Two Effects of the European Financial Crisis

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Abstract

Background: The European financial crisis has affected most of the EU member states, and European institutions have had to create new financial instruments to counter the impact. Most effects in the economic and political spheres can be attributed to high unemployment and changes in governments in peripheral countries (Greece, Ireland, Portugal, Spain and Romania). Objectives: The aim of this paper is to demonstrate the economic and political effects of the European financial crisis in some peripheral countries that have implemented austerity policies.
Methods/Approach: The methodology used is mixed: an analysis of the primary economic variables of the selected countries in comparison to those of countries with low-risk premium was performed, and the relation between the bailouts and elections was presented. Results: The exacerbation of the crisis in the Eurozone is mainly due to the high political costs of austerity measures and not the high level of public spending and/or the alternations in the governments of peripheral countries.
Conclusions: The European financial crisis is primarily a result of weak economic governance, and its effects are differentiated. The peripheral countries possess the highest rates of unemployment, and there is a higher tendency towards political instability in rescued countries.

Keywords: financial crisis; governance; bailouts; European institutions; and peripheral countries

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Introduction

In 1999, the Euro was launched and scarcely ten years later (2009), had the European Union (EU) encountered a banking and sovereign debt crisis that had substantial spill-over effects on national politics and the quality of life of most citizens. When the euro was launched in early 1999, some experts were optimistic about this important development viewed by many as a powerful sign of a closer European integration. As a major development, the introduction of the Euro brought certain expectations, such as: increase in cross-border competition, promoted structural reforms and displacement of the dollar as the most traded currency in the world. For
a while, investors believed that the risk associated to all members of the Eurozone was practically the same, and it became cheaper for countries such as Greece to borrow from the international market. In 2009, the risk premium soared for peripheral countries (Greece, Ireland, Portugal, Spain and Romania). In this paper, we refer to “peripheral” countries as those who joined the EU after the 6 original members, are geographically distant from central-Europe, and have had problems with economic instability.

The depth and severity of this crisis is disturbing. The economic and political consequences of the crisis are pervasive. Even a small Eurozone country with economic problems can destabilize a larger country and the financial instability can become widespread. In addition, the European institutions have been criticized for not responding assertively and appropriately to the crisis. Greece (2010), Ireland (2010), Portugal (2011), Spain (2012), and Cyprus (2012) have been bailed-out (rescued financially).

European voters have punished governments in all peripheral Eurozone countries, and there have been important changes. In Spain, Mariano Rajoy, from the people’s party (PP) won the 2011 elections in Spain from an eight-year, incumbent, left-wing government led by Jose Luis Rodriguez Zapatero. The case of France is also interesting, in 2012, Sarkozy, a centre-right partisan (UMP), was the first incumbent defeated since 1981, and Francois Hollande, representing the socialist party, became the first President of France, since Mitterrand. This shift in power also had an impact on the Franco-German axis; Sarkozy was a crucial ally of Angela Merkel, while Hollande’s difference of opinion with regards to the European crisis has made it difficult for them to find common ground.

The European crisis has had an adverse impact on most Member States, and countries in the Eurozone have been particularly affected. However, peripheral countries such as Portugal, Ireland, Greece and Spain have been the worst hit countries in the EU. This crisis has introduced not only economic but also political and social problems. The weak economic governance in the Eurozone largely contributed to the crisis, and the Troika (European Central Bank, European Commission and the International Monetary Fund) was formed to organize the bailouts. The political consequences of the crisis were substantial and led to power shifts in many European countries, among them Portugal, Ireland, Spain, Greece and Italy. The population did not welcome the austerity measures introduced by the Troika and many protests ensued. Concerning the social consequences of the crisis, in mid-2013 the unemployment rate in Spain was 26.7% and in Greece 27.3%.

Scholars have debated the main causes and consequences of the European crisis. Some of them focused on the economic effects, others on the political impact, and several on the social implications. This paper emphasizes the economic and political consequences of the crisis, focusing on the strong link between them. Several European governments were forced to relinquish power due to the implementation of austerity measures by the Troika while in other countries the crisis exacerbated their existing problems, and heads of state or government had to resign. Overall, the crisis has admonished the failures of the European economic governance to respond promptly and adequately when faced with an important challenge. The negative effects of this crisis were not only present in the economy but also permeated throughout national politics. A stronger economic governance and greater economic policy-coordination is essential for the EU. Has the European financial crisis affected differentially the EU countries? Are the peripheral countries the ones who have mostly experienced the political and economic impacts of the crisis?
**Literature review**

Weak economic governance in the Eurozone and the European financial crisis

The requirements that must be met by countries that share a single currency are listed in the literature on optimum currency areas (Saucedo, Bacaria, Fortuno, 2012). Several studies show that the Eurozone is not an optimal currency area (De Grauwe, Heens, 1993; Bayoumi, Eichengreen, 1997; Fidrmuc, Korhonen, 2003) and members of the currency area no longer have their monetary policies. The European Central Bank (ECB) implements a monetary policy that is not optimal for various members of the Eurozone; such countries utilized the instrument of fiscal policy to offset the loss of monetary policy.

Our argument is that the misuse of fiscal policies in the Eurozone (excessive public deficits and public debts) was not the main factor that contributed to the European sovereign debt crisis (Bordo, Meissner, Stuckler, 2010), but rather the weak European economic governance is at fault (Featherstone, 2011). The crisis that started in the housing sector in US was the catalyst of the European financial crisis, but there were weak structural conditions in the European economic governance. The argument focuses on the following:

1. Institutional weakness in the implementation of fiscal discipline: the Stability and Growth Pact (SGP) is an instrument that was designed and promoted by Germany to its neighbours with recurrent instability problems, and was not observed initially by France and Germany. The European institutions failed to fulfil the SGP in practice, so when larger countries in the Eurozone failed to comply the SGP, there were no incentives for the peripheral countries to comply. The SGP did not work from the start, because there was a breach that did not involve any sanctions by the European institutions, although there was a possibility to apply a financial penalty.

2. German policy of beggar-thy-neighbour: prior to the European crisis, Germany implemented a labour reform that reduced its labour costs, which made it more competitive with its neighbours in the Eurozone through increased exports. Trade deficits increased for most European countries, while Germany increased its trade surplus. These adverse shifts in the balance of payments and the differential competitiveness could not continue in the long term in a currency area where countries already had their monetary and exchange rate policies (Lane, 2012). The economic governance is weak and the European institutions did not anticipate that the differential in competitive positions could cause problems in the sovereign debt market.

3. Self-fulfilling market sentiments (negative): in a monetary union, members generate debt in a currency that cannot issue it; this situation does not happen in countries with their own central banks, so there is a higher probability of a liquidity problem in countries that share a common currency. The liquidity problem can turn into a solvency problem in times of recession due to falling tax revenues and increased government spending, which generates an increase in the public deficit (De Grauwe, Ji, 2013). This situation creates uncertainty in the markets if countries default and impact sovereign debt markets with a rise in the risk premium generated by the same financial markets (De Grauwe, Ji, 2013). The weakness in European economic governance is evident in view of the vulnerability of countries that are members of a monetary union and lack mechanisms to counteract the negative sentiments of the markets that exacerbated the crisis. The prohibition of European bailouts is another of the failures of European governance (Dabrowski, 2010), since it created further uncertainty in financial markets, although funds launched in recent years have improved the situation. Moreover, the decision of the President of the ECB, Mario Draghi, in September 2012, declaring that the central bank would be
willing to buy the necessary sovereign debt to reduce the risk premium of the peripheral countries, eased the anxiety in the markets.

The above three structural elements are part of the weakness in the economic governance of the Eurozone. When the crisis hit the housing sector in the US, the structural conditions for a sovereign debt crisis were present. The economic recession of 2009 in the Eurozone was the catalyst for the increase in risk premiums for most peripheral European countries. The theoretical argument is that high deficits of the peripheral countries of the Eurozone were not the cause of the crisis, but rather the product of it, and the origin can be traced to the weak economic governance.

Economic voting

The literature on economic voting orbits around notions that voters reward or punish the governments with their votes. Many scholars have focused their research on the change in support for the head of state or government. However, others have emphasized that there can be a change in support for a political party or a coalition. For Lewis-Beck and Nadeau (2011), the economy is a valence issue for the electorate. That does not mean that it is the only issue important to them, but rather that it is a priority in most cases depending on the context. Terrorism and security are also important to voters and can decrease voter’s attention on economic performance. According to Singer (2011) “economic issues rise in importance during recessions or periods of volatility; they fade in importance when citizens perceive crisis in other areas of government performance; and citizens who are vulnerable to the effects of economic shifts give greater weight to economic importance in evaluating incumbents”.

In the EU, citizens have suffered adverse consequences generated by the global financial crisis (e.g. US), the banking crisis (e.g. Ireland), and the sovereign debt crisis (e.g. Greece), among others. The economic and political decisions taken by government officials have had important repercussions on the quality of their lifestyles. Citizens and politicians protested against the austerity measures introduced by the Troika, and as a consequence, in some countries, their heads of state or government had to resign. Some assert that the European integration can influence national vote choice (Evans 2002; Tillman, 2004), while others just as positively assert that it has virtually no effect (Mair, 2000; Sitter, 2001).

The political effects of the economic crisis at the supranational level (i.e. the European institutions) could be analysed vis-a-vis the 2014 European Parliament elections to determine whether or not economic voting influenced the electorates. In most cases, the supranational decisions, mainly concerning the austerity measures imposed for the bailouts had a negative effect on national politics, and consequently, some members of governments had to resign (e.g. Portugal, Ireland, Greece and Romania). In other countries, the heads of government relinquished their posts (e.g. Italy) in response to intense pressure from financial markets and European institutions. As noted by Kriesi (2012), governments were severely limited by the constraints imposed on them by international pressure. The manoeuvring space did not allow them to make concessions to deal with their demands. For the purpose of this paper, the political consequences of the economic crisis in Portugal, Ireland, Greece, Italy and Romania are analysed at the national level in order to demonstrate how, in some countries, the economic crisis merely amplified existing political problems, while in others it basically generated a crisis.
Methodology
The text addresses some of the economic and political effects of the European financial crisis, and it was deemed necessary to analyse some EU countries. The idea was to employ a mixed methodology that includes both the analysis of the main economic variables and changes in government caused by the crisis.

Data
Most of the data in this paper originates mainly from primary sources. The economic data utilized was collected from different international organizations and the information about election results in the selected countries stems from official sources. In Table 1, all of the data to depict the economic and political consequences is presented by variable and source.

Table 1
Data and sources for the analysis for the consequences of the European financial crisis

<table>
<thead>
<tr>
<th>Type of consequence</th>
<th>Variable</th>
<th>Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td>Economic growth</td>
<td>International Monetary Fund, World Economic Outlook Database</td>
</tr>
<tr>
<td>Economic</td>
<td>Government spending</td>
<td>International Monetary Fund, World Economic Outlook Database</td>
</tr>
<tr>
<td>Economic</td>
<td>Unemployment rate</td>
<td>International Monetary Fund, World Economic Outlook Database, OECD Short-Term Labour Market Statistics and OECD Economic Outlook Databases</td>
</tr>
<tr>
<td>Economic</td>
<td>Labour costs</td>
<td>AMECO Database, European Commission</td>
</tr>
<tr>
<td>Political</td>
<td>Elections</td>
<td><a href="http://www.govno.it/">http://www.govno.it/</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td><a href="http://www.primeminister.gov.gr/">http://www.primeminister.gov.gr/</a></td>
</tr>
<tr>
<td></td>
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<td><a href="http://www.portugal.gov.pt/">http://www.portugal.gov.pt/</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td><a href="http://gov.ro/">http://gov.ro/</a></td>
</tr>
<tr>
<td>Political</td>
<td>Austerity measures and bailouts</td>
<td>International Monetary Fund, European Union.</td>
</tr>
</tbody>
</table>

Source: Authors’ analysis

Methods
In the economic analysis, the variables of government spending, unemployment, and labour costs were analysed. Two types of countries were included; the first group are competitive and low unemployment countries (Germany and Finland), where the crisis had no significant effect, while the second group is comprised of countries with high unemployment rates and low competitiveness (Greece, Ireland, Italy, Portugal and Spain) where the crisis had devastating effects. Another difference between the groups is that the first group has a low risk premium, whereas the countries of the second group have high-risk.

In the political analysis, countries where the crisis and austerity measures affected changes in governments are presented. We selected Portugal, Ireland, Greece, Italy and Romania to illustrate the political effects of the financial crisis. For each of the above-mentioned countries the authors analyse the circumstances attendant upon the ousting of heads of state or government—those who were removed, in notable cases, due to a lack of support from their parliaments that precipitated early elections. Another variable that is important is the bailouts, because three countries (Portugal, Ireland and Greece) requested financial assistance conditional on the
implementation of austerity policies. The Italian case interests the authors because the markets influenced the fall of the prime minister. Alternately, the case of Romania is noteworthy because the conditions (austerity) attached to the loan requested by the Prime Minister were an important factor that determined his continuation in power.

**Results**

**Economic consequences**

The EU is facing one of the worst economic crises of the past 60 years of history. The current crisis has placed the EU in a vulnerable position regarding international investors and demonstrated the system failures of an incomplete Monetary Union. European economic governance has been seriously questioned for its lacklustre reaction to recent problems.

The current crisis is the product of two other crises: the financial crisis that began in September 2008 with the Lehman Brothers’ bankruptcy in the US which rapidly spread to the rest of the world, and the sovereign debt crisis that initiated in October 2009 when the former Greek Prime Minister Georgios Papandreou stated that the Greek public deficit was higher than what had been announced months before by the previous prime minister. The 2009-2012 period has been catastrophic for the EU in general, but mainly for the peripheral countries, because they have fallen into an economic downturn.

The launch of the euro impacted the risk associated with each of the countries belonging to the euro area. In other words, there was a convergence in the risk premium among all members of the Economic Monetary Union (EMU). In order to enter the EMU, euro area members have to pass the same economic tests, but the different characteristics of the economies of the Eurozone do not correspond to the same risk.

Interest rates on bonds of Eurozone governments converged from 1995 to 1999. Since 1999, the risk associated with the bonds of Eurozone governments had been practically the same. The fact is that, although 12 countries shared the same currency, their economies did not necessarily have the same conditions. There were economies like Germany and Finland with high competitiveness which contrasted to others like Greece and Spain with low competitiveness.

In late 2008, the credit fell and investors observed the public finances of governments, very closely. From 2009 the risk premium increased for peripheral countries like Greece, Ireland, Portugal, and to a lesser extent, Italy and Spain, but in the summer of 2012, the risk premium of the latter countries reached record levels. The ECB’s decision to buy an unlimited debt in the secondary market in September of 2012 has helped to reduce the risk premium of the peripheral countries of the Eurozone; therefore, in the first quarter of 2013, there has been a significant decrease in the risk premium.

The economies of Ireland and Spain have already been bailed out in order to stabilize their financial systems. In the case of Spain, its “Cajas”. Greece and Portugal, on the other hand, have been bailed-out to generate solvency, because these economies did not have enough liquidity to cover the payment of short-term bonds. In all four cases the bailouts were implemented after a significant increase in the risk premium.

Before the financial crisis broke, the Eurozone economy was growing around 2% per year. However, in 2009 there was a drop in the economic activity of 4%. Figure 1 shows the economic growth in the Eurozone and forecasts for 2013. This figure
illustrates how, after the fall in the economic activity of 2009, there was another
descent to a lesser extent in 2012; the latter as a result of the sovereign debt crisis in
peripheral countries. According to the International Monetary Fund (IMF), the
forecast of economic growth for the Eurozone in the coming years will be below
1.5%.

Some experts have mentioned that the economic crisis in the Eurozone is a result
of high spending in recent years. However, when comparing debt (% GDP) in the
Eurozone with the US, from 2000 to 2008 the Eurozone debt remained stable (Figure
2). The increase in debt, as a result of the financial crisis in late 2008, was lower in the
Eurozone than in the US, so that argument cannot be entirely valid.

**Figure 1**
Economic growth in the Eurozone and forecasts from 2013 to 2016

![Economic growth in the Eurozone and forecasts from 2013 to 2016](source: International Monetary Fund, World Economic Outlook Database, April 2013)

**Figure 2**
Government debt (% GDP) in the US and the Euro area

![Government debt (% GDP) in the US and the Euro area](source: International Monetary Fund, World Economic Outlook Database, April 2013)

Public debt in the euro area members varies considerably with the Eurozone
average. Figure 3 shows the public debt (% GDP) of some euro zone members. Countries like Greece and Italy have public debt with values close to 100% (% GDP)
since 2000, while other countries in Figure 3 have had values close to 60% until 2008.
With the financial crisis almost all countries increased their public debt; however countries like Greece, Ireland, Spain and Portugal had sharp increases. The sovereign debt problem is not due to the fact that the Eurozone has overspent, but due to the fact that some peripheral countries recorded increases in public debt.

In the US some states spend more than the average. However, the difference from the EU is that in the US there is an adjustment mechanism that serves the states with economic troubles, whereas in the EU there is no such mechanism. The US has a centralized budget that is more than 20% of its economy; while the EU’s budget is 1% (fiscal policy remains at national level). Although the European Stability Mechanism (ESM) was created, it cannot be compared to the adjustment mechanisms that exist in the US.

Figure 3
Government debt (% GDP) of some Euro area countries

Source: International Monetary Fund, World Economic Outlook Database, April 2013.

The impact of the sovereign debt crisis has hit European countries, differently. The issue of unemployment is that wherein the greatest differences were observed in the Eurozone, because labour markets in the Eurozone have different degrees of flexibility (Bernal-Verdugo, Furceri, Guillaume, 2012). Figure 4 shows that Spain and Greece had high unemployment rates in 2012, with levels close to 25%, while Germany had an unemployment rate very close to 5%. Figure 4 also shows that from 2008 there has been a substantial increase in the unemployment rate in countries like Spain, Greece and Portugal; in Germany the same metric has decreased.

Table 2 shows the current and projected unemployment rates in 2013 and 2014. The euro area will have an increase in the unemployment rate in 2014, but other countries will have a reduction from -0.87 (US) to -0.04 (Japan). Therefore, in 2014 unemployment will remain a great issue across Europe.
Figure 4
Unemployment rate of some Euro area countries

Source: International Monetary Fund, World Economic Outlook Database, April 2013.

Table 2
Unemployment rates

<table>
<thead>
<tr>
<th>Country</th>
<th>Current (May 2013)</th>
<th>Projected (Q4 2014)</th>
<th>Change (points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>7.60</td>
<td>6.73</td>
<td>-0.87</td>
</tr>
<tr>
<td>Canada</td>
<td>7.10</td>
<td>6.71</td>
<td>-0.39</td>
</tr>
<tr>
<td>OECD</td>
<td>8.01</td>
<td>7.85</td>
<td>-0.16</td>
</tr>
<tr>
<td>Japan</td>
<td>4.10</td>
<td>4.06</td>
<td>-0.04</td>
</tr>
<tr>
<td>Euro area</td>
<td>12.20</td>
<td>12.26</td>
<td>0.06</td>
</tr>
</tbody>
</table>


The underlying problem in the Eurozone is the competitive gap among member states. Figure 5 shows that Unit Labour Costs (ULC) vary significantly in the Euro area because while in Germany the ULC have been decreasing considerably in the last decade (thereby becoming one of the most competitive countries, in Spain), Greece, Ireland and Italy their ULC have increased in the last decade. Since 2009, most countries in Figure 5 show a significant reduction of ULC. The difference in the competitiveness of euro area countries is significant, and it is one of the variables that explain notable vulnerability in that area.

Although members of the Eurozone share the same currency, the economic and financial results are different. Therefore, the financial problem of a small country can affect the entire Eurozone, while in the US, financial problems or a competitiveness gap in the states have no effect on the whole country, because there is an adjustment mechanism on a centralized budget which is greater than the one that exists in the EU.
The issue of moral hazard has been mentioned in the bailouts that have occurred in the Eurozone (Jones, 2010; De Grauwe, 2011b). Countries that provide money for bailouts like Germany have no incentive to grant money, because it creates the risk of generating bad behaviour in countries that receive the money. The outcome shows that there is moral hazard: solidarity is more complicated when the Federal State does not have a centralized budget. Gros and Mayer (2010) suggest the creation of a European Monetary Fund as a measure to bail out European countries. Other authors have highlighted that Europe needs some kind of Political Union (De Grauwe, 2011a) and the joint issue of Eurobonds.

The response of the European institutions has varied over time and has been differentiated. On the one hand, the ECB implemented programs to provide liquidity and to reduce the interest rate from the onset of the financial crisis. When the sovereign debt crisis began, the ECB bought government bonds to reduce risk premium, whereas in September of 2012 the president of the ECB bought the debt without limit, reducing the risk premium. On the other hand, the institutional response to stop public debt was the Treaty on Stability, Coordination and Governance, which further restricts the range of public deficit of the Eurozone countries.

Since 2010, the Troika (the ECB, the European Commission and the IMF) insisted on implementing austerity policies to the bailed-out countries. However, there has been a change in the discourse, since austerity measures were requested for longer periods and with more flexibility. The serious economic problems of Spain and Greece have caused a relaxation by the Troika in the pursuit of austerity.

**Political consequences**

Since the beginning of the crisis, the Portuguese government had stated that it would not resort to an EU bailout. In March 2010, the Portuguese Parliament approved the first SGP that included a reduction in social spending, an increase in taxes for the wealthy, and the privatization of public companies, among others. Two months later, the Prime Minister of Portugal, Jose Socrates, was able to overcome a censure motion presented by the Marxist left politicians for his crisis measures. On March 11th, 2011, he presented his 4th austerity plan that was rejected by the opposition and provoked the resignation of his government. While still in office, in April 2011, Jose Socrates requested the activation of an EU bailout, and formally
began to negotiate with the IMF and the EU. On May 3rd, the Portuguese Prime Minister announced that the IMF-EU bailout rose up to €78 billion for three years. Nevertheless, the political tensions generated by the crisis became an insuperable obstacle for Socrates’ government. The Portuguese crisis broke out the day before the approval of the new Financial Stability Mechanisms in the euro zone.

In 2008, the fiscal banking crisis affected Ireland. Brian Cowen’s management as Prime Minister of the Irish Republic coincided with the financial and banking crisis of his country. The government tried by all means to avoid asking for external aid. The Eurozone members offered financial aid; however, Cowen wanted to avoid a reform package with his creditors, which package was in fact a requirement of the bailout mechanism approved by the EU. Cowen had to abandon his first position due to the fear of the aid-associated demands. On November 22nd, 2010, the by-then Prime Minister of Ireland announced that the government had to increase taxes and lower expenses to admissible levels. Ireland had to be bailed out in November 2010 for 85 billion Euros by the IMF and the EU in order to underpin its banking sector. After accepting the IMF-EU bailout, the Irish government sank, leaving the Prime Minister’s position unsustainable. According to a poll in Ireland, the bailout reached historical minimums with only 8% of satisfaction with the government’s performance. To the Irish people, a bailout meant national humiliation, betrayal and to surrender their autonomy to the European Commission, the ECB and the IMF. Shortly thereafter, Cowen turned in his resignation and called for snap elections.

In April 2010, the then Prime Minister of Greece, Georgios Papandreou, heir to a political dynasty, sought support from his European partners to reduce an inherited debt. During the crisis, Brussels fiercely pushed the Greek government to approve the bailout deal. The Greek people, outraged by cuts and austerity measures, protested in the streets and organized general strikes. The first bailout was not enough so a second bailout was necessary. In this precise context, Papandreou expressed his intention to hold a referendum on the European bailout plan and the membership of Greece in the Eurozone. The Greek Prime Minister was confident that the vote would confirm Greece as a member of the EU. The internal and external reaction was immediate to Papandreou’s announcement; it generated a market panic as well as anger from its European partners. Particularly, Germany and France pushed the Greek Prime Minister to return to the original plans of the bailout. Finally, Georgios Papandreou backed down to international pressure. This failure and the abandonment of his initiative forced him to resign in order to reach an agreement to form a new unity government in Greece.

In 2011, the Italian economy had been growing at 0.3% and public debt rose above 120% of GDP. In November 2011, the then Prime Minister of Italy, Silvio Berlusconi, immersed in lawsuits for fraud and sex scandals, resigned as Prime Minister of Italy after the EU and the markets forced him to resign as a prerequisite to their support for the Italian crisis. Indeed, the European crisis had achieved what the Italian liberal parties had failed to accomplish: the end of the reign of Berlusconi over the Italian political scene. Having lost the parliamentary majority, Berlusconi announced he would resign from his position after the budgets with the adjustments required by Brussels for 2012 were approved. No doubt the strong action of the President of Italy, Giorgio Napolitano, had achieved what seemed impossible to many: to speed up Berlusconi’s exit of power. Until the end, after 17 years in Italian politics, Berlusconi kept the tension in a country where economic and political times are difficult.

The crisis strongly affected Romania, which requested a loan of 20 billion Euros to the ECB, IMF and EU. The adjustment measures applied by the Romanian Prime
Minister, Emil Boc, included: reduction of the salaries of civil servants by a quarter and elevation of the VAT, among others. These measures were well received by the EU and the IMF, but strongly rejected by the Romanians. Consequently, Emil Boc resigned due to the mass protests that rejected the austerity measures backed by the IMF.

Internal and external pressures have created tensions at the political level, mainly in European governments, and some of them have not resisted the attack. The situation is critical, and the forced departure of governments has failed to ameliorate the European crisis. In some cases, it has had the opposite effect to the one expected and has worsened the political crisis. Undoubtedly, the European crisis has shown the fragility of the system and has claimed victims in its wake, overthrowing governments.

With the looming threat of contagion and the uncertainty of the Euro, European leaders decided to bailout the indebted countries like Greece. Countries like Germany initially disagreed with other Eurozone members with regard to the collective rescue of Greece. Germany’s position was simple: to exclude from the Eurozone those countries which did not respect the rules and threatened the euro. However, the European Commission, along with countries such as France, pressured the German Chancellor to reach an agreement. Later, France and Germany agreed a plan to bail-out Greece with the IMF and the Eurozone countries.

The crisis revealed shortcomings in the functioning of the Eurozone: The level of political and economic integration to support the euro is insufficient; there is a lack of cooperation among the members of the Eurozone; a tool to appropriately manage any crises was non-existent; there was a lack of control and supervision of the European Commission over the Public Accounts of member countries.

At the European Council in 2011, the 17 members of the Eurozone, along with the countries which aspired to join the EU, agreed to sign a new treaty that would establish strict limits on spending and government borrowing, including penalties for those governments that violated the limits. The other members of the EU were prepared to join the treaty, subject to parliamentary vote, except for the UK.

The Euro group’s role as coordinator and European economic governance body has become more important since the European crisis broke out. The Troika has imposed austerity measures to the bailed-out governments; its mission is to monitor the fulfillment of the program according to its commitments. Both actors play an important role in decision-making bodies, control and monitoring of the agreements reached at the respective bailouts requested by the European governments. In the European political scene, substantial changes can be observed before and after the European crisis. The European political reconfiguration is partly explained by the changes that arose as a result of internal and external political pressures. Some governments were overthrown by strikes and protests, others lost the support of their coalition governments, and some succumbed to external political pressures.

Conclusions

The global financial crisis led to a global credit crunch, although in developed countries it was even deeper. Despite the fact that it initiated in the housing sector in the US, in 2009 most developed countries had a sharp drop in production. And, Europe was no exception. Although manifest in several variations, all of the countries in the EU registered an economic contraction.

The launch of the Euro led to a convergence in the risk associated with the bonds of the Eurozone governments. The global financial crisis led to an increase in public debts in the Eurozone, which caused a boost of the risk premium, mainly in
Peripheral European countries. In 2010, a sovereign debt crisis began in the Eurozone and some countries were bailed out, like Portugal, Ireland, Spain, Greece and recently Cyprus. This crisis was not anticipated by the European institutions, and they created new tools to help the economic governance of the Eurozone—most notably, the Treaty on Stability, Coordination and Governance, the ESM, the establishment of the Troika and a new temporal function de facto of the ECB (the unlimited purchase of government debt in the secondary market.)

The crisis increased the sovereign debt of countries like Greece, Portugal, Spain, and Ireland, eventually leading them to request bailouts. The bailouts were granted with conditions (i.e. implementation of austerity policies of public spending, cuts and tax increases) which would ultimately cause an even steeper drop in economic activity. The economic consequences of the financial crisis were such that the unemployment rate in countries such as Spain (27.17%) and Greece (24.5%) increased to historic levels, which has led to social discontent.

The financial crisis caused poor economic performance in the EU Member States, which led to alternation of political parties in governments where elections were held, as in the case of France and the UK, among others. Also in some cases, the economic impact of the crisis led to call snap elections, as in Spain and Greece, while in Italy, having a high risk premium, the former Italian Prime Minister Silvio Berlusconi was forced to resign, and a technical government headed by Mario Monti was installed.

The financial crisis in Europe has lasted more than four years, unemployment has increased mainly in the peripheral countries, there was an alternation of political parties in government, and internal migration has burgeoned within the borders of Europe. Finally, the financial crisis has led to an as-yet unfinished institutional change in the EU which has been the result of different preferences with respect to economic austerity. The Franco-German axis has been reconfigured; some fissures have spawned as a result of the preference of Germany for austerity policies and France for economic growth. In sum, the crisis differentially affected the EU countries, while the peripheral countries have experienced the most significant economic and political impacts.

References


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