Keeping the Euro alive: The EU's response to the debt crisis

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Structure of presentation

1. EU crisis governance (I): What was decided, why, and how?
2. EU crisis governance (II): What have been the economic and political effects of the rescue measures?
3. Longer-term impacts: How will European integration look after the crisis?

Keeping the Euro alive -- Short-term response to the debt crisis

- Life support: Bailouts for Greece (May 2010, July 2011), Ireland (Nov 2010), and Portugal (May 2011), conditional on harsh austerity; plans for writedown on Greek debt
- Vaccination: Creation of bailout funds (EFSF/EFSM → ESM from July 2012); ECB purchase of government bonds on secondary markets
- Immune system boost: Recapitalization requirements for banks; ECB provision of cheap credit to banks

Firewalls against future crises -- Longer-term measures

- "Six-pack": Stricter EU monitoring of member-state economic policy (pre-screening of budgets; check for economic "imbalances", etc.); stiffer and more automatic sanctions in case of excessive debt/deficit
- Fiscal compact (supported by 25 of 27 EU states): Binding "debt brakes" in national law; further toughening of sanctions for excessive debt/deficit

EU crisis governance -- The roads not taken

Default, plus possibly Eurozone exit and currency devaluation

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Grave economic and political consequences

Pooling of Eurozone debt via joint Eurobonds

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ECB acts as lender of last resort in purchasing state debt

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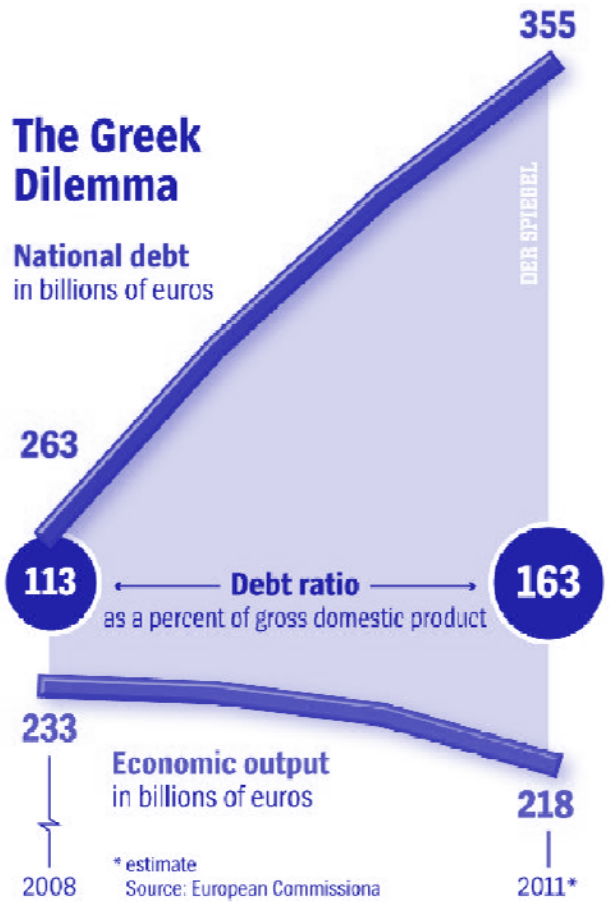
Opposed by Germany (and others): Legal concerns;
fear of inflation;
fear of "transfer union"

Features of EU crisis governance

- German dominance, enabled by Germany's financial capacity, exercised via Merkozy tandem, enjoying strong support at home
- European Council as core decision maker; ECB in secondary role; little influence of European Commission and European Parliament
- Lack of democratic accountability, as anti-crisis measures are agreed on without debate or mandate

Economic consequences of the rescue measures



- Deepening of recessions: Austerity stifles economic growth, thus further reducing tax income, resulting in calls for more austerity
- Rise in unemployment: Rate rises above 20% in some countries, even higher among youth
- Contagion: Crisis spreads from country to country, particularly after July 2011 decision on Greek debt writedown

Political consequences of the rescue measures

- <u>Legitimacy deficit:</u> Citizens view anti-crisis measures as externally imposed, not democratically legitimated
- <u>Government collapse:</u> Greece, Italy, Slovakia, Romania; plus power change through elections in Ireland, Portugal, Spain
- <u>Blame game between member states:</u> Xenophobia and nationalist sentiments stirred up

European integration after the crisis -- Two scenarios

Stabilization:

Italy, Spain and Ireland regain competitiveness; Greece and Portugal receive long-term support; EU-wide economic policy coordination prevents recurrence of crisis; EU regains output-based legitimacy in most states

Disintegration:

Austerity leads to long recession in most EU member states; anti-EU mobilization and pressure for exit from Euro rise in worst affected countries; Eurozone is reduced to Northern core around Germany