The EU, the Euro zone, and trade agreements

Maria Lorca-Susino
University of Miami

The EU and The Euro

- **Copenhagen Criteria →** defines whether a country is eligible to join the EU:
  - Institutions to:
    - preserve democratic governance,
    - rule of law,
    - human rights,
    - market economy,
    - and capacity to cope with competitive pressure, and accept the obligation and adhere to
    - the aims of political, economic and monetary union.
      - (http://www.eurotreaties.com/compenhageneu.pdf)

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The Maastricht CRITERIA

- Set the standards to ADOPT the euro

Target	Requirement
Inflation Rate	No more than 1.5 percentage points higher than the 3 best-performing Member States of the EU.
Public finances	The ratio of the annual government deficit to gross domestic product must not exceed 3% at the end of the preceding fiscal year.
Interest rates	The nominal long-term interest rate must not be more than 2 percentage points higher than the 3 best-performing Member States.
Exchange rate stability	Applicant countries should have joined the exchange rate mechanism under the European Monetary System for 2 consecutive years and should not have devaluated its currency during the period.

To maintain the euro

- Once the euro has been adopted ➔ countries must comply with the economic and monetary requirements established in ***Title VI of the Maastricht Treaty***.
- **Title VI: Economic and Monetary Policy**
  - Chapter 1: **Economic policy** –Article 104
    - Art. 104C – Excessive government deficits
      - Art 104C-2b: government deficit to GDP
      - Art 104C-2c: government debt to GDP
    - Art 104.14: Protocol on excessive Deficit Procedures
    - Art 103: No bail-out rule ➔ to avoid members states from becoming responsible for financial liabilities of other members
  - Chapter 2: **Monetary policy** – Article 105
    - Art 105.1: objective: price stability by European System of Central Banks (ESCB)
    - Art 105.2: explains tasks of ESCB
  - Chapter 3: **Institutional provisions**

•*On the* ***Excessive Deficit Procedure*** *--- The Stability and Growth Pact (SGP)*
- Article 1: The reference values referred to in Article 104c.2 of this treaty are:
  - 3% for the ratio of the planned or actual government deficit to GDP
  - 60% for the ratio of government debt to GDP at market prices

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Eurozone Member States: EMU and €

Economic and Monetary Union (EMU)

1. Monetary Policy:

-European Central Bank

- Price stability
- 2% inflation rate

2. Economic Policy:

•Fiscal Policy: Stability and Growth Pact

- Gov. Deficit to GDP: 3%
- Gov. Debt to GDP: 60%

1. MONETARY POLICY

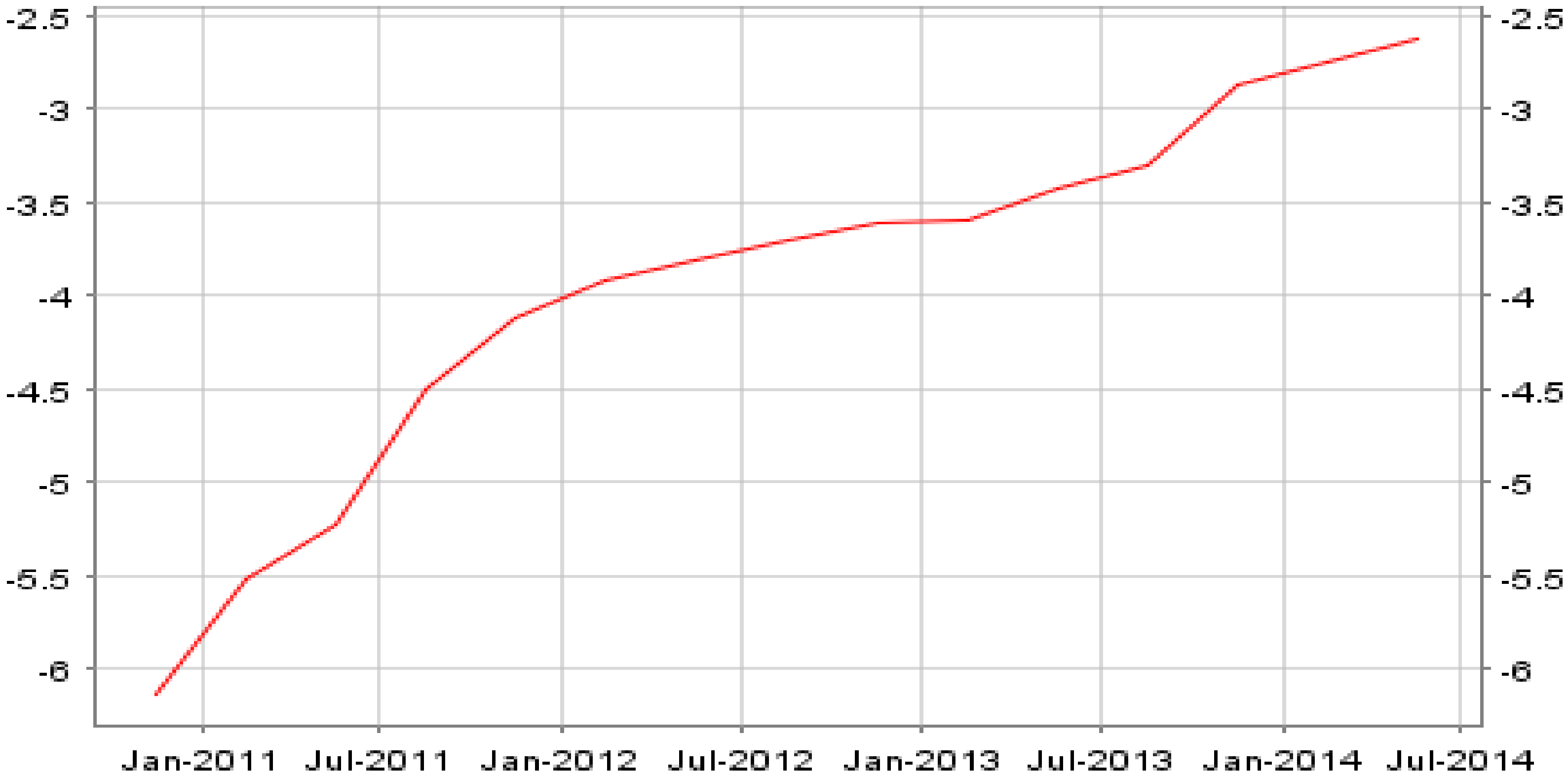
Harmonized Index of Consumer Price (HICP)

2. Economic Policy: Fiscal Policy

- The Stability and Growth Pact (SGP): A set of requirements to maintain fiscal discipline in the EMU.
- The SGP was initially proposed in the mid 1990's by Theo Waigel (German finance minister)
  - Germany obsession: maintain low inflation
    - an important part of the German strong economy's performance since the 1950's.
- After adopting the euro, the SGP ensures that Eurozone Member States continue to observe them.
- The requirements:
  - an annual budget deficit no higher than 3% of GDP
  - a national debt lower than 60% of GDP or approaching that value.

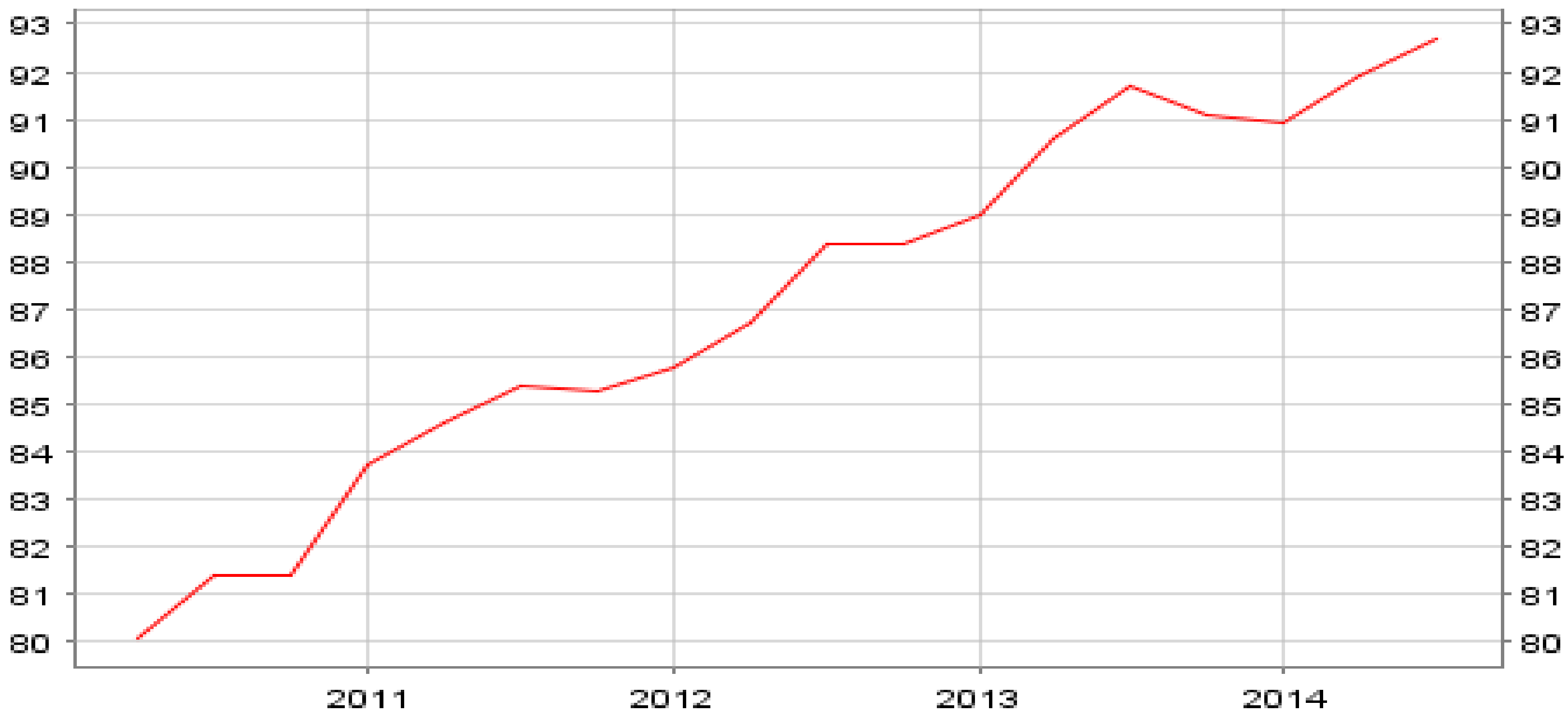
1. Eurozone: annual budget deficit / surplus

SGP: Deficit =< 3%



2. Government National: Debt Level

SGP: Gov Debt <60%



The Euro and…


FINLAND
SWEDEN
ESTONIA
LATVIA
LITHUANIA
DENMARK
UK
IRELAND
NETHERLANDS
POLAND
BELGIUM
GERMANY
CZECH REPUBLIC
LUXEMBOURG
SLOVAKIA
AUSTRIA
HUNGARY
FRANCE
SLOVENIA
PORTUGAL
ITALY
SPAIN
GREECE
MALTA
CYPRUS

The EU 28 and the Eurozone 18

Country	Entry Date Actual
Austria	January 1, 1999
Belgium	January 1, 1999
Netherlands	January 1, 1999
Finland	January 1, 1999
France	January 1, 1999
Germany	January 1, 1999
Ireland	January 1, 1999
Italy	January 1, 1999
Luxembourg	January 1, 1999
Portugal	January 1, 1999
Spain	January 1, 1999
Greece	January 1, 2001
Denmark	Never joined
Sweden	Never joined
United Kingdom	Never joined

Greece and the Euro

- **1. Greece became member on January 1, 2001**
  - Greece could not become part of the Eurozone in 1998 with the rest of the original eleven countries because it was not able to meet the targets established in the convergence criteria.
  - On January 1, 2001, Greece became the twelfth member of the European Union to adopt the single currency, the euro, after working to meet the EU's economic convergence criteria.
  - In less than two years, the Greek central bank worked to bring high interest rates down to euro levels of 4.75 percent.
  - Greece also squeezed double digit inflation in the early 1990s down to 4.2 percent. Control of the country's monetary policy will now be turned over to the European Central Bank.

Denmark, Sweden, and the U.K.

- **Denmark's** national currency, the KROEN linked to the Euro through
  - The government has met the economic convergence criteria for participating in the third phase of the (EMU), but Denmark, in a September 2000 referendum rejected joining the EMU
    - New Referendum: ?
- **Sweden:** rejected the euro in a popular vote maintains its own currency, the Swedish Krona
  - The Swedish Riksbank founded in 1668 is the oldest central bank in the world
  - Convergence problems – Working on inflation
- **The U.K.** The currency is the pound sterling.
  - The Bank of England is the Central Bank
  - The UK chose not to join the euro at the currency's launch.
  - British Prime Minister, Gordon Brown MP, has ruled out membership for the foreseeable future.
  - Former Prime Minister Tony Blair promised to hold a public referendum based on a number (five) points.
  - In 2005, more than half (55%) of the UK were against adopting the currency, while 30% were in favour.

Enlargements: 2004 & 2007

Country	EMU entry date	Expected
Cyprus	January 1, 2008	
C.Republic		2013
Estonia	January 1, 2011	
Hungary		2012
Latvia	January 1, 2014	
Lithuania	January 1, 2015	2013
Malta	January 1, 2008	
Poland		2012
Slovenia	January 1, 2007	
Slovakia	January 1, 2009	
Bulgaria		2012
Romania		2014

Due to economic turmoil these countries will not be making this deadlines since they are far from complying with the Maastricht requirements

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The euro and the Treaty of Lisbon

WHERE	Contribution
PREAMBLE	Strengthening and convergence of economies to establish an Economic and Monetary Union and the euro as a single and stable currency
Title I: Common Provisions Article 3	The Union should work for: **balance economy and growth and price stability ➔** to establish an economic and monetary union whose currency is the euro
Title III: Provisions on the Institutions Article 13	The European Central Bank becomes formally an institution of the Union
Title VIII: Economic and Monetary Policy Article 119	Adoption of an economic policy based on: •close economic coordination of Member States' (MS) economic policies • the introduction of the euro with the following guiding principles: • Stable prices, sound public finances, and balanced balance of PYMT
Chapter 1 Monetary Policy Article 120	Member States (MS) shall conduct their economic policies with a view to contributing to the achievement of the objective of the Union

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WHERE	Contribution

Article 121	1. Economic policy ➔ a matter of common concern
	2. The Council on recommendation from the Commission ➔ formulate a draft with broad lines of the economic policies of the MS
	3. The Council monitors the economies and reports to the Commission
	4. NEW: if guidelines are breached ➔ a MS risk jeopardizing the proper functioning of economic and monetary union…
	    1. The commission adopts warning
	    2. A QM in the Council can
	        1. Make recommendations (public or not public)
	    3. The MS concerned has no vote

Article 122	Measures in case of severe difficulties ➔ Measures can be taken and financial assistant can be granted
Article 125	No bail-out rule ➔ The Union shall no be liable for or assume the commitments of central governments, regional, local or other public authorities

WHERE	Contribution

Article 126
 	
The Most Important Article
	1. MS shall avoid excessive government deficits
	2. The Commission to monitors budgetary discipline
	    1. No more than 3% government deficit except:
	        1. Substantial decline
	        2. Exceptional decline
	    2. No more than 60% government debt
	        1. Unless the ratio is diminishing sufficiently
	3. Limits are set in Protocol No. 12
	4. Commission reports about risk of excessive deficit
	5. The Economic and Financial Committee gives opinion on report
	6. NEW → The Council based on the report ask MS and the Council decides
	7. If the Council decides there is an excessive deficit → adopt without delay the recommendation of the Commission that shall not be public
	8. If the MS does not take the actions recommended, the Council will ask the MS to submit a report with a time table
	9. If the MS still does not comply, the Council may take second set of sanctions
	10. The President of the Council shall inform the European Parliament of the decisions taken
	11. When the Council adopt a decision:
	    1. The vote of the MS is not taken into account
	    2. A QM of the other MS is: 55% of the MS of the Council comprising 65% of the population

WHERE	Contribution
Chapter 2: Monetary Policy Article 127	1. Objective of Price stability 2. Tasks of the European System of Central Banks
Chapter 4 Provisions specific to MS whose currency is the euro Article 136	1. Strengthen coordination of their budgetary disciplines 2. Set put economic guidelines 3. Coordinate budgetary disciplines 4. Follow economic guidelines

Article 138	1. To secure the euro's place in the world:
	    1. The Council, on a proposal from the Commission, adopt common positions on economic and monetary issues
	    2. Unified representation within the international financial institutions and conferences

PROTOCOLS

Number 4:	On the Statute of the European System of Central Banks and of the European Central Bank
Number 5:	On the Statute of the European Investment Bank
Number 12:	On the Excessive Deficit Procedure
Number 13:	On the Convergence Criteria
Number 14:	On the Euro Group
Number 15:	On certain provisions relating to the United Kingdom of **Great Britain and Northern Ireland** RECOGNISING that the United Kingdom shall not be obliged or committed to adopt the euro without a separate decision to do so by its government and Parliament.
Number 16:	On certain provisions relating to **Denmark** TAKING INTO ACCOUNT that the Danish Constitution contains provisions which may imply a referendum in Denmark prior to Denmark renouncing its exemption GIVEN THAT, on 3 November 1993, the Danish Government notified the Council of is intention not to participate in the third stage of economic and monetary Union

The EU and the Euro zone: The economic Crisis

WHY DID THE CRISIS HAPPEN

- A slowdown in the US economy caused over-extended American homeowners to default on their mortgages ➔ banks all over the world with investments linked to those mortgages started losing money.
- America's fourth largest investment bank, Lehman brothers, collapsed under the weight of its bad investments, scaring other banks and investors with which it did business.
- The fear that more banks could fail caused investors and banks to take extreme precautions. Banks stopped lending to each other, pushing those reliant on such loans close to the edge.
- European banks that had invested heavily in the American mortgage market were hit hard.

Responding to the Crisis

- To prevent a complete collapse of the banking system ➔ European governments came to the rescue of their banks with ➔ 1.6 trillion euros, the equivalent of 13 % of the EU's annual GDP were committed between 2008 and 2011.

- The EU also launched a Europe-wide recovery programme to safeguard jobs and social protection levels and to support economic investment.

- The euro broadly maintained its value and successfully shielded euro zone countries from the worst effect of the economic crisis by providing EU companies with a stable playing field for international trade and investment.

The Trigger: Greece!

- In May 2010 ➔ bankruptcy with a country debt expected to reach about €350bn by 2014.
- Greece has not respected the Stability and Growth Pact
- Greece used "creative accounting" to work out the numbers on its national accounts in 2009, which led to the budget crisis in 2010.
  - in 2008 Greece presented budget deficit estimates for 2009, which stood at about 6.7% of GDP
  - in October 2008 the newly elected Greek government revised the estimate: from 6.7% of the gross domestic product (GDP) to 12.7% of GDP
  - It was then explained that Goldman Sachs helped Greece ➔obscure billions in debt from the budget overseers in Brussels.

The First Bail-Out

- The FIRST lending facility, or bailout, of €110bn ($146.2Bn) on May 2, 2010
  - €30bn in standby agreement with the IMF and €80bn from euro area member states in the form of bilateral loans
- The terms of the bail-out : three year bailout plan that Greece would have to repay with an interest of 7.5%.
- **The first loan, worth €30bn, was given before May 19, 2010 ➔the date by which Greece had to make debt repayment and avoid defaulting on its massive debt.**
- **IN RETURN**: Greece was asked to take some **extreme austerity measures**: cut €30bn over the next three years ➔ ***reduce public debt from 13.6% in May 2010 to less than 3% by 2014.***
  - Some of these austerity measures:
    - scraping bonus payments for public sector workers,
    - capping annual holiday bonuses,
    - increasing the Value Added Tax from 21% to 23%,
    - raising taxes on fuel, alcohol, and tobacco by 10%
    - and taxing illegal construction
  - **Results: General Strikes**

And later….

- In March 2012 ➔Greece asked for more money
- **The second bail out: euro area finance ministers and the IMF approved a second round of economic assistance for Greece, worth EUR 164.5 billion.**
- In return: Greece agreed to about €78bn in **additional austerity measures** and asset sales through 2015.
  - €6.4 billion spending cut from June 2011 to December 2011,
  - another €22 billion up to 2015,
  - and €50 billion in sales of assets.
  - **This time some sacrifice on the bondholders' side.**

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Greece is NOT alone … in the WORLD

- “Default”:
  - **Argentina**
  - **Mexico** first country which had difficulties.
    - the US provided funding with about $50bn in loans.
  - The East Asian crisis was different.
    - Those countries helped either by the IMF, the World Bank, G7 countries, or a combination.
    - **Thailand**—the first country in the area which ran into financial difficulties → the US did not rush to save it ➔ this country was regarded as insignificant ➔ The 1997 East
    - This lack of response on the part of the US has been blamed and used to explain the spillover effect to the rest of the area.
    - Years later, **Russi**a ran into sovereign debt difficulties and defaulted selectively after receiving some help.

Not alone in … Europe

Country	Amount in euros
Greece	110bn in May 2010
Ireland	85bn in November 2010
Portugal	78bn in April 2011
Greece 2nd	164bn in march 2014
Spain	Set aside EUR100 billion in loans IF NEEDED between July 2012 and December 2013
Cyprus	10 billion to restructure its banking sector on 24 April 2012

The EFSF has already committed about €256 billion out of the €440bn available to help Greece, Portugal and Ireland.
The TROIKA ➔ the IMF, The European Commission and other ECB

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The saving mechanism

A SOUP OF LETTER

THE BAILOUT SYSTEM

- Two vehicles to save the Eurozone:
  - 1) The European Financial Stability Facility (EFSF) → €440 bn in loans from plus the IMF, the European Commission and other → $622 bn
  - 2) The European Stability Mechanism (ESM) → in effect in 2013 → $996bn

The No Bailout rule

- EU approved 3 lending facilities in May 2010 to deal with Greek sovereign debt crisis and stop its spread to other countries.
  - **Deal with the no bail-out rule and art 125:**
    - Article 125 (ex Article 103 TEC) states that neither the EU nor a member state should be liable or assume the commitment of any public body or entity of any member state.
    - This article directly bans any direct fiscal transfers from one member state to another and also seems to ban purchases of sovereign debt in the primary market
- **On May 11, 2010:** the Council of the European Union approved the Council Regulation (EU) No 407/2010, which established the European financial stabilization mechanism
  - **the No-Bail out rule of Article 125 was bypassed using Article 122(2) of the Treaty**.

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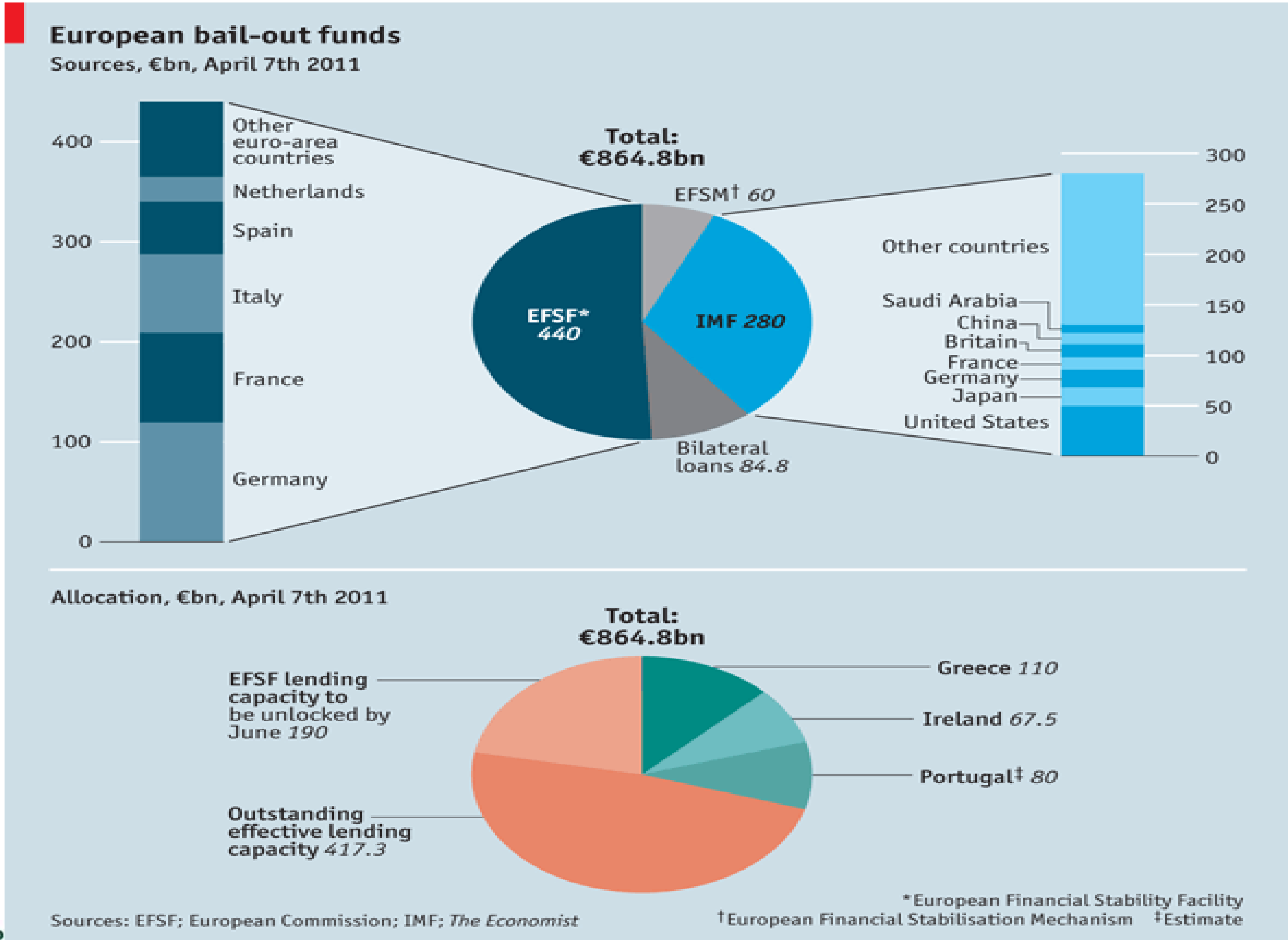
EFSM – the temp fund

- On May 9, 2010, the EU's finance ministers adopted a regulation establishing a **European Financial Stabilization Mechanism (EFSM)**
  - 2nd Facility: maximum total lending capacity of €60bn from the EU budget and administered by the European Commission
  - 3rd Facility: the capacity to issue bonds guaranteed by EAMS for up to €440 billion for on-lending to euro area member states (EAMS) in difficulty, subject to conditions negotiated with the European Commission, and in liaison with the European Central Bank and International Monetary Fund, and to be approved by the Eurogroup.
  - International Monetary Fund: €250bn


European bail-out funds
Sources, €bn, April 7th 2011
400
300
200
100
0
Other euro-area countries
Netherlands
Spain
Italy
France
Germany
Total: €864.8bn
EFSM† 60
EFSF* 440
IMF 280
Bilateral loans 84.8
300
250
200
150
100
50
0
Other countries
Saudi Arabia
China
Britain
France
Germany
Japan
United States
Allocation, €bn, April 7th 2011
Total: €864.8bn
EFSF lending capacity to be unlocked by June 190
Outstanding effective lending capacity 417.3
Greece 110
Ireland 67.5
Portugal‡ 80
Sources: EFSF; European Commission; IMF; The Economist
*European Financial Stability Facility
†European Financial Stabilisation Mechanism ‡Estimate

Where is this money coming from?

Country	Amount
Germany	**119,390.07 (27%)**
France	**89,657.45 (20%)**
PIIGS Portugal Ireland Italy Greece Spain	**161,562.71 (36%)** 11,035.38 7,002.40 78,784.72 12,387.70 52,352.51

The ESM – The Permanent Fund

- The temporary fund EFSF is set to expire on June 30, 2013, and has around 140 billion euros of bailout fund left available.
- The ESM, which was originally scheduled to come into force in July 2012, has been expected to help increase the "firewall" and calm market.
- Sept 10, 2012 ➔ Federal Constitutional Court of Germany approved the ratification of the European Stability Mechanism (ESM) paving the way for the permanent bailout fund and other crisis-battling instruments to go into operation.

- But the court said the German parliament should "receive comprehensive information" over future decisions made by the ESM and Germany's financial burden in the fund should be limited to its share of the capital stock or about 190 billion euros (245 billion U.S. dollars).
- Any increase of the burden should not happen "without agreement of German representatives," said Court President Andreas Vosskuhle in a statement.

- The court has been considering more than 1,000 petitions against the ESM and the fiscal pact filed by German lawmakers, economists, professors and ordinary people since July. Around 37,000 plaintiffs were involved.
- The opponents argue that the ESM, as well as the fiscal pact to enforce budget discipline, strips the parliament of the power to decide how taxpayers' money should be used, thus infringing German constitution.
- They fear that Germany's contribution to the fund could be increased when the debt crisis spreads further in Europe.
- Once coming into force, the ESM will have a capacity of 500 billion euros for lending and purchasing bonds of indebted countries, such as Greece and Portugal.

Final Thoughts

That which does not ‘kill’ us makes us stronger

Friedrich Nietzsche

- The EU and the Eurozone are in serious danger
  - Lack of supervision (see no evil, hear no evil, speak no evil)
  - This shows negligence ➔ EU politicians should be held accountable
- Common fiscal policy ➔ not viable
  - Budget will be imposed ➔ fiscal sovereignty
  - Politicians are not longer needed…
- If PIIGS are asked to leave:
  - Currency devaluation with lack of comp ➔ immediate bankruptcy
- What about Germany leaving the EU?
  - Best economy in the area and record high export rate despite euro
  - FX vendors still maintain the DEM as a currency
- **Solution is not:**
  - The European Monetary Fund
  - Institution to supervise financial activity


Thank you