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# Financial and Monetary Stability in Emerging Countries

*In memoriam of Professor PAUL BRAN, PhD.  
Rector of Bucharest Academy of Economic Studies between 1996-2004*

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# THE EUROZONE DEBT CRISIS. CAUSES AND POSSIBLE SOLUTIONS. THE CASE OF GREECE

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**Abstract.** *This article presents the debt crisis in eurozone, which is the result of a concept error of the Economic and Monetary Union. The situation has become critical for countries such as Greece, Portugal, Ireland, Spain. The duality that characterizes nowadays the financial aspect of the European integration can be barely maintained on long term, because the Monetary and Economic Union operates with the participation of 16 member states, while the members of the eurozone remain sovereigns on their budgetary policies. Without broad structural reforms, the sustainability of the Economic and Monetary Union is questioned.*

**Keywords:** debt crisis; budget deficit; public debt; budgetary policy.

**JEL Codes:** E52, E58, E63, F36.

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## **1. General considerations regarding the coordination between the budgetary policies and the monetary policy in Eurozone**

The regulations for the eurozone have been established by the status of the European Central Bank and the conditions of adherence to the eurozone have been imposed by the Treaty of Maastricht and through the Stability and Growth Pact. Afterwards, these conditions have become less strict, in order to accept the adherence of Italy, who had a great budgetary deficit. This has been a political decision by means of which smaller and more different economies in comparison with Germany and France were allowed to enter the eurozone. But the smaller states were more susceptible to divergencies, yet this didn't represent a problem as the Monetary Union's purpose is precisely to achieve the convergence of the member states' economy.

The development of the national economies has an impact on the inflation perspectives within the eurozone, they influence the monetary conditions of the area and as a consequence the economic policies, especially the budgetary ones, of the states participating to the eurozone has to be rigorously monitored imposing their close coordination.

The budgetary policies within the Eurozone are elaborated by the national governments of the member states, but they have to respect the regulations of the Stability and Growth Pact, which represent an instrument of budgetary coordination. The budgetary policy is maybe the one registering the greatest differences between member states, due to the fact that the public budget represents the most representative form of expression of the national sovereignty from economic point of view. Important instrument of economic orientation, the public budget, by means of the expenses and public incomes, influence both public and private investments and

the savings and monetary circulation. For these reasons, the coordination of the budgetary policies of the eurozone states is particularly difficult to be realized (Seria Micromografii. Politici europene, 2005, *Uniunea\_Economică\_și\_monetară.pdf*, pp.10).

The arrangements regarding the coordination between budgetary policies and monetary policy within the eurozone are quite complex. Among the institutions participating to the coordination process, the European Commission occupies a central position, taking part to the meetings of all the other bodies, establishing the agenda for the European Council and proposing the procedures concerning the financial sustainability of the member states.

However, in the eurozone there hasn't been yet developed a framework for political cooperation between the European Central Bank and the national governments, even if the single currency creates the necessity of a close collaboration. The absence of a place where there can be defined a common position for monetary and budgetary policies makes the institutional organization of the eurozone more oriented towards the information exchange, than towards the identification of action lines for the coordination of activities. The European Central Bank, doubtful concerning the budgetary decisions of national governments, tend to defend the freedom of action in order it might, if necessary, counterattack the tendencies towards budgetary deficits. The national governments, unable to convince the European Central Bank to pay more attention to the specific conditions of their economies, being unfamiliar with the budgetary behavior of the other governments, are skeptical regarding the cooperation and prepared to counterattack any position of restrictive character of the monetary policy and they are obstinate concerning the acceptance of the supplementary reduction of their fiscal sovereignty (Panico, Vazquez Suarez, 2008, p. 16).

The method used for the coordination of economic policies is used especially on a "slight consolidation", that is on the ability to convince the national governments to follow an appropriate behavior by means of monitored dialogue, information exchange, warnings and pressures.

The procedures regarding the intensification of the coordination of monetary and budgetary policies try to establish "common behavior regulations", mentioning the Procedure of excessive deficit and the Stability and Growth Pact. The procedures are implemented by means of a report made by the European Commission on the base of the results of multilateral surveillance. The Financial and Economic Committee examines the report and expresses its opinion about it. Economy and Finance Ministers Council of the European Union (ECOFIN) takes a formal decision regarding the existence of a violation and recommend to the concerned state correction measures, imposing two limit terms concerning the adoption of measures and the rectification of violation. In case the member state forgets about the limit terms, ECOFIN can notify this issue and may demand to the state to make a deposit to the Commission, the amount of which depends on the level of violation. If ECOFIN decides that during a period of two years the violations haven't been rectified, it may demand the change of the deposit in penalty.

## **2. Debt crisis triggers in the eurozone**

With a certain delay, the Eurozone has been affected by an international financial crisis having been unleashed in the USA in August 2007. Since the beginning of the second semester of 2008, eurozone GDP registered a dramatic decrease, counting at the end of the year a real increase rate of only 0.5%, in comparison with the former year, when this rate was 2.8%. 2008 represented a year of profound recession, with a GDP decrease of 4.1% in the eurozone, followed by a slight revival in 2010.

The global effect of these economic conditions was the drastic deterioration of the general budget balances of the governments of the eurozone member states, reaching a budgetary deficit of 6.3% of GDP in 2009, in comparison with 0.6% of GDP in 2007 and 2% of GDP in 2008. The public debt registered a continuous increase from 66% of GDP in 2007

to 78.7% of GDP in 2009. The budgetary deficit was considerable in Spain, where it increased from 4.1% in 2008 to 11.2% in 2009, while during the years preceding the crisis it has registered excess. Greece represents a particular case, the past budgetary deficits increasing continually, reaching 13.6% of GDP in 2009. As a consequence, in 2009, Greece, Belgium, Germany, Italy, France, Spain, Ireland, Holland, Austria, Portugal, Slovenia and Slovakia entered the procedure of excessive deficit. The member states having the best position concerning budgetary balance and public debt are Denmark, Sweden and Finland, and it is due to the high budgetary excesses registered before the beginning of the crisis.

Table 1

**The evolution of budget balances during the period 2006-2011 within the eurozone  
(% of GDP)**

Member state within the eurozone	2006	2007	2008	2009	2010	2011
Belgium	0.3	-0.2	-1.2	-6	-5	-5
Germany	-1.5	0.2	0	-3.3	-5	-4.7
Ireland	3	0.1	-7.3	-14.3	-11.7	-12.1
Greece	-2.8	-5.1	-7.7	-13.6	-9.3	-9.9
Spain	1	1.9	-4.1	-11.2	-9.8	-8.8
France	-2.3	-2.7	-3.3	-7.5	-8	-7.4
Italy	-3.3	-1.5	-2.7	-5.3	-5.3	-5
Luxemburg	1.4	3.6	2.9	-0.7	-3.5	-3.9
Holland	0.6	0.2	0.7	-5.3	-6.3	-5.1
Austria	-1.6	-0.4	-0.4	-3.4	-4.7	-4.6
Portugal	-3.9	-2.6	-2.8	-9.4	-8.5	-7.9
Slovenia	-1.3	0	-1.7	-5.5	-6.1	-5.2
Finland	4	5.2	4.2	-3.8	-4.3	-2.9
Malta	-2.6	-2.2	-4.5	-3.8	-4.3	-3.6
Cyprus	-1.2	3.4	0.9	-6.1	-7.1	-7.7
Slovakia	-3.5	-1.9	-2.3	-6.8	-6	-5.4
UE-16	-1.3	-0.6	-2	-6.3	-6.6	-6.1

Source: [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2010/pdf/ee-2010-4\\_en.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-4_en.pdf)

In the case of three eurozone countries: Italy, Belgium and Greece it is foreseen a public debt of over 100% in 2010 and 2011:

Table 2

**The evolution of public debt within eurozone during the period 2006-2011 (% of GDP)**

Member state within the eurozone	2006	2007	2008	2009	2010	2011-forecasts
Belgium	87.9	84.2	89.8	96.7	99	100.9
Germany	67.6	65	66	73.2	78.8	81.6
Ireland	24.9	25	43.9	64	77.3	87.3
Greece	95.9	95.7	99.2	115.1	124.9	133.9
Spain	39.6	36.2	39.7	53.2	64.9	72.5
France	63.7	63.8	67.5	77.6	83.6	88.6
Italy	106.5	103.5	106.1	115.8	118.2	118.9
Luxemburg	6.7	6.7	13.7	14.5	19	23.6
Holland	47.4	45.5	58.2	60.9	66.3	69.6
Austria	62	59.5	62.6	66.5	70.2	72.9
Portugal	64.7	63.6	66.3	76.8	85.8	91.1
Slovenia	26.7	23.4	22.6	35.9	41.6	45.4

Member state within the eurozone	2006	2007	2008	2009	2010	2011-forecasts
Finland	39.2	35.2	34.2	44	50.5	54.9
Malta	63.7	61.9	63.7	69.1	71.5	72.5
Cyprus	64.6	58.3	48.4	56.2	62.3	67.6
Slovakia	30.4	29.3	27.7	35.7	40.8	44
UE-16	68.3	66	69.4	78.7	84.7	88.5

Source: [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2010/pdf/ee-2010-4\\_en.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-4_en.pdf)

In economic literature there's appeared two hypotheses regarding the triggers of debt crisis within the eurozone:

- The unhealthy combination of fiscal indiscipline of the member states and the speculative out of control attacks on the financial markets
- The existent imbalance between the eurozone member states, due to the conception defect of the Economic and Monetary Union

In fact, the main cause of the internal structural imbalances in Economic and Monetary Union is the great current account imbalances within the Economic and Monetary Union. Though the current account imbalances have internal roots, the associated problems do not limit only to national level. Taking into account the collateral effects on the financial markets integrated in the eurozone, they represent a problem also for other member states and for the Economic and Monetary Union itself. The main problem for the eurozone member states with current account deficits was the fact that the capital inflow hasn't always been efficiently allocated. In Spain and Ireland there's been registered an enlargement of the real estate markets, in Greece the great government deficits have been financed and in Portugal the private consumption has been supported. This allocation stimulated the domestic demand and as a result of the inflexibility of the employment market, the level of wages increased more than the level of work productivity. This led to the reduction of the competitiveness for the concerned countries and as a consequence the imports have increased, the exports have decreased and the current account deficit has accentuated.

The debt crisis within the eurozone affected profoundly especially three states: Greece, Spain and Portugal, leading to a lack of trust between these countries and the other member states. The possible default of the Greek public debt would have a quite reduced global effect on the other member states, taking into account the fact that the Greek GDP represents only 2.5% of the eurozone GDP. A greatest danger caused by the default of the Greek public debt would be the loss of confidence of foreign investors in the other eurozone countries, especially in Portugal and Ireland, which are also confronting budgetary deficit issues and considerable public debts. Italy has also a great public debt, exceeding 100% of GDP, but its deficit is though under the eurozone average deficit and as a result, it doesn't make part of the category of countries being the most exposed to risk. Spain has a relatively decreased debt, of only 53.2% of GDP in 2009, being under the Eurozone average with about 25%.

### 3. The impact of eurozone debt crisis on Greece

The economy of Greece registered the fastest increase within the eurozone during the period 2000-2007, with average annual increases of GDP of 4.2%. However, the GDP per individual remained under the Community average, being in 2009 at 93% of the Community average. The economy of Greece confronts significant problems, including the increase of unemployment, an inefficient bureaucracy, fiscal evasion and corruption.

The international financial crisis had a profoundly negative effect on Greece, especially on the industries – tourism and maritime transport, having been affected by the economic decline, registering in 2009 a decrease of income of 15%.

How can be explained this debt crisis present in Greece? Greece have clearly a unsustainable budgetary policy. At the same time, since the adherence to the Economic and Monetary Union in 2001, this country had an inflation rate permanently higher than the eurozone average, generating a significant deviation from the purchasing power parity and determining important losses of the competitiveness and high current account deficits (Arghyrou, Tsoukalas, 2010, p.6). In order to maintain the orientations of the Economic and Monetary Union, the Greek government declared permanently and deliberately before and after the adherence to the eurozone false official economic statistics. The international financial crisis evidenced the deteriorated budgetary position of Greece, generating among others the increase of the unemployment rate, a huge public debt of 115.1% of GDP in 2009, the massive increase of the budgetary deficit from 5.1% in 2007 to 13.6% in 2009.

In order to overcome the debt crisis in Greece, there have been taken into account several solutions, such as the withdrawal of Greece from the eurozone, accompanied by the restructuration of its public debt and the financial support from the part of the other eurozone member states. Some specialists consider that the retreat of Greece from the eurozone wouldn't have been a feasible solution, because the expenses would have exceed with a high rate the benefits. Any sign of retreat from the eurozone would have result a massive retreat of capital affecting seriously the bank system. Finally, there has been chosen the financial support.

The ministers of Finance of the eurozone and the International Monetary Fund approved at the beginning of May 2010, an emergency package of financial loan for Greece of 110 billion Euro for the following 3 years, that is to be covered by the loans of the eurozone member states (80 billion Euro), and by the loan accorded by the International Monetary Fund (30 billion Euro). In exchange, in order to obtain financial support and to avoid bankruptcy, the Greek government assumed austerity measures in amount of 30 billion Euros. As measures we can mention: the 13<sup>th</sup> and the 14<sup>th</sup> salaries won't be accorded any longer, the minimum retiring age will be 60 years, the VAT will increase from 21% to 23%, the budgetary expenses will be reduced to 10% of GDP, the public investments will be reduced, a new tax will be introduced to illegal constructions, new taxes will be imposed on pollution, gambles and profits of companies. It is estimated a reduction of public expenses with about 7% of GDP and an increase of incomes of about 4% of GDP until 2013.

Beside these direct fiscal measures, there have been initiated a series of structural fiscal reforms such as: the reform of pensions, of healthcare and fiscal system. Some of these concrete measures are:

- The increase of standard retiring age to 65 years, without the possibility of anticipated retirement;
- The implement of the accrual accounting within the hospitals;
- The limitation of exemptions and deductions from the income tax;
- The fierce fight against fiscal evasion;
- Auditing individuals owning wealth and carrying out independent activities.

The progress registered after the implement of this program is monitored each semester on the base of some quantitative performance criteria.

#### **4. Possible measures for the exit of eurozone from debt crisis**

The Eurozone is extremely prudent in its economic policy actions. While the European Central Bank was forced to deal with turbulences on the market, its actions were tied to those of the EDF and of other important central banks. Beside the advantages of a common currency, the governments of the European Union's member states showed a strong solidarity. Some of them lead directly to a significant financial support for the countries not having adhered to the Euro currency. A monetary union with inflation differences within member

states supports the risk of the appearance of a debt spiral leading to the increase of debts according to the inflation level.

As the profound causes of the current account imbalances have an internal character, it is very important to act in order to correct them, an issue being in the charge of the member states. Thus, it is needed a series of structural reforms necessary to increase the competitiveness of commercial societies on the internal market by means of the increase of productivity and costs control. The countries having current account deficits must improve the flexibility of employment markets and to consolidate the national budgets. The countries having current account surplus must act by stimulating the internal demands and the imports utilizing incentive fiscal policies.

The ministers of Finance of the 16 eurozone member states signed on the 7<sup>th</sup> of June 2010 an agreement allowing the introduction of a European Financial Stability Facility counting an amount of 440 billion Euros, as guarantees of the European Union's member states. This "vehicle with special purpose" will help the eurozone member states in case they won't be able to solve the economic problems, each country being allowed to loan 440 billion Euros. A second proposal for the assurance of financial stability on long term having been made by the European Union leaders refers to the creation of a single authority in charge with the surveillance and the coordination of budgetary policies. But this proposal has no chance to be materialized because of the opposition of France and Italy.

In our opinion, the optimal solutions could be the fundamental changes regarding the restructuration of the Economic and Monetary Union and the solution of the contradictions referring to imposing a single currency and a common monetary policy in countries having different budgetary policies. Beside the solution of serious budgetary issues within the eurozone, it is considered beneficial the creation of a surveillance mechanism and assistance within it, which might react faster to crises situations. The new system should also define clearly the assistance costs, both in monetary terms and loss of fiscal sovereignty terms.

### **Conclusions**

Several specialists and we consider that the eurozone is not an optimal area for a single currency, as the member states gave asymmetric feedbacks regarding different types of markets and economic shocks. It is considered that the healthy fiscal nucleus of the eurozone is composed of three states: Germany, Finland and Holland. As a result, the eurozone would form a closer and stronger union if it enlarged on a more limited geographical area.

The duality that characterizes nowadays the financial aspect of the European integration can be barely maintained on long term, because the Monetary and Economic Union operates with the participation of 16 member states, while the members of the eurozone remain sovereigns on their budgetary policies. Without broad structural reforms, the sustainability of the Economic and Monetary Union is questioned.

In conclusion, the adherence to the eurozone having a weak structured economy generates net expenses and in case it is not accompanied by adequate national policies it doesn't guarantee the economic catch up. At the same time, the member states have to be competitive, needing for this purpose a structural adaptation of the economy before the adherence in order to reduce the impact of the competitiveness as a result of the participation to an economic and monetary union. As a result, we consider that Romania should wait until it becomes competitive and prepared to enter the eurozone, because it hasn't the degree of optimality desired by the institutors, the case of Greece being a relevant example.

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