The Euro Crisis Reexamined: The Manifestation and Influence of European Integration

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Abstract. A decade ago, the Euro crisis created a massive shock to the Eurozone countries and posed a significant threat to the status of the Euro currency. With the joint efforts of all Eurozone member states and EU institutions, a set of rescue measures were taken, and the effects and results of the rescue plan have already manifested. Although the effectiveness of the rescue plan still needs time to observe, scholars have already conducted studies on various aspects of the Euro Crisis from diverse angles under different theoretical frameworks. This paper, though, intends to provide a more general review of European integration as an influential factor in the Euro crisis. By conducting case analyses on the crisis and Eurozone member states involved in the crisis, this research examines the cause, turning points, and current solutions to the Euro crisis by putting the events into the context of European integration. The corresponding results conclude that European integration holds an indispensable role in analyzing and interpreting the Euro crisis.

Keywords: Crisis, Euro, European, Integration, Debt

1 Introduction

Economic or financial crisis has long been one of the most important social incidents of modern human history. From the 1636 Dutch tulip bulb market bubble crisis, the first economic bubble in human history, to the 2006 United States sub-prime mortgage crisis, which ultimately induced a massive global financial crisis in 2018, the crises damaged economies, but also reformed human societies by forcing social, economic, and political structures and behaviors to progress [1,2]. Thus, the study of past economic crises holds significant research value in multiple fields of humanities and social sciences.

In the recent decade, one of the most studied economic crises is the Euro crisis. Amidst many different perspectives of studying it, many scholars chose to investigate the influences of the Euro crisis on the progress of European integration, or vice versa, as the main topics of their studies. Hutter and Kriesi argued that the affair of European integration became more politicized during the Euro crisis, especially in the South where countries hardest hit by the Euro crisis are located [3]. Borzel and Risse emphasized on the nature and progression of politicization on the outcome of the Euro crisis

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to explain the same effect [4]. Degner developed a liberal intergovernmentalist link between crises and European integration and argued that the Euro crisis deepened European integration [5]. Schimmelfennig, on the other hand, argued from a noefunctionlist perspective, concentrating on transnational interdependence and supranational capacity manifested in the outcome of the Euro crisis [6]. Nevertheless, most of these studies are confined to specific theoretical frameworks. A more general evaluation transcends approach-specific analyses on the scale of influence European integration has on the Euro crisis is to some extent lacking.

Yet, acknowledging the importance of European integration is of great significance, both academically and practically. In academia, the results of this study will contribute to a more comprehensive understanding of the Euro crisis beyond theoretical differences; practically, this paper should draw more attention to the factor of European integration from Eurozone countries and EU institutions in dealing with the Euro crisis, and any future economic predicaments.

This paper aims to deliver a general overview of the Euro crisis against the backdrop of European integration through theoretical analysis and case analysis. Individual countries are also reviewed as case examples. First, the paper examines the forewarning and cause of the Euro crisis in the context of European integration. Then, in the same context, the paper assesses the negotiating process and the proposed solutions to the Euro crisis. Last, the paper suggests future implications of the relief mechanism in response to the Euro crisis on European integration.

2 The euro crisis

In 2006, the United States economy was attacked by the sub-prime mortgage crisis, which had bankrupted Lehman Brothers and endangered many American financial institutions, knocked the American economy into recession, and quickly evolved into a global financial crisis in 2008. The Europeans knew that they would be heavily affected but might never have imagined it would later be the fuse of their own crisis – the European debt crisis, which later deteriorated into such a predicament that even threatened the value and position of the Euro currency [1,7]. When the financial tsunami came ashore in Europe, it was first handled separately by individual national governments. However, when the severity of the crisis exceeded the capacity of some governments, the economic dilemma burst into the sovereign debt crisis.

With the continuing worsening of the sovereign debt crisis and the emerging danger of governmental default, the sovereign debt crisis started to degenerate into the Euro crisis, which posed an immediate depreciation danger to the Euro currency [7-9]. Worrying that the crisis might shake the foundation of the Eurozone or even impair the European Union (EU), after a modest bailout by the International Monetary Fund (IMF), the European Financial Stability Facility (EFSF) was born as a temporary fix to the crisis in June 2010; and later in 2012, the European Stability Mechanism (ESM) was established as the permanent solution to present and potential future European financial turbulences; the EFSF had then stopped granting new financial assistance [10,11]. The rescue package consisted of an enormous amount of capital bailout loans from the European Central Bank (ECB) and the EFSF or the ESM; continuous purchasing of Treasury bonds of troubled countries; and compulsive austerity policies and reforms required for the distressed countries to adopt to help them rebalance national fiscal instability [7,11]. As of now, the EFSF and the ESM have helped Eurozone countries, including Greece, Spain, Portugal, Ireland, and Cyprus [10].

2.1 The early stages and evolution

The blasting fuse of the Euro crisis was commonly identified to be the 2008 global financial crisis [1,9]. Nevertheless, in 2006, when the sub-prime mortgage crisis started to show in the United States, the European financial sector had already started to feel the shocks because the European financial market had always been deeply integrated with the US market: some European financial institutions were heavily invested in the US sub-prime mortgage market; others were holding an enormous amount of financial products and derivatives in the US market; the foreign direct investment (FDI) of the United States contributed by the European public and private investors were also very high [8,9]. But these were only forewarnings of the bigger crisis. Later, when the US sub-prime mortgage crisis evolved into the global financial crisis in 2008, the situation got aggravated. However, the subsequent development of how this worldwide financial crisis triggered the Euro crisis on the European continent was more complicated than mere apparent financial losses.

In late 2009, Greece astonishedly declared that its expected public debt and fiscal deficit would reach 113% and 12.7% of its GDP, respectively, which violently breached the limits of 60% and 3% regulated by the EU Stability and Growth Pact [12]. Because of the significant worsening of the financial situation of the Greek government, Standard & Poor's, Moody's, and Fitch, the three most major credit rating agencies in the world, downgreaded the sovereign debt rating of Greece; hence, had kicked off the European sovereign debt crisis [12]. Not long after, similar sovereign debt dilemmas happened in Ireland, Portugal, and Spain [1]. The contributing factors behind the European sovereign debt crisis were multifaceted; however, many can be examined in the context of European integration and the Eurozone system [9,13].

One common belief was that the European sovereign debt crisis was related to the result of loose domestic fiscal policies adopted by some Eurozone member states, such as Greek [7]. Generally, whenever a state wanted to implant stimulus fiscal policies, its government had to evaluate the contagion effects of the policies on inflation and exchange rate [7]. But by joining the Eurozone, these constricting elements had been significantly weakened because the pressure on the domestic inflation rate could be shared and flattened by other states in the Eurozone; furthermore, the Eurozone integration made sure trades and capital flows between Eurozone member states were free of exchange rate risks [7]. These all made it more worry-free for Eurozone states to adopt loose fiscal policies to boost the economy. As a result, when the years were good, economically weaker Eurozone states were tempted to violate the EU Stability and Growth Pact regulations to improve their fiscal health but maintain loose fiscal policies and build their economic growth on high sovereign debt [7,13].

Some other scholars argue that the happening of the European sovereign debt crisis should also be attributed to the fact that Eurozone countries had to deal with domestic financial predicaments with their hands tied, because Eurozone countries surrendered their power of making independent monetary policies [14]. This power was transferred to Eurozone supranational financial institutions, such as the European Monetary Union (EMU) and the European Central Bank (ECB). Without this power, the member states had lost one of the most effective macroeconomic tools to regulate economies. Take Greece as an example: after the financial crisis hit Europe, in order to keep the Greek economy growing and avoid economic recession, the Greek government had no other means but to extent their already-loose fiscal policies and expand their national spending to stimulate the economy; in the end, caused a much worse fiscal deficit [12].

Experts had also argued that the Eurozone had neglected the developmental and economic imbalance between Eurozone member states [5-7,14]. For instance, some Eurozone member states, such as Germany, had an export-driven economic growth model; some were debt-driven, like Greece; some lacked strength in national productivity, and some suppressed labor costs in order to maintain competitiveness in industrial production [7,14]. Instead of allowing some room for flexibility to accommodate the distinctive needs of individual member states, the Eurozone deployed a series of rigidly uniform monetary policies to all member states. As a result, conflicts never stopped to exist between domestic fiscal policies and supranational inflexible monetary policies. Combined with the negligence in supervision duty of European central institutions, like the EMU, on member state's fiscal health, all these catalysts brought by the progress of European integration through the hands of the Eurozone had contributed to the European sovereign debt crisis [5,6].

For Greece, one other underlying reason for its sovereign debt crisis was that before joining the Eurozone in 2001, the country also concealed the real situation of its fiscal deficit with the help of Goldman Sachs using financial derivatives and zaitech in order to fulfill the budget deficit requirement of joining the Eurozone written in the Treaty of Maastricht [12]. Later in 2004, Greece again revised previous years' fiscal deficit data to make its deficit look lesser [12]. The direct reason behind the cover-up of the fiscal deficit and public debt in the first place was the intention of the Greek government to join the Eurozone. Greece was an early member of the European Union (former the European Community) since 1981; and the Greek government had long had a vision that joining the Eurozone and adopting the Euro currency would let Greece continue to issue debts at a relatively low cost and level out the risk of inflation [1,7]. However, Greece had been struggling to meet the requirements of joining the Eurozone for several years. This situation directly led to the conspiracy between the Greek government at that time and Goldman Sachs [12]. Certainly, the Greek government was the main party to blame, responsible. However, the motives behind its choices at every step along the way to its own sovereign debt crisis can be easily understood from the perspective of European integration.

As several other Eurozone member states, such as Spain and Portugal, followed the path of crisis after Greece, sovereign debt crises of individual Eurozone member states spread and exacerbated, and finally grew into the Euro crisis. The reason for this escalation was that the deep integration of the Eurozone economy had also made it vulnerable to contagion effects: without any intervention, the debt crisis of one or more member states would ultimately spread to all Eurozone countries through the highly integrated European economy [15]. An example of direct influences would be the immediate financial losses: many Eurozone member states held a large number of Greek public and private debts, with Germany and France holding the most [7]. If Greece had defaulted due to the sovereign debt crisis, other Eurozone countries and their banks would immediately suffer great financial losses. Indirect influences would include chain effects, such as threats to the solvency of European banks, liquidity problems domestically and continentally, depreciation of the Euro, and eventually, jeopardizing the legitimacy and credibility of the Euro currency in the global market [1,7,9,13-15]. These aftermaths would very likely lead to the failure of the Euro currency and even the dissolution of the Eurozone or EU; and by the look of the European sovereign debt crisis at that time, the Euro crisis was already unfolded.

Some scholars illustrated the contributing factors of the Euro crisis mentioned above in this section under the framework of political theoretical frameworks. The intergovernmentalists described the causality between the factors and the crisis as bargainings of governments of Eurozone member states [5]; the neofunctionlists explained the developing process of the crisis through functional spillover [6]. But none of these explanations alone was sufficient to generate a comprehensive understanding of the crisis; only by considering the aspects altogether beyond the differences of theoretical framework in the dimension of European integration can provide a more thorough understanding of the Euro crisis.

2.2 Negotiation, current solutions, and implications

Even though the crisis was degenerating and the Euro was depreciating rapidly, at first, Eurozone member states with stronger economies, such as the North, including countries like Germany, were reluctant to the seemed apparent solution - a bail-out rescue. Instead, the North countries proposed austerity measures to be imposed on the problematic countries in the South as a means of self-rescue [15]. Their reason was explicit: neither the Treaty of Maastricht nor other European Union pacts or agreements regulated that Eurozone member states have responsibilities to save one another; there were no “bailout” rules [15]. The North also thought it unfair because the bailout money paid from the Eurozone, or EU institutions, was foremost taxpayer money from Eurozone member states. Issuing capital bailout to Greece and other troubled South states basically meant letting the North citizens pay for the financial predicament of countries other than their own [13,15]. Moreover, even though many of the Eurozone member states were spending over budget regulated by the Pact, the South countries were spending at a much higher rate and with a much higher fiscal deficit. At the same time, these South countries were opposing the austerity measures despite their financial predicaments [15]. The then performances of Greece and other troubled South states all made them less excusable in the eyes of the North.

This North and South divergence revealed another systematic problem of the Eurozone, which can be easily observed in the dimension of European integration – the imbalances among Eurozone member states. These member states had uneven social, political, and economic foundations; they also had different economic growth rates and growth models, inflation rates, trade deficit or surplus, labor costs, industrial structures, as well as different debt levels, and unbalanced capital flows between states [7,14]. Letting these states with distinctive characteristics join together as one under the same set of rules did not erase these dissimilarities. If any, it only made the imbalances more obvious in the European environment: stronger nations had stronger voices and barging positions, while weaker ones had the opposite [6]. Consequently, during the Euro crisis, states that were hardest hit by the crisis, which were the relatively weaker side of the bargain, would be most willing to comprise in order to get the rescue they need. On the contrary, states that were the lightest hit by the crisis would naturally be less compromising and would seek a plan that would minimize their liability in the collective rescue mission; normally, the country that was less compromising would be more likely to achieve the policies they preferred [6]. In the matter of the Euro crisis, the North coalition was the stronger side, with the South being the more compromising side. The actual negotiation process of potential solutions to the Euro crisis reflected this assumption: Germany and France, being the head of the North and the South respectively, both had steadfast positions on how the Eurozone, the EU, and the individual states, should deal with this crisis; the North in general was more persistent because they were the lightest affected [6].

In June 2010, the North and the South had finally come to an agreement despite their discrepancies, under the pressure and urgency of the Euro crisis. As a result, the European Financial Stability Facility (EFSF) was set up as a temporary solution to the crisis, and started to issue financial assistance to Greece, Ireland, and Portugal [11]. The EFSF was an emergency relief mechanism and rescue fund. Even though it operated as a private company in Luxembourg under the Luxembourg laws, it was guaranteed, with limited liability, by the eurozone member states. Later in 2012, the European Stability Mechanism (ESM) was established as a more developed and permanent version of the EFSF; different from the EFSF, the ESM was an intergovernmental institution functioning under international law; the EFSF had stopped granting new financial assistance since July 2013 [10]. The two institutions were separate institutions but with identical goals - to provide financial assistance to financially distressed Eurozone countries in times of crisis [10]. A series of relieving measures were formulated and carried out by the temporary EFSF and the permanent ESM, measures including but not limited to: providing massive financial bailout funds; purchasing large numbers of Treasury bonds and other sovereign debt financial products of troubled countries [10,11].

However, these assistances came with compulsory conditional policies: Eurozone member states receiving help and loans were required to execute austerities measures and reformations to help them recover and rebalance their national ledger; they also needed to accept surveillance and supervision from entitled European institutions, the ESM/EFSF, the European Commission, the ECB, and the International Monetary Fund (IMF) periodically [10]. These institutions were responsible for monitoring and auditing the states that had received assistance quarterly to make sure the states were conforming with the conditions and were up to the mark with the promised reformations. So far, the ESM and the EFSF have granted financial assistance to five countries, including Greece, Ireland, Cyprus, Portugal, and Spain. All five countries have safely landed their economy and are in the process of repaying the loans to EFSF or ESM [10,].

If the states that have received financial assistance keep fulfilling their loan repayments, and all the Eurozone member states continue to realize promised contributions to ESM, the ESM should become greater in rescue capacity and maintain a good financial status. On top of that, if the countries that had been assisted keep implanting fiscal and economic reformations required by the supervising institutions, these states would also benefit from a more stabilized economy, more balanced fiscal policies, and lower sovereign debt levels. And then, the rescue of the Euro crisis can deem to be effective and successful.

Reflecting on the negotiation process of the rescue plan, undoubtedly, it evolved a lot of hard bargaining; but the logic behind the uniformity in confronting the Euro crisis could be easily understood if examined in the light of European integration. As the Eurozone countries were discussing potential rescue measures for the European sovereign debt crisis, the contagion effects start to show. Spain, Italy, Ireland, and Portugal successively got their sovereign credit ratings downgraded by international credit rating agencies [15]. The European financial market was fluctuating violently: capital flights had started; the interest rates were rising; liquidities were straining in the money market; the Euro was depreciating [9,13]. Even though the North countries were less affected, they were caught up in the chain effects of the crisis and were extremely anxious about the contagion effects growing out of control [7]. If the crisis continued to fester, disastrous damages to the Euro currency and the European financial market were destined to happen, which would damage all Eurozone countries severely.

Consequently, despite all the reluctance and doubts inside the Eurozone, the ESM and the EFSF were still established. Their operating mechanism was the result of all the Eurozone member countries yielding to each other, simultaneously achieving what was most important to them. For the North countries and others that were less affected by the Euro crisis, their main concerns were stabilizing the Euro currency, safeguarding their economies, and avoiding spending taxpayer money or bearing too many liabilities in the rescue; for the South, getting financial aid was their first priority. Thus, the ESM and the EFSF were the equilibrium of both sides, with them compromising on specific issues in exchange for what was more oppressing: the ESM and the EFSF acquired financial contributions and guarantees that were to some extent tax-payer money from Eurozone member states, yet issued bonds and other financial products to finance the rescue loans and promised not to use paid-in capital unless in extreme emergencies; the North nevertheless made significant capitals contributions, with Germany alone contributed over one-quarter of it; at the same time, the countries being aided received rescue loans, but were required to undergo austerity measures and go through certain financial reforms.

The reaction chain and the fundamental reason for the catastrophic aftermath of the Euro crisis stemmed from the deepening of European integration throughout the years. Thus, in order to solve it, actions must be taken on the level of European integration, too. Ergo, no matter the North or the South, the Eurozone member states stood together for a unified remedy to overcome the economic winter. The Europeans' solution to the

Euro crisis is a perfect example of the manifestation of European integration during financial crises.

3 Conclusion

This study is aimed to examine the impact scale and the effects of European integration in the event of the Euro crisis. After examined and evaluated the cause, the development, and the current solutions of the Euro crisis, the main findings of the paper are as follows: from the Greek sovereign debt crisis to the European sovereign debt crisis, and later to the Euro crisis, the European integration had played a catalytic role; current solutions of the crisis are also designed and implemented within the structure of the Eurozone alliance and an integrated Europe; implications of the crisis and its solutions are better understood considering the factor of the European integration. All these findings lead to the conclusion that for the purpose of achieving a comprehensive and in-depth understanding of the elements of the Euro crisis, viewpoints and evaluations in the context of the European integration are indispensable.

However, this study still has a few limitations: the long-term effectiveness of the rescue mechanism still needs time to observe. In the future, periodic studies can be conducted to evaluate the adaptability and efficiency of the relief mechanism. Moreover, since the ESM has become a permanent regulatory and relief mechanism for European economies, examining its effectiveness in future possible European financial predicaments, such as the current economic dilemma caused by the Pandemic crisis, can also contribute to the further understanding of the relationship between European integration and European economy.

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