Crisis in the euro area: identification, evolution and adopted measures.

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Abstract

Before the outset of the economic euro area crisis, the Euro accomplished 10 years in which the member states enjoyed low inflation, low interest rates and smooth finance conditions. Everything seemed to be going well, except for the facts that an integrated financial system has been lacking and that the exchange rates against dollar have been too high. This has led to difficulties in the process of finding common solutions to a crisis which affects differently each state and thus the whole Union. Finding efficient ways to guide the peripheral countries out of the crisis has proven to be a challenge to the economic framework of the Union’s governance and, thus its ability to respond to adverse situations.

Keywords:

Euro area crisis – Sovereign debt – Unemployment – Financial stability

Introduction

The events of late 2007 marked an end of one of the greatest periods of economic growth of capitalism. The following 5-6 years have been characterized by high financial and economic uncertainty. Since its occurrence in Europe, the crisis brought to light the weaknesses of the Union. It has evolved from purely economic to the political-institutional one. This requires a redefinition of the crisis in Europe, especially on the euro area.

The Union's economic problems are partially due to its inconsistent economic and political framework. Both its ambitious enlargement policy and internal differences in terms of levels of industrialization, infrastructure, as well as political and legal frameworks, have made the successful decision taking concerning efficient corrective economic measures more difficult. The economic crisis in Europe, expressed in terms of instability, different trends in unemployment and difficulties financing the Member States, is reflected from the economic sphere to other areas of the Union such as Common Security and Foreign Policy: there is no single European voice but; instead many voices are beings projected from a national to a supranational sphere. The fact that the Union is still under construction makes it not only a fascinating subject but also a priority for the European authorities. The more internal cohesion it builds, the more resistant will be the Union to adverse situations like the current one.

The European Stability Mechanism or the golden rule, are only temporary gauzes that will not prevent the continuation of bleeding recently suffered by the Union. Further integration into a more compact political architecture is essential to effective output of the crisis. Even more so, it may help solve the structural problems currently plaguing the European Union. A possible increase of weight in European Central Bank monetary decisions and a greater role of the leading figures of the Institutional Architecture of the Union (President of the European Council, High Representative, and President of the Commission) could be of utmost importance.

This paper is of economical nature and therefore the variables that it deals with will be treated from an economical perspective. The exceptions are only the correction mechanisms described therein. Thus, the work remaining to be done at the institutional, social and even cultural level will not be treated in it. It must, however, be stressed out that, despite the economic and financial origin of the crisis, non-economic approaches have to be taken into consideration, in order to fully understand current situation in its complexity. Therefore, the temporary solutions to the crisis (described in Section 3 of this document) are the most urgent steps that the Union should take in the short term. The long-term solutions will come through patching intra-institutional gaps with effective measures which could lead to stronger political union, as well as through strengthening the European values at both individual and collective levels.

1. Identifying the crisis.

Since 2007, capitalism as we understand it today seated on the foundations created after World War II, faces its second and arguably deepest crisis. After this, a series of international financial institutions like the International Monetary Fund, the International Bank for Reconstruction and Development and other political ones such as the European Economic Community were created. Their objectives were to avoid falling back into a war situation at least as devastating than that experienced in the first half of the forties, not to fall into the influence of the communist block and to act as a catalyst for economic growth after the destruction of main bulk of European infrastructure.

As in any system, the structural weaknesses are exacerbated in times of crisis revealing its limitations. About capitalism many -most negative- things can be said, e.g. it is a system that generates intra and international inequalities[1], promotes selfishness and obtaining of own benefit sometimes at the expense of benefit and welfare of others; it also ignores non-monetary resources such as culture or the environment or creates an exaggerated and senseless idea of competition among component members. Nevertheless, it this is the system responsible for the highest economic growth experienced by mankind. It has managed to bring the living standards of people in developed countries to limits never dreamed in the past: it increased levels of hygiene, widespread literacy, increased life expectancy, improved communication and, thanks to the role of the State, provides the basic conditions of life to the sectors of the population in need.

None of these avoid the fact that states are currently experiencing a retreat from the services provided by themselves, an accentuation of economic and social inequalities, increases in unemployment and a slowdown in economic dynamics affecting, among others, the enterprising initiative of citizens.

[1] In the present document the term "inequalities" will be present several times as is it is considered to be one of the characteristics of the crisis. It refers to the inter or intranational differences that existed in capitalist economies before the crises and that have been accentuated as a consequence of this period. Variables like Gini Index, the existence of basic interprofessional salary or the Multidimensional Poverty Index designed to measure inequalities and/or ensure minimum values on it will not be regarded in this document whose focus will mainly deal with the effects of the crisis in the Euro area and the measures adopted by the EMU to solve it.

The effects of the crisis are homogeneous neither in form nor in time. The way how society is affected by the situation cannot be described with a single pattern: households, enterprises and public administrations are passive subjects of the more than obvious weakness of the system. Furthermore, among them there are several layers which different features that suffer in other way respect to each other.

To discuss the current crisis two previous approaches will have to be used for its identification. The first is the financial market and its possible regulation. This approach will lead to the U.S. as the epicentre of the financial turmoil. The second vision is one in which some historians and economists justify the cyclical nature of the economy and would attribute the crisis to the macroeconomic growth experienced in the nineties and the first half of the two thousand[2].

Despite the importance of its consequences, the crisis is mainly concentrated in the United States and in Europe particularly in the euro area. This can be clearly seen by watching the trend of world GDP between 2007 and 2011 in which 2009 is the only subperiod where this indicator drops[3]. Moreover slowing emerging economies such as China have no direct relationship with the crisis as growth figures of around 10% of annual GDP are very difficult to maintain over the time. Of course, there is no doubt that the downward of the trend of imports in Europe has affected them.

[2] See Graph 1 in the annex.
[3] See Graph 2 in the annex.

1.1 *Different views for identifying the crisis.*

1.1.1 The financial market and the crash of the housing bubble.

The beginning of the current economic situation must be regarded from a multidimensional point of view. On one hand we could point its origin coming from the United States[4] due to the crash of the housing bubble in 2007. The excess of *subprimes*[5] in the mortgage market and the absence of regulation dealt to the contagion of the whole financial system. Unfortunately, this is the main feature of the highly interconnected society – and economy – in which the financial system is rooted. The use of technology which gives access to any financial market to any potential investor from any part of the world is responsible of this fact[6]. Furthermore, another aspect of this development must be taken into consideration in order to understand better nowadays circumstances: the opacity that hides the attributes of financial products which flow from market to market and from broker to broker, polluting financial markets, a crucial element for the growth of modern economies[7].

The lack of transparency dealt to an almost total absence of trust within the market and the interbank market was the first sector to suffer this. On account of this, banks had it more difficult for financing themselves and started to sell assets. Due to that, their price started to fall and consequently banks and financial institutions became high risks of bankruptcy such as Northern Rock (in the United Kingdom) or Bear Sterns and Lehman

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[4] Since the US is the leading world economy, its trends and politics influence the rest of the world. Taking the leadership of the world's economy since postwar times, the US managed to implement an international economic system in which the dollar is assumed as the main exchange currency and consequently being an essential part of the reserves of deposits in the federal banks**.** As we will see later, the model on which International Institutions like the International Monetary Fund were based are the crystallization of this fact.

[5] See definition in Box 1, page 11.

[6] Economics is a social science that is highly affected by the concept of globalization. It has two different meanings well differentiated in French with the definition of the words *mondialisation* and *globalisation*. ce n'est pas le même concept en anglais? →les mots sont écrits dans la meme façon mais la pronounciation est differente et la signification des termes sont differentes aussi (Thème 1, Fiche 2) The first one defines the outbreak of new markets, actors or rules and the second one describes how easy is for these new actors to have access to these new markets independently from their place of residence or the physical or virtual location of the market (Vérez, 2008).

[7] Financial markets are essential structures in current nation-states. They are partially responsible for the transformation of the savings into investment, a crucial process with a high relevance in the macroeconomic health of the society. Saving as a macro magnitude in itself has no great utility for the economical growth and will partially determine the rate of interest of banks. On the other hand, investment (considered as a private element in this context) is the main source of funding for private enterprises and consequently will affect the level of Foreign Direct Investment (FDI) as well as the exports.

Brothers (in the United States) in 2008. States that face these situations find themselves in a dilemma regarding to a possible intervention in the economy, either to become member of the administration council of the institution as their rescuer or, in a more liberal way, let the bank fall in insolvency. This second option was taken by the British and American government in the case of Northern Rock and Lehman Brothers. The later had enormous effects in the world financial stability. After the disastrous situation the American government decides to save AIG assurance and the business banks Goldman Sachs and Morgan Stanley in order to avoid new unfavourable situations following the criteria of “too big to fail”. These actions reopened one more time the moral hazard dilemma that lays out the question about the incentives for other economic institutions of letting being rescued by states in the same way that others experienced before.

Box 1: Subprime crisis

For a better understanding of the subprime crisis, the perception of houses had by both householders and financial actors e.g. commercial and investment banks in the late 90’s and the 2000’s has to be taken into consideration. With a steadily increasing value, houses were not only perceived as a place to live and where to have and develop a family but also they were considered to be a highly interesting financial asset. Therefore, in that period the mortgage market grew and financial activities, performed specially by investment banks and speculators, became normal. In the context of the American financial market which the rate of interest imposed by the Federal Reserve after the 9/11 was of 1%, the need of negotiation and speculation with financial assets especially subprime mortgage became very attractive due to the possibility of increasing earnings with a high degree of probability and low risk.

Additionally, a deeper view to the interconnections between actors within the financial and mortgage market has to be taken. Due to the high sophistication of the American financial markets, the activity and dynamism of the financial actors are much higher than in other countries. When householders do want to get a mortgage, they don’t contact directly a commercial bank but with a broker which works for a certain one. Simultaneously, commercial and investment bank exchange mortgage which are already transformed in financial assets are susceptible to be negotiated in any financial market worldwide. At this stage take place the process of classification and qualification of the mortgages which has been the origin of the subprime crisis.

In the beginning of this process, mortgages were offered only to those households that have the resources enough to deal with the payment but since this situation became more common among families with upper-middle income, mortgages began to be offered at families with low income capacity and low solvency. This led to the classification of mortgages according to their risk of default thus giving them different returns. Thus, lower risk mortgages, lower interest rate but higher safety was defined as *Prime Mortgages* and those with higher risk, higher interest rate but less security were defined as *Subprime Mortgages*. It is at this point where it has to be distinguished on the one hand the activities of rating agencies and the other hand mortgage transactions in the financial market. Rating agencies, responsible for the evaluation and determination of the fundamental characteristics of these assets in terms of risk of non-payment, did not apply objective criteria for rating these assets even reaching AAA rating - the highest value implying that their safety is the same as debt bonds issued by the major powers - to mortgages that clearly did not meet the requirements for this assessment.

Because of the lack of supervision of these valuations by third actors - states, independent agencies-, investment banks could freely negotiate these assets in the global financial market and contaminating it with opaque and overpriced products. This is the fundamental reason why the global financial crisis (GFC) is caused by the so-called subprime crisis since *subprime Mortgages* have been responsible for the spread of toxic assets by global financial actors.

Their lack of transparency and their high volatility made it difficult, and sometimes even impossible, to determine their value and therefore the package or funds in which they were included. This has been seen on 9 August 2007 when BNP Paribas reported that the value of three funds cannot be calculated and freezes funds valued at U.S. $ 2.2 bill. The collapse of large investment banks, insurance companies and the rescue of many others have been a consequence thereof, thus involving not only to families who had acquired a mortgage but also to states putting in hard choice to drop or redeem financial agencies.

The greed for profit maximization by banking institutions and rating agencies, the high level of leverage in the financial market, high interconnection between global financial markets, the necessity of borrowing of the U.S. in order to deal with its imports and the absence of financial market supervision have been triggers of this situation. The effects have been seen in the world economy in general but most especially in European due their high interdependence both in real and financial terms with the U.S. economy.

Today it can still be seen how the housing prices have dramatically fallen and both households and banks do not see them as potential investments. There is also a change in the trend of banks to perform "green" investment i.e. respecting moral patterns and environmental criteria as it can be seen with Triodos Bank. However, the effects of the subprime crisis in Europe have been transformed into a systemic crisis of debt and lending revealing the structural financial and political weaknesses of the Union.

Finally, this situation has made clear the impunity that mayor financial institutions' responsible persons have in the capitalist system. Besides the fact that their way of acting influenced and has determined the economic trend in the last five years, financial leaders still have powerful and relevant positions in the global financial market e.g. Mario Draghi was Vice President of Goldman Sachs and is nowadays President of the European Central Bank.

Source: Hugo Céspedes – La Crisis Subprime http://www.slideshare.net/hugoces/la-crisis-subprime

1.1.2 The crisis as result of economic growth.

The ten-twelve previous years to the crisis were a period of economic growth due to the abundant liquidity and low rates of interest[8] as a consequence of an expansive monetary policy and macroeconomic inequalities. More precisely, the potential economic growth originated by such a policy has two main consequences. Firstly, there will be outflows of capitals if the final rate of interest is lower than the world average. Second, expansive monetary policies can derive –depending on the economic context- on changes on the real wages due to rises in the level of prices and thus creating macroeconomic inequalities.

In the case of the United States, a laxest monetary policy and the merging of the "dot.com" companies dealt to a credit expansion that stimulated the economy, especially the consumption and the investment in the country[9]. All in all, the crash of the housing bubble is a consequence of these facts.

Despite the economic growth, inequalities have arisen during the ten previous years of the crisis. It can be clearly seen in the increase of the United States' current account deficit ($499.3 billion, the largest of the OCDE members)[10] that is mainly supplied by the surpluses of Asian nations (especially China) and the oil exporters (Middle East and Russia). In other words, the expansion of the credit in the US has been financed by Chinese and Middle Eastern funds. Simultaneously, the growth in the US was based in the imports coming from Asia which gave these countries the possibility to increase their incomes and invest their surpluses in American public debt. By doing this, the American debt's rate of interest maintained low provoking consequently an additional positive trend providing financial stability to the country. This is an important fact

[8] Real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator (definition by the World Bank).

[9] From a macroeconomic perspective, the production (Y) of certain economy is described by five components, three that are inherent to the internal economy: consumption (C), investment (I) and public expenses (G). Additionally, there are two components that connect the national economy with the international economy: exports (X) and importations (M).

These are the elements of the main macroeconomic equation: $Y = C+ I+G+X-M$ which describes the effects of changes of these elements in the whole economy. Despite its simplicity it helps scholars to understand from a basic perspective the role that each and every variable plays in the economy and the possible repercussion in some of them due to the changes in others, e.g. the adoption of expansive/restrictive fiscal policies (affecting the parameter "t" that belongs to the consumption; $C = C_0+cY_d$ where $Y_d = Y - tY +$ transfers) or changes in the customs duties (affecting the parameter "m" included in the variable M; $M = m_0 + mY$).

[10] http://stats.oecd.org/index.aspx?queryid=28898&lang=en

because stability is translated into financial terms by the offer of security to investors who participate in enterprises listed on American stock exchanges. It had an additional effect by incentivising the finance entities to create products with a higher interest.

1.1.3 The European crisis[11]

The European situation is different since the 17 euro area Member States depend on the monetary policy pursued by the ECB[12]. Besides the fact that a single currency avoid countries to be exposed to speculative attacks, improves the commerce and transactions within the euro area, protects them from the outside and creates a strong rival for the dollar in the world exchange reserves, it also causes structural economic differences in each member state or aggravates alleviating the impact of the crisis heterogeneously within the euro area.

The European project is based on the idea of convergence so that southern –and also peripheral- countries converge in economical and social terms towards the central ones. Therefore, the politics of integration become questionable because the requirements for candidate countries to be accepted constantly increase. Additionally, candidate members always share common borders with the Union which implicitly establish an important requisite for being a candidate member. These are contradictions with the European idea of fighting against inequalities.

Thus, the European project has shown itself its weaknesses by prioritizing its criteria concerning a monetary union and excluding by now a fiscal, social and/or budgetary dimension which is obviously an indispensable step towards the political union. As a matter of fact, the rejection to the enlargement of the communitarian budget which was already less than 1% of the GDP shows the lack of coordination and motivation for the leading member states to combat unemployment or taxation differences among them. This not only complicates the integration process but also the harmonization and

[11] Source for this section: Malanda Saiz, C. 2011. *La crisis de la deuda en la Zona Euro: gobernanza económica y eurobonos".*

[12] The Euro's creation in 1999 involved the transfer of sovereignty in monetary issues from the state level to supranational level. Thus, central banks should cease to perform their functions to enable the creation of a European Central Bank which had full authority to exercise independent monetary policies. Therefore, national central banks would remain as supervisors of national economies and as executors of decisions made by his superior in Frankfurt. See section 2.1.1.2 for a more detailed description of the ECB.

elimination of the intraeuropean differences – which is also by definition against to the European Ideal.

Due to the high interdependency of the nowadays economy, the crisis has at European level serious repercussions concerning national deficit and debt highlighting not only the weaknesses of the economies but also exposing them to international influence and complicating its financing capacity. Greece is the perfect example therefore. In October 2009, President George Papandreou revised up its economy figures: Greece had an internal deficit of 13.7% and its debt rose to 113.4% of GDP. After the publication in January 2010 of a report performed by the Commission at the request of the Council[13], there were sharp falls in the stock market, an increase in the risk premiums and downgrades in the rating of its long-term debt by rating agencies which failed to detect any irregularities. Athens unsuccessfully tried to save the crisis by increasing taxes, cutting public sector wages and other general cuts. On April 27, 2010, Standard & Poor's downgraded Greek debt by rating it at the level of the junk bond[14].

This situation highlighted the European budget's lack of flexibility to face unexpected situations causing economic uncertainty and volatility in the financial market of the entire euro area. On 11 February 2010, the European Council stated that *"the Member States of the euro area will act with determination and coordinated, if needed, to safeguard financial stability in the euro area as a whole."* In that time was not yet decided whether Greece would need financial help from their partners. It was on May 2 of that year when an agreement was formalized between the government, the EU, the ECB and the IMF which established a system of intergovernmental loans. The rate of interest that Greece should pay would be much less than the one set by the market. The aid's total amount would be €110 bill. in three years in exchange for strict austerity measures and reforms besides severe fiscal adjustments, which Greece undertook. Out

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[13] "Report on Greek Government Deficit and Debt Statistics. Brussels, 8.1.2010 COM (2010) I final": http://epp.eurostat.ec.europa.eu/portal/page/product_details/publication?p_product_code=COM_2010_report_greek.

14 According to the European Institutions *"Credit rating agencies provide independent opinions on the creditworthiness of an entity, a debt or financial obligation, or financial instrument. This Regulation provides for a new legal regime to monitor this activity"* and are regulated by Regulation (EC) No1060/2009.

http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_transactions_in_securities/mi0009_en.htm Consulted on May the 7th, 2013 of the total, €80 bill. corresponded to the contributions of the members of the Eurogroup in loans and the remaining money coming from the IMF. That is, the EU budget had no role in the rescue but was used directly as a warranty.

1.1.3.1 The creation of a rescue mechanism

The Greek bailout had two main consequences. The first was the demonstration of the ability of the Union to partially respond to extremely adverse circumstances which was the case when the Greek risk premium’s level which was at 965 points and fell to 481. The second consequence was the appreciation in Brussels of the generalization of the debt crisis and very likely other countries would end up needing the help of their fellows within the Union.

This was the starting point for the creation of a financial stability package[15] as follows:

- European Financial Stability Mechanism (EFSM): a financial assistance of up to €60 bill, provided by States through the Commission and guaranteed by the EU budget.

- European Financial Stability Facility (EFSF)[16]: tool to participate in the financial market by issuing bonds, notes or other products, capturing funds with a limit of €440 bill.

It could be added to these two items a maximum contribution of € 250 bill by the IMF. In other words, the European Union had created a temporary means of rescue with a capacity of €750 billion. However, the mobilization of such vehicle was subjected to very strict conditions for the country receiving aid (as had happened with Greece). It has been used in the bailouts of Ireland and Portugal as well.

1.1.3.2 The case of Ireland

Ireland was the first country in the euro area which dealt with recession as the crisis that came from the United States was accompanied by the crashing of the housing bubble. Rating agencies had begun to decrease the value of the Irish debt rating. Despite the government's plans to cut public spending and raise taxes, it had to rely on foreign aid.

[15] Art. 122.2 TFEU, European Union 2008. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:en:PDF
[16] Main features of the EFSF are described in the section 3.1

The rescue set at € 85 billion was approved in December 2010 by the Irish government and thus should contribute to the rescue of the banks and the restructuring of public accounts.

Irish low taxation level is the main responsible for putting the country as the first victim of the crisis in Europe. This situation is possible due to a lack of regulation in fiscal matters at supranational level. Ireland has taken the opportunity of being member of an economic union and having a low taxation level to attract Foreign Direct Investments (FDI). Since its role is mainly focused on the financial sector, the State has difficulties to play its social role such as promoting public education or a public health system and consequently to reduce internal inequalities.

It is a contradictory fact that Ireland were the first country to be rescued and also it were accepted as a member of the Union with such weak social measures that make it difficult to converge towards other member states.

1.1.3.3 The case of Portugal

This situation had further difficulties. The existing economic plight was joined by political instability. In early 2010, the government introduced an austerity plan (decreasing military and social expenditure, raising taxes on high incomes, making privatizations and freezing wages) that did not prevent the increased risk premium and that the rating agencies decide to downgrade the qualification of the Portuguese debt. In March 2011 the government resigns due to the rejection by different political groups of the proposal for the fourth austerity plan.

Under the direction of a functioning government, Portugal asked for financial support. On May 10, 2011, he received[17] € 78 billion in exchange for an adjustment plan that included cutting staff wages and pensions until 2013, health spending cuts and a reduction in unemployment benefits.

[17] The approval of the bailout was affected by the electoral success of a political group in Finland, the "True Finns" who had ideas contrary to this kind of "solidarity" European and blocked for few weeks the aid package. The agreement was unlocked when this party decided to withdraw from negotiations to create a government in their country because of disagreements with potential government partners.

1.1.3.4 The rescue mechanism becomes permanent

It was agreed at the European Council of 16 and 17 December 2010 that the TFEU would be amended to establish a permanent mechanism to ensure the financial stability of the entire Euro area. The European Stability Mechanism (ESM) replaced above-mentioned structures on January 1, 2013.

The reform of the basic legal text of the EU is based on the addition of a paragraph to Article 136 of the Treaty[18]: *"The member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."*

It is expected that this new mechanism provides a borrowing capacity of up to € 500 billion and that the rating agencies will give to it the highest rating, capital must be subscribed € 700 bill. But participants must pay € 80 billion in cash and the balance consisting of reserve capital and government guarantees. The contribution of each Member State depends on its share in the ECB[19] discounting the countries outside the euro. Thus, Germany is the state with a higher quota (€21,6 bill.).

1.1.3.5 Greece does not get better

A year after the decision of bailouting Greece; there were no signs that showed an end to the current situation. Rating agencies continued to beat the Greek bond and Athens had to increase the debt's interest rate reaching historic maximums. At this time, the European Commission had to admit that Greece could not reach deficit targets envisaged under the rescue plan that was designed to supply the various tranches of aid. This made for the first time the question of the output of Greece from the euro to be raised creating unforeseen consequences on Member States plus Greece itself on which it would be obliged not only to pay its debt and interest thereof in drachmas but also it would be leading alone a very adverse situation. Therefore it was decided to include, not

[18] "European Council 16–17 December 2010 Conclusions", http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/118578.pdf#page=6

[19] There is a reduction for those Member States whose GDP is under the 75% GDP average.

without controversy, private banks voluntarily in financial aid. Meanwhile the stock market of other countries such as Italy and Spain suffered great instability.

On July 21, 2011, the Eurogroup decides to approve a bailout that would cost them €109 bill. and the banks €50 billion.

2. Summary of the crisis.

The crisis can be also regarded and defined from the evolution of the consequences it has created. Taking into consideration that the effects of the crisis are slightly different in Europe and in the US and they also differ among the members of the Union due to the asymmetries in the nature of the member states economies, common features can be found in order to describe the crisis according to the similarity of the effects that it has in each different country.

From a more economic perspective, in this section it will described the consequences of the crisis in the euro area concerning the evolution of four variables; the GDP growth trend in the period 2000-11, gross domestic debt, unemployment and foreign direct investment. These four dimensions are important to describe the growth of capitalist economies after the 80's, the time period *par excellence* in which non-regulation policies were applied, which dealt to the systematic deficiencies that caused the widespread of the crisis.

Non-conservative policies of encumbrance, permanent budgetary deficits, no measures to catch the attention of potential investors or the absence of surveillance mechanisms for the financial activities to avoid bankruptcies are responsible for the severe aspects of the crisis in the euro area. Now, assuming these responsibilities from the intergovernmental side of the Union while watching two different economic trends within it – the expansive trend represented by Germany and other central and northern European countries, the opposite trend represented by France and the southern-peripheral countries- Europe and specially the euro area has to face the challenge of regulating and adjusting the continental economy as a whole in order to promote homogeneity, balanced public accountings and economic growth.

2.1 *Actors involved in the crisis*

The world financial crisis has dealt to an important political mobilization at international level in order to avoid a similar situation like in 1929. At that time, nations answered individually and uncoordinatedly failing in the control of its widespread. The lack of international governance is partially solved after the creation of the international economic institutions like the International Monetary Fund and the international summits of the most economic powerful countries such as the G20.

Nowadays these international institutions and the European intergovernmental and supranational organisms are taking the leading role when it comes to deal with severe economic and financial adversities.

Since we are focusing the approaches to the crisis from a European perspective, in this section an overview on the euro area will be taken – its members, the relevance of its GDP globally and its government -, the United States, the International Monetary Fund and the G20 in order to see and to prove the role they play in the crisis. The aim of the paper is not to go too deep into definitions and descriptions; we will just illustrate their main features and their role in the crisis which will help us to get a better overview of the crisis.

Interdependency and hierarchy of the economy are the key words for understanding the roles and the correlation among the actions performed by the actors involved in this global crisis.

2.1.1 The euro area.

The term 'euro area' is the official term for the group of countries that have adopted the euro as their single currency. All other terms, such as 'euroland' and 'euro zone', should be avoided.[20]

Members and their relevance within the area.

The euro area –also abreviated in the literature as EA17- is composed by 17 European member states. Most of them adopted the Euro as their currency in 1999. Since the

[20] Art 7.3.1 Interinstitutional style guide.
http://ec.europa.eu/languages/documents/publications/interinstitutional-style-guide_en.pdf

typology of countries is a subject with many possible perspectives, this paper is not going to come into detail in this aspect. It will just expose some data as an argument to justify the positions of these countries in the top of the most relevant index lists.

The Euro area is populated by 332.4 mill. inhabitants which each one correspond €28.3 thousands of the global production. Its economic activity mainly concerns services (72.9% GDP), followed by industry (25.4% GDP) and agriculture (1.7% GDP).

In relation to its degree of openness, the exports –excluding intra-euro area trade- concern 15.6% of the World GDP. This makes the Euro area the most relevant part in the largest market in the World. In terms of internal GDP, the imports of goods and services concern 24.3% and the export of goods and services concern 25.2%.

Table 1 Members of the euro area and their economic weight in the area, the Union, OECD and in the World in the year 2011[21].

State	Admission	GDP (constant 2000 US$ bill.)[22]	% in Euro area GDP	% in EU GDP	% in OECD GDP	% in World GDP
Austria	01.01.1999	229,56	3,22	2,32	0,74	0,54
Belgium	01.01.1999	272,27	3,82	2,75	0,88	0,64
Cyprus	01.01.2008	12,38	0,17	0,13	0,04	0,03
Estonia	01.01.2011	8,74	0,12	0,09	0,03	0,02
Finland	01.01.1999	148,52	2,09	1,50	0,48	0,35
France	01.01.1999	1506,14	21,15	15,23	4,87	3,54
Germany	01.01.1999	2141,76	30,07	21,65	6,93	5,03
Greece	01.01.2001	141,40	1,99	1,43	0,46	0,33
Ireland	01.01.1999	124,36	1,75	1,26	0,40	0,29
Italy	01.01.1999	1150,82	16,16	11,63	3,72	2,70
Luxembourg	01.01.1999	26,91	0,38	0,27	0,09	0,06
Malta	01.01.2008	4,70	0,07	0,05	0,02	0,01
Netherlands	01.01.1999	444,70	6,24	4,50	1,44	1,04
Portugal	01.01.1999	122,88	1,73	1,24	0,40	0,29
Slovakia	01.01.2009	47,29	0,66	0,48	0,15	0,11
Slovenia	01.01.2007	26,04	0,37	0,26	0,08	0,06
Spain	01.01.1999	713,33	10,02	7,21	2,31	1,68
Euro area	-	7.121,79	100,00	72,00	23,05[23]	16,73
E. Union	-	9.891,85	-	100,00	32,02[24]	23,24
OECD	-	30.897,44	-	-	100,00	72,60
World	-	42.560,39	-	-	-	100,00

Source: World Bank database.

In the euro area is produced around 17% of the global production which is an important data because it shows its relevance in the world economy. Moreover, the euro area economy (17 member states out of the 27 of the Union i.e. the 63% of its members)

[21] To see whole data set and results classified into tables go to table 4 – 9 in the annex.
[22] GDP is defined as the sum of all goods and services produced in a country (GDP = $\sum (P_i * Q_i)$) during a year without taking into account the nationality of the resources used for the production. Therefore its growth/diminishment can be caused by changes either in prices –inflation/deflation- or in the amount of the production. Choosing GDP in constant prices a.k.a. real GDP, gives the reader the production of an economy with a stabilized price component; in this case, the price component is fixed with reference to the US dollar in the year 2000, i.e. US$ 2000 = 100 in the index series used to mathematically obtain this variable. In data shown in Table 1, 2, 4, 5 and 8 and Graph 1 and 2 the inflationary component has been neutralized.
[23] Not all Euro-area countries are OECD members.
[24] Not all EU countries are OECD members.

produces 72% of the whole Union. Concerning the Organization for Economic Co-operation and Development (OECD) composed by 34 countries whose aim is to stimulate economic progress and world trade, the economy generated by the 17 single-currency countries amounts to 23%.

These results show the relevance that euro area members have in the different developed world economic subgroups. Most developed countries are in the top of the classification of the main economic indicators such as shown above and other more such as the Multidimensional Poverty Index (MPI) or Index of Sustainable Economic Welfare (ISEW). In other words, it refers to the organization of the global economy into a hierarchy that leads to severe inequalities among its members. This can be only understandable from the concept of exchange and financial globalization. There is a high concentration of economic weight in Europe, North America and Eastern Asia which are mostly responsible for the global economy. Despite this fact, in the last 60 years the global economy is experiencing a swapping of the places where relevant economic centers are located[25].

Table 2 Relevance (in %) of the Euro area, European Union and OECD in the world between 2000 and 2011.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2011-2000
Euro area	19,35	19,41	19,20	18,82	18,50	18,17	18,04	17,88	17,71	17,31	16,94	16,73	-2,61
EU	26,24	26,36	26,18	25,85	25,49	25,14	24,97	24,80	24,54	24,01	23,52	23,24	-3,00
OECD	81,16	80,86	80,51	79,93	79,22	78,48	77,64	76,62	75,60	74,30	73,49	72,60	-8,57
World	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: World Bank database.

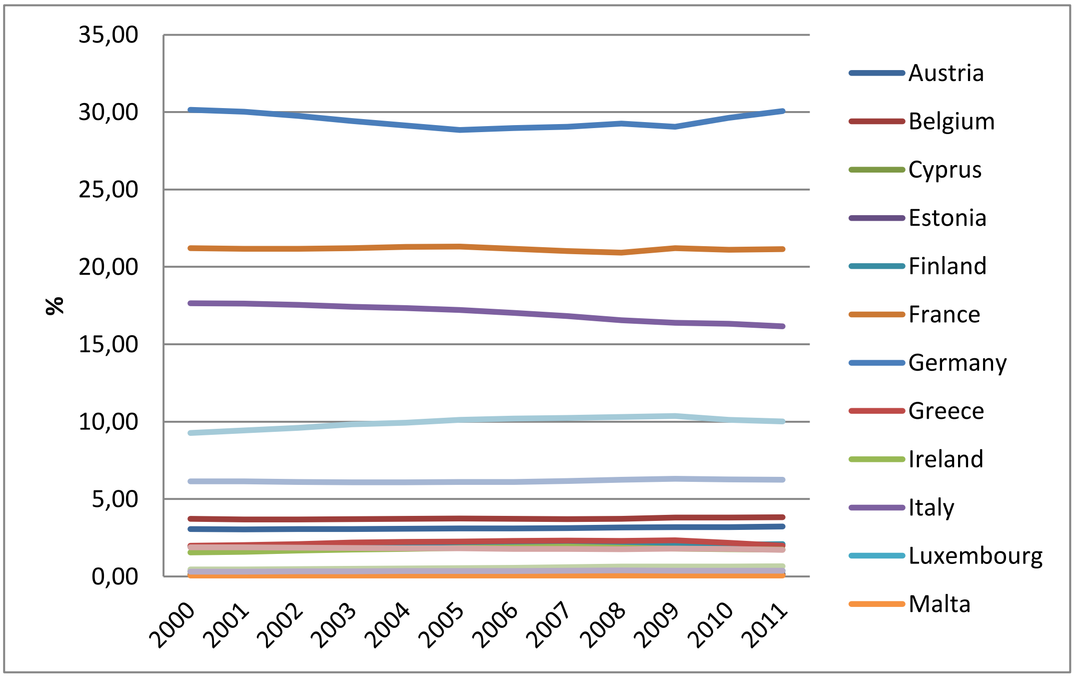
This economic tipping over is shown in the table 2 where the decrease of the of the euro area GDP (-2.61% from 19.35% to 16.73%), the European Union GDP (-3.00% from 26.24% to 23.24%) and the OECD GDP (-8.57% from 81.16% to 72.60%) has materialized in the 2000-2011 period. Merging countries such as BRICS which are partially responsible for the global economic growth in the last 10 years are not members of any of these groups. What has been described before is the result of the swapping experienced by world economy, assuming that merging countries[26]' economic

[25] Vérez, 2010.
[26] Such as BRICSs, MESTs

growth and the diminishment shown in Table 2 are constant. Nevertheless, deeper research on this phenomenon should be taken in order to extract more precise conclusions. Concerning the topic of this paper, its description is enough in order to frame the euro area economy in the global context.

Despite the hierarchical organization of the global economy and the exceptional situation of the euro area into it, there are several inequalities within and among its members. It can be seen examining the differences of the %GDP in the euro area in countries like Germany or France and Slovenia or Cyprus. These data are influenced by the size of the country, population and other variables, however they give an overview of the economy in the euro area and the importance that it has at a global level.

Graph 1 Relevance (in % total GDP) of Euro area members within it.



Source: World Bank database. Extracted from Table 6 in the Annex, page 9.

Table 3 shows that the crisis has not affected the inner hierarchy of the euro area and the growth tendency of the members has not changed their relative position into the hierarchy.

Economic features and growth trends.

Table 3 Members of the euro area, their GNI p.c. and correspondent development index in 2011.

State	GNI p.c. (current US$)[27]	HDI[28]	Gini Index[29]
Austria	48190	0,885	29,1
Belgium	45990	0,897	33
Cyprus	29450	0,848	n/d
Estonia	15260	0,846	n/d
Finland	47770	0,882	26,9
France	42420	0,893	n/d
Germany	44270	0,920	28,3
Greece	24480	0,860	34,3
Ireland	39930	0,916	34,3
Italy	35290	0,881	36
Luxembourg	77850	0,875	n/d
Malta	18620	0,847	n/d
Netherlands	49650	0,921	n/d
Portugal	21210	0,816	n/d
Slovakia	16070	0,840	n/d
Slovenia	23610	0,892	n/d
Spain	30890	0,885	34,7
Euro area	38654	0,869	n/d
EU	34000	n/d	n/d
OECD	36070	n/d	n/d
World	9511	0,682	n/d

Source: World Bank database and UNDP Human Development Report 2013.

[27] Gross national income per capita (formerly GNP per capita) 2011, Atlas method and PPP which is described by the World Bank as "*the gross national income, converted to U.S. dollars using the World Bank Atlas method, divided by the midyear population. GNI is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad. GNI, calculated in national currency, is usually converted to U.S. dollars at official exchange rates for comparisons across economies, although an alternative rate is used when the official exchange rate is judged to diverge by an exceptionally large margin from the rate actually applied in international transactions. To smooth fluctuations in prices and exchange rates, a special Atlas method of conversion is used by the World Bank. This applies a conversion factor that averages the exchange rate for a given year and the two preceding years, adjusted for differences in rates of inflation between the country, and through 2000, the G-5 countries (France, Germany, Japan, the United Kingdom, and the United States). From 2001, these countries include the Euro area, Japan, the United Kingdom, and the United States*."

[28] UNDP Human Development Report 2013, consulted on May 2, 2013.

[29] Source World Bank, 2011. Consulted from UNDP: http://hdrstats.undp.org/es/indicadores/67106.html

This table tries to describe from a bird's-eye view the inequalities mentioned above in the countries and allows comparing them at state level. The first column shows the Gross National Income (GNI) p.c. According to World Bank criteria, all members belong to the qualification of high-income economies[30]which mean that their GNI p.c. is at least $12.476. The second column shows the Human Development Index which is a composition of GNI p.c., expected years of schooling and life expectancy at birth[31]. Its minimum value is 0 and its maximum is 1. According to the UNDP 2013 Ranking, all members have also a very high human development, in other words, their HDI is at least 0.805. Finally, the third column shows the Gini Index which is an indicator that measures the inequalities concerning incomes within a population. Despite its limitations it is a useful guideline for classifying economies. A Gini Index of 0 represents perfect equality while an index of 100 means perfect inequality. There is a strong equality trend among the euro area members.

From a political perspective, the French-German couple has become the motor of the Euro area and the Union. It is not only an economic but also an ideological motor based partially on the force of its heterogeneous nature[32]. Both countries are seen as the two main founders of the Union because of their alliance and put in common of coal and steel are considered to be the ancient and original *raison d'être* of the creation of the European Union.

Table 4 Relevance (in %) of France and Germany within the euro area.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
France	21,20	21,17	21,18	21,22	21,29	21,32	21,16	21,01	20,92	21,20	21,11	21,15
Germany	30,15	30,02	29,75	29,43	29,13	28,85	28,98	29,05	29,26	29,05	29,63	30,07
Total	51,36	51,19	50,93	50,65	50,42	50,17	50,14	50,07	50,17	50,25	50,74	51,22

Source: World Bank database

Since these are the two strongest economies in the area – they produced more than the half of the euro area GDP in the period between 2000 and 2011-, the responsibility of finding a recovery path towards prosperity and growth mostly relies on them. Since France and Germany produce around 8% of the World GDP –see Table 1-, it can be

[30] http://data.worldbank.org/about/country-classifications/country-and-lending-groups
[31] For getting additional information about the construction of the HDI consult UNDP: http://hdr.undp.org/en/statistics/hdi/
[32] France's economy is mainly based in consummation (C).Germany's economy is based in Investment (I)

concluded that these two countries are one of the most relevant economic sectors worldwide.

The complexity of the European institutional architecture plays an important role in the repercussions of the crisis as well. Due to its intergovernmental and supranational nature, the creation of a consolidated answer to the crisis has become one of the most challenging topics in the continent.

After having got a description and an economic overview of the euro area, it is now necessary to see the economical effects of the crisis among its members in order to get an empirical proof of the existence of the crisis. Therefore, real GDP variation rates have been calculated in the period 2000-2011 with the formula:

$$T_t = \frac{Y_t - Y_{t-1}}{Y_{t-1}}$$

Table 5 Euro area countries real GDP variation rate evolution in the period 2000-2011.

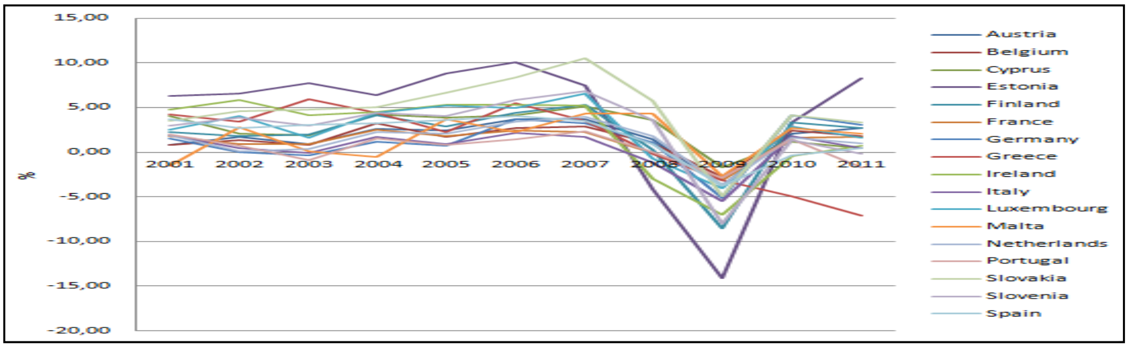
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2008-11
Austria	0,86	1,69	0,87	2,59	2,40	3,67	3,71	1,44	-3,78	2,05	2,70	0,84
Belgium	0,81	1,36	0,81	3,27	1,75	2,67	2,88	0,99	-2,78	2,42	1,78	1,35
Cyprus	4,03	2,09	1,93	4,22	3,91	4,13	5,13	3,63	-1,67	1,14	0,48	-0,07
Estonia	6,28	6,56	7,77	6,34	8,85	10,10	7,49	-4,15	-14,07	3,33	8,28	-3,86
Finland	2,28	1,83	2,01	4,12	2,92	4,41	5,34	0,29	-8,54	3,32	2,74	-2,91
France	1,84	0,93	0,90	2,54	1,83	2,47	2,29	-0,08	-3,15	1,66	1,70	0,14
Germany	1,51	0,01	-0,38	1,16	0,68	3,70	3,27	1,08	-5,13	4,16	3,03	1,81
Greece	4,20	3,44	5,94	4,37	2,28	5,51	3,54	-0,21	-3,14	-4,94	-7,10	-14,47
Ireland	4,79	5,87	4,16	4,51	5,34	5,31	5,18	-2,97	-6,99	-0,43	0,70	-6,74
Italy	1,86	0,45	-0,05	1,73	0,93	2,20	1,68	-1,16	-5,49	1,81	0,44	-3,36
Luxembourg	2,52	4,09	1,67	4,37	5,25	4,94	6,59	-0,73	-4,08	2,91	1,66	0,35
Malta	-1,55	2,81	0,13	-0,50	3,67	2,22	4,28	4,36	-2,65	2,71	2,10	2,09
Netherlands	1,93	0,08	0,34	2,24	2,05	3,39	3,92	1,80	-3,67	1,63	0,99	-1,13
Portugal	1,97	0,76	-0,91	1,56	0,78	1,45	2,37	-0,01	-2,91	1,40	-1,67	-3,19
Slovakia	3,48	4,58	4,78	5,06	6,66	8,35	10,49	5,75	-4,93	4,18	3,35	2,36
Slovenia	2,94	3,83	2,93	4,40	4,01	5,85	6,87	3,59	-8,01	1,38	-0,17	-6,90
Spain	3,67	2,71	3,09	3,26	3,58	4,08	3,48	0,89	-3,74	-0,32	0,42	-3,65
Euro area	1,97	0,91	0,71	2,19	1,67	3,25	3,00	0,38	-4,44	2,10	1,51	-0,96
EU	2,12	1,29	1,45	2,54	2,07	3,31	3,23	0,28	-4,33	2,20	1,52	-0,74
OECD	1,29	1,54	2,00	3,07	2,52	2,88	2,59	-0,02	-3,91	3,20	1,49	0,65
World	1,67	1,97	2,74	3,99	3,50	3,99	3,95	1,33	-2,22	4,34	2,73	4,81

Source: World Bank, World development indicators 2012.

As a result yearly real GDP changes have been obtained in percentage as seen above. Since in each cell there is a percentage (variation rate), each number expresses the GDP relative increase/decrease in relation to the previous year e.g. the Austrian GDP increased a 0.86% in 2001 in relation to the 2000 GDP. All negative values are highlighted in yellow and the last four rows represent the euro area as a group, the European Union, the OECD and the World GDP. It can be seen that some negative values appear already in 2008 but most decreases, both in number and in magnitude, appear in 2009. This is an empirical evidence of the crisis. It is also relevant to point out that besides Italy; all PIIGS countries still have after 2009 some negative GDP growth rates. On the other hand, other negative values should be considered in 2002 and 2003 due to economic fluctuations. Finally, the growth rate between 2008 and 2011 is shown in the last column. Since 2008 is the first year in which the crisis was felt in the area and

2011 is the most recent data, calculating a growth rate between these two years shows in real terms how countries have overcome the crisis. It can be seen that 10 countries of the area are still under the level of the years previous to the shock. The euro area and the Union of the 27 are also slightly under this level. As a final remark for this table, it must be stressed out that data of countries which suffered the crisis or whose economy is highly vulnerable to externalities influence the results shown in the rows concerning the euro area and the EU. This is due to the fact that these values have been calculated without taking into consideration the weight of each economy within the area. Therefore, a weighted calculation could increase the accuracy of calculations[33].

Graph 2 Euro area countries GDP variation rate.



Source: World Bank, World development indicators 2012.

Results given by Table 5 are now plotted in Graph 2. Here it can be better seen the euro area GDP decrease in the in the period 2008-2009. Again, no positive growth was experienced by the 17 member states in that period. It can be also seen how sensitive some countries are e.g. Estonia and Slovakia –their differences between 2006 and 2009- towards economical fluctuations or the serious situation of the Greek economy still in 2011.

Table 6 Mean and median of euro area countries GDP growth rates in the period 2000-2011.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2011-08
Mean	2,55	2,54	2,12	3,25	3,35	4,38	4,62	0,85	-4,98	1,67	1,26	-2,20
Median	2,28	2,09	1,67	3,27	2,92	4,08	3,92	0,89	-3,78	1,81	1,66	-1,13
Std Deviation	1,80	1,97	2,39	1,69	2,21	2,23	2,25	2,53	3,03	2,15	3,01	4,30

Source: World Bank, World development indicators 2012.

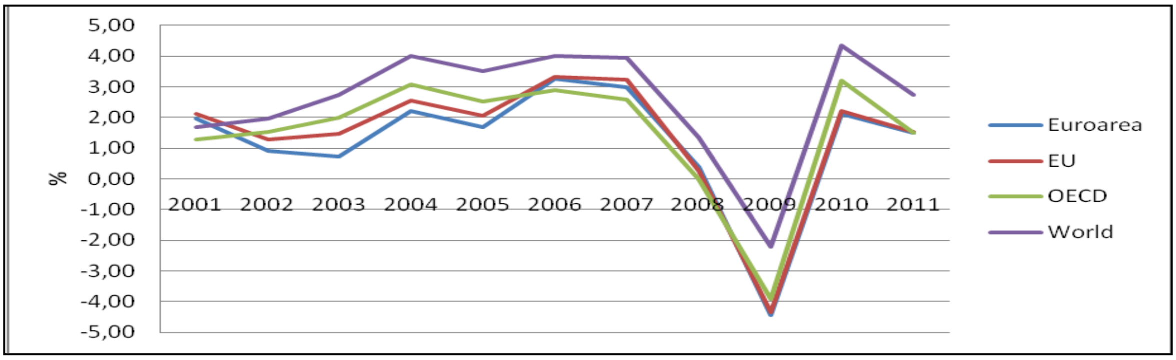
[33] See Table 12, 13 and 14 in the Annex to see in detail the data for calculating a weighted mean concerning population.

Table 6 summarizes the conclusions and the overall perspective given by Table 6 and Graph 2. Mean ($\bar{x}$), median and Std. Deviation (δ) of euro area countries GDP growth rate in the period 2000-2011 are used now to show the slowdown of the economy in 2008 and the repercussion of the crisis in 2009. It clearly shows that 2009 is the only overall period in which the GDP decreases. It is also the year which has the largest standard deviation (3,03%) presenting the disparities of the effects of the crisis among the members countries.

Results obtained for the years 2010 and 2011 have two different lectures. On one hand, the euro area has achieved to grow despite the crisis and the repercussion that it has had in the structural weaknesses of the member countries. On the other hand, this growth has been financed by an emphasized increase on the sovereign debt as will be shown in section 2.2 causing financial difficulties in several countries.

For the period 2008-11 the mean and median are negative showing that the euro area as a whole has not recovered its GDP to the previous-crisis level. Furthermore, the GDP dispersion for that period is the largest one in the last decade.

Graph 3 World groups GDP variation rate.



Source: World Bank, World development indicators 2012.

From a more global perspective Graph 3 shows the effects of the crisis on variation rates at different levels of the economy. One conclusion of the plot is that the economic global relevance of the euro area significantly influences world growth trends. Therefore, the euro area GDP variation rate experienced the biggest diminishment dragging the European, OECD and world GDP variation rate to a negative field. This idea should not be a surprise for the reader because in Table 1 was shown the weight of the euro area in the World GDP (16,89%) and in Table 4 it could be seen that the half of this production was performed by Germany and France that are the 4th and 6th largest economies in 2011 according to the World Bank[34].

Other more positive conclusion is the reestablishment of GDP variation rates to the previous-crisis level and even higher after 2009 –Tables 5 and 6-. The rise of merging and other developed countries growth rates and the global relevance of the euro area economy and its positive growth can be drawn as possible explanations for this fact.

It should be also pointed out again that the trend of the euro area plotted in Graph 3 and data exposed in Table 7 have been calculated as a simple mean[35]. Following indicators are obtained approaching same calculations with a weighted mean in terms of population.

Table 7 Weighted mean and median of euro area countries GDP growth rates in the period 2000-2011

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2011-08
Mean	1,08	1,24	1,39	1,06	1,11	1,04	1,04	1,23	-0,98	0,89	0,85	-1,35
Median	0,06	0,03	0,02	0,07	0,06	0,09	0,10	0,01	-0,10	0,05	0,05	-0,02
Std. Dev	0,16	0,09	0,12	0,16	0,13	0,26	0,23	0,09	0,36	0,27	0,21	0,24

Source: World Bank, World development indicators 2012 and Eurostat.

Similar results are obtained using weighted indicators. However, it must be stressed out that the growth's dispersion is considerably lower according to this criterion. This table shows how influenced were the previous-exposed data influenced by the size of national populations[36].

[34] http://data.worldbank.org/indicator/NY.GDP.MKTP.KD?order=wbapi_data_value_2011+wbapi_data_value+wbapi_data_value-last&sort=asc , consulted on May the 14th 2013

[35] The simple mean is mathematically expressed by $\sum(x_i/n)$, does not take into consideration the relevance of each sample within the data set.

[36] To see the process of calculation of these indicators go to Tables 12, 13 and 14 in the Annex.

2.1.1.1The Eurogroup[37]

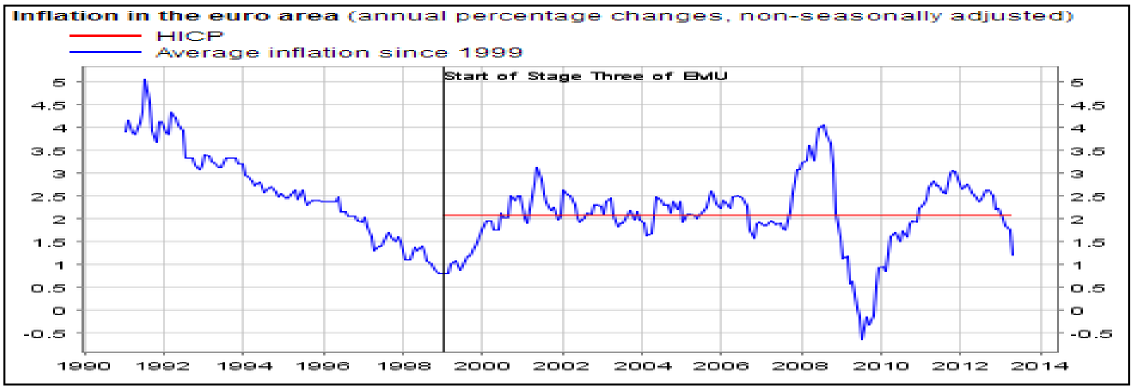
It is the informal gathering of the Finance Ministers of the Member States whose currency is the euro. It was created to enforce the economic policy coordination amongst Member States sharing the single currency. It is composed by the Finance Ministers, the European Commission and the European Central Bank. Since 2004, the Eurogroup decided to nominate a President for a renewable two-year term. Jeroen Dijsselbloem, the Minister of Finance to the Netherlands, is the current President of the Eurogroup.

2.1.1.2The European Central Bank (ECB)[38]

It is the Central Bank of those countries who share the Euro as a currency and it is the key stone of the Eurosystem also composed by the National Central Banks (NCBs) which are coordinated by the execution of the monetary policy performed by the ECB. Therefore, the Eurosystem is referred to be the monetary authority of the euro area.

The Eurosystem[39] is characterized by acting within a framework of "*clearly defined roles*", speaking with a single voice and having well defined responsibilities for all its members.

<u>Graph 4</u> Inflation in the euro area (annual percentage changes, non-seasonally adjusted)



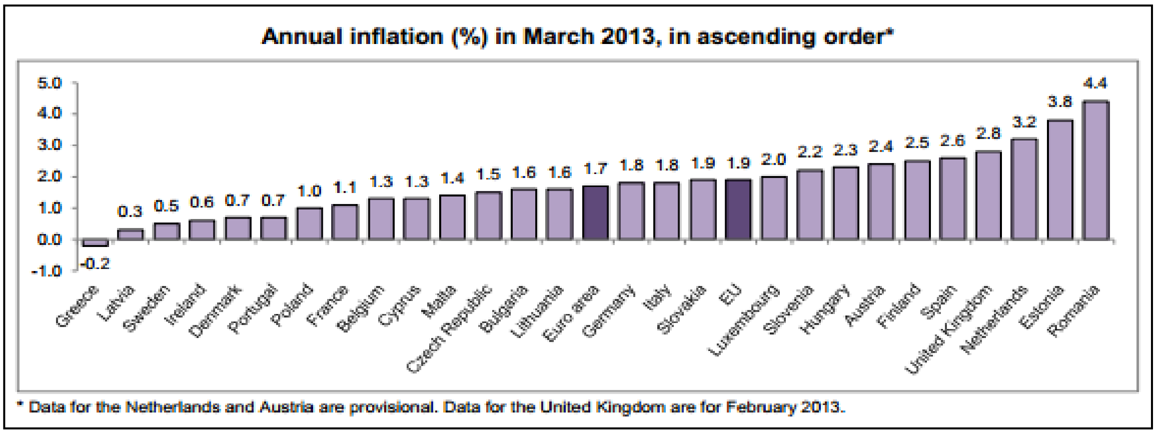
Source: ECB, consulted on May the 7th, 2013.

Concerning the ECB, its main objective is to keep prices constant[40] and therefore its monetary policy is mainly focused in achieving this goal. According to Graph 4, it can

[37] http://eurozone.europa.eu/eurogroup/about-the-eurogroup/history?lang=es
[38] ECB, consulted on May the 7th, 2013 http://www.ecb.europa.eu/mopo/intro/objective/html/index.en.html
[39] ECB, consulted on May the 7th, 2013. http://www.ecb.europa.eu/ecb/orga/escb/html/mission_eurosys.en.html

be concluded that the mission of the ECB being satisfactorily achieved. Since 1999 the average inflation rate is slightly above 2%.

Graph 5 European annual inflation in % in March 2013



Source Eurostat news release 60/2013, consulted on May the 7th 2013.

The euro area annual inflation rate was 1.7% in March 2013 which represents a decrease of 0.1% in relation to February. Despite the inflational disparities shown by different countries in the euro area and in the Union, the inflation average is still under 2%. This is another evidence of the success of the ECB according to its main aim.

Moreover, it is committed to contribute to the achievement of the objectives of the Union such as *"full employment"* and *"balanced economic growth"* [41]. Anyway, a clear hierarchy of aims is described in the Treaty of the Functioning of the European Union and therefore, price stability is still fixed as the main goal of the Eurosystem and more precisely of the ECB.

The instruments[42] that the ECB has are mainly based in the fact that the ECB is the sole supplier of monetary base and therefore has a total control on the quantity of currency in circulation and the reserves in the NCBs. As a matter of fact, it is able to fully manage the liquidity in the money market and consequently determinate its interest rates.

[40] Art. 127.1 TFEU
[41] Objectives of the Union set up in the Art 3 TEU.
[42] Monetary policy instruments, http://www.ecb.europa.eu/mopo/intro/operational/html/index.en.html

The capital of the ECB[43] is composed by the shares coming from the NCBs of all EU member states. It amounts to €10.760,65 bill. according to the last revision on December 29th, 2010. NCBs' shares are calculated in relation to the total population and gross domestic product of the EU and they are adjusted every five years and when a new country joins the EU. This procedure is made on the basis of data provided by the Commission. Since 1 January 1999, the capital has changed four times due to the 5-year periods and the two enlargements in 2004 and 2007.

According to that, the next table shows the ten largest capital keys in the ECB's capital.

Table 8 Ten largest NCB's capital keys in the ECB's capital subscription.

Country's NCB	Capital key %
Germany	18,94
France	14,22
England	14,52
Italy	12,5
Spain	8,30
Poland	4,90
Holland	3,99
Romania	2,46
Belgium	2,43
Sweden	2,26

Source: ECB. Extracted from Table 4 and 5 in the Annex, p.6

This will be relevant for the better understanding of the section 3.2.5 the funding of the ESM.

2.1.2 The United States

As in each and every political, social, economical or conflicting situation, the United States have been present in all stages of the crisis especially in its origin. As mentioned in section 1.1.1, the origin of the crisis after the crashing of the housing bubble and the transmission of its effects through the financial markets due to the lack of regulations, take place in the North American country. The financial crisis has had in the US more unpleased repercussions as expected. On one hand the risk of falling into recession

[43] Capital subscription, http://www.ecb.int/ecb/orga/capital/html/index.en.html

several times after 2008 and on the other hand the tensions between republicans and democrats enormously affect the fiscal and budgetary policies of the superpower. Trying to keep low rates of interest in order to promote the restructuration of the housing sector by facilitating sales, the US has had to deal with the rise of the Chinese Yuan and its correspondent repercussion in the costs of the American imports and the increase of the amount of the American public debt bought by China.

It cannot be forgotten that the US represents 27.59% of the World GDP and consequently, its global position is strongly determined by the activities and policies performed by other influential economies. As a matter of fact, the US needs a strong world economy in order to sustain its level of exportations – they have the biggest external deficit in the OECD. They also need strong economic allies able to buy their sovereign debt at a low rate of interest in order to finance their exports.

Beside these facts, the US economy is still playing the leading role worldwide. It still has strong influence in the financial markets, a strong technological development and the most important fact; it is a key element in global economy and politics. This can be clearly seen in the internal structure of the International Monetary Fund or the World Bank and the relevance of the dollar as the main world currency. From a political perspective, American influence can be seen in the Israel-Palestinian conflict, in the Cuban embargo situation or in the presence of military bases within German borders.

An overview of the US economy:

Table 9 Main features of the US economy.

	GDP (constant 2000 US$ bill.)[44]	% in OECD GDP	% in World GDP	HDI[45]	Gini index[46]
USA	11744,22	38,01	27,59	0,937	40,8

Source: World Bank Database.

As we can see, the role of the US at international level is very important. Although there are several inequalities within the country – the Gini Index is higher than in the European countries -, its economy represents more than one fourth of the global one.

[44] World Bank Database
[45] UNDP Human Development Report 2013, consulted on May 2, 2013.
[46] Source World Bank, 2011

2.1.3 International institutions

The international institutions that are actively participating in the current crisis have their origin in the Bretton-Woods agreements in 1944. They were the result of the economic cooperation that took place after the World War II due to the situation experienced by the powers involved in the war.

2.1.3.1 International Monetary Fund (IMF)

Role in the crisis[47]

The crisis has turned out as the perfect opportunity for the IMF to play a more active role in economy, e.g. since the start of the crisis it has committed over $300 billion in loans to its member countries. On the one hand, it has established several measures to contain the effects of the crisis and on the other hand it has observed many fissures of the Global Architecture and of the IMF itself and has been worked since 2009 to fix them[48].

By increasing quota subscriptions of member countries and securing large temporary borrowing agreements from member countries, the Fund has increased its lending capacity. Additionally, it has reformed its lending framework in order to improve lending facilities with measures such as the Flexible Credit Line[49].

However, the most important measure was the creation of a crisis firewall to help to strengthen global economic and financial stability. In April 2009 the G20 members agreed to increase borrowed resources available to the IMF by up to $500 billion. In April 2010, the Executive Board expanded and made more flexible New Arrangements to Borrow[50] (NAB) with the addition of 13 new participating countries and institutions. On November 15, 2011, the National Bank of Poland – the 14th participant - joined the NAB bringing the total to about SDR[51] 370 billion (about $570 billion). In December 2011 as a decision of the International Monetary and Financial Committee and the

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47 http://www.imf.org/external/np/exr/facts/pdf/changing.pdf

48 Initial Lessons of the Crisis for the Global Architecture and the IMF, http://www.imf.org/external/np/pp/eng/2009/021809.pdf

49 http://www.imf.org/external/np/pdr/fac/2009/032409.htm

50 “The NAB is a set of credit arrangements between the IMF and 38 countries and institutions which is used in circumstances in which the IMF needs to supplement its quota resources for lending purposes.”, IMF Standing Borrowing Arrangements (http://www.imf.org/external/np/exr/facts/gabnab.htm)

51 Special Drawing Rights, see Table 10

general support by the G-20 leaders at the Cannes summit on November 3-4, 2011, the euro area member states committed to provide additional €150 billion.

Historic and functional background[52]

The main objective of the IMF was to deal efficiently with the problems of the International Monetary System. According to the Bretton-Woods agreements the dollar was the main international currency which was established as the main reference in order to fix the exchange rates. The IMF was the main agent who guaranteed the cooperation among nations needed to keep the system stable and simultaneously ensured the American leadership.

The establishment of an international system with fixed exchange rates was the solution that guaranteed stability after two world wars and an economic crisis. The IMF has implemented the supervision mechanisms to avoid recessions, devaluations and ensured the amount of resources that States with difficulties in the balances of payments would need to preserve their – and consequently the global- stability.

Since the responsibilities of this institution were to act as a financial hub for its members and to be the promoter of debating monetary questions, the IMF should have been financed with enough resources that were enough for fighting against macroeconomic inequalities. Therefore, the member states of the Fund contribute to its budget according to their relative importance within the group. The budget is composed by Special Drawing Rights (SDR), the accounting unit of the IMF. Its current budget has an amount of SDR 210.000 mill. or US$300.000 mill.

After the recent changes of the global economy, on April the 28th 2008 the Council of governors reformed the structure of quotes and representation in the institution in order to adjust this structure to the weight of the economies in the world. According to that the ten most relevant countries are:

[52] Ref. Vérez 2008 and IMF, http://www.imf.org/external/np/exr/facts/quotas.htm

Table 10 Quotas and voting power of the 10 most important members of the IMF

	% Quota	% Votes
United States	17,69	16,75
Japon	6,56	6,23
Germany	6,12	5,81
France	4,51	4,29
United Kingdom	4,51	4,29
China	4	3,81
Italy	3,31	3,26
Canada	2,67	2,56
Russia	2,5	2,39
Netherlands	2,17	2,08
Subtotal	54,04	51,47

Source IMF, Member's Quotas and Voting Power, and IMF Board of Governors consulted on February 10, 2013. http://www.imf.org/external/np/sec/memdir/members.aspx#1

As we can see any decision that affects similarly to the 10 first countries would be approved or denied almost just by their position since they represent the 54.04% of the institutional budget and the 51.47% of the whole Voting power. It is also important to mention that BRICS[53] are in the group of the 20 most relevant countries in the IMF. Additionally, 5 out of these 10 countries figure in Table 7 as five of the ten largest NCB's capital keys in the ECB's capital subscription.

2.1.3.2 World Bank (WB)

Role in the crisis[54]

The World Bank has been acting as an designer and observer institution. Its role during this period – together with its original mission of supporting the IMF- has been to create and develop reports on the repercussion of the different aspects of the crisis, especially in the financial sector. From the WB's perspective, the role of the state and its involvement in the financial sector can help maintain economic stability. This could have negative effects since investors may feel a loss of incentives to deal in the market.

[53] Brazil, Russia, India, China and South Africa
[54]World Bank, consulted on February the 13th, 2013 Rethinking the role of the State in Finance 2013, http://go.worldbank.org/MVI44MKNU0

Therefore, the state must provide supervision ensuring healthy competition and strengthening financial infrastructure in other words, there must be an adjustment from direct interventions to less direct involvement. Furthermore, solid and transparent institutional frameworks must be built to promote financial stability. A complementation of anticipatory supervisory action and market discipline, e.g. less complex regulations, can be a more effective enforcement and better monitoring by stakeholders.

Concerning the role of state-owned banks and despite their unimpressive track record in credit, the WB propose them as a positive element toward stabilization of aggregate credit in a downturn since it is shown that lending performed by state-owned banks played a countercyclical role during the global financial crisis. Unfortunately, this perspective is specially challenging in weak institutional environments.

Historic and functional background[55]

It was concurrently created to the IMF in order to support its functioning and its mission. The WB in itself is a group of five institutions: The International Bank for Reconstruction and Development (IBRD)[56], the International Financial Society (IFS), the International Association of Development (IAD) and the International Centre for Settlement of Investment Disputes (ICSID).

To what the crisis concerns, the IBRD is the most important international institution. Its objectives are to help the member states for reconstruction and development, to promote international exchanges and stabilize the balances of payments[57]. In order to manage its functions, the IBRD has a Council of governors with plenty of rights to admit and suspend a member, to re-size its social capital, to establish agreements with other international institutions and to delegate their power to the administrators responsible for the general policy. There are 24 administrators and 5 are elected by their representing country: the US, Japan, Germany, France and the United Kingdom. 19 are elected by the head of state and government of the countries. The President is chosen

[55] Ref. Vérez 2010
[56] Ref. Vérez 2010
[57] World Bank's statute, Consulted on February the 13th, 2013. http://web.worldbank.org/external/default/main?pagePK=7333373&contentMDK=22956367

from the 25 administrators and presides the Administration council without taking part in the voting except in the case that there were a draw.

2.1.4 The Group of Twenty (G20)[58]

The G20 is the summit of the 19 emerging and industrialized countries and the European Union[59] whose objectives refer to policy coordination between its members in order to achieve global economic stability, sustainable growth; promoting financial regulations that reduce risks and prevent future financial crises and modernizing international architecture. It represents almost 90% of the world economy, 80% of international global-trade, 2/3 of the global population and 84% of all fossil fuel emissions.

The G20 was established in September 1999 after a meeting of finance ministers and central bank governors of seven major[60] industrial countries met in Washington, D.C. Finance ministers and central bank governors started to hold annual meetings after the inaugural meeting on December 15-16, 1999, in Berlin. Its presidency rotates annually among its members and leads a three-member management group -previous, current and future chairs – referred to as the Troika.

The Leaders' Summit take place in irregular periods of 6 or 12 months in which topics such as reforms of the international financial institutions and international architecture, collaboration with the IMF, jobs, growth and access to food fuel and finance among the world's poorest are dealt.

After dealing with points 2.1.3 and 2.1.4 it can be seen that there is an International structure, composed by some elements that apparently deals with international-sized (economic) problems. At present, this is the closest example of world (economic) governance that we can see. The main objectives of these institutions are to achieve international economic stability and progress e.g. supervising the currency markets,

[58] http://www.g20.org/docs/about/about_G20.html
[59] Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States of America plus the European Union, which is represented by the President of the European Council and by Head of the European Central Bank
[60] Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

minimize –or definitely eliminate- barriers for the poorest countries to access to loans and consequently eradication of poverty and get high rates of employment. Unfortunately on the other hand, it can be seen that the repercussion of their policies is still unclear and unimpressive; there are still poor and very poor countries in which no positive trend can be seen neither in the political nor in the economic dimension.

Concerning the science of International Economics, this inexistent international governance is one of the main obstacles for equal growth and development among nations. Inherent characteristics of the current system such as fiscal and prices regulation, financial supervision or detection of externalities can be only dealt efficiently from an international scene where authorities could act unanimously and equally in order to mitigate the differences of the national institutional frameworks and of the weaknesses proper to each economy.[61]

[61] Vérez 2010

2.2 Gross sovereign debt

Government (public) debt and government deficit are highly interconnected terms. The public debt can be originated as a consequence derived from unbalanced budgetary policies, too ambitious growth policies based on expensive infrastructures and/or from inequalities in the external sector (differences between exports and imports). Central Governments are obliged to find solutions for getting a general economic equilibrium by financing its operations[62]. One of the ways they find them is by owing short- and long-term bonds. If they are sold, they enable the emitter to get additional monetary resources and at the same time, oblige him to pay it back with an interest whose amount would depend on the duration until the repayment is due.

Another important term comes here into force: credit rating. Countries and financial assets are classified into a list according to economical and political criteria which define their creditworthy capacity. The rating acts in financial markets as signals/labels so that investors can easily recognize them and decide whether is worthy or not to acquire or speculate with them. Public debt emissions are not an exception and the classification of the countries by the Credit Rating Agencies (CRA) defines enormously the financing capacity of central governments.

In order to get a better understanding of the current encumbrance policy, a look back to the eighties must be taken. After the crisis of the seventies and its correspondent stagflation[63] several measures were taken in order to promote deregulation of markets and non-intervening policies in the economy. In the meantime, states like the US and the United Kingdom –guided by Ronald Reagan and Margaret Tatcher- applied Supply policies according to this concept As a matter of fact, public debt started to grow in those capitalist countries.

This example was followed by the European states making current economic situation possible. Another explanation could be that the explosion of in-debt-based growth after the crisis was performed by Euro members because in many ways the euro was a foreign currency for them (De Grauwe, 2011)

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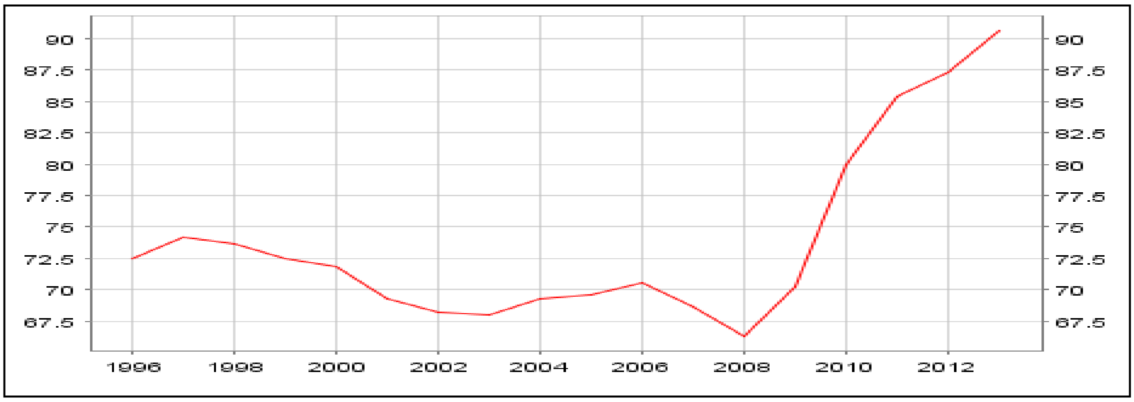
[62] This is not the only solution for financing operations e.g. monetizing the debt (which is forbidden in the union due to the art.123 TFEU) . Consequently, this would reduce the interest of the debt but not its amount. It could also drive to inflation. Another way to finance inequalities is the internal debt based on the same principle of the emission of bonds but offered to the national population.

[63] Period of time with economic recession and inflation.

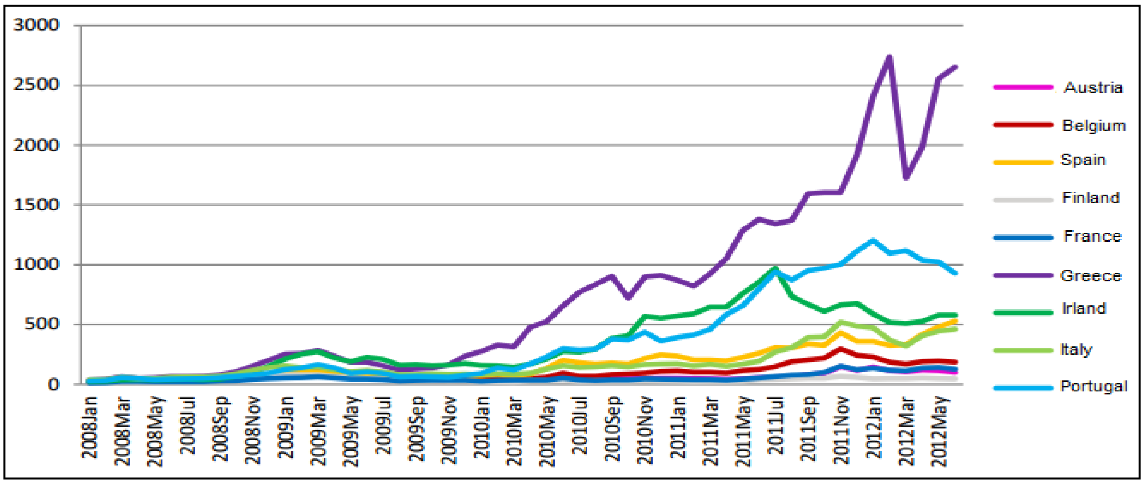
Graph 6 Evolution of the Government debt (as a % of GDP) in the euro area.



Source ECB, consulted on May the 7th, 2013.

It can be seen if government debt data are examined. The Government debt remained stable between 66% and 71% of the GDP until 2008, and then it sharply grew up to 87% in 2012[64]. In the year 2012 the government debt in the euro area has increased to 87.3% of GDP while the government deficit has decreased to 3.7% of GDP[65].

Graph 7 Evolution of the long-run national debt’s risk premium in PIIGS.



Source ECB, elaboration by Álvarez Fernández (2013)[66]

The risk premium defined as the difference between the national 10-year bond and the German one has notability increased since January 2010. This fact has acted as a “punishment” in financial markets due to inefficient or even irresponsible national structural growth policies.

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[64] See the whole data set in the annex, Table 1.
[65] Eurostat news release No. 64/2013.
[66] Masterthesis by Silvia María Álvarez Fernández, University of A Coruña.
http://ruc.udc.es/dspace/bitstream/2183/9981/3/AlvarezFernandez_Silvia_TFM_2013.pdf

The asymmetry of patterns is evident and shows once again the fragility of the European economy and its dependency from external factors, in this case foreign investors and credit rating agencies. The higher the Government debt has been in the euro area the higher was the debt's risk premium and consequently the interest that central governments have to pay for being financed.

It also shows the lack of coordination and compromise of the countries with the Union since no member has respected the limitations of the deficit spending and debt levels signed in the Maastricht Treaty. As facts have evidenced several years later, a more strict supervision of the role of the State as a borrowing finance agent should have been taken from the institutional government framework of the Union. If strict supervision measures would have been implemented on time, current situation could have been avoided.

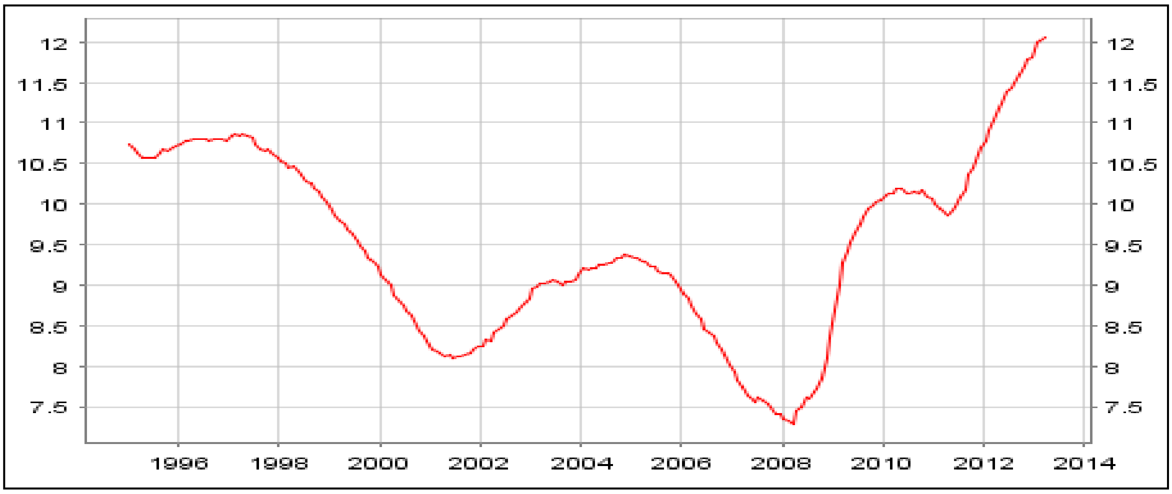
All these facts highlight once again the need for more solid governance in the Union and the lack of transparency regarding national economic data.

2.3Unemployment

The unemployment[67] in the euro area has obviously increased since the breaking up of the crisis up to 12.1% in March 2013, a data which is slightly higher than in the UE27, 10.9%. The unemployment rate for males (11.9%) and unemployment rate for female (12.2%) are very similar which is a signal of gender equality within the European labour market. On the other hand, there are significant disparities between central and peripheral countries. The former have moderate rates around 4.7% (Austria) and 5.4% (Germany) while the latter have 17.5% (Portugal), 26.7% (Spain) and 27.2% (Greece).

These are results consequence of insufficiencies in the labour market's demand[68] due to difficulties for financing enterprises –direct consequence of the financial crisis and restructuration of the banking sector-, the decrease of the consummation due to the consumers' lack of trust and the loss of competitiveness of the European economy due to the rise of developing exporting economies such as China or India whose labour unit costs are considerably lower than the European ones, a fact that drives to lower prices and therefore a better introduction in foreign markets.

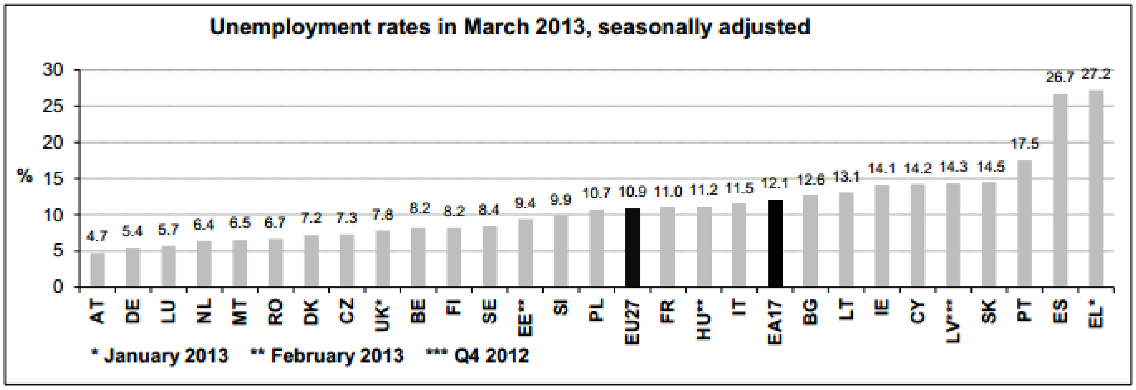
Graph 8 Unemployment rate (as a % of labour force[69]) evolution in the euro area in the period 1996-2013.



Source ECB[70], consulted on May the 7th, 2013

[67] All data mentioned in this paragraph are extracted from Eurostat news release No. 70/2013.
[68] In the labour market, the demand represents the capacity of enterprises to hire individuals belonging to the active population sector depending on the level of salaries. The supply represents all individuals able to work and ready for it depending on the level of salaries.
[69] The unemployment rate is calculated dividing the unemployed population by the labour force.
[70] See the whole data set in the annex, Table 2.

Graph 9 Unemployment rates in March 2013, seasonally adjusted



Source Eurostat news release No. 70/2013, consulted on May the 7th 2013.

There are two main reasons for the contrasts shown in the graph above. On one hand, the strength of the national industry sectors which delimitates the influence of the crisis within the country. On the other hand the proportion of part-time jobs which reduce considerably unemployment rates but do not provide the worker with a salary high enough for getting an over-average life standard. Other variables which measure internal inequalities, such as Gini Index, should be regarded to get a truthful vision about the evolution of living standards during the crisis.

As shown in 2.1.1, the members of the euro area are all developed countries which in demographic terms mean that they all experienced a demographic transition[71] together with their industrialization process. As a matter of fact, they have to deal with an aging population, and consequently with higher dependency ratios and with low-qualified labour force highly sensitive to the economic trends. Low-qualified middle-aged employees hired during the economic expansion of the area will have difficulties to be

[71] It refers to the transition from high rates of birth and deaths to low rates of birth and deaths. The fact that a country experiences this transition reveals the industrialized nature of its economy. As a result of the industrialization process, the rate of death sharply sinks –due to better life standards- before the birth rate does the same creating in this way a huge positive difference between these two variables which is often called "baby boom". In other words, there are small differences between the amount of births and rates, i.e. little demographic growth, at the beginning and the end of the process while during its development, there is an explosion demographic growth.
There is no general description about the length of this phenomenon but it can last from 25 years –as happened in Spain in the 1960's during Franco's dictatorship- to 150 years –as happened in Sweden between 1815 and 1965. As a matter of fact, there is an enormous increase in the country's production and economy during the time that this layer of the population is part of the national working force. After that, the next demographic generation, which is not so large than the previous one, has not only to maintain the same economic level nationwide but also has to be efficient enough to provide the dependent part of the population – the baby boom generation- with resources to mitigate the unfavorable consequences of a high dependency ratio – the relationship between dependent and productive demographic sector.

successfully reintroduced into the labour market. Therefore, re-estimations for the rates of structural unemployment will be needed after the crisis in order to readjust social policies.

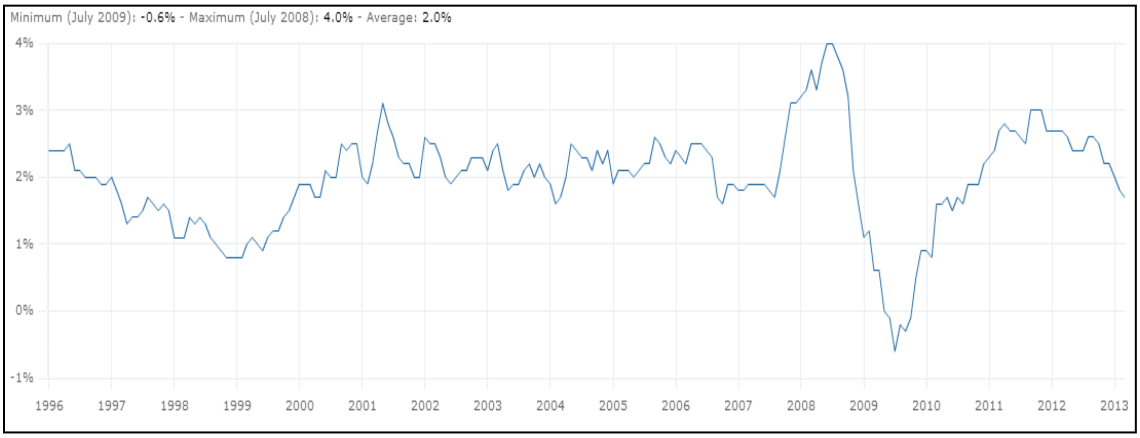
To sum up, the current unemployment originated by the crisis can be classified into two categories. First, medium or high-qualified employees that were expulsed from the labour market due to the contraction of the working demand. They will be employed either in the same or in lower levels of the market after the crisis, so they are not a setback for the Union after the recession. Second, the unemployed low-qualified labour force which will not be part of the labour market after the crisis due to its obsolescence. Additionally, a deep inspection of the consequences of the crisis in the part-time jobs, e.g. in Germany, will have to be taken to get a more accurate view of the post-crisis situation.

From an academic point of view, the role of the State concerning structural disequilibria – overproduction and unemployment- has been debated since the very origin of the economic theory. Those who supported the idea that overproduction could not take place in any economy because "the supply always creates its own demand" by the so-called Say's law or law of the market versus those who thought that the labour market's demand should be stimulated in order to achieve an optimal numbers of working individuals. This could be easily simplified to the ancient debate between classical and Keynesian economists or in other words, whether the intervention in the economy is positive or not for its growth and developent.

Concerning unemployment, there are *a grosso modo* three kinds of theories that try to describe the unbalance responsible for it the classical one, the Keynesian and those which relate unemployment with inflation[72]. Since they all concern the labour market, they deal with salaries and their (in)-flexibility only modifiable by supply-side politics. As it is shown below, inflation plays no role in the topic dealt in this paper; therefore all these theories have no use to explain current situation.

[72] All of them supported by the Philips curve which is a concept that relates the rate of unemployment and the inflation in any economy. The shape of the Philips curve changes if the theoretical approach is taken from a long-run perspective. Theories such as rational expectations or NAIRU –non accelerated rate of unemployment- are used as a link between the concept of the long run and the Philips curve.

<u>Graph 10</u> Harmonized Index of Consumer Prices (HICP) between 1996 and 2013.



Source ECB, consulted on May the 7th, 2013.

In the classic theory, wages' (W) flexibility is assumed as the factor that ensures the balance in the labour market –and consequently full employment- and the prices' (P) flexibility is the one that ensures the balance in the goods market. The reason for that is the trust that classic economists have in the system and therefore they consider the economy to be able to auto-regulate itself by its own mechanisms without the need of explicit intervention. Therefore, the only possibility for having unemployment is too-high real wages (W/P).

However, this description does not fit with the situation in the euro area as it can be seen in Graph 10. There is price flexibility but no inflation, so there is no global/harmonized increase of prices. As mentioned above, the cause of unemployment's increase is the contraction of the labour market's demand (Keynesian unemployment). Keynesians require for their model non-flexible W and P which are the responsible for the absence of equilibrium in the labour market. Keynesian unemployment is associated with an excess in the goods market –due to a positive difference between goods supply and demand- and a labour supply's excess which is explicitly responsible for the unemployment[73]. In other words, inequalities in both markets are of the same kind and consequently inefficient.

Households would be ready to increase their consummation if they could work more. Thus, the labour demand would increase and consequently they could hire more individuals. Contrarily, enterprises do not have any incentive to increase the production

[73] Unemployment is here referred as the difference between full employment level and the actual level of employment in the economy

because the rise of the demand would be lower than the production's rise. For overcoming this vicious circle, an augmentation in the exogenous components of the demand, e.g. public expenses, is needed. Put differently, Keynesian unemployment can be reduced with expansionist budgetary policies. As a matter of fact, an increase in the employment will be achieved and consequently higher household incomes and an additional increase in production... These will lead to the traditional multiplier effect of the Keynesian Theory.

Coming back to the topic here concerned and according to the theoretic description expressed before, a short-run solution for the current unemployment situation in Europe cannot be found. Despite the weaknesses of the European labour market demand, on February the 8th, European leaders decided to reduce the seven-year budget in a 3.3% from more than €992 billion –which corresponds only to 1% of the European GDP- to €960 billion. With such restrictive budgetary policies –and consequently restrictive public expenses policies- no reduction of the unemployment can be foreseen within the single currency area.

2.4Foreign Direct Investment (FDI) [74]

In 2.2 and 2.3 the crisis has been approached from a national/institutional perspective but another way to quantify its effects could be evolution of the FDI[75] level during this period. FDI describes the role of the Multinational Enterprises (MNE)[76] and its relevance in the global economy. FDI outflows show the capacity of enterprises to invest abroad while FDI inflows show the capacity of the economy to attract foreign investors. The former implies a non-institutional[77] power in the economy and the higher values are found in developed countries such as United States, France, Germany or Japan. The latter implies non-exploited potential for growth and development in factors such as legal framework, relative low labour unit costs or fiscal regime.

As the global evolution of this variable shows, the importance of MNEs has constantly increased since 1982 with the only exceptions of the 2001-2002 and 2008 crisis period. After 2009 Global FDI flows have increased and in 2012 they will be $1.6 trillion, the same amount than in the pre-crisis year 2006.

According to the ECB's Working paper series No. 329 Apr. 2004 *On the determinants of Euro area FDI to the United States: The knowledge – capital – Tobin's Q Framework*, most Global FDI flows occurs between developed countries, e.g. concentrated FDI stocks in the European Union and the United States are 72% of the total world outward and 56% of the total world inward stock in 2002. In other words, the weight of the US, UK, France and Germany is predominant and has not decreased during that period[78]. This shows once again the hierarchy of the world economy.

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[74] UNCTAD, *World Investment Report 2012.*Switzerland, United Nations.

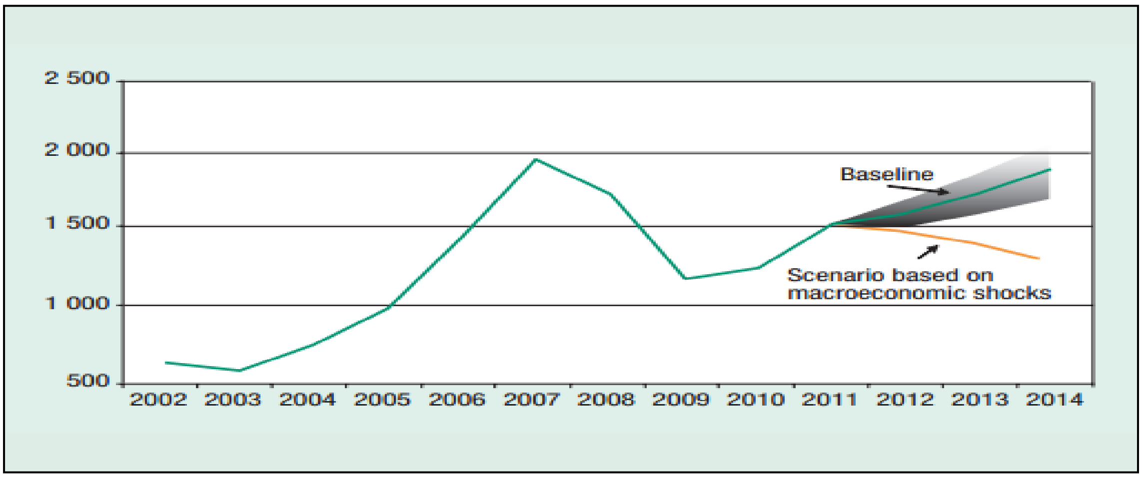
[75] Defined by the US Bureau of Economic Analysis (BEA) as the acquisition of foreign assets (based on residence) with the intention to exert control. More precisely, FDI reflects entering into a long-term relationship with the host country and second it does not only represent a transfer of resources across national borders but also a transfer of corporate control. [ECB Working Paper Series No. 329, p.10]

[76] MNE refers to an enterprise which has filial in many countries and are partially or fully controlled by its centralized administration at least until a certain point. In other words, a MNE is an enterprise whose actions are beyond the borders of a single country. MNE are formed by merging, annexing and other kind of strategic alliances. [Extracted from Vérez 2008, Source: Sherbrooke University]

[77] The influence of the MNE in the global economy is a highly significant variable for taking into consideration the leadership and position of each economy in relation to each other. They do not only produce a significant part of the global population and hire several hundred thousand employees but also exercise a strong influence in national governments as well as in international institutions. Additionally, the influence they have in national governments can be seen as a loss of people's sovereignty [Vérez 2008].

[78] Vérez 2010

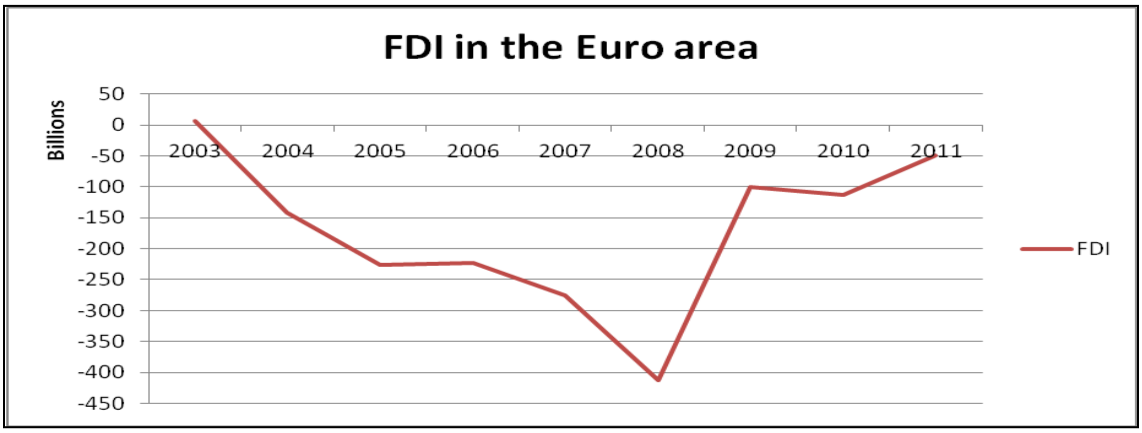
Graph 11 Global FDI flows in US$ bill. for the period 2002-2011, and projection for 2012-2014.



Source UNCTAD. World Investment Report 2012, chapter 1, page 17.

Despite the concentration of the FDI between the developed countries and its positive forecasts, the European debt crisis remains the biggest threat to the world economy as well as the rise of global energy prices.

Graph 12 Evolution of Foreign Direct Investment in the euro area.



Source World Bank Report 2012. See the whole dataset in the Table 3 in the Annex, page 5.

This graph shows the repercussion of the crisis in terms of FDI in the euro area. As we saw in previous sections, the year 2008 is crucial for explaining the evolution of economic variables in the area. The area experienced a loss of capitals, due to the €400 bill. FDI net outflows, which was partially recovered in 2009.

In a comparison of Graph 11 and Graph 12 it can be drawn that the decrease of the FDI in the euro area in 2008 significantly affected the global FDI trend. However, since both global FDI and euro area FDI trend differ in the period 2003-2007, it can be concluded that the global centres of business and investment have changed. Nowadays, the single currency area has lost its relevance in the sector in contrast to the BRICS and the Asian Tigers[79].

The fact that FDI outward flows are increasing more than the inward flows within the Union and the US develops a delocalization process of their enterprises and consequently a rise in the GNP[80]. On the other hand, it is a loss of opportunities to sink national unemployment and raise productivity. Anyway, collaboration between both superpowers is mandatory to maintain the economic standards developed due to the business expansion during the last two decades.

In these previous 30 pages the effects of the crisis have been described at the economic level and as a conclusion for this second section of the paper, it can be seen that the period 2007-2009 revealed weaknesses of the Union –and more precisely the euro area- in terms of the most relevant economic variables. Their evolution and their effect in the real economy are what have been called the “Euro crisis” or the “debt crisis”. The consequences of these shocks can be easily seen in the European political and social daily life which is highly determined by economic issues. This period has increased the role of the Eurogroup and the European Central Bank in the governance framework of the Union as well as the role of the heads of state and government which have had to decide their support to the Union in monetary terms to make possible the creation of several rescue mechanisms to ensure stability and growth. A deeper view into these will be explained in the third section of the present document.

[79] Hong Kong, South Korea, Singapore, and Taiwan.
[80] GNP is defined as the whole set of goods and services produced by an economy no matter the place of production. In this more accurate way, inequalities between developed and undeveloped countries are bigger because the main part of the production in undeveloped economies is being executed by the developed ones.

3. Overcoming the crisis

Solutions for overcoming the first severe challenge for the Euro area members require both economic and political coordination between them. The crisis demands global – supranational- solutions which involve all states directly or indirectly affected by the complexity of the situation.

As a direct consequence of the crisis, the idea of a heterogeneous euro area in terms of growth has been has been pointed out by economist as the most probable economic context for the next decade. Two- (or even three-) speed Europe or core Europe are those definitions created to describe the phenomena.

Basing on statistical indicators shown in Table 6 in section 2.1.1, the coefficient of variation (also called Pearson's Coefficient of Variation) has been calculated in order to show empirically the potential existence of a multi-speed euro area. The coefficient is calculated using following formula:

$$CV = \frac{\delta x}{\bar{x}}$$

Since it is a ratio that divides the standard deviation by the mean of the population, the closer it is to zero, the less dispersion is in the population. On the other hand, the higher the result of the coefficient, the larger dispersion in the population. It has to be mentioned as well that growth rates can be negative –as seen in Table 5 especially in the period 2009-. However, the coefficient of variation is positive by definition, thus measured in absolute values. Therefore, the value obtained for the period 2009 has to be positive even if the mean for that year is negative.

Table 11 Coefficients of Variation for GDP growth rates in the period 2000-2011

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2011-08
CV	0,7	0,78	1,13	0,52	0,66	0,51	0,49	2,96	0,61	1,29	2,39	1,96

Source: World Bank Database. World development indicators 2012

Values shown in the Table 11 point out that growth's dispersion until 2007 is relatively low. Homogeneity can be seen in terms of GDP growth in the 17 countries and consequently the right steps towards a convergence between them. In the period 2008 – growth in 2007-08 – the first impact of the American financial crisis clashes in the area creating the first disparities between central and peripheral countries. In 2009 there is a very low dispersion because all countries have been affected by the crisis revealing national weaknesses and institutional fissures. Finally, in 2010 and 2011 the dispersion increases. In this last period the level of dispersion is much higher than in any other year from the 2000-2007 period showing the beginning of the dispersion in the growth trend in the euro area.

This conclusion was already expected in 2009 and 2010 by the heads of the Union. Therefore, the introduction of measures that ensured financial stability in the Continent became a necessity for guarantying growth, welfare and especially economic trends' perspectives.

Table 12 Coefficients of Variation for weighted GDP growth rates in the period 2000-2011[81]

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2011-08
CV	0,147	0,075	0,086	0,147	0,121	0,252	0,218	0,075	0,370	0,306	0,251	0,178

Source: World Bank Database. World development indicators 2012

However, according to the indicators shown in Table 7, dispersion in terms of population-weighted data has not increased in real terms within the area. Therefore, the previously-mentioned data are susceptible to be questionable. Further research should be performed in this aspect in order to obtain solid empirical conclusions that could support the truthfulness of these two contradictory conclusions.

No matter if the heterogeneity of growth is rising within the area, solutions have to be found. Since the origin of the European project implies a shift of sovereignty which is already partially achieved due to the EMU, a solution for the crisis had to be proposed mainly from this supranational sphere. Not only net contributors to the Union must be active in this task by helping to finance those countries in troubles, but also countries affected by the crisis must accept the economic measures imposed from the supranational level and commit themselves to perform any reform or measure needed to the recovery of the national economy and consequently of the monetary union.

[81] The whole process of calculation can be seen in Table 12, 13 and 14 in the Annex.

It cannot be forgotten that no member state of the Union has respected the compromise done according to the Maastricht Treaty through which they agreed to perform non-indebting policies which help them to keep a financially healthy economy.

All measures adopted as a consequence of the crisis, reflect the too-long duration of the Union's waiting time for coordination against adverse situations putting in evidence its weaknesses.

3.1 European Financial Stability Facility[82]

The European Financial Stability Facility (EFSF) was created by the euro area Members States after the decisions taken on May the 9th, 2010 within the framework of the Ecofin Council. Its mandate is to preserve financial stability in Europe by providing financial assistance to euro area Member States following a macroeconomic adjustment programme.

Since the financial aid procedure and capacities are *a grosso modo* the same that are performed by the European Stability Mechanism, this temporary rescue mechanism will not be extensively described in this paper. Therefore, section 3.2 approaches in detail all ESM relevant features concerning a better understanding of the economic governance reactions towards the crisis[83].

In the same way as in the ESM, the Eurogroup and more precisely the Ecofin directs decisions and activities of the mechanism.

After the entrance into force of the ESM on October the 8th, 2012, the EFSF is continuing with the ongoing programmes for Ireland, Portugal and Greece. The financial assistance that is being performed to Spain, more precisely to the Spanish banking sector, was transferred from the EFSM to the ESM. Thus, the existence of the EFSF will cease once all loans and funds have been fully reimbursed.

The EFSF was set up to lend money to euro area countries which suffer financial instability. Its borrowing capacity is guaranteed by the other euro area countries and was set up as a private company under Luxembourg law with a highly limited capital relative to its borrowing and lending capacity.

This Facility, acting on behalf of the guarantor euro area countries had to face all features of procedures established by guarantor members. In other words, for macroeconomic statistical purposes, the money got by beneficiary countries was recorded as a loan from the EFSF to the guarantor countries. As a consequence, the gross government debt of the requesting country increases and additionally the gross

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[82] EFSF's website. http://www.efsf.europa.eu/about/index.htm
[83] For a more comprehensive comparison between EFSF, ESM, Euro area intergovernmental loans and the European Fiancial Stabilisation Mechanism see Table 12 in the Annex, p.13.

government debt of the guarantor countries increases in proportion to their respective shares in the guarantees provided to the EFSF.

To what the main purpose of the EFSF concerns –which is to achieve Financial Stability as already described in the name of the Facility-, this lending procedure does not solve the problem that suffer requesting countries. On one hand, the support operations are treated similarly as bilateral loans from one euro area country to another. On the other hand, the absence of a large enough subscribed capital of the Facility does not change in the medium term the perspective that CRAs get from countries in difficulties. Therefore, no aid provided by the EFSF can efficiently cope the expectations of the requesting country and the notation agencies.

3.2 European Stability Mechanism[84]

The European Stability Mechanism (ESM) is a reaction towards the failure of the EU's economic governance to prevent national policies that could contribute to create new major imbalances in the euro area countries. The mechanism was designed after the conclusions of the European Council at its meeting on 24-25 March 2011[85] adding the following paragraph to the art.136 TFEU *"The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."* The Treaty Establishing the European Stability Mechanism was signed on 2nd February 2012 and was inaugurated on 8th October 2012.

A part of these conclusions was the reform of the Stability and Growth Pact in order to "*enhance the surveillance of fiscal policies and to foster the early application of enforcement measures. A new macroeconomic surveillance framework, [...], a separate "Euro Plus Pact'*"[86]. These are the complement of the supervisory architecture's strengthening for the financial system that came into force at the beginning of 2011. The European Systemic Risk Board and the three new European Supervisory Agencies – the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority improve the capacity of the Union to overcome another high magnitude crisis. Since this last fact is unforeseeable and external shocks can occur, a framework which could provide *"temporary financial support to euro area countries, with the aim of providing bridge funding for the period of time needed to implement a deep adjustment programme to correct imbalances and regain market access."*[87] is needed. This sentence stresses out the key point of this measure since its purpose is to facilitate euro area countries the time necessary to achieve financial stability conditioned to the implementation of an adjustment programme capable of redressing the situation. Simultaneously, the non-concessional terms of the financial assistance has to act as an incentive for the member state to recover market financing as soon as possible. As a part of this incentive, the assistance

[84] ECB Monthly Bulletin July 2011, p.71-84 and Treaty *"Establishing the European Stability Mechanism"* (T/ESM 2012).
[85] Decision 2011/199/EU amending art. 136.
[86] ECB Monthly Bulletin July 2011, p.72.
[87] ECB Monthly Bulletin July 2011, p.72.

will take place in stages conditioned on the country's adherence to the targets described in the adjustment programme. Despite the fact that the nature of the balance of payments constraint is different for euro area countries, the features of the European crisis management framework resemble the IMF-supported adjustment programmes.

There are three main facts that motivated the euro area crisis management framework. First, even under the institutional umbrella in the euro area governance framework, shocks and crisis can develop and asymmetrically hit a member state. Due to the high interdependence of the euro area economies and the lack of a central fiscal authority, it could destabilise it as a whole. Second, concerning the financial sector, its failures can re-price sovereign risk due to different fiscal and structural positions. Therefore, liquidity should be properly addressed in order to avoid timely situations to become structural and compensate this way the imperfection of the markets as devices for disciplining public policy. Third, the credibility of the Union by managing crisis responses has to be clear and concise. In this way, investors will correctly price the risk when lending to governments.

All in all, the described framework is designed to minimise moral hazard and strengthen incentives to undertake fiscal and macroeconomic adjustment and to achieve market financing as soon as possible.

3.2.1 Main features of the ESM

Since the European Stability Mechanism is based on the Treaty T/ESM 2012, it is defined as an intergovernmental rule-based organisation established under public international law. Its Board of Governors composed by the finance ministers of the euro area countries –members of the Eurogroup- will take the most important decisions in relation to the intergovernmental organisation. Those decisions will follow the Rules of Procedure of the Board of Governors established on October the 8th 2012[88]. Additionally, the European Commissioner for Economic and Monetary Affairs and the President of the ECB will be observers of the procedure[89].

[88] Procedure for the Board of Governors
[89] Rules of Procedure of the Board of Governors, art. 3.1.(b).(i)

Mutual agreement, which means that a decision should be taken unanimously by voting countries –abstentions do not avoid the adoption of a decision butwill ensure the decision-making efficiency of the ESM. There are four key issues that will be adopted following these criteria:

1. The granting of financial assistance.
2. Terms and conditions of financial assistance.
3. Lending capacity of the ESM.
4. Changes to the menu of instruments.

All other decisions of the Board of Governors have to be taken by qualified majority –80% of the vote-. Finally, votes will be weighted in direct relation to the shares of the Member States in the capital of the ESM.

Moreover, the Board of Directors is the second decision-making body which will be responsible for all delegated tasks given by the Board of Governors. Each euro area Member State will appoint one Director and one alternate Director. The European Commission and the ECB will act as observers in this process. Also a Managing Director will chair the Board of Directors and will be in charge of the daily ESM's management. In order to have a smooth transition from the EFSM to the ESM, it will be based in Luxembourg.

Since non-euro area countries can participate in the ESM under a voluntary basis, they will also represent in relevant meetings of the mechanism and will have access to all relevant information concerning provision of financial assistance to euro area countries. Concerning this point –which is defined as the first key issue adopted by mutual agreement by the Board of Governors- the ESM will act in collaboration with the IMF because it is expected to play an important role during activation and monitoring processes. As already mentioned in section 2.1.3.1, the International Monetary Fund has increased its role as a global monitoring and saving actor. During the collaboration of the ESM with the IMF will be the first time that the latter gets involved in activation and monitoring actions in countries which do not present –serious- problems in their balance of payments. On the other hand, the European Central Bank will also work in collaboration with the European Commission and the IMF to measure the potential risk to the financial stability of the euro area as a whole. Also ECB staff will supply technical advises to the negotiation of a macroeconomic adjustment programme.

Optimistically, the involvement of the ECB and the IMF in the financial assistant process could be seen as a small step towards a possible global economic governance.

3.2.2 Instruments of financial assistance

As mentioned before, financial assistance will take place in form of loans as with the EFSF which will be known as ESM stability support (ESS). It "*will be conditional on agreement to and compliance with a strict macroeconomic adjustment programme*"[90]. Its due date will depend on the nature of the imbalances but also on the capacity of the member state to re-enter the financial market. Also the interest rate on the loans will be highly influenced by the borrower and its financial context. It could be either fixed or variable and will be the addition of the financial costs to the ESM and a charge of 200 basis points. If a certain amount has not been refunded after three years, a charge of 100 basis points will be added. Nevertheless, price-fixing policy will be regularly reviewed by the Board of Governors. Should be the policy or structure changed, incentives must properly set as follows in order to keep moral hazard issues and incentives for stability strong enough to avoid the ESM become attractive for countries without budgetary discipline:

- The similarity of the pricing structure of the ESM must be kept in relation to the financing IMF principles.
- The rate of interest must be fixed so as financial assistance becomes unattractive. In other words, it must be higher than the historical minimum average rates applied by markets under "normal conditions". On the other hand, this minimum level will compensate the risk assumed by members.

Exceptionally, as the ECB currently does, the ESM may acquire bonds of any euro area member in the primary market. Therefore, just by absorbing primary debt assets a backstop facility would be created and potentially help the beneficiary country recover access to market financing. In the same way as the loans described above, conditions

[90] ECB Monthly Bulletin July 2011, the instruments of financial assistance, p.76

and modalities of this action will be specified in the terms and conditions of financial assistance for the beneficiary country always subjected to the same conditionality as under the ESS. This last measure could be a way to solve partially financial difficulties, therefore is important for the ESM to have a wide spectrum of instruments to preserve its goals. Since the access to the primary market will significantly depend on the developments in the secondary market, the ESM have the possibility to access and act there in order to effectively preserve financial stability in the euro area as a whole. Anyway the ESM Board of Governors is authorised to decide by mutual agreement to expand the instruments available to the ESM. On the other hand, expansions of EFSF's instruments imply an amendment to its Framework Agreement.

3.2.3 Implementation of the Mechanism

The implementation of the mechanism can be divided into three phases. First, the financial assistance request and the activation of the mechanism. Secondly, monitoring of the macroeconomic adjustment programme compliance and third, the post-programme surveillance.

Phase 1. Financial assistance request and activation.

This is the most interesting phase of the implementation because it concerns both EU supranational and intergovernmental institutions, other international institutions such as the International Monetary Fund and the ECB and especially concerns the euro area country which is in financial troubles.

When a euro area country requests financial assistance to the ESM, the Eurogroup and ECOFIN Presidents and the Managing Director of the IMF have to activate it. And following the request, the Commission together with the IMF and in liaison with the ECB will determinate *"whether there is a risk to the financial stability of the euro area as a whole and will undertake a rigorous analysis of sustainability of the public debt of the requesting country"*[91].

[91] ECB Monthly Bulletin July 2011, Implementation of the Mechanism, p. 77

Conclusions drawn from the sustainability analysis will determinate if a macroeconomic adjustment programme can restore public debt to a recovery path and therefore make efficient the assistant given by the mechanism to the requesting country. At this very point, another important concept becomes relevant concerning the understanding of the functioning of the ESM. The Memorandum of Understanding (MoU), which is the paper including all negotiated macroeconomic adjustments demanded to the country that requested financial support, is the result of the sustainability analysis developed by the European Commission, together with the IMF and in liaison with the ECB. Additionally, it *"should be fully consistent with the overall EU framework for economic policy coordination"*[92].

The Commission, as the technocratic body of the Union, will propose the macroeconomic adjusting programme to the EU Council and the Board of Governors of the ESM will decide the granting terms and conditions.

Phase 2. Monitoring of the adjustment programme.

Once the assistance has started, the Commission-IMF-ECB trio will monitor the implementation's fulfilment by reporting to the ECOFIN Council and the Board of Directors of the ESM. The latter will indeed be responsible for the decision by mutual agreement of the disbursement of further tranches of the loan.

Phase 3. Post-programme surveillance.

Its implementation can be performed once the second phase has finished. Its initiative concerns –as seen in other procedures in the Union- a Commission proposal which will be delivered to the EU Council. The surveillance can last as long as the loan has not been fully repaid.

In relation to the institutional control exerted on the ESM there are two aspects to be considered. First, in order to increase its integration, involvement in the EU institutional framework and transparency towards the European population, the ESM will be under

[92] ECB Monthly Bulletin July 2011, Implementation of the Mechanism, p. 77

the control of the ESM Board of Governors. Second, the Parliament will also be regularly reported on the establishment and the operations of the ESM. In other words, the ESM will be strongly connected with the intergovernmental and supranational dimension of the EMU. Second, the ESM will be subject to internal and external audits whose results will be quarterly published summarizing its financial position and a profit and loss statement showing the results of its operations.

Since financial assistance will be strictly conditional according to the implementation of the macroeconomic adjustment programme, any requesting euro area country which does not adhere to it will be subject of suspension of the disbursement of tranches. As a matter of fact, the country would lose the support of the ESM assuming consequences of debt variations in the financial markets and risking the exposure of the private sector. All in all, the beneficiary country should be highly interested to adhere to the programme.

To what concerns moral hazard, conditions and terms of financial assistance can modify the conduct of the beneficiary country and consequently increase it. As mentioned before, the ESM institutional design and its pricing structure is mainly focused on the preservation of low moral hazard levels. Practical arrangements for the disbursement of official financial assistance are not an exception. Therefore, strict criteria for financial assistance and policy conditionality are needed from the institution to fulfil objectives. On the other hand, the requesting country must be committed to the implementation of the macroeconomic adjustment.

3.2.4 Private sector involvement

The ESM will also take into consideration the proper involvement of the private sector to cope the difficult financial situation. This will lead *"to ensure an appropriate pricing of risk in the government bond markets and fair and proportionate burden sharing between taxpayers and private creditors in the provision of the financial assistance"*[93].

In connection to what this paper deals with, the most relevant fact concerning the private sector involvement is that in the case of an adjustment programme cannot

[93] ECB Monthly Bulletin July 2011, Private sector involvement, p. 78

restore public debt, the beneficiary country *"will be required to engage in active negotiations in good faith with its non-official creditors to secure their direct involvement in restoring debt sustainability"*[94]. The ESM may provide liquidity assistance if there should be an adequate private sector involvement.

3.2.5 The funding of the ESM

The capital structure of the ESM has been designed to ensure its highest possible credit rating while guaranteeing a significant lending capacity -€500 bill. as already mentioned-. It will increase the robustness of the mechanism and set the appropriate incentives for euro area countries.

Table 13 ESM capital structure.

Concept	Amount in € bill.
Subscribed capital[95]	700
Paid-in capital[96]	80
Callable capital[97]	620
Lending capacity	500

Based on ECB Monthly Bulletin July 2011, The funding of the ESM, p. 82

Paid-in capitals reduces "migration risk" – the risk coming from potential downgrades of individual euro area credit ratings- which means that sovereign credit ratings will affect less the overall rating of the ESM. The use of callable capital, based on a simple majority decision by the Board of Directors, gives the institution more flexibility. As a consequence of a call in capital decision, there are incentives to contributing euro area countries to approve the financial assistance only if they consider it indispensable for the stability of the financial stability of the euro area as a whole and second if they are convinced that the loans are going to be pay back.

[94] ECB Monthly Bulletin July 2011, Private sector involvement, p. 80

[95] Is the addition of "Paid-in capital" and "callable capital".

[96] Paid-in capital is defined as the amount of capital contributed to any corporation or institution in form of stocks or any kind of internal participation.

[97] It makes reference to the part of the capital which is not payed but accounted as part of the subscribed one.

The capital structure plotted on Table 13 allows debt owed by the ESM to be classified as public debt of “European institution” instead of individual euro area countries. Furthermore, the contribution of each member is performed according to their share in the ECB’s capital key[98] –based on equal weight to the country’s shares in the total population and total EU GDP- with the sole exception that for low GDP countries, i.e. less than the 75% of the EU GDP average – the contribution will be reduced for a maximum period of twelve years after the ESM entry force or after their entry into the euro area.

3.2.6 Conclusions

The existence of the ESM is a crucial step towards more rational economic policy coordination. Its internal structure lead by the Board of Governors, i.e. the ECOFIN which is an intergovernmental body, and its capital structure ensures the efficiency and success of the mechanism concerning the financial stability within the euro area.

In terms of integration, the capital structure is perfectly adequate to the demands of the ECB concerning moral hazard and thus reducing the contagion effect among the single-currency countries. Additionally, the role of the Commission and the Parliament reflects the link between the mechanism and the supranational dimension of the Union.

The fact that makes comparisons not possible and ensures continuity in the existence of the ESM is its definition as an international institution. On the one hand, it legitimizes the mechanism as an authority whose indications and conditions, in the form of macroeconomic adjustment program, must be followed in order requesting countries to preserve the financial assistance. On the other hand, the definition together with the subscribed capital guarantees its AAA notation.

Finally, the unpleasant loans conditions and the macroeconomic adjustment program are a message of economic policy straightness to members and show them that adhering to an ESM financial assistance should be only regarded as an ultimate measure to deal with sovereign debt difficulties.

[98] See Table 8 in section 2.1.1.2 the European Central Bank, page. 34.

3.3Golden rule[99]

"The budgetary position of the general government of a Contracting Party shall be balanced or in surplus […] as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit[100] *of 0,5% of the gross domestic product at market prices"*[101]

The Treaty on Stability Coordination and Governance in the Economic and Monetary Union (TSCG), where the so-called "golden rule" is described, is an intergovernmental accord which is not integrated in the legislation of the Union. However, the Treaty establishes a five-year deadline since its entrance into force to incorporate it to the legal system of the Union[102].

It is important to point out the existence of a narrow connection between the TSCG and the TESM described in the section 3.2. Therefore, the financial assistance performed by the ESM is conditioned, since May 1 2013, to the previous signature of the TSCG by the requesting country. One year after the signature, the financial aid will be also conditioned to the inclusion of the budgetary balance into the internal legal system.

Since its aim is to preserve the single-currency integrity, the TSCG establishes an indicate obligation concerning each signatory country's administration to cope its budgetary situation with balanced or positive results. This *golden rule* is concretized in some precise demanding which concern public deficit and public debt and are more intense than those described in the TFEU.

Furthermore, another institutional obligation described in the art 3.2 precises that the *golden rule* has to be incorporated to national legal systems *"through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary*

[99] EFSF website http://www.efsf.europa.eu/about/index.htm and La crisis del euro y la regla de oro: problemas constitucionales.
http://www.uria.com/documentos/publicaciones/3607/documento/a9.pdf?id=4414

[100] It refers to the budgetary imbalances mostly due to medium and long-term policies that cannot be enough financed by taxes and national revenues. Concepts like public debt and its interest do not correspond to the term "structural deficit".

[101] Art.3 Treaty on Stability Coordination and Governance in the Economic and Monetary Union (TSCG), Brussels, 2012.

[102] Art. 16 TSCG, Brussels, 2012.

processes". Additionally, Contracting Parties have to ensure national authorities' independency to which concerns the observance of the *golden rule*.

Concerning the role of the Court of Justice of the European Union (CJEU), its authority has been limited and it is destined to watch the correct implementation of the *golden rule* within the national legal system. In relation to possible sanctions –which amount can be even 0.1% of the national GDP- , the CJEU is legitimized to punish any member state only if it is requested by another member state and not by the Commission.

The Commission is legitimized to propose and recommend an adequate path towards the correct implementation due to an excessive internal budgetary deficit[103]. However, these obligations have a limited force and therefore there is no compromise to accept its indications if a qualified majority of States oppose the proposed or recommended decision.

As a matter of fact, there are two facts that can call into question the surveillance mechanism of the *golden rule*. On the one hand, the Commission –the technocratic body of the Union- has no influential power during the process. On the other hand, the only legal power to denounce the bad implementation of the *golden rule* in the national legal system relies on the other Contracting Powers of the TSCG. In other words, member states, in order to preserve the stability of the EMU, have to observe the implementation of the mechanism not only in their own national systems but also in the other ones. This could be seen by some authors as a step towards a fiscal federalism but it cannot be neglected that this measure introduces a climate of distrust –or indifference- in the Union and more precisely in the euro area.

There are discussions by many authors concerning the advantages and disadvantages of the implementation of the *golden rule* to the national constitutions or legal systems. Since disparities among national legal systems –concerning their nature and content- are more than obvious in the euro area, the implementation of the mechanism will have certainly different effects in the national constitutions and in the national public opinions. Those who think that budgetary restrictions will help the country to reenter the path of growth will be definitely in favor of this measure. On the other hand, those who believe in the economic growth based on the efforts and incentives given by the

[103] Art. 7 TSCG, Brussels, 2012.

Government –and generating consequently a budgetary effort- will strongly oppose the decision adopted by most EMU members.

4. Conclusions

The financial crisis, which originated in the United States in 2007-08, has transformed its nature after its occurrence at the Old Continent. Although it was supposed to be a strictly financial phenomenon, it later became a process which revealed the specific weaknesses of the member states of the EU and in a more global perspective, it revealed the flaws of the Union as a whole.

Disparities in terms of Inflation, Gross (Public) Sovereign Debt, Unemployment and Foreign Direct Investment, among the euro area members, have not been efficiently approached by the economic framework governance of the Union. Late and insufficient responses, which were used by speculators for rising profits putting thus into unnecessary risk instable countries, have made the necessity of the Union to deeply reflect on the improvements necessary to cope the numerous lacks of the policies directed from Brussels.

Concerning economic growth, it has been emphasized in the section 2.1.1 with several tables and graphs, that the main negative trend in terms of GDP can be only seen in the 2008-09 period. There are only few exceptions such as PIIGS countries, which have also suffered negative growth after 2009. It holds especially true for Greece. On the other hand, after the year 2009, the slowness in the GDP growth rate can be enunciated. The correct term to define this situation is "*recession*" and therefore, the term "*crisis*" cannot be properly used to strictly make reference to the pattern of the GDP after 2009.

Additionally, the recession has not modified the relative importance of the euro area's economies within the EMU. Germany and France are still the hegemonic powers defining what we could call the center of the euro area if a center-periphery approach is to be taken. The peripheral countries have also not experienced changes in this sense, which can be statistically seen in the GDP Growth Std. Deviation shown in Table 7.

However, Table 11 and 12 show the susceptibility of the topic to be discussed and even distorted. Depending on the approach, changes on the growth's dispersion can be seen in the euro area. Therefore, in the beginning of the section 3, calculations based on a simple and on a weighted mean are exposed illustrating that if the effects of the recession are distributed within the area in terms of population, no increase in the in the growth's heterogeneity can be seen in the 2000 – 2011 period.

According to the euro indicators described in sections 2.1.1.2, 2.2, 2.3 and in 2.4, a common pattern of these variables can be found. Without a shadow of a doubt, it presents another assertion of the euro area inner hierarchy. PIIGS countries have the highest levels of unemployment, public debt and inflation. They do not show any symptom of recovery in a short or medium-term. Doubtlessly, this will maintain, or even increase disparities among member states. It is also likely to affect the inner structure of the single-currency area in the medium term.

On the other hand, there are some positive aspects to the role of economic institutions. The ECB has successfully achieved prices stabilization, whereas the IMF plays an active role in the distribution of tranches of the financial assistance to instable countries.

The research carried through in this paper provides several critics which could be drawn in relation to the role of the economic governance of the Union. The first and most obvious one is the delay in the answer to the difficult situation experienced by several countries. Intra-governmental loans did not completely solve the problem, due to the absence of interest of the biggest member states, as well as to the lack of coordination in the EMU. These are potential explanations for this fact. The second of them, obviously to the economists, is that the insufficiency of the measures taken was not seen or was ignored by politicians. This is at least partially responsible for the deterioration of the financial situation of peripheral countries. The absence of the effective intervention performed by the Commission – the technocratic body of the Union - has unmistakably led to the current economic context. The third critique is the upgrade of the EFSF to the ESM was performed too late. The ESM has been presented as a very good solution for the performance of the distribution of financial assistance to keep financial stability within the euro area. Sadly, its entrance into force has come 3 years late. The fourth and final critique concerns the absence of the political will by the member states to create binding decisions concerning budgetary, financial, debt and fiscal stability, which would indeed be a colossal step towards the construction of a real European Union.

Finally, it must be mentioned that the euro area crisis, mainly understood as a structural challenge, can be approached from many different perspectives as is the case with any other issue in social sciences. However, in this very precise topic, it cannot be forgotten that current circumstances come together with a significant crisis of the European values. European Society has claimed a change, a definitive change in terms of values, which guide the system. They should be promoted from a supranational level. In a situation in which the social living standards are sinking and the banking sector is being reimbursed in order to maintain their level of surpluses, it is quite obvious that equality and welfare are not being promoted enough from the institutional dimension.

The current crisis, initially understood as an economic phenomenon, has to be approached by institutions as an opportunity to evolve and change from its very root the values that act as guidelines for the construction of a European Union. Peace and Security or the assurance of the nourishment of the European population cannot be the cornerstones upon which the Union is based anymore. In the medium term, the construction of a unique social model, an efficient supranational fiscal discipline and a real Common Foreign and Security Policy should be the main goals of European leaders.

The context of the current financial instability should be the definitive turning point for the Union to finally consider correcting its weaknesses and start a consolidated path towards a common social and economic European power.

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