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The Eurozone Crisis: Short-Run versus Long-Run Solutions

Abstract

RESEARCH OBJECTIVE: The main objective of this article is to present the result of the comparison of the short-run and the long-run solutions available for the Eurozone crisis. The main focus lies in examining if the provisions provided for the short-term are sufficient compared to the long-term solutions.

THE RESEARCH PROBLEM AND METHODS: The existing monetary policy in the European Monetary Union at the beginning of the crisis will be examined together with the measures pursued immediately following the crisis as well as future prospects. The study is based on a literature review.

THE PROCESS OF ARGUMENTATION: The monetary policy showed structural problems clearly emphasizing that the Eurozone was not prepared to address this crisis. The first reactive measures were taken several months after the start of the crisis. The implemented solutions on the short-run did not meet the requirements to garner lost trust and determination. In summary, the decided provisions on the short-run solutions were not sufficient.

RESEARCH RESULTS: On the one hand, some efforts were made to find short run solutions. But these short-run solutions could not solve the financial difficulties of the affected Eurozone countries. On the other hand, long-run solutions are highly discussed in the literature but are not set in place. Therefore, only a political and monetary union can solve the structural problems of the Eurozone. However, in the foreseeable future, politicians need to spend more efforts into this aim.

CONCLUSION, INNOVATION AND RECOMMENDATION: The paper underlines the need for a political and monetary union. A first step in the

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long-term would be the introduction of the European Monetary Fund and later on the Eurobonds.

KEYWORDS:

Eurozone, debt crisis, EFSF, ESM

KRYZYS STREFY EURO:
ROZWIĄZANIA KRÓTKO- CZY DŁUGOTERMINOWE

Streszczenie

CEL NAUKOWY: Głównym celem tego artykułu jest prezentacja wyniku porównania dostępnych krótko- i długoterminowych rozwiązań kryzysu strefy euro. Zasadniczą kwestią stanowi zbadanie, czy rozwiązania krótkoterminowe są wystarczające w porównaniu z długoterminowymi.

PROBLEM I METODY BADAWCZE: Polityka monetarna Europejskiej Unii Walutowej na początku kryzysu zostanie przeanalizowana w powiązaniu ze środkami zastosowanymi tuż po jego powstaniu, podobnie jak jej perspektywy na przyszłość. Badanie oparte jest na przeglądzie literatury przedmiotu.

PROCES WYWODU: Polityka monetarna ukazała strukturalne problemy, które wskazują jasno, że strefa euro nie była gotowa, by sprostać temu kryzysowi. Pierwsze środki zaradcze podjęto kilka miesięcy po wystąpieniu kryzysu. Zastosowane rozwiązania krótkoterminowe nie spełniły wymogów polegających na odzyskaniu utraconego zaufania i determinacji. W rezultacie środki powzięte na krótką metę okazały się niewystarczające.

WYNIKI ANALIZY NAUKOWEJ: Z jednej strony czyniono pewne wysiłki, by znaleźć rozwiązania krótkoterminowe; te jednak nie były w stanie rozwiązać kłopotów finansowych dotkniętych nimi krajów strefy euro. Z drugiej zaś strony, dyskutowano żywo o rozwiązaniach długoterminowych w literaturze, jednak nie zastosowano ich. Dlatego też jedynie unia polityczna i monetarna może rozwiązać strukturalne problemy strefy euro. W przewidywalnej przyszłości politycy muszą jednak włożyć więcej wysiłku w realizację tego celu.

WNIOSKI, INNOWACJE, REKOMENDACJE: Artykuł podkreśla potrzebę jednoci politycznej i monetarnej. Na dłuższą metę pierwszy krok polegałby na wprowadzeniu Europejskiego Funduszu Monetarnego, a następnie obligacji monetarnych.

SŁOWA KLUCZOWE:

strefa euro, kryzys zadłużenia, EFSF, ESM

INTRODUCTION

The idea of European integration started with the elimination of economic borders among the member countries so that eventually their economics would intertwined and start functioning as a one (Wach, 2017, p. 9). This invariably did not happen in a homogenous way leading to crisis in the Eurozone.

The crisis in the Eurozone, also called Eurozone debt crisis is a financial crisis that affected the member states of the Eurozone. According to De Grauwe (2010), the crisis did not begin in Greece as many believe which has led everyone to have a prejudiced view about Greece being the main culprit. The real reasons for the crisis started much earlier.

In the years 2007-2008, the world was hit by the subprime crisis that originated in the Unites States. Nonchalant monetary policies and the upward trend in debt instruments as a consequence of global disparity were the two essential causes of the real estate bubble. On the onset of the crisis, it seemed that most of the countries were not affected and they will survive the financial onslaught. However, soon after the collapse of Lehmann Brothers, the global economy crashed. The main reason for such a crash was because of the wrong assumption of the people regarding the ongoing growth of asset prices. Instead of saving money, they financed their consumption by taking loans. As the asset prices decreased dramatically and the people got notice that they were heavily indebted. This situation resulted in the uncertainty concerning the niveau of future asset prices on the short-run as well as on the long-run which made economic decisions nearly impossible. Especially the financial sector was confronted with huge problems. (Allen & Carletti, 2010). The uncertainty induced that banks refused to lend money on short-term. The cash market came to a halt, and the financial base of many institutions did not exist anymore. The consequence of this resulted in a snowballing effect worldwide, and it reached the shores of Europe in 2009. Stabilizing the financial sector and thereby the domestic economy, the several European governments incurred more debt than necessary.

The main objective of this article is to present the result of the comparison of the short-run and the long-run solutions available for the Eurozone crisis. Balcerowicz (2014) describes Greece, Italy, Ireland,

Portugal, and Spain as the worse performed countries between 2008-2013. Therefore, this study focuses primarily on these countries. For comparison purposes, the selected countries are compared to Germany. The study is based on a literature review.

This article consists of six sections. In the first section, we provide a detailed literature review regarding the Eurozone crisis and the situation in affected GIIPS countries namely Greece, Ireland, Italy, Portugal, and Spain. The second section describes the monetary policy in the European Monetary Union. The third and the fourth section describe in detail the short-run and the long-run solutions. The fifth section presents the research results. Finally, the last part provides the summary of the study.

1. LITERATURE REVIEW

The Euro zone crisis specifies to the sovereign debt crisis .2007 was a year of stable growth for the countries of GIIPS namely Greece, Ireland, Italy, Portugal and Spain (Broner, Erce, Martin, & Ventura, 2014). The downfall of the Lehman Brothers in September 2008 triggered the global financial crisis. The EU also experienced the first-hand effects of the global financial crisis. It looked like the majority of the EU member states had weathered the storm by summer 2009. The actual status of the Greek fiscal debt was known in autumn 2009 triggering a series of crisis (Begg, 2012). During this period, low growth coupled with significant budget deficits led to an increasing debt to GDP ratio. The sovereign debt in the hands of the domestic residents in GIIPS was less than 50%. The end of 2009 and 2010 saw severe sovereign debts in the GIIPS. The new government formed in 2010 in Greece revised the fiscal accounts for previous years because it found deficits higher than reported. This incident triggered a loss of confidence in the practical constraints of the euro countries leading to the deepening of the crisis (Broner et al., 2014). According to De Grauwe (2010), three reasons played a pivotal role in initiating and intensifying the crisis.

1. The loss of credibility of the Greek government because of the deception and mismanagement.
2. The destabilizing role played by the financial markets for example how the sovereign bonds crashed. In 2009, there were

nominal levels of interest rates and the governments added many new bonds in the market. When the markets fell a few weeks later, the bond market crashed in some countries.

3. The crisis was allowed to propagate because of the doubts created by the European Central Bank and the other Eurozone countries. They failed to give a clear message showing the willingness to support Greece.

The reasons for the sovereign debt crisis were different in most member states though the final result was similar. For Ireland and Spain, the cause of the crisis was the burst of the real estate bubble leading to a banking crisis. The reasons in Portugal and Italy were more of general economic weakness like slow growth, the dearth of reforms and debt problems, and so forth. In Greece, the reasons were mostly attributed to very high deficits (Honkapohja, 2014). Table 1 provides an overview of the reasons leading to the Eurozone crisis in the GIIPS countries.

Table 1
Overview of the reasons leading to Eurozone crisis in the GIIPS countries

Country	Root Cause	Explanation for Sovereign debt
Ireland	Real Estate bubble burst to lead to Banking Crisis resulting in sovereign debt.	The global financial crisis had a strong impact on the economy of Ireland. The property bubble that was built up due to the availability of cheap loans when euro was introduced burst sending the banking system to the crisis. The banks were over-exposed to loans taken of cheap credit. This cheap money affected the economy immediately as property related taxes began to fall increasing the gap between expenditure and revenues generated in Ireland (Gillespie, 2012).
Greece	Structural problems like politics, corruption, policy making, and governance, and so forth leading to budget deficit resulting in sovereign debt.	From the mid-1990s Greece’s growth was on an upward trajectory culminating in the historic Olympics hosted in Athens, 2004. The complete picture changed when the Greek government openly admitted considerable divergence between budget deficit targets. In 2009, the budget deficit was 15.8% during the year-end closing. As the interest rate touched 10%, Greece asked for a bailout package. In an unprecedented move, EMU violating all its principles granted a loan of 110 billion euros .

Italy	Low underlying productivity growth, poor regulation, less competition and inflexibility in the labor market.	Having the weakest GDP in OECD, Italy's economy was rather fragile. Joining the EMU and rapid globalization raised inflexibility costs. Italy got over the 2008 economic crisis based on structural reforms, but by 2011 the financial market turbulence and contagion from other struggling EU countries resulted in deterioration of the bond market sentiment. Ad mist these developments aroused fears about Italy's fiscal instability (Goretti et. al., 2013).
Spain	Real estate bubble burst to lead to revenue loss as tax system was heavily dependent on real estate industry for tax based revenues.	Spain has the dubious distinction of having the highest unemployment rate in the Eurozone plus one of the highest public deficit levels. Spain's fiscal crisis can be explained more as a revenue crisis. During the crisis, revenue dropped mainly due to the real estate bubble. During the period of growth, the government collected high revenues in the forms of taxes like transfer tax, corporate taxes, VAT, etc. When the real estate bubble burst, revenues dropped dramatically causing the deficit. Spanish tax system was more dependent on the housing bubble in revenue generation than GDP. Spanish revenues from GDP stood at 36% the average euro zone value was 45% of GDP (Conde-Ruiz et. al., 2013).
Portugal	Adoption of Euro and removal of automatic stabilizers like currency devaluation caused a problem similar to balance of payment crisis.	Portugal's current crisis can be explained as an external debt and a balance of payment crisis. In the year 1995, the net international investment position (IIP) and net external debt were roughly equivalent. By the year 2010, the net international investment was about -108% of GDP and net external debt was about 85%. Portugal has always had significant trade deficits. Before the introduction of the Euro, Portugal balanced current transfers and incomes by the devaluation of its currency escudo. With the launch of the euro, the balancing act cannot be performed. Over a period the current assets accumulated and these could no longer be devalued against foreign financial assets held by residents. Without this automatic stabilizer, the balance between the net external debt and balance of income could not be maintained. Thus it can be summarized as the reasons for Portugal's problems are the adoption of the euro and removal of stabilizers to maintain the equilibrium (Cabral, 2013).

Source: Own study.

2. MONETARY POLICY IN THE EUROPEAN MONETARY UNION

To understand the Eurozone debt crisis, it is important to emphasize the monetary policy of the EMU since it serves as a normative limit. This section provides an overview of the Maastricht Treaty of 1992 as well as the Stability and Growth Act of 1998.

“The Maastricht Treaty (...) sets the ground rules for the European Monetary Union (EMU) ...” (Dornbusch, 1997). If a state wants to become a member of the EMU, it has to fulfil different criterions.

The Maastricht Treaty names four criteria namely 1) the inflation rate, 2) the stability of the nominal exchange rates, 3) the nominal interest rate and 4) the public deficit of 3% as well as the public debt ratio of maximum 60% of the GDP (Buitier, Corsetti, Roubini, Repullo, & Frankel, 1993). The third and fourth criteria are also known as Excessive Deficit Procedure (EDP) (Von Hagen & Eichengreen, 1996). Furthermore, Buitier, Corsetti, & Roubini (1993) describes three principles of fiscal behavior of a member of the Eurozone. First, according to Article 104c of the Maastricht Treaty, each “member state shall avoid excessive deficit.” Which means, the net borrowing should not surmount 3% of the GDP and the gross government debt should not outshine 60% GDP. Second, the Treaty contains a “no-bail-out-clause.” Every Eurozone member is responsible for its public debt and cannot be excluded from the community. Third, the Treaty “... bans direct central bank financing and access to favorable financing of public deficits, by prohibiting the granting of central bank credits to governments, the obligatory purchase by banks of public debt instruments and privileged access by governments to financial institutions.”

To ensure that the Maastricht criteria will also be adhered to in the case of an EMU membership the Stability and Growth Pact (SGP) has been entered into force in 1998 (Lane, 2006). From Von Hagen’s (Von Hagen, 2006) point of view, the SGP tightened and completed the fiscal rules from the Maastricht Treaty. The SGP renewed the EDP in various points:

1. Introduction of an early warning system
2. Definition of tangible ideas against violations of the 3% constraint

3. SGP as a guideline for the participate countries on how to implement the EDP efficient and on time.

Majocchi (2003) points out that the SGP could exacerbate the situation of a member country in the case of fulfilling the 3% rule. He is also critical of “the principle of unanimity” which makes a European economic policy impossible.

Another flaw of the EMU is that despite of the common currency each membership country retained the responsibility for the economic policy. Moreover, like De Grauwe (2011a) mentioned, by the introduction of the Euro these countries lost the possibility to issue debt in their own currency.

In summary, the financial policy before the crisis was only geared to avoid excessive debt but neither to prevent a crisis in the European Union nor to give support to member countries in case of a crisis. The occurrence of the crisis leads to various discussions among the member states searching frantically for the right and final solution.

3. SHORT-RUN SOLUTIONS

As the Eurozone had not created a mechanism to address crisis if and when one occurs, when actually faced with one it had no plan in hand how to address or avoid it. After several rounds of discussions, some short-run measures are identified. The short run solutions identified constitutes namely structural reforms and austerity measures, conducted by the EMU on the one hand and the European Central Bank (ECB) on the contrary. Especially Germany being the largest economy in Europe insisted for structural reforms and austerity in exchange for the bailout package.

In general, countries of a monetary union are dependent on the trust of investors, and therefore they are exposed to liquidity movements. In a case of suspicion, they can come into a “bad” Equilibrium, investors would sell their bonds, the interest rate would increase, and losses of the balance sheet would occur (De Grauwe, 2011a). Additionally, De Grauwe (2011a) states, that this situation will lead to a funding problem, then into sovereign debt and finally into a domestic bank crisis. Finally, this escalation scenario creates difficulties for the country to stabilize the budget (De Grauwe, 2011a). The described

scenario by De Grauwe (2011a) appeared in the EMU with Spain, Greece, Ireland, and Portugal. In 2009 and the foreseeable future none of these countries were able to finance their budget. Therefore, structural reforms were needed.

In particular for Greece, Portugal, and Ireland the liquidity market ran dry, and these countries were looking for financial support (Schuknecht, Moutot, Rother, & Stark, 2011). In the absence of an efficient mechanism, the EMU had to react and implemented the *European Financial Stability Facility* (EFSF) in May 2010 in order to solve the liquidity and solvency problem of the affected countries and to show investors the capacity to act. The EFSF was designed as Special Purpose Vehicle (SPV) based on Luxembourg law (Ruffert, 2011). The EFSF offered bonds guaranteed by the European Commission, the member states of the Eurozone and the IMF to investors and allowed funding in the affected countries (Lane, 2012; Schilirò, 2012). In 2011, the competence of the EFSF was extended. The EFSF was from then on allowed to step into the secondary markets and was able to recapitalize financial institutions (Ruffert, 2011). Apart from this, another issue was to rebuild the trust in the troubled countries and the Eurozone as such. The EFSF had a limited amount of 440 billion Euro and a limited duration of three years (De Witte, 2011). De Witte (2011) also mentioned legal doubts if the EFSF is associated with the European law.

The successor of the EFSF is the *European Stabilization Mechanism* (ESM) introduced in 2013 as a permanent mechanism. Christova (2011) shines a light on the legal aspects of the ESM as presented in the following paragraph. To remove the legal problems of the EFSF, the Treaty of the Function of the European Union (TFEU) has been changed, and Article 136 has been extended in order to give the ESM a legal base. The mechanism is composed of four sources. The first one is the EU budget which provides at most 60 billion Euro in loans or credit lines. If this amount does not suffice the members of the Eurozone will provide an additional 440 billion Euro as credit guarantees. This source is comparable with the further EFSF, but the no-bail-out clause has been cancelled. The International Monetary Fund (IMF) is the third source and can provide additional 250 billion Euro as a guaranteed credit line. The European Central Bank (ECB), the fourth source acts as back up and can purchase government bonds from the Eurozone member

states. The Board of Governors (Minister of Finance of the Eurozone member states) is the decision maker of the ESM.

With the ESM a new feature has been implemented, the so-called “collection action clause” (CAC). CAC is valid for new government bonds from Eurozone countries. That means if a Eurozone country wants to join the ESM the private bondholders have to take some losses (Christova, 2011; De Grauwe, 2011a). This puts them in a worse position than the original government bonds and makes Eurozone bonds less attractive.

4. LONG-RUN SOLUTIONS

As shown before the short-run solutions could not solve the financial difficulties of the affected Eurozone countries. The core of the crisis is the structural problem. On the one hand there is a centralized monetary policy, and on the other hand, there exists an own economic policy in each Eurozone country. By fiscal union, one means how well we would be able to execute effectively the fiscal constraints of the monetary union. Fiscal union or political union is the presence of centralistic arrangements. The duty of the centralistic system is to ensure fiscal discipline (Balcerowicz, 2014). As De Grauwe (2010) mentioned, the monetary policy and the economic policy are into a disparity. The only way to solve this disequilibrium is to lead the EMU into a system of federal states according to the example of the United States with an economic, political and monetary union. However, a more appropriate example would be the success of the Indian Union with a massive land mass of the size of a continent, religiously, culturally and linguistically more diverse and still resilient and have a strong democracy (Haidar, 2015).

In such a complete union, a federal government has the authority over the fiscal policy. As De Grauwe (2011a) shows, this government also has the power over the common budget and can issue public debt in Euro currency, which is under its control. The fiscal discipline is the key for the success of a monetary union as divergence even by a single member affects the other members of the union. Any deviation seen in a member country will result in other member states financing its debt. This calls for a fiscal discipline and fiscal

coordination criteria (Ahmad & Fanelli, 2014). To overcome the crisis long-term, the European Union needs a strong banking system. A strong banking system would be able to help the economy recover from the crisis by financing growth (Avaro & Sterdyniak, 2014). The crisis has exposed the structural problems that exist within the Eurozone. Since the monetary union is not consolidated into a political union, any imbalance caused will result in increasing divergence between the member nations and there exists no mechanism to correct or prevent them. This has also been the reason why some countries lost their competitiveness. Figure 1 shows the unit labour costs (ULC) among the euro zone countries from 1999-2009. It is seen that the stronger economies like Germany and Austria have consolidated their competitiveness by making improvements; the GIIPS countries saw their competitive positions deteriorate at the beginning of the crisis. These divergent situations add to fall in competitiveness as any budgetary divergences. Any state that is not competitive enough sees this effect in the form of deterioration in the budgetary situations.

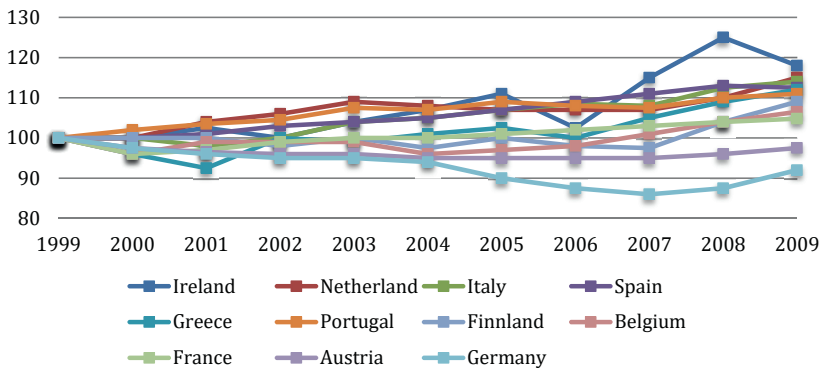


Figure 1. Relative unit labor costs in the Euro Zone.

Source: Adapted from Grauwe, 2010, p. 4.

Unfortunately, from today’s perspective, it is more fiction than reality. Moreover, in the foreseeable future, there will not be a consensus within the EMU. Therefore, other solutions are under discussion to protect the Eurozone against a crisis in the future.

Eurobonds could be one solution. When the limited possibilities of the ECB to provide the market with liquidity became obviously, the cries for Eurobonds became louder. Much variation has been discussed, but all have the guarantee from European government in common. Eurobonds in this context have many advantages. First, they would have a high volume, and therefore they would be very liquid. Second, as a safe bond class, they would be a favoured first-class investment for different kind of investors. Third, they would be issued under comfortable conditions towards solving the solvency problem for banks. Fourth, they would show a better-integrated Eurozone (Pisani-Ferry, 2012). De Grauwe (2011a) states the prevention from moral hazard as a fifth advantage. Especially the third point is object of several discussions. How should each country participate from the favorable, meaning low conditions? Should every country lend debt on the equal interest level? De Grauwe (2011a) does not agree to that point. He would prefer "...a pro-rata basis of its capital share in the ECB." Each country would pay the interest rate based on the domestic interest level of these countries. This suggestion could be a solution in the beginning, but as a final solution, it would be more equitable if each Eurozone country pays the same interest rate.

Before the introduction of Eurobonds is possible, some hurdles need to be removed. Pisani-Ferry (2012) lists three obstacles. At first, changes in the treaty would be necessary. Furthermore, a consensus must be established between the countries who would benefit more from the Eurobonds and the countries who would benefit less from the Eurobonds, especially concerning the budget sovereignty. Also, the last hurdle would be the introduction of "...a system of ex-ante control and veto..." and an institutional framework.

A *European Monetary Fund* (EMF) is also a highly discussed possibility to handle the fragile Eurozone. According to De Grauwe (2011a), an EMF would act as a shield to support Eurozone countries in financial difficulties. On the one hand, the EMF gives financial assistance, and on the other hand, it determines the conditions of the support. An EMF would also reinforce the solidarity in the Eurozone. Gros & Mayer (2010) propose an EMF where the moral hazard effect can be limited by using financing mechanism and specific conditions. Funding for the fund should depend on the two criteria of the deficit and the debt level. First, they suggest 1% per year from the difference

between the indeed public debt and 60% according to the Maastricht treaty and second, 1% of the difference between the actual deficit and the 3% of GDP according to the Maastricht treaty. That would mean that if a country performs well and meet the criteria, it would not pay a contribution to the fund. In the worst case, only the countries in trouble would pay all the contributions. Therefore, from the author's point of view, a financing system comparable with insurances would be more suitable. Every country pays a basic premium depending on the public debt and the annual deficit. So if a state exceeds the Maastricht criteria, it should pay the premium according to the proposal from Gros & Mayer (2010). This system corresponds more to the solidarity principle of the EMU.

COMPARISON OF SHORT-RUN AND LONG-RUN SOLUTIONS

The ESFS and further the ESM as short-run solutions point out four failures. First, the budget of both instruments is limited. De Grauwe (2011b) said that no one except a central bank could guarantee the disposability of the budget. Furthermore, neither can predict if the amount is sufficient for the future. Only an independent central bank is able to provide unlimited cash. Second, the construction "...as an intergovernmental organization under public international law..." (Christova, 2011) is inappropriate for the issues of an instrument like this. The decisions are made by the Ministers of Finance on the political level. Third, De Grauwe (2011b) mentions that the ESM cannot solve liquidity and solvency problems simultaneously. It is hard to say whether a country is in a liquidity crisis or affected by solvency problems (Tirole, 2012) since those two contradict each other. De Grauwe (2011b) prefers a separation of the two functions, a central bank should be responsible for the liquidity provision, and a supervisor should have the responsibility for the solvency function. The latter means to take "... over the responsibility of regulating and supervising the banks." The fourth failure is the appearance of moral hazard. That risk would occur in that case of a central bank guaranteeing for a durable availability of cash to pay out government bond holders. Therefore, it is wrong if a central bank gives up its position

as lender of the last resort. (De Grauwe, 2011b) Especially the EFSF promoted moral hazard because of the “no-bail-out clause.” The effect should be moderated with introducing of CAC in the ESM. As Christova (2011) argues the CAC has no effect on the engagement of private investors will be decided “case-by-case.”

During the Eurozone debt crisis, the *European Central Bank* plays a crucial role and acts in different ways. After the ESFS was put in place, the ECB started the *Securities Market Program* in May 2010. In a nutshell, the program promotes outright purchases of private and public debt securities on the secondary market (Buiter & Rahbari, 2012). The activity is also called Outright Monetary Transaction (OMT). This action has been controversially discussed such as Tuori (2013). Tuori argues that according to the TFEU the ECB is prohibited from financing public debt. However, during the crisis, the ECB took the position of a stakeholder as well as a politician. Both positions do not correspond to the independent role of the ECB. Moreover, as we see now in Greece, it exists a risk for the ECB to become Eurozone’s bad bank for bonds of countries in difficulty. However, the Court of Justice of the European Union allowed OMT’s by its case from the 16. June 2015. The attempt to increase the demand and therefore to decrease the interest rates for the sovereigns did not quite succeed (Shambaugh, Reis, & Rey, 2012). Usually, the ECB secures facilities with bonds. The ECB also used three-year *Long-term refinancing operations* based on a low-interest rate to provide liquidity in 2011 and 2012, both amounting to 500 billion Euro each (Shambaugh et al., 2012). Another instrument is backdoor lending which is called into action in Greece right now. The initiatives did not yield desired results because the banks were worried about the low quality of the borrowers (Feldstein, 2015).

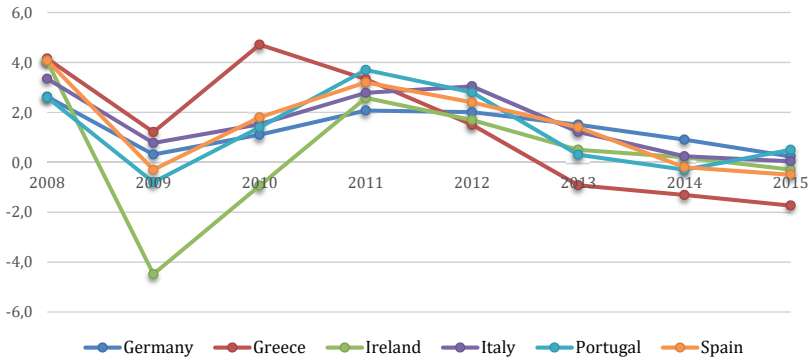


Figure 2. Inflation rate: all items (annual growth %) in GIIPS in comparison with Germany.
 Source: Adapted from OCED, (Country statistical profiles: Key tables from OECD – ISSN 2075-2288 – © OECD 2017).

The response given to the crisis has not provided the economic results to the euro area. The GDP growth has not happened, and unemployment has risen (Figure 2 & Figure 3). Internal adjustments done have helped in reducing the current-account to deficit substantially.

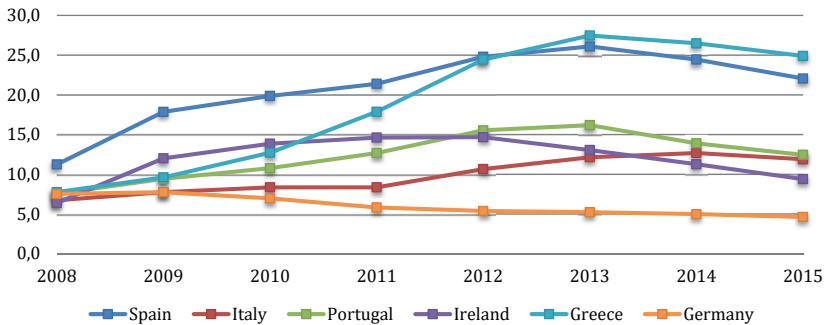


Figure 3. Unemployment rate: Total labor force (%) in GIIPS in comparison with Germany.
 Source: Adapted from OCED, (Country statistical profiles: Key tables from OECD – ISSN 2075-2288 – © OECD 2017).

A small measure of wage and price adjustments were done in the crisis countries, but the price difference between Germany, France, and Italy has been adjusted only marginally. Also, the existing area-wide

inflation is low. The further lower it gets, the more difficult it would be to make necessary adjustments (Sapir & Wolff, 2015).

In general, the European policy makers did not advice on austerity as a policy to recovery. Furthermore, from their point of view austerity in budgets would help the affected countries in restoring credibility to the markets that the European governments are willing to control the crisis. This effort should bring confidence in the markets and should provide immediate relief in the form of reduction in interest rates for government bonds (McMenamin, Breen, & Muñoz-Portillo, 2015).

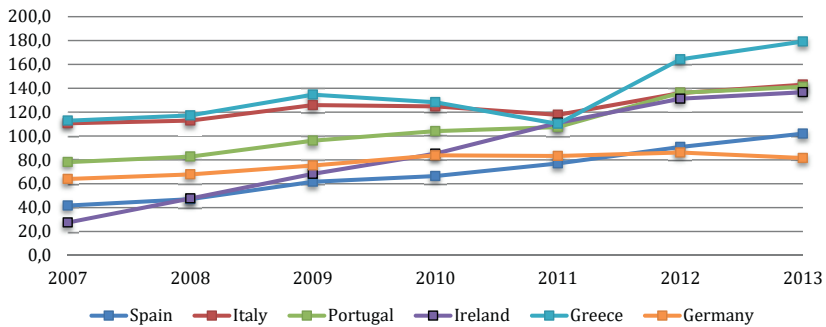


Figure 4. Real Debt as % of GDP of GIIPS in GIIPS in comparison with Germany.

Source: Adapted from OCED, (Country statistical profiles: Key tables from OECD – ISSN 2075-2288 – © OECD 2017).

Figure 4. strongly agrees with the analysis of 2 studies namely Gros and Maurer (2012) and Monastiriotis (2015). The debt to GDP ratio continues to increase in the time of austerity triggering the question whether austerity is self-defeating in the short run. The austerity has an impact both on the long-term as well as short-term of the economy. In the short-run austerity can become self-defeating because it reduces output. This would increase the ratio of public debt to GDP. The public debt to GDP ratio is considered as an indicator of sustainability by financial markets. The effect of loss in demand is only for the short period of time. When the markets recover in the long run the negative impact during the short-run would be adequately compensated Gros and Maurer (2012). In the troubled economies, exports have not improved because of the weak export base. Domestic consumption further reduced fuelling the recession.

The loss in consumption power was greater than the cost savings. The challenges facing the New Greek government is ensuring that there is no default at the same time stay clear of the austerity-driven recession (Monastiriotes, 2015, pp. 2-3). Sinn (2014) argues that the Eurozone crisis cannot be overcome by growth inducing programs as the underlying reasons are a lack of competitiveness of the southern European countries and France (Sinn, 2014, p. 1).

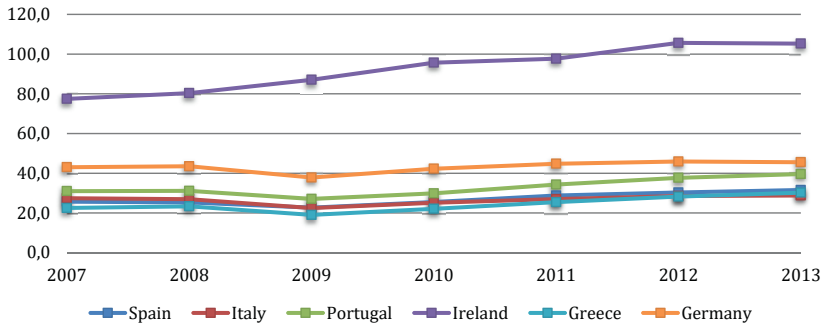


Figure 5. Export of Goods and Services as % of GDP in GIIPS in comparison with Germany.

Source: Adapted from OCED, (Country statistical profiles: Key tables from OECD – ISSN 2075-2288 – © OECD 2017).

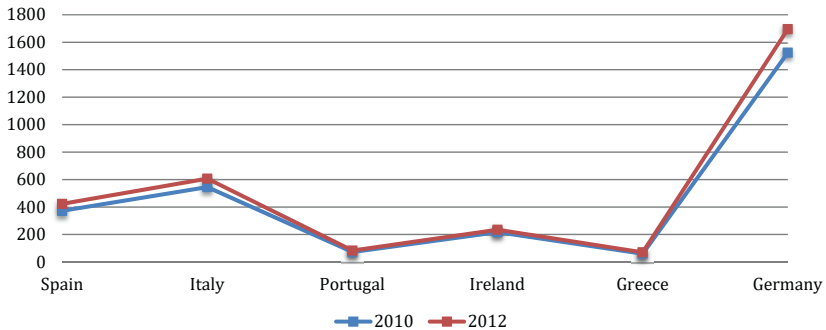


Figure 6. Export of Goods and Services as % of GDP in GIIPS in comparison with Germany.

Source: Adapted from OCED, (Country statistical profiles: Key tables from OECD – ISSN 2075-2288 – © OECD 2017).

For the period of 2010 to 2012, export of goods and services are comparable to the GIIPS region confirming the apprehension of having a strong euro that discourages export. Figure 6 can be used to explain Figure 5 for the period of 2010 to 2012. Both export values and GDP have remained stagnant raising questions of the economy slow down and no indications of growth (Own interpretation).

CONCLUSION

This paper has been opened by the question if the short-run solutions are enough to prevent the EMU against further crises and whether there is the need to install ulterior policies. It could be shown that the EMU was not well prepared to fight against the debt crisis and that that the core of the crisis was a structural problem. The monetary policy exhibits many weaknesses like the “the principle of unanimity” and the responsibility for the economic policy of each country of the Eurozone. So, it needed several months to determine the EFSF as a first reaction to the crisis. Moreover, it was three more years needed to implement the ESM as a permanent tool in the case of crisis. Wach (2016) point out that an effective Europe Integration coupled with the Europeanisation of business can intensify the internationalisation of firms particularly SMEs providing economic benefits to the member states (Wach, 2016, pp. 169-170).

The implemented solutions on the short-run tried to garner lost trust and determination. However, it did not meet the requirements. Especially the CAC in the ESM and the weak position of the ECB defeated the purpose. The ECB could more act as a lender of the last resort. It can see then, that the short-run solutions will not the final method to solve the crisis in the EMU. Furthermore, the austerity measures carried out in the euro zone has been asymmetric. While the suffering economies had budget cuts, the performing core countries like Germany had rising governmental spending. Their budget deficits have been steady, and the GDP has been on the rise. In contrast budget cuts in the periphery countries have resulted in a declining GDP. Having a stable Euro, the Eurozone needs a stable equilibrium mechanism to be ensured (Baimbridge et. al., 2015, p. 139). Also, countries like Germany benefited from earlier reforms on the labor market, for example,

Agenda 2010. Its unemployment rate decreased during the crisis while the rate increased in countries like Greece and Spain.

That leads to the conclusion that the decided provisions on the short-run were not sufficient. All points to the fact that only a political and monetary union can solve the structural problems of the Eurozone. Studies done by Narayanan, Allen, & Naser (2015) precisely show the benefits of a political union in the form of India and how the economic reforms done after a similar crisis were strong and provided a recovery path to the Indian Union. Such studies point out the benefits of a political union (Narayanan, Allen & Naser, 2015). However, in the foreseeable future, there will not be such a union. At the present moment, such an idea would fail on the contradiction on the wealthy states of the EMU. Therefore, a first step in the long-term would be the introduction of the EMF and later on the Eurobonds.

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