procedural steps could be taken. Thus, there was always a risk that the Commission would seek to water down proceedings against countries. Second, a qualified majority was then required in the ECOFIN Council in order to approve further procedural steps. Countries that "sinned" retained the right*

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[35] Schuknecht, Ludger, Philippe Moutot, Philipp Rother, and Jurgen Stark. "The Stability and Growth Pact: Crisis and Reform ." *Occasional Paper Series* (129). https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp129.pdf.

to vote and needed only a few additional countries – prospective sinners among them – to block such steps.”[36]

The problem stems from leaving the enforcement and punishment aspects of the SGP to the member state collective authorities within the EU. For the SGP to fulfill its intended purpose, there must be a separate institution to assume the role of enforcer. It would only be logical for the ECB to take on this task. Because in the wake of the ineffectiveness of the SGP, Greece was allowed to continue to amass a larger debt burden which would cause not only the near collapse of its economy but a painful recovery as punishment by the EU leadership. The Greek case has shown that not only does the SGP lack the necessary tools to operate as intended, but because of the structure of the EMU combined with the ideological rigidness of the European leadership, the options for Greek recovery were and are very limited.

Part 3: The EMU and its effects on the Greek crisis:

Greece has suffered for many years from poor government, inadequate tax collecting infrastructure, and a poorly diversified economy. The inability to collect the needed tax revenue to help offset the cost of government spending led to the continuous massive borrowing. However, as the EU was enjoying growth and high performance and confidence in their single market and currency, the housing market in America had created a bubble that was ready to burst. In 2008 the U.S financial and housing markets collapsed as a result of a massive amount of bad mortgages being defaulted on that were sold as secure investments all over the world. The shockwaves from the crash became

[36] Schuknecht IBID

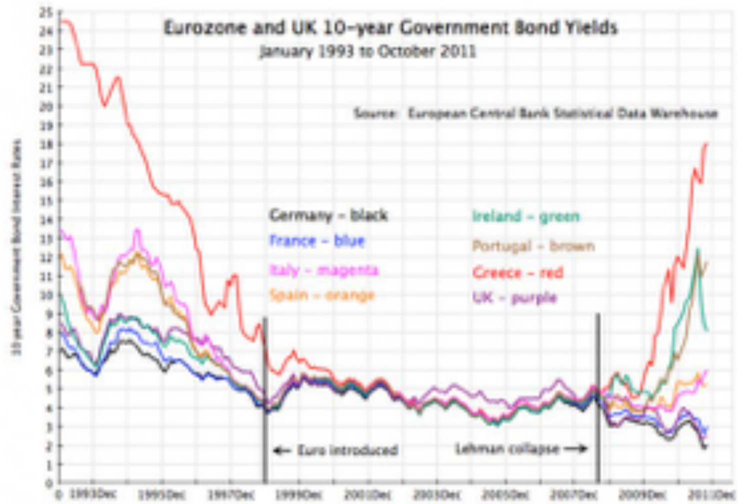
international, hitting the EU particularly hard and give them what would become its first large test in this economic experiment.

The crash in the United States led to the exposure of the underlying problems within the eurozone economies, showing that government debt for some of the member states were at unsustainable levels and payments could not be make on existing loans. The biggest of these offenders was obviously the Greek economy, which had used its position in the eurozone to borrow more debt than would normally be allowed because it was tied to the other member states.

As a consequence the European Union was forced to step in, with help from the ECB and IMF, in the form of multiple bailout packages. In return for the money to keep the country from going under, Greece had to agree to restructure its economy and social welfare programs, while at the same time implementing harsh austerity measures. The results have been mixed. At times Greece has started to show signs of improvement with government expenditures modest gains in the Greek markets, while at other times Greece continues to teeter on the brink of collapse.

The Greek debt crisis was essentially a powder keg waiting for the right spark to trigger an explosion. When the monetary union was formed, interest rates for the currency were to be tied to the three best performing economies in the EU. Because of this Greece was allowed to borrow money at interest rates lower than it would have gotten otherwise, allowing for multiple Greek governments to continuously borrow to help prop-up its extensive social safety net while building up massive debt. In the run up to the 2009 crash consecutive Greek governments had amassed 320 billion euros in debt, totaling 180% of GDP.

Chart 5: Government Bond Yields 1992-2011 [37]



What the graph shows is that prior to the introduction of the euro, Greece was seen as a risky investment. When they joined the euro, Greece was then seen as a safer bet since they had the backing of not only the ECB but the collective eurozone economy. However, despite this, once the shocks from the financial crash in the United States hit Europe, the crisis countries emerged with Greece being the worst affected. Because of this, as the graph shows, the interest rates for Greek 10-year government bonds rose dramatically, quickly returning to the levels before the introduction of the euro.

The Greek case follows the restrictions that belonging to a common currency, outlined by Paul De Grauwe. In his work, De Grauwe gives a scenario between the UK and Spain and analyzes how each country is able to respond when faced with an

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37 Thompson, Derek. 2011. "The Most Important Graphs of 2011." *The Atlantic*. https://www.theatlantic.com/business/archive/2011/12/the-most-important-graphs-of-2011/250240/ (March 22, 2018).

economic downturn and possible debt crisis. Since the UK belongs to the EMU but not the common currency the government would sell their bonds in order to keep money within their national markets. If investors weren't interested in purchasing government bonds, the UK government then had the option to issue more money in order to pay back lenders. In the case of Spain, the options that were available to the UK cannot be used by the Spanish government since it belongs to a common currency. While Spain would be able to issues Spanish bonds, the paths differ from there. De Grauwe writes: “The investors who have acquired euros are likely to decide to invest these euros elsewhere, say in German government bonds. As a result, the euros leave the Spanish banking system. There is no foreign exchange market and flexible exchange rate to stop this.”[38]

The Greek case has followed the same path as Spain did in De Grauwe’s scenario. When Greece entered into a debt crisis, money had not only fled the country in search of more stable investments but the wealth held by the average person decreased or disappeared, reducing the governments ability to generate the needed tax revenue. A report from the Guardian noted that that the poorest 20% of the Greek people experienced a 42% drop in disposable income since the 2009 crash.[39] The bailout programs that were designed by the Troika were touted as rescue packages to help stabilize the Greek economy, what they were in actuality were loans in order to pay back creditors.

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[38] De Grauwe IBID pp 9-10

[39] Smith, Helena. 2016. “A Year after the Crisis Was Declared over, Greece Is Still Spiralling Down.” *The Observer*. https://www.theguardian.com/business/2016/aug/13/greek-economy-still-spiralling-down-year-after-crisis-declared-over (March 22, 2018).

Such rescue packages only kept Greece from going into default while wealth and standards of living crashed for the average Greek. De Grauwe attributes this to the loss of economic sovereignty with joining a monetary union. He writes: “in a monetary union, financial markets acquire tremendous power and can force any member country onto its knees.”[40] He explains this by noting: “When investors distrust a particular member government they will sell the bonds, thereby raining the interest rate and triggering a liquidity crisis, This may in turn set in motion solvency problem, i.e. with a higher interest rate the government debt burden increases, forcing the government to reduce spending and increase taxation.” He continues: “Such forced budgetary austerity is politically costly, and in turn may lead the government to stop servicing the debt, and to declare a default.” [41] The austerity imposed by both the Troika and creditors combined with the budgetary restraints from the SGP has made it even a miracle Greece is still a country.

The austerity imposed on Greece has helped to keep unemployment high throughout the country and increased poverty as a result of spending cuts. Aside from the bailout agreements, there is little room for Greece to move around to try and promote growth through fiscal measures. Because Greece is part of the eurozone and the single currency it is subject to the guidelines of the EMU on how the county’s economy can operate. The Stability and Growth Pact restricts its ability to implement fiscal tools to

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[40] De Grauwe IBID pp 10

[41] De Grauwe IBID pp 10

push money back into the economy by focusing on demand and employment, rather than inflation or a stable currency.

The Greek case has been a small part of the larger European experiment designed and pushed by ideology and not good economic practices. As stated before, the SGP is designed in a way where it only works if the economy of a member state is already performing well. If a country is underperforming within the eurozone, it has little options available. Because a country such as Greece belongs to the single currency, it has surrenders a good portion of its economic sovereignty under the guise that a rising tide lifts all boats. The European experiment and the Greek recovery have been steered by neoliberal or market-fundamentalist ideology. Jurgen Habermas notes in his book *The Crisis of the European Union: A Response*: "The shattering of neoliberal illusions has fostered the insight that the financial markets - indeed, more generally, the functional systems of world society whose influence permeates national borders - are giving rise to problems that individual states, or coalitions of states, are no longer able to master."[42]

Speaking in times of economic downturn author Robert Skidelsky noted in the essay '*Austere Illusions: Fiscal contraction is contractionary, period*': austerity is exactly the opposite of what is needed. A government cannot liquidate its deficit if the source of its revenues, the national income, is diminishing"[43] This is the trap much of Europe, and in particular Greece, has found itself in. The idea is by purging the state and inefficient

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[42] Habermas, Jürgen, and Ciaran Cronin. 2012. The Crisis of the European Union: a Response. Cambridge: Polity. pp 5

[43] "Austere Illusions: Fiscal Contraction Is Contractionary, Period." 2013. *British Politics and Policy at LSE*. http://blogs.lse.ac.uk/politicsandpolicy/austere-illusions/ (March 22, 2018).

aspects of the market out of the economy as much as possible, growth will resume; because as the former treasury secretary for Herbert Hoover, Andrew Mellon advised the President: "enterprising people will pick up the wrecks from less competent people."[44]

Robert Skidelsky explains that those who push for austerity are driven more by ideology rather than empirical proof. Skidelsky states that these advocates rest on one central thesis. He writes: "If fiscal contraction is part of a credible 'consolidation' program aimed at permanently reducing the share of government in GDP, business expectations will be so encouraged by the prospect of lower taxes and higher profits that the resulting economic expansion will more than offset the contraction in demand caused by cuts in public."[45]

Skidelsky's analysis mirrors what Joseph Stiglitz writes about in his book on the euro and the European crisis. In the book Stiglitz argues that the ultimate flaw in the euro and Eurozone is that from its design and inception, the euro has been based of off neoliberal ideology, or as he refers to it as 'market fundamentalism.' Stiglitz asserts: "The failure of the Eurozone, both in its structure and policies, can thus in large part be attributed to the combination of a misguided economic ideology that was prevalent at the time of the construction of the euro and a lack of deep political solidarity."[46] This lack of solidarity would be a constant reminder as each round of debt talks began between Greece and the EU.

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[44] Skidelsky IBID

[45] Skidelsky IBID

[46] Stiglitz IBID pp 10

Ideological rigidness combined with political calculations at the national level within the 'healthy' economies have spelled troubling news for those member states experiencing economic woes. As stated before, Germany has been reluctant to rework the EMU in a way where benefits are more evenly spaced out. Successive German governments have long argued over the need for fiscal restraints in the development of the European economy and the single currency and they have fought to push a German version of fiscal conservatism onto the other eurozone countries.

In an effort to help stimulate the bloc, the ECB has been using quantitative easing (QE) to push 2.3 trillion euros back into the eurozone economy. Through QE the ECY has been purchasing, on average, 60 billion euros a month in private and government bonds since 2015. Actions taken by the ECB have resulted in faster growth. Between April and June of 2017 the bloc grew at 0.6%. Because of this the eurozone is forecasted to grow by 2.1% for the fiscal year. This would be the largest increase in the European economy since the start of the crisis.[47] While this will be initially viewed as welcomed news and a sign that the European economy is in the recovery stage, any celebration is misplaced. The European leadership has done little to reform the eurozone economy to where shocks are more evenly spread throughout the region. Instead, they will continue to be localized while other countries within the EMU will prosper.

Conclusion:

[47] "Eurozone Growth Hit 10-Year High in 2017." 2018. *BBC News*. http://www.bbc.com/news/business-42870993 (March 22, 2018).

Jean Monnet, who is considered the founding father of the European project, once stated: “people only accept change when they are faced with necessity and only recognize necessity when a crisis is upon them. I have always believed that Europe would be built through crises and that it would be the sum of their solutions.”[48] Little did he know how correct he would be. While a united Europe has been a decades long project, the EU remains young. Regardless of its youth, the European Union has already confronted crises ranging from economic (sovereign/Greek debt crisis), social (the refugee and migrant crisis), and political (the rise of the far-right parties and leaders). The succession of crises testing the economic, social, and political spheres of the EU has illuminated the cracks and weaknesses within the European institutions.

As demonstrated, the European leadership failed to produce the conditions to become an Optimum Currency Area. Instead, personal political gains, rigid economic ideology, and a drive to make history quickened the process and led to a common currency and economic union that could function well when times are good but would be unable to properly cope in the event of an economic downturn. The lack of economic solidarity combined with superficial political solidarity was exposed and fully on display when the Union entered the debt crisis. The policy that resulted when problems arose in 2009 only provided further proof that solutions were being filtered through an ideological prism rather than sound economic theory. What was shown was that the EU leadership, along with the ECB, are only willing to go so far and only down a narrow pathway for recovery. As a result, divisions have been further solidified amongst the member states.

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[48] Burgess IBID pp 34

As the EU has been able to slowly move out from under the shadow of the crisis, new issues arise stemming from the former crisis.

The experience of the sovereign debt crisis has affected the European project greatly and will continue to for years to come. The dream and work of harmonization, that is the same standards, laws, and regulations equally applied to and under all member states, has been tested through the series of crises that has put further strain on European unity. The financial crisis has only helped to solidify the divisions and reenforce stereotypes between the northern makers and the southern takers. A 2013 poll conducted by the Economist magazine and Pew looked into what various EU countries felt about each other. The poll asked the respondents from each country to rank the most and least trustworthy, arrogant, and compassionate.

Chart 6: Attitudes of Fellow EU Countries

Who is trustworthy, arrogant or compassionate?

EU nation most frequently cited as top choice by other country

	TRUSTWORTHY		ARROGANT		COMPASSIONATE	
Viewed by:	most	least	most	least	most	least
Britain	Germany	France	France	Britain	Britain	Germany
France	Germany	Greece	France	France	France	Britain
Germany	Germany	Greece/Italy	France	Germany	Germany	Britain
Italy	Germany	Italy	Germany	Spain	Italy	Germany
Spain	Germany	Italy	Germany	Spain	Spain	Germany
Greece	Greece	Germany	Germany	Greece	Greece	Germany
Poland	Germany	Germany	Germany	Poland	Poland	Germany
Czech Republic	Germany	Greece	Germany	Slovakia	Czech Republic	Germany

Source: Pew

[49]

What the chart shows is that the European countries continue to hold a diverse and often conflicting opinion about themselves, making the desire for harmonization of the member states much more difficult. It is not surprising that each country thinks the highest of themselves, but these negative opinions only work to foster resentment and impede growth and legitimacy of the European Union. While these negative opinions aren't new, many of them rooted in complex and often violent interactions throughout history, the continuation into the modern european political area can affect to what extent countries are willing to work with each other.

In regard to Germany, their economic power and influential standing within the EU has given them a complex image from their fellow member states. As the chart shows, while Germany is seen as the most trustworthy, it is also thought of overwhelmingly as the most arrogant and the least compassionate. The Economist explains this view being a result of their economic might combined with the harsh policies pushed on the other member states. They note: “this antipathy towards Germany is understandable. As the main paymaster for the euro area, Germany is blamed for the strict austerity measures imposed on Greece as a condition for bailing out the country.” They continue. “These have resulted in a cycle of declining growth, weakening demand and real hardship. Indeed, Germany's economic dominance is reflected in its several

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[49] “Polls Apart.” 2013. *The Economist*. https://www.economist.com/blogs/graphicdetail/2013/05/what-europeans-think-each-other (March 22, 2018).

nominations as the most arrogant and least compassionate country."[50] Germany's continued economic success in the eurozone while ensuring that austerity measures are imposed on the other member states only work to show that Germany prefers the current status quo where they are the main beneficiaries. A poll conducted by the European Parliament in 2017 wished to see whether or not citizens in the member states felt they had benefited from EU membership. (See chart below)

Chart 7: Attitudes Toward EU Membership by Country [51]

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51 | They've Benefitted from the EU?" *World Ec* g/agenda/2017/11/which-countries-feel-the 2018).

What they found was that there is mixed feelings in regard to EU membership. Not surprisingly, countries that have benefited the most economically have a more favorable view of being in the union. Ireland, while it did suffer its own economic troubles in 2009 was able to rebound and continues to be a place for much foreign investment and opportunities. Countries such as Greece, Cyprus, and Italy hold the lowest unfavorable ratings due to the persistent economic problems they face. Even the United Kingdom with 55% reporting a sense of benefiting from being in the EU was able to vote to leave the union, how much longer will other countries remain if they continue to struggle against their counterparts.

As stated before, the negative opinions held about one another has furthered slowed the process of harmonization and integration for the EU. However, what steps could be taken to ensure a more balanced monetary union and European governing body? Several reforms such as transnational political parties, centralized lending practices, and targeted loan applications could be implemented that allow for better cohesion in the European political and economic arenas.

A common critique of the European Union as a whole is its democratic deficit where European citizens feel underrepresented and controlled by bureaucrats in Brussels. While a more democratic union would help to provide a more common voice and work to rebuild the image and opinions of the European Union, the recent rise of the far-right across Europe could put the EU in more danger if it were subject to more democratic means of operation. However, the EU still needs better representation of its citizens. One way to address the issue is by allowing transnational political parties and elections to the

European Parliament. Under the current system, people run for office in their home country and upon election are grouped with other members of parliament that are members of similar parties. The implementation of transnational European parties would allow a better sense of European unity and commonality.

One way the eurozone needs to be reformed is by instituting centralized lending practices. Under the current system, member state countries are able to unilaterally obtain loans from private lenders. As we have seen with Greece, however, when member states have been left to secure loans, they have been able to run up higher debt levels because they are tied to the larger eurozone economy. Simply put, countries are able to get larger loans from private lenders because they are backed by the economic power and singular interest rated of the eurozone.

By reforming lending practices to a more centralized approach will be able to correct several of the above problems. Processing loans through the ECB or a newly created EU institution would allow for higher control over the fiscal situation of the member states. This would prevent eurozone countries from running up higher deficits and ultimately debt levels. Essentially, this would help to hold countries within the strict limits laid out by the Stability and Growth Pact. Instituting centralized lending practices would also reduce the risk of asymmetric shocks within the eurozone. As it has been shown, the eurozone was developed with too high of a probability of asymmetric shocks and imbalances in labor and capital concentration, this has lead to an increasing wealth gap and inequality not only within the individual countries but also between the different eurozone countries.

The final reform would be the application of targeted loans. What this would do is allow the ECB, working with the commission and affected country, to push money back into targeted sectors of the crisis countries. Countries that have been receiving bailout funds since the beginning of the financial crisis have had to used the funds to keep their economy from going into depression or to make payments to creditors. With the implementation of centralized lending, rescue funds would be able to help push money back into the countries economy with hopes of reducing unemployment, adding to the tax base, and encouraging spending and growth. As shown in regard to the Greek situation, the current practices have only proved to be impractical and exploitive. Money that is loaned to Greece to keep the country afloat quickly ends up back in the hands of private lenders.

While the government has made great strides, albeit coerced, in reducing its massive expenditures, the economic situation of Greece remains worrisome. Growth remains slow, and while the European leadership with no-doubt welcome any positive news with praise and talk of the policies worked, the toll the crisis and slow growth has taken on the Greek people cannot be ignored. Since the start of the crisis and austerity measures in 2010, suicides have risen at an average yearly rate of 7.8%. The yearly average before the crisis was 1.6%. The amount of people unable to obtain medical attention went from 10% in 2010 to 22% in 2015, this has been attributed to cost. [52]

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[52] Filippeos, Katherine. 2017. “Increase in Suicides and Child Mortality During the Crisis in Greece.” *News from Greece*. http://greece.greekreporter.com/2017/04/11/increase-in-suicides-and-child-mortality-during-the-crisis-in-greece/ (March 22, 2018).

For the European project to work, it must work for everyone. Prolonged crises and slow growth for ideological reasons does nothing to help foster a union. Countries like Germany have only been able to perform as well as they have because of the economic underperformance of their fellow member states. However, economics tends to be cyclical and eventually the German powerhouse will take a turn for the worse. One can only wonder how the member states will react to this and how much of the 2009 crisis they will take into account. The future of the EU is forged in current and past choices.

As it stands, the euro is the second most powerful currency on the planet, the eurozone is also the world's largest trading bloc, and the European Union remains a powerful voice and force in international affairs. Simply put, the European project is too important to remain divided and in its current state. With the liberal Western order being challenged by both foreign and domestic entities, the European Union needs to hold itself as the example of political and economic freedoms. This push-back against Western hegemony and liberal ideals has put the global order at risk. The United States has abdicated its role as the beacon for the liberal world order and has instead chosen to look inward towards more nationalist and protectionist policies. Also, the rise of China has continued to show that capitalism and democracy do not always go hand in hand, and people are willing to forgo political freedoms as long as their economic needs are met. The European Union must demonstrate that there is still a need and desire for democratic means of government and open markets that operate in an efficient and prosperous manner. Eventually, Europe will be prosperous again, the 2009 crisis will be forgotten except for a few and the lessons still unlearned. The actions taken in response to the crisis have proven to be little more than a band-aid. Structural reforms in the economic and political arenas will do little to hold off the next economic crisis, and depending on how big the next one is will determine if the EU will survive.

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