



The Eurozone

POL 137: IR IN WESTERN EUROPE

“United in diversity.”

- EU Constitutional Treaty

I. Single Currency

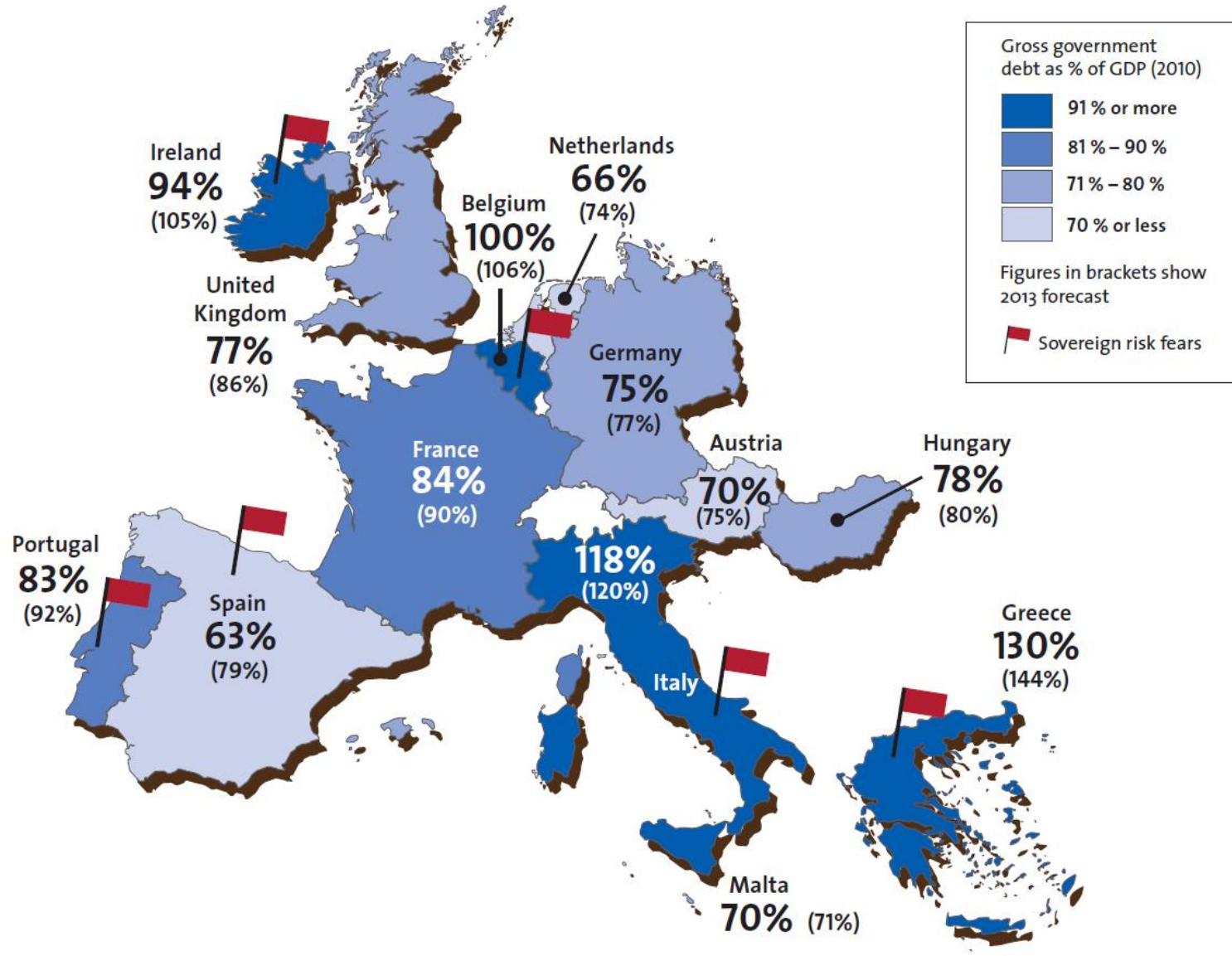
- ▶ Monetary union → **one** exchange rate and **one** monetary policy
 - Increased interdependence
- ▶ Convergence criteria
- ▶ Varied economies
 - Growth, unemployment, inflation, debt, etc.



II. A Crisis of Debt

- ▶ Structural deficits: (permanent) imbalance of gov't revenues and expenditures
 - Juxtaposed to cyclical deficits
- ▶ 2009 → Great Recession and downgrading of sovereign debt
- ▶ Interdependence with domestic banking system
- ▶ Greek insolvency → possible contagion
 - Intervention from *Troika* (IMF; European Commission; ECB)
- ▶ 2010 → Greek bailout with austerity conditions

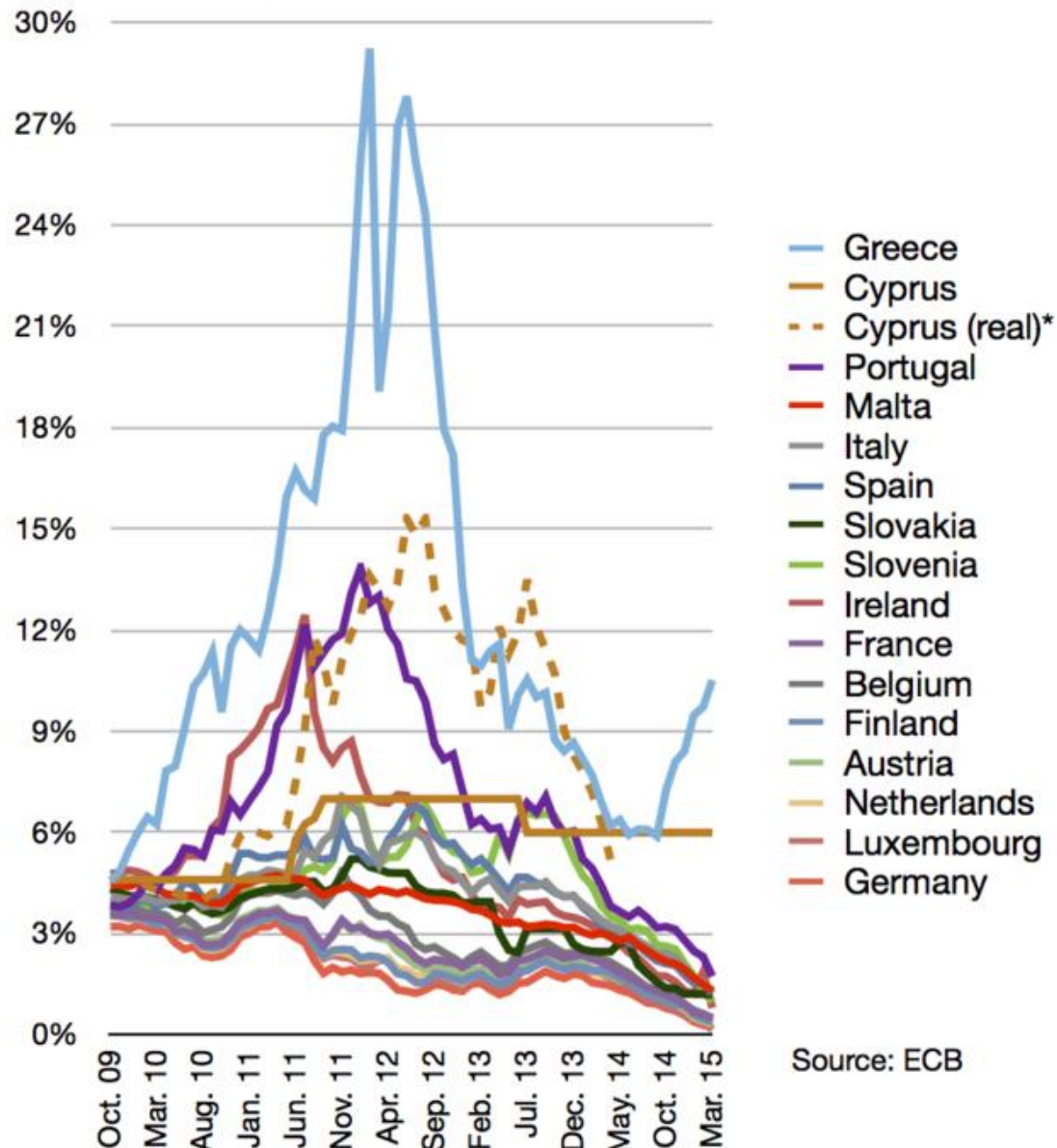
EU countries with largest debt to GDP ratios



Strategic Trends 2011 (Center for Security Studies, ETH Zurich)
Source: IMF 2010, CSS ETH Zurich



Long-term interest rates



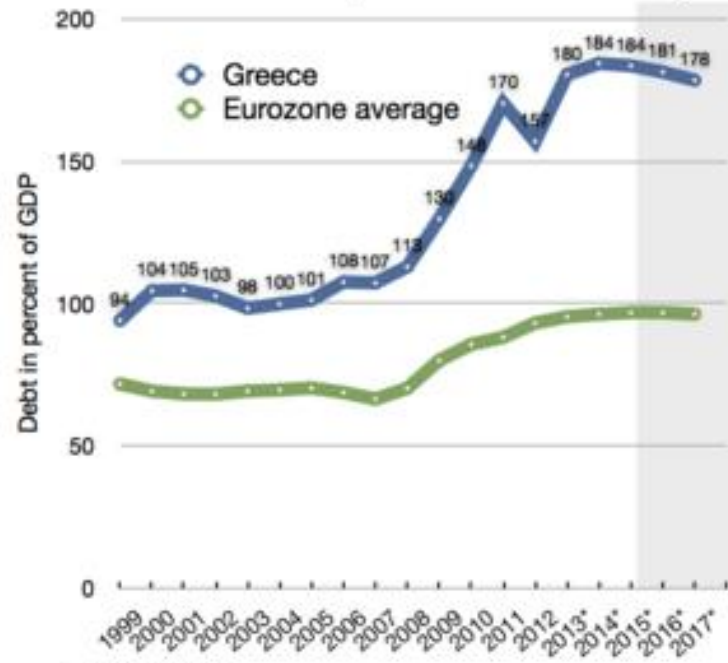
Source: ECB

* actual market trade values without cut-off yield for Cyprus government bond maturing 3 February 2020

10-year government bond yields

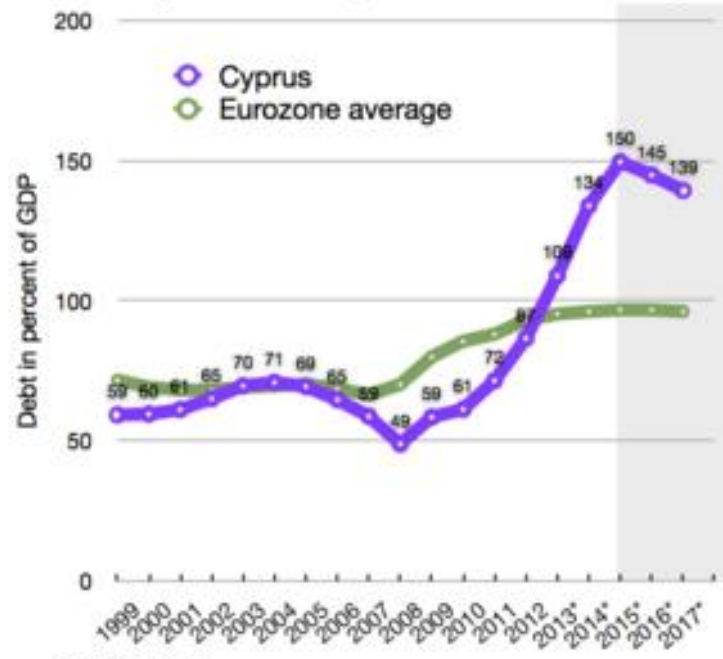
A yield being more than 4% points higher compared to the lowest comparable yield among the Eurozone states (i.e. yields above 6% in September 2011) indicates that financial institutions have serious doubts about credit-worthiness of the state

Greek debt compared to Eurozone average



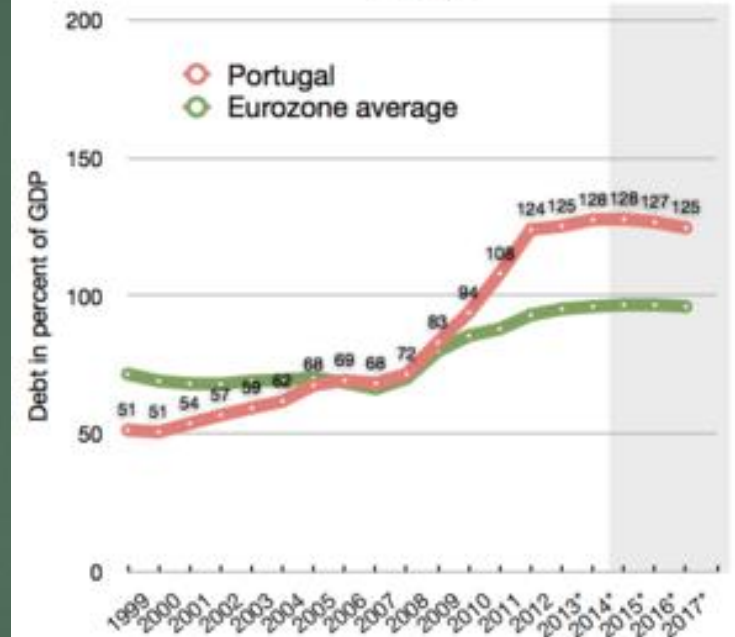
Source: Eurostat
 * Ernst & Young using data from Oxford Economics

Cypriot debt compared to Eurozone average



Source: Eurostat
 * Source: Ernst & Young using data from Oxford Economics

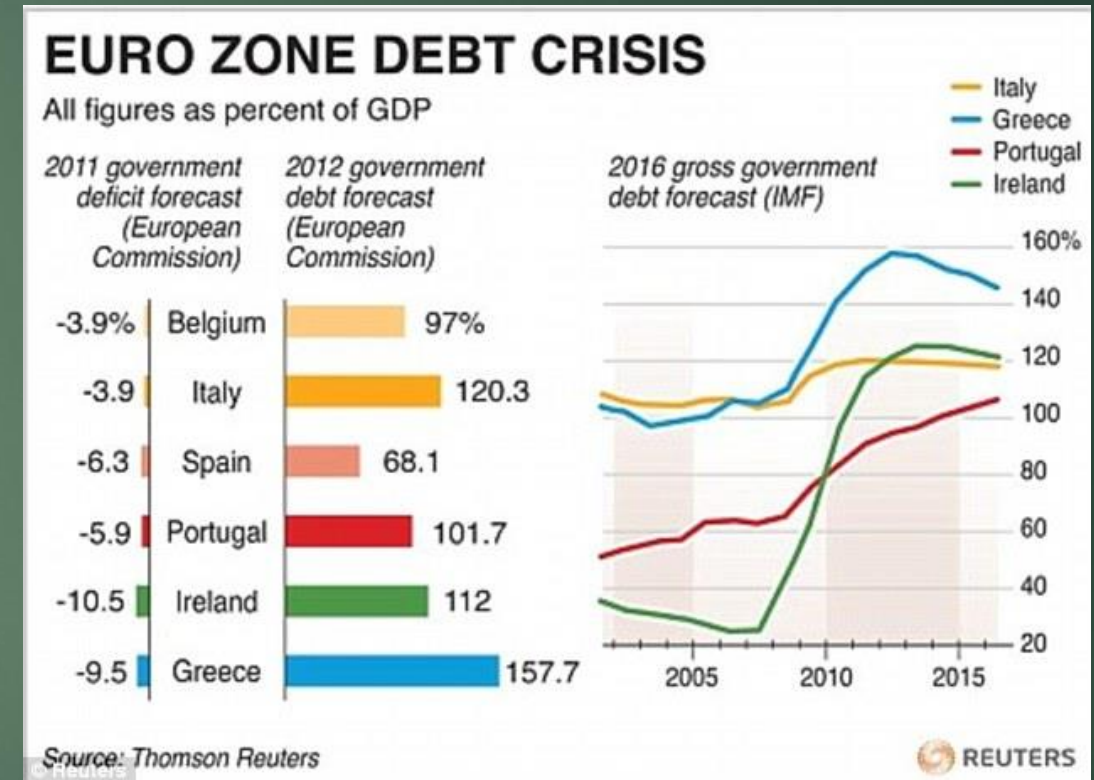
Portuguese debt compared to Eurozone average



Source: Eurostat
 * Source: Ernst & Young using data from Oxford Economics

Debt compared to EU average, Greece, Cyprus, Portugal

- ▶ Euro states are interdependent
 - Germany: the creditor
 - PIIGS: the debtors
- ▶ Disparity and interdependence creates resentment
 - Response in Mediterranean states (debtor states)
 - Response in Germany (creditor states)
- ▶ Effects:
 - Unemployment
 - Change in governments
 - Distrust in EU
 - Stalled integration
 - Possible breakup of Eurozone?



European Debt Pressures, Reuters 2012

III. Keeping the Euro Together

- ▶ Trilemma of alternatives:
 - 1) Monetary integration
 - 2) Executive federalism
 - 3) Democratic federalism

- ▶ In the pursuit of any two, one of these will suffer
 - France and Germany seek monetary union with national influence
 - Democratic federalism suffers
 - Fear/mistrust among members?

Union or Dissolution?

Discussion Activity

- ▶ Benefits and disadvantages from single currency

- ▶ With a partner, discuss:
 - 1) Do you believe the debtor economies should be allowed to fall and exit the Euro?
 - 2) If you were a strong Euro economy, would you opt to stay or leave the Euro?

IV. *Grexit*: The Dissolution of Union

10

- ▶ 2015 election led left party to government
 - Promise to cut austerity
- ▶ Stare down between Greece and ECB (Euro creditors) over finances



From 4bit News