CHAPTER-3

Globalization has become a very well-known word in the vocabulary of a majority of individuals. It is considered a process and a state of mind. It is also referred to as an interconnectedness of world economies. In globalization, it is technology which is playing an important role in bringing countries of the world together. Since 1945, the most impressive development has been the development of a globalized economy. The volume of transactions had significantly been increased that is accruing across the national boundaries. In the year 1990, major changes occurred on the world stage, and the world has become more interdependent. More regional economic arrangements have negotiated. These regional economic arrangements are part of that globalized era, which would play a crucial role in the economic integration of the world.

In the 21st century, the very concept of 'globalization' presents challenges to world economies. On the one side, there are numerous opportunities which were created by globalization, and the other side is full of challenges and crises, particularly financial crisis. The most important feature of globalization is 'interconnectedness' where regions, or economic bloc are connected to each other. On the other hand, when this one region or economy was hit by a crisis, the impact on another region/economy is coherent. Economy globalization which was considered as the victory of economic liberalism has presented a number of challenges. Some of those have occurred on the local level and some on the international level. The Asian financial crisis spread regionally. However, on some level shocks hit across state borders. Domestic government and international financial institution rolled bailout packages to generate growth and employment in affected countries. However, the international financial crisis is a reversion feature of the global financial system, which includes the Mexican debt crisis, oil crisis, and recently the 2008 American financial crisis and Eurozone debt crisis. So, it would pertinent to assess the American financial crisis and more importantly the Eurozone debt crisis in the context of globalization.

3.1 Global Financial Meltdown

The financial crisis of 2008-14, which has its genesis in the United States, changed the lives of Americans and people across the world. It is one of the most important economic event since the Great Depression of 1930. The crisis has its repercussion on the investment and banking sector as well as on the import-export regime. A wave of fear has been spread following the collapse of Lehman Brother, a financial institution established in the United States. The meltdown impacted not only the United States but also developed economies in Europe and developing and emerging economies such as China and India.

The 19th and the early 20th centuries witnessed several financial crises linked with the banking sector and many recession coincided with these meltdowns. The financial meltdown includes bursting of financial bubbles, currency crisis, crashing of stock markets and sovereign defaults. The reasons for the present financial turmoil have been analyzed on a wide scale. For example, **Avgou Leas** asserted that the meltdown began in the United States and the United Kingdom when the global credit market began to decline in July 2007 and started to show its effect in the middle of 2008. The stock market, across the world, began to decline. The outcome was that large financial institutions and banks got collapsed. **Adamu** mentioned that from London to Tokyo, Seoul to Sydney, Sao Paulo to Moscow, Bombay to Frankfurt financial markets slipped and collapsed. **Greenspan** referred to this as '*Once-a-century credit Tsunami*.'[1]

The crisis caused a significant slowdown around the world markets, it also affected the growth prospects in the developing economies Governments are trying to control the crisis but the future scenario is very uncertain. Stock markets in developed and developing countries down to 50-75 percent. During 2008, the United States has to lost equities worth $ 16.2 trillion. The International Monetary Fund had to revise the growth prospect/forecast for developed and developing economies. The impact on

[1] Mishra, R.K., Trivikram, K and Kolluru, Srinivas (2013) "*The Impact of Global Financial Meltdown on India's Macroeconomic variables"* in Mishra, R.K. and Trivikram, K. (eds) The Global Financial Crisis : Challenges and Opportunities. Academic foundation, New Delhi, p. 23.

developing countries will depend on their direct and indirect trade with effecting economies.

3.2 American Sub-prime Crisis

In September 2008, the collapse of Lehman Brother[2], brought a wave of fear around the globe. Massive monetary and fiscal stimulus package was injected in the economy so that slowdown could be prevented. GDP goes down in many countries especially in Europe, where the crisis turned into the Euro crisis. Early in the 20th century, the banking regulation was slack than it is today. There was a system of national banks in the United States. Insurance companies were the sole authorities to grant mortgages. The financial industry in the United States was slightly regulated even during the Great Depression of 1929-30. A new law was brought in by the government of the United States regarding regulation after the great depression of 1929-30. A new process of deregulation began in the United States. However, the process of deregulation of financial services and market began in 1979-80. Before the 2007 sub-prime crisis, the United States also faced a recession in 1978. The recession of 1978, also caused difficulties for the U.S. financial institution. Interest rates were very high.

Depository Institution Deregulation and Monetary Control Act, 1980, Garn-st Germain Depositary Institution Act, 1982 and Alternative Mortgage Transaction Parity Act, 1982 were some of the major acts that played an important role liberalizing the financial sector.[3] Saving and Loan Association (SandL) which were created for disbursement of loan-related matters were also faced failure. The new act, named Financial Institution Reform, Recovery and Enforcement Act (FIRREA) had been passed which replaced all previous acts regarding regulation. Fannie Mae and Freddie Mac[4] were given authority to support mortgage lending to lower-income families. The initiative taken by both the firms played an important role in the US subprime crisis in the future.[5] Actually after the great depression of 1929-30 the

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2 Global financial service firm in the United States.

3 Kolb, Robert W. (2011) *"Financial Crisis of our time"* Oxford University Press, London. p. 10-11.

4 a previously privately owned firm sponsored by the federal government to transact in the mortgage market in support of the housing industry

5 Kolb Robert W. (2011) "*The Financial Crisis of Our Time*" Oxford University Press, London, pp. 10, 11, 12.

mortgage finance market saw its boom in the United States. Many financial institutions played an important role in developing the securitization of mortgages.

The above analysis clearly shows that deregulation was not a new phenomenon to the United States. Many agencies were set up to securitize the mortgage. Also in the 1970's, the United States felt the blow of recession. Again in 2001, the economy in the United States experienced a mild recession. Federal funds rate was lowered by Federal Reserve from 6.5 percent to 1.75 percent between 2000 and 2001. All this was done to create a flood of liquidity in the U.S. economy. Deregulated financial markets provided space to banking sector to expand at a massive level and to extend loans and provide mortgages to the least solvent customer. Increase in interest rates made it impossible for subprime mortgages to be repaid. As a result, speculative bubble burst that made significant borrowers defaulted.

Industry related to financial services twice-folded from 4 percent to 8 percent of GDP between 1990 and 2006 in the United States. In 2006, the share of these industry is more than 41 percent of the profits of the US domestic economy. The six largest banks Morgan Chase, J.P. Bank of America, Wells Fargo, Citigroup, Goldman Sachs, and Morgan Stanley has assets worth 65 percent of U.S. GDP.[6]

The subprime crisis was not the overnight phenomena. Actually, it took years to lay the foundations for disaster. During 1993-2004, home prices took surge to reach its maximum limit. Subprime lending rose from $ 65 billion per year to $ 332 billion. There were different types of mortgages provided by financial institutions to homebuyers, some of them were, "piggyback mortgage," 'cash-out mortgage'.[7] While providing loans, lenders provided little attention about the verifiability of their applicants, claims of wealth and income. A combination of various factors over the years up to 2006 resultant into increase to financial fragility of many indebtedness homeowners. By October 2008, the world economy and financial system in the U.S. stood in a grave risk and troublesome in the real estate market as large as they were,

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6 Cafruny, Alan W and Talani, Leila Simona (2013) "*The Crisis of the Eurozone"* in Cafruny, Alan W and Schwartz, Herman M (eds) Exploring the Global Financial Crisis. Viva Books, New Delhi, P. 117.

7 Kolb Robert W. (2011) "*The Financial Crisis of Our Time*" Oxford University Press, London, pp.17.

had come to seen quality small as the world faced an economic disaster with the potential to rival.

Freddie Mac announced in 2007 that it is not interested in buying risky subprime mortgage and related securities. The Mortgage Bankers Association reports that 4.95 percent of all mortgages and 13.3 percent of subprime loads experienced late or missed payments. Bear Stearns announces a problem at two of its hedge funds in a bailout attempt. While seeing the deterioration of its financial institution, Bank of America injected $2 billion into countrywide. Citigroup, Merrill Lynch, Morgan Stanley announced written off down a significant amount of U.S. dollar. In 2008, Lehman Brother holding incorporated files for chapter II bankruptcy protection.[8]

The impact of the crisis cannot be measured in the U.S. alone rather be seen what has been happening in Eurozone economies like Greece, Portugal, Spain, Ireland and Italy. All of the above Eurozone economies also bore the brunt of American financial turmoil. How the American financial crisis spread into Eurozone and how the crisis impacted the major Eurozone economies itself? This is an important and vital question before thinkers as well as research scholars. Here, we would try to find out the causes of the Eurozone crisis and its impact on the whole of the region.

3.3 The Making of the European Monetary Union (EMU)

The launch of the third stage of the Economic and Monetary Union in 1999 brought positive sentiments towards the ever closer union in the Eurozone. However, some doubts were raised regarding the success of EMU design in the near future. Euro was considered an option against the dollar. The subprime crisis erupted in the United State hold its grip across the Atlantic that caused havoc in the Euro area. The first causality felt by European banks that took advantage of financial deregulation, had made mass purchases of US mortgage-backed securities. The banking crisis threw light more on the chronic problem of the design of Euro and the EMU. The contradiction of supranational currency and national fiscal policies further

[8] Kolb, Robert W. (2011) "*The Financial crisis of our time",* Oxford university Press, London, pp. 301-302.

deteriorated the situation. Before we go the analyses of the crisis, it would be worthwhile to through the making of EMU and the Euro.

The monetary history of Europe cannot be traced back with the aftermath of the Second World War. But the early post Second World War period is a natural starting point because that period saw both the lowest point in terms of monetary integration and the beginning of the overall integration process. The period led to the creation of the European Economic Community, the European Monetary System (EMS) and and the European Economic and Monetary Union (EMU).

The Second World War ruined the large part of Europe. The physical destruction overcome after a short period and led the European leaders to think about economic integration. However, there were institutions like International Monetary Fund and World Bank, also called Bretton Woods institution established in 1944, for the smooth running of world trade. For a long time, the Bretton Woods institutions remained irrelevant for many of the signatory members because of another consequence of war, which posed more difficult to overcome than the physical destruction, namely the absence of an international financial system that could form the basis for a revival of multilateral trade.

During the 1940s most trade in Europe were being conducted a sum of through 200 bilateral trade agreements. "*These agreements contained a bilateral line of credit which determined in effects by how much the bilateral current account could deviate from zero since deficits in excess of the specified bilateral credit line had to be settled in gold".*[9]

The first step towards European monetary integration was the creation of **Organization** for **European Economic Cooperation** (OEEC) in 1948. The OEEC was basically an answer to the United States call for cooperative European efforts so that the aid under the Marshal Plan provided by the United States could be better used. The OEEC was created to replace the bilateral payment agreements which were signed among various European nations with the aim to revive international trade.

[9] Gros, Daniel and Thygesen, Niels (1992) "*European Monetary Integration: From the European Monetary System to European Monetary Union",* Longman Group. U.K. p.4.

The second most important agreement in the European Monetary integration was the creation of the **European Payment Union** in September 1950. All the members of OEEC took part in EPU by setting the exchange rate that was deemed to reflect the reality of each nation's economic situation, the European Payment Union made it easy the convertibility of European currencies.

An important part of the EPU agreement was the asymmetry between the settlement terms for debtors and creditor's positions. All creditors' positions above the first, 20 percent tranche were settled with 50 percent gold; for creditor's position exceeding the full quota, the managing board of EPU had to propose special settlement terms.[10] EPU helped to secure the stability of exchange rates and also promoted free trade among member nations. But EPU fell victim to different types of problems of member states. Price fluctuation and the convertibility of European currencies between issuing banks were some of the reasons behind the EPU failure. At last, EPU dissolved in 1958 and participating countries made their currencies convertible. EPU was replaced by the European Monetary Agreement (EMA). The primary function of the EMA was to provide financial safety to participating countries.

In the Hague summit which was concluded in 1969, European leaders reaffirmed to move forward for an Economic and Monetary Union. A group of experts under the chairmanship of **Pierre Werner** was constituted. The committee produced its report in 1970. How EMU could be attained by 1980. The Monetary Union would consist, total and irreversible convertibility of currencies, to eliminate of fluctuation in exchange rate, full liberation of movements of capital. However, the Werner report was never endorsed at the political level.

A step forward to establish EMU was in 1978 when the European Monetary System was negotiated and fructified in 1979. In 1979 the United States after the abandoning of gold parity and the sudden introduction of a system of generalized floating exchange rate, in fact, led the establishment of decade of international financial instability, with the large exchange rate depreciation as a salient feature, the widespread use of trade restriction and capital controls as well as retaliatory increase

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[10] Ibid, p. 6

in oil and commodity prices. "*The impact of destabilizing dollar on European currencies was particularly disruptive. The EMS was established with the aim of limiting the oscillation of the exchange rate of member countries through a mechanism of coordinated exchange market intervention"*.[11]

The EMS established an Exchange Rate Mechanism (ERM) and a European Currency Unit (ECU) based on a basket of currencies. The ERM rule fixed that currency could not fluctuate ± 2.25 percent as agreed parity. EMS was successful in its mission to create macroeconomic convergence in the 1980s. The EMS can be considered an important tool providing a stable framework for a coordinated response to outside shocks which include fluctuations in the US dollar and in oil price. The European Monetary System was, no doubt, originally designed to be as symmetric as possible.

There were some other important developments in the 1980s that helped to relaunch the European Monitory Union's process. The creation of the Single European Act (SEA) in 1986 strengthen the organ and structure of the EU and decided to establish a Single European Market by 1992.

Article 102(a) of the Single European Act was about cooperation in economic and monetary policy. The act mentions 'Economic and Monetary Union' for the first time but in a bracket. Despite the fact that EMU was on agenda the member states were reluctant for treaty-based commitment. The SEA stated. *"In order to engage the convergence of economic and monetary policies which is necessary for the further development of the community, member states shall cooperate....*" Article 102(a) mentions.[12]

3.4 The Delors Committee Report

The government of France had been active at the ECOFIN meeting the decision on January 1987 realignment in strengthening of the European monetary system. Before

[11] Saccomanni, Fabrizio (2015) "*Prof. Mundell and the Unpredictable Euro crisis The International Spectator"*, vol. 50, No. 4, December 2015. Pp. 251-255.

[12] Laursen, Finn (2013) *"The Eurozone crisis and other Policy Challenges in the EU*", in Laursen, Finn (ed) The EU and the Eurozone Crisis, Policy Challenges and Strategic Choices. Ashgate, United Kingdom,. P.9.

setting up the Delors Committee on EMU, efforts were also made for an EMU in Europe Former chancellor Helmut Schmidt and former president Valery Giscard d Estains set up a committee in 1986 for an EMU. The committee published its report in 1988. The committee also hinted out the creation of the Association for Monetary Union in Europe (AMUE).

Hanover summit meeting was held in June 1988. In the meeting, it was agreed to form a committee under the commission's president **Jacques Delors** to look or study the steps needed to achieve the EMU within the time framework. The committee consists of President Delors, twelve governors of the EC's national central bank, one additional member of the EC Commission, three independent persons. In April 1989, the committee produced its report and in 1989's Madrid summit, the report was accepted. There were many similarities between the Werner Report and Delors Report regarding the liberalizing of capital market and centralization of monetary policy.

Monetary Union was defined as a 'currency area' in which policies are to be operated jointly to achieve common macro-economic objectives. (1) total and irreversible convertibility of currencies (2) the complete liberalization of capital market. (3) The irrevocable locking of exchange rate parities. These were the three main conditions to be fulfilled in order to achieve macro-economic objectives. It would be possible only if there is a single currency. The report emphasized on a common monetary policy with a new institution to implement it that would be a European System of Central Banks (ESCB). The task of the ESCB would be to govern national central banks whose functions would gradually cease as monetary union developed.[13]

For the attainment of the Economic and Monetary Union, the Delors Committee established a formal timeline. EMU was to be achieved through three stages. The First stage would start from 1 July 1990 in which the members of EMS were to abolish all existing capital controls on the movement of capital across borders. The members who did not join the ERM, expected to join within the limit, United Kingdom joined of the ERM 1990. However, in 1992, the PM John Major decided to leave the ERM. Spain and Portugal too joined. In 1992, changes were made in the Rome treaty and a

[13] Goodman, S.F. (1996) "*The European Union",* Macmillan, United Kingdom, P. 208

new treaty called, Maastricht treaty came into force in 1993. The **Second** stage was launched on January 1, 1994. In this stage, the European Monetary Institute (EMI) was set up. The EMI established a cohesive regime of Central Bank coordination. The third stage depended on progress made by member states. The final stage was scheduled to begin in 1996 only after the above condition was fulfilled. Due to currency turmoil, the third stage could not be started and re-scheduled on January 1, 1999.

3.5 The Maastricht Treaty, Convergence Criteria and the Starting of Second Stage of EMU (European Monetary Union)

The European Council agreed in Strasbourg on December 9 to call an Intergovernmental Conference at the end of 1990 to revise the Rome treaty, despite UK opposition. The revision of the treaty is likely to be based on the route to European Monetary Union described in stages two and three of the Delors report. The revision of the treaty consists that the European System of Central Banks (ESCB) would be set up in stage 2. National Central Banks would remain accountable at national level under the constitutional arrangement. Alongside national central banks, a European Monitory Fund (EMF) would be established. There were three main functions of the EMF;

(a) to set a European standard for member countries,

(b) to issue ECU as a dual currency on the European standard, in substitution for the national currencies of member countries on demand,

(c) *To take over the administration of the EMS, including the EMS, the committee of Central Bank Governors, the EMCF and the permanent secretariat*.[14]

On the recommendation of the Intergovernmental Conference, the Maastricht Treaty was signed in 1992 and come into force in November 1993. The **Convergence**

[14] Dyson, Kenneth and Quaglia, Lucia (eds, 2010) "*European Economic Governance and Polities: Commentary on key Historical and Institutional Documents*", Oxford University Press. London, Pp. 413, 415.

Criteria ensure that member countries ready to adopt the Euro had to fulfill the following conditions:

- *the average of the inflation rate of three best performing state will be benchmark for the member state and they have to keep the inflation rate below that 1.5 % of the average inflation rate*
- *the government debt should be below than 60% of the GDP,*
- *the government deficit should be below than 3 percent of the GDP,*
- *The nominal long term interest rate may be less than 2 percent of the average of the three best performing member states in terms of price stability.*
- *Observance of normal fluctuation margins in the European Exchange Rate Mechanism (ERM), without devaluation for at least two years*.[15]

Article 104(C) of the treaty mentioned that the fiscal criteria were subject to a number of discretion. When a country's public debt shows a diminishing tendency and inching towards the reference value, then the excess was disregarded. Criteria as laid down in the Maastricht Treaty was fulfilled only by the France and Luxembourg.

The reunification of Germany caused a rising fiscal deficits and inflationary upsurge. Spain and the United Kingdom joined the EMS in 1990 amid this upsurge. From the very beginning of the Delors plan, there could be three major categories of countries to be identified. The first group comprises, the core countries, whose margins of exchange rate fluctuation was 2.25 percent, which had exhibited the lowest rate of inflation. The second group comprises countries like the United Kingdom, Italy, Spain and Ireland which had high inflation or high public debt. The third group comprises countries like Greece and Portugal which were less industrialized and outside the ERM. In this extreme economically diverse situation between individual countries, a "two speed", Europe evolved with the northern industrial core countries of Germany,

15 Laursen, Finn (2013) "*The Eurozone Crisis and other Policy challenges in the EU"* in Laursen, Finn (ed) The EU and the Eurozone crisis: Policy Challenges and Strategic choices. Ashgate Publishing Limited, England, p. 10.

the Netherlands, France and the former EFTA countries. On the other side, there were countries like Pourtgal, Spain, Greece, Italy, and Ireland with high budgetary deficits.[16]

During Stage 2 the members have started the process to establish a European Monetary Institute. The mentioned that the Single currency will not be the present 'basket' ECU (European Currency Unit) but it would be a new currency. The European Monetary Institute shall be established in accordance with Article 109 (f) of the 'Treaty' on European Union (Maastricht Treaty). All the central banks shall be the members of the EMI. The main tasks of the EMI is:

- to strengthen cooperation between national central banks.
- to maintain the price stability of member states,
- to monitor the functioning of the European Monetary System,
- to oversee the development of ECU.

3.6 The Third/Final Stage

In December 1995, the Madrid European Council was an important step towards the final journey of EMU. It had been decided by the heads of the state and governments that the final stage of EMU to be started/begin on 1 January 1999. However, the final stage was to depend on progress achieved by member states in conforming to the convergence criteria. The final stage was scheduled to begin in 1997. It was re-scheduled on 1 January 1999. The decision to abandon the 1997 date had already been at European council meeting in Cannes in 1995 on the initiative of the new French government Under President **Chirac**. Accession of member countries into EMU.

[16] Lucarelli, Bill (2013) "*Endgame for the Euro: A critical History*". Palgrave Macmillan, London, p. 91.

Table No. 1.5
Countries in Eurozone

Country	Date of Accession
Belgium, Austria, Finland, France, Luxembourg, Ireland, Italy, Netherlands, Portugal, Spain, Germany	1 January 1999
Greece	1 January 2001
Slovenia	1 January 2007
Cyprus, Malta	1 January 2008
Slovakia	1 January 2009
Estonia	1 January 2011
Latvia	1 January 2014
Lithuania	1 January 2015

3.7 Creation of the Single Currency the 'EURO'

During the launch of the third and final stage of the EMU, it was agreed that the name of the single currency would be "Euro".

The decision of the name 'Euro' was taken for symbolic and political reasons. The policymakers of France supported the use of ECU, which is also the name of a historic French coin (e'cu). But German policy markers opposed the name ECU, which was also evocative of the instability of ERM, especially after the exchange rate crisis of 1992-93. The ECU was also devalued against D-mark by 40 percent. So the new name 'Euro' was accepted and French were isolated. The meeting of ECOFIN in Verona in the year 1996 decided that 100th part of euro would be named the 'cent' and the euro coins would bear the national symbol on one side and one or more European themes on the other. "*The € is inspired by the Greek epsilon pointing back to the cradle of European civilization and the first letter of Europe, crossed by two parallel lines to indicate the stability of the Euro. The early definition of a distinctive symbol for the Euro also reflects the vocation of the Euro to become one of the world's major currencies*".[17]

[17] Dyson, Kenneth and Quaglia, Lucia (eds, 2010) "*European Economic Governance and Policies : Commentary on the Key Historical and Institutional Documents"*. Oxford University Press. New York. Pp. 510, 511 and 556.

The European council's meeting was held at Brussels in 1998, in which heads of the state took part, and it was decided that eleven out of fifteen member states would take part in the third stage of EMU. United Kingdom and Denmark stayed away. Greece and Sweden were not fulfilling the convergence criteria. Greece joined enter in 2002. Slovenia joined the EMU in 2007, and two Baltic states, Estonia in 2011, Latvia in 2014 and Lithuania in 2015. Till the date, the Eurozone comprises of 19 member states.[18] Andora, Monaco, San Marino, and Vatican City have an agreement with the European Union to use the euro, and they issue their coins.

3.8 The Stability and Growth Pact (SGP)

The countries which joined the European Monetary Union once have to follow some rules. The rules have been elaborated in Stability and Growth Pact. The SGP was known as a major building block of the EMU. The country once in EMU could not be freeriding. Member states have to maintain their debt and budgetary rules. But if a member state in EMU violates these rules, he could be penalized.

The SGP has its two arms called 'preventive arm' and 'corrective arm'. The preventive arm is related to strengthening surveillance of budgetary position and coordination of economic policies, whereas corrective arm is related to speeding up and streamlining the implementation of the excessive deficit procedure of the treaty. The main purpose of Stability and Growth Pact is to maintain fiscal discipline within EMU. A member country has to comply with tight budgetary disciple, deficit-to-GDP (Gross Domestic Product), and debt-to-GDP ratio, which should not exceed a reference value of 3 percent and 60 percent, respectively.[19]

However, since the inception of SGP, it has been criticized on certain levels. It has been argued that bigger economies like Germany and France never obeyed SGP criteria. For example, in the year 2002, Germany and France were failed to adjust their budgetary deficits. According to SGP rules, they should have been punished. But

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[18] Austria, , Estonia, Finland, France, Belgium, Cyprus, Ireland, Italy, Latvia, Malta, Netherlands, Germany, Greece Portugal, Slovakia, Slovenia, Lithunia, Luxembourg, and Spain.

[19] Steinbach, Armin (2014) "*Economic Policy Coordination in the Euro Area*", Routledge. New York. P. 60-61.

it did not happen. In the meeting of Council of Economic and Financial Affairs Ministers (ECOFIN) the move was defeated. In these circumstances, SGP was revised in 2005.

The new and revised SGP was more flexible than his predecessor and in this Fiscal sustainability was given more importance. The medium-term budgetary objective of a country is based on its debt ratio and high potential growth. It can be understood in this way. Countries that have low debt and high potential growth can run a small deficit over the medium term. On the other hand, counties that have high debt and low potential growth should have a surplus or balanced budget. The preventive arm was also strengthened and corrective arm was also adjusted by allowing more room for economic judgments.[20]

3.9 ECOFIN

Economic and Financial Affairs Council is responsible for economic policy, regulation of financial services, and taxation in the European Union. ECOFIN is composed of all finance ministers of member of states. ECOFIN also prepares the EU's annual budget. The council sees all the aspects of the single currency, the Euro. From time to time, it inspects the smooth running's of the Euro and inspects its feasibility as a global currency.

3.10 Euro group

It consists of the finance ministers of the Eurozone countries. The group is referred to as 'Eurogroup.' The group has its president, who is elected by the Eurogroup members for the term of two and half years. Close coordination of economic policies of the euro area member states is the prime task of Eurogroup.

[20] Verdun, Amy (2013) *"Economic and Monetary Union"* in Cini, Michelle and Borragan, Nieves Perez-Solorzano (eds) European Union Politics. Oxford University Press. United Kingdom. P. 303.

3.11 Eurozone Crisis

In the history of European Union (EU) the ongoing Euro crisis is the most perilous and has political and economic repercussions. The European Union is undergoing a turbulent phase especially the member states who have adopted the single currency 'the Euro'. The European governments seem unable to deal with the crisis. After the crisis that broke out in 2008 and reached on the peak in 2009, the economic activities seems very slow. The single currency, introduced after a number of marathon meetings and projected as an alternate of 'the Dollar,' is under threat of its survival. The growth rate in the Euro area is still below expectations. Crisis can cause lasting damage to its economies. The political consequences have also been intense. During the crisis, Greek people elected its new government under **Alexis Tsipras.** Franco-German alliance has also been weakened by the crisis. The future of European integration and European Monetary Integration brought into question. The origin of the crisis lies in the financial sector but it threatened to spill over into the real economy. The crisis has different interpretations by academia and economists.

3.12 Origin of the Crisis

The financial crisis which started from the United States in the wake of the subprime loans hold the grip over Europe as European banks have also invested in the United States in the mortgage market. The problem which started in the European area in 2008 reached its optimum level in 2009. Between 2004-2006 the total investment of European banks in the United States was around two trillion dollars. Not all but a large amount of this money went into the housing market. When the assets bubble was busted in the United States after the insolvency of Lehman Brother[21] it came to know that European banks were also in danger. The first sign of trouble came from the French firm BNP Paribas[22] in which after a press release, the firm discontinued its trading in the United States due to subprime crisis. The assets of the firm in the US were in stress. Within weeks it was clear that several European banks were irreparably damaged by the disaster in the United States. The funds that were used by European

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[21] Global Financial Service firm in the United States.
[22] BNP Paribas is a French international banking group.

banks had been invested in securities in the US, which created a shadow banking system in the US.

The concomitant recession in Europe led to a sudden rise in fiscal deficit. The peripheral economies of the Eurozone were most exposed to these external shocks in which Greece emerged as the perceived weakest link. Other Eurozone members like Portugal, Ireland, Italy, and Spain were also in the grip of the crisis. The prime reason for the crisis in Southern economies of the Euro area was exceeding the Debt-GDP ratio. The increasing public debt in these Southern economies during the crisis is one of the main issues that needs to be addressed. Among the Eurozone economies, Ireland and Spain were the countries that had a very low level of public debt 24 percent and 36 percent of GDP level of public debt 24 percent and 36 percent of GDP respectively when the crisis began. In these countries especially, in Portugal and Spain Household indebtedness rose sharply. The low borrowing cost increased the private indebtedness, which came with the single currency, "the Euro." However, this is just one reason that can be held responsible for the disaster.

The debt crisis which broke out in Ireland, Greece, and Portugal has wider ramification in the European financial market and thus causing drastic fluctuation in the stock market and foreign exchange market. Eurozone's third and fourth-largest economies, Italy and Spain, respectively, saw interest rates shoot up and surging risks of their national debts. All that was enough to cause more panic in the market. The credit rating of nine Eurozone members was downgraded by international rating agencies among them France and Austria also share the stage. The Spanish case came on the scene that exposed the vulnerability of its banks. There are many analyses of the causes of the European financial crisis. But before we discuss different dimensions of the crisis, we would like to discuss some of the case studies of crisis in different Eurozone countries.

3.13 GREECE

Greece is the worst affected country in Eurozone owing to the financial crisis. The crisis has crippled the Greek economy; unemployment was at its peak level; social welfare schemes almost came to an end; the government had to cut wages.

The Troika[23] had to come out to rescue the ailing Greek economy with a bailout package. But the bailout package came with hard austerity measures, with reducing its current account deficit and budget cut on welfare schemes. Greek government's gross debt, which was 109.4 percent of GDP in 2008, reached 126.7 percent in 2009. Subsequently, it further rose in 2011 of 172.1 percent of GDP. So the condition of the Greek economy was deteriorating. The expenditure was far more than revenue. Greek economy was not in the condition that it could support government debt.

Table No. 1.6
Greece General Government Gross Debt Percent of GDP 2008-2016

Year	Debt Percent of GDP
2008	109.4
2009	126.7
2010	146.2
2011	172.1
2012	159.6
2013	177.4
2014	179.7
2015	177.4
2016	179

It was not the first time when Greece defaulted its sovereign debt. Regarding indebtedness and repayment, it had been a negative record. From 1844 to 1913, Greece defaulted a number of times. Greece's participation in the world trade was approximately 0.18 percent Industry, and education faced backwardness. Greece imported all durable goods. It is right between the period 1950 and 1980, GDP

[23] Troika consists, the European Central Bank, European Commission and the International Monetary Fund.

increase 4.5 fold, but the country was not able to develop modern industry. The primary source of income was broadly tourism and shipping.

During 1979 the fixed capital formation reached 32 percent, but subsequently, it declined to 21 percent when the country joined the European Union in 1981. In the same year, its income level amounted to 64.4 percent of EU-9 [24] countries average. In the 1980's Greece felt a slow growth rate of 1.6 percent per annum while between 1994 and 2007, its annual growth rate was 4 percent. By 2008 per capita income of the country totaled 94.8 percent of the EU-27[25]. But after that growth, budget deficit and public debt increased in Greece. Country's budget deficit was only 2 percent before the joining of the European Union, but it reached 16 percent by the 1990s. Public debt rose from 22 percent to 100 percent during the period 1979 and 1990's.[26] The reason was excessive government borrowing.

Greece joined the European Monetary Union on 1 January 2001. Between 2001 and 2009 it appeared that Greece going well according to Maastricht criteria. It is perceived as a disciplined member of the Eurozone. But in October 2009, the new Prime Minister of Greece, George Papandreou announced that Greece is exceeding its budget deficit. It is much higher than announced by the previous government.

The whole Greek incident spread uncertainty around the Eurozone. The contagion spread quickly to other Eurozone members. The previous government in Greece misled not only the country but the whole European Union. It was clear that Greece was insolvent.

There were specific reasons behind the Greek tragedy [27] Greece hosted the 2009 Olympic games. Before that event, the Greek application for hosting Olympic games had been rejected. But Greece won the bid for 2004 games. Greece spent enormously on the preparation for the games. New stadium, an Olympic village, and several sport complexes were made for the event. The original budget for the preparation was € 2.5 billion. But it was increased to € 4.6 billion. For transportation € 1.3 billion and for

[24] At that time EU consists nine members
[25] In 2008, there were twenty seven countries in the European Union.
[26] Berend, Ivan T (2013) "*Europe in Crisis : Bolt from the blue?*" Routledge New York, p. 19-20.
[27] Not limited to that.

Olympic village € 600 million were sanctioned. Total 4 percent of the GDP consumed in the event. The expenses were going up with the passing of the event. Most of the costs were covered by the foreign loan. No doubt, the Olympic games gave credit to Athens for organizing such a gigantic event successfully but the economy was telling another story. The budget deficit reached 4 percent beyond the eurozone limit of 3 percent[28]. The cost of hosting the games for out-weighed the benefits. The total loss from the Olympics were from $ 15 billion to $ 20 billion.

The Greek government's policy of keeping the voters happy and liberal welfare policies creates an inefficient and protectionist economy. Every year the salaries of workers went up automatically. The good criteria to rose salaries may be the performance and productivity. But this fact had been ignored in Greece. A large part of Greece relied on pensions. No country in the European Union spends so much on a pension. Greece spends 17.5 percent[29] of its GDP on disbursing pension.

Another factor that can be held responsible was rampant corruption and tax evasion. A study finds that the average income of a Greek person was approximately 92 percent higher than they reported to the government finance department. However, it is also true that honest taxpayers who were timely paying their taxes were penalized by paying higher taxes on their income they voluntarily declared. In the year 2008, half of the deficit was due to tax evasion budget was in poor condition.

The private banking system in Greece had failed. Before the crisis, the balance sheets of banks increased. In December 1999, it was € 181 bn, but in June 2010 it reached € 544 bn. Much of the lending was of poor quality. Non-performing loans increased in the course of the recession, reaching something € 80bn in 2014. It is an estimate that Greek banks had the highest ratio of non-performing loans in the world around 31.3 percent.[30] The size of the Greek banking system falls steadily during the crisis. It

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28 Berend, Ivan T. (2013) "*Europe in Crisis? Bolt from the blue"?* Routledge New York, p. 14.

29 Nardelli, Alberto (2015) "*Unsustainable Futures. The Greek Pensions Dillema explained*". The Guardian. 15 June 2015. https://www.google.com/amp/s/amp.the guardian.com/business /2015/unsustainable-futures-greece-Pensions-dillema-explained-financial-crisis-default-eurozone.

30 Flassbeck, Heiner and Lapavitsas, Costas (2015) "*Against the Troika : Crisis and Austerity in the Eurozone*". Verso. London. p. 105, 107.

appears that Greek banks are carrying a considerable proportion of non-performing loans. These were the sign of failure of the banking system.

Sovereign states always have an option at times of crisis that they can devalue their currency to boost exports, Since, Greece is a member of the European Monetary Union, it cannot manage its own monetary policy. It is a matter that lies in European Central Bank and Eurogroup. Greece could have taken advantage by devaluing its currency, but it could not do.

The credit rating of Greece deteriorated as two credit rating agencies Moody's and Standard and Poor's placed Greek debt on 'negative watch' and lowered its credit rating. That spread a wave of fear among investors and raised the cost of future loans.

In 2010 European Commission inspected the Greek budget to restore confidence in the figures. The meeting of the European Commission was held in Brussels. The eyes were on Germany, the biggest economy of the Euro-area. Angela Merkel was reluctant to provide any bailout package to Greece. However, after a tough negotiation, it was agreed that Greece would be bailed out. EC, ECB, and IMF came forward to rescue Athens. A bailout package was approved for Greece.

3.14 SPAIN

From 2006, the economy of Spain shows the sign of depletion. Before 2006 the economy was at its peak. The deterioration of the international macroeconomic context also highlighted the vulnerability of Spain's economy. The high dependence on constructions and real estate sector proved fatal. During 2007-08 there was slowdown in Spain, and in 2009 the economy was in recession. The most significant blow of the crisis was on employment. The unemployment rose exponentially. GDP Fell 6.3 percent. However, with the output slightly increased to 0.6 percent in 2010, the economy shows the sign of recovery.

Spain was regarded as one of the great European success stories of the second half of the twentieth century. Spain surpassed its difficult time of dictatorship and entered a new era of democracy after the death of Francisco Franco[31] After that, Spain joined the European Union in 1986. Joining the bloc meant enormous opportunities for Spain. The economy became more liberal, making Spain the fifth largest economy in Europe, four-time more significant Greece, and six times the size of Ireland.

Spain became a member of the Eurozone on 1 January 1999. Before the adoption of the Euro, Spanish currency was called 'Peseta.' In the period between 2000-07, the real GDP growth in Spain was 34.5 percent in cumulative terms. The annual growth rate was 3.8 percent. Due to this high growth rate, the employment opportunities in Spain rose by 12.2 percent during the same period. Joining the European Monetary Union meant the interest rate fell considerably. All the scenarios led to high growth in the housing sector.

The real estate sector was mostly financed by public and private sector banks. The growth in the real estate sector was 20 percent; it reached 25 percent in 2005. The construction sector also reported a growth of 5 percent. The house prices also increased by 135 percent in the period 2000-07. The 2007-08 global financial crisis has exposed the serious structural vulnerability of the Spanish economy. When the crisis hit the peripheral economies of the Eurozone, including Spain, it was clear that the path they were going on was not stable. Spanish real estate boom, which was on its peak at a time, fell sharply. Banks were not able to lend money to creditors.

Spain's banking sector was among the healthiest in the world. Before the onset of the crisis, Spain's Debt to GDP ratio was lower in comparison to Greece and Ireland. But the slash in prices of houses deteriorate the balance sheets of bank.[32] In Spain, there are two types of banks, traditional banks and savings banks. Saving banks, also known as ***Cajas. Cajas*** played an essential role in the Spanish banking industry.

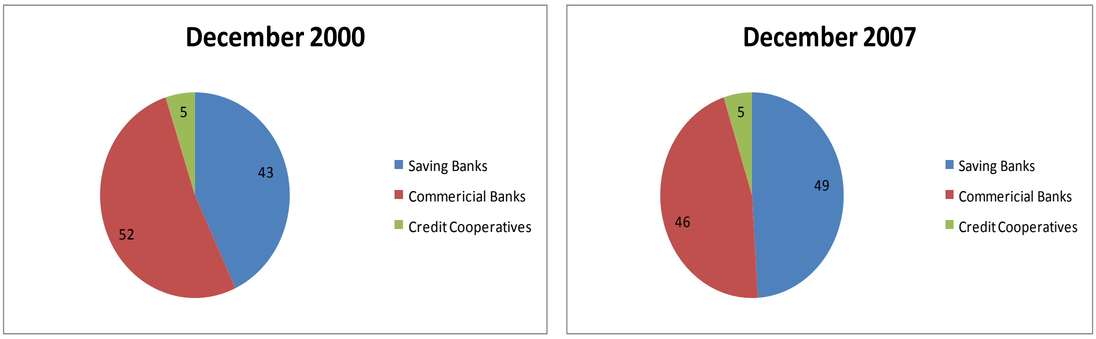
Due to their low borrowing rates, *Cajas* provided 46 percent of loans of total banking sector. Between 2000-07, lending by Cajas rose 266 percent compared to other banks.

[31] A General as well as a dictator who ruled over Spain From 1939 to 1975. The emergence of Franco in the power due to Spanish civil war after that he took control over Spain. All the opponents in politics were oppressed by Franco. He quelled the culture & language of Spain's Basque and Catalan province/Region.

[32] Bergareche, Borja (2011) "*The Pain in Spain*" World Policy Journal. Duke University Press. United States. Volume XXVIII, No. 1, Spring 2011, p. 53.

Out of full credit, 49 percent [33] was accounted for by cajas/saving banks in comparison to other banks, which accounted for 46 percent in the year 2007.

Figure No. 2.1
Distribution of lending by type of institution as a percentage



Source: Bank of Spain (Banco de Espana) (www.bde.es/f/webbde/secciones/)

Since 2008 the housing prices began to fell. By 2010 it reached 10 percent. The investment in new houses decreased. The construction sector, which had provided most jobs or employment, came to a halt. This caused considerable losses to Spanish banks that had lent mortgages, and they funded most of the construction sector. Banks were now in huge losses. In 2010 the Spanish economy shrank 0.3 percent. The Debt to GDP ratio, which was 35.60 percent in 2007, rose to 60.10 percent in 2010. Further, it was 100.40 percent in 2014. In 2017 it was almost 98.10 percent of the GDP.

[33] https://www.bde.es/bde/en/secciones/informes/otras_publicacio/informe-sobre-la/

Table No. 1.7
SPAIN: Evolution of debt

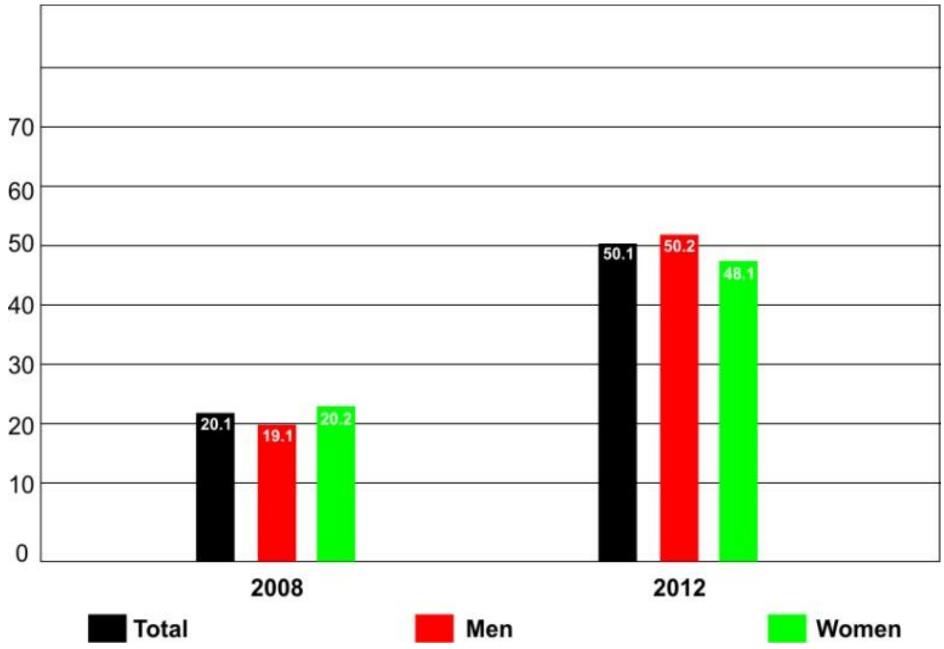
Year	Debt (Percentage of GDP)	Debt per capita ($)
2017	98.10	27708
2016	99.00	26341
2015	99.30	25657
2014	100.40	29791
2013	95.50	27933
2012	85.70	24491
2011	69.50	22107
2010	60.10	18444
2009	52.80	17063
2008	39.50	13988
2007	35.60	11518
2006	38.90	10995
2005	42.30	11123
2004	45.30	11201
2003	47.60	10177
2002	51.30	8684
2001	54.20	8269
2000	58.00	8507

Source: .www.countryeconomy.com

The most terrible impact of the crisis was on employment. The unemployment rate hit an all-time high at 20.1 percent in 2010. The worst affected class were the youngsters between the age group of sixteen to twenty-five years among them the unemployment rose to fifty-one percent in 2012. In 2008 total unemployment between the age group of sixteen to twenty-five years was 20.1 percent, among them 19.1 percent men and 20.2 percent women were unemployed. In 2012 the unemployment was at its peak level, which rose to 50.1 percent.

Figure No. 2.2

Unemployment in Spain



Source: ec.europa.eu/eurostate/statistics

During 1973 when Europe was also faced with economic crisis, the unemployment in Spain reaches 18.1 percent, where between 1976-1980, the total number of unemployed people increased by 923,000.[34]

In 2012, the International Monetary Fund released its report regarding Spain's financial woes and suggested that the Spanish banking sector needed immediate assistance. Spanish government asked the European Union for the recapitalization of the banking sector. The European Union agreed to lend funds to Madrid to its insolvent banks. A bailout package was also approved for Madrid. "*€ 100 billion financial assistance was granted to Spain in 2012. The government of Spain also took measures to improve the fiscal condition of the country. Social spending was reduced. Wages were cut by five percent. Pension reforms were introduced that were based on*

[34] Aldasoro, Miguel De (1982) "*Spain at the Gates of Europe in* Dahrendorf, Ralf (ed) Europe's Economy in Crisis", Weidenfeld and Nicolson. London. p, 163.

Toledo Pack". [35] The retirement age increased to 67 years. Now the automatic increase in pension would came to an end.

3.15 PORTUGAL

In 2009, the Portuguese economy faced a slump. Along with other Euro area member, Portugal was also in recession with high unemployment, falling GDP, high bond yields, and increasing government debt. Global recession, the lack of competitiveness were some of the reasons for the slowing down the economy. The global recession that started in the United States had also affected the Euro area. European governments took measures to slow down the impact on the domestic level. It was the European Central Bank who played the lead role in easing the crisis.

Portugal joined the European Community in 1986. The years it joined the community marked a significant progress. Then on 1 January 1999, Portugal admitted to the Euro area. Actually, in Portugal, there was no housing boom like Spain and no political instability like in Italy. Then what had happened?

From 2000 onwards, there was an increase in capital inflows in many European countries, but in Portugal, it brought a slump. The economic downturn was due to different reasons. In the country, the underdeveloped credit market caused foreign capital to go to the non-tradable sector, such as services. This may be causing productivity to fall and the real exchange rate to appreciate, taking resources away from the tradable sector, such as manufacturing. Despite the increase, the unemployment in the country labor costs have only started falling only four to six percent.[36]

The economy of Portugal was also in trouble before beginning of the crisis. Being part of the Euro area meant low-interest rates. Low-interest rates fueled an economic

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[35] Approved in 1995, the Toledo Pack brought reform to Spanish social security system. The Main aim was to streamline & guarantee to the social security system. In 1997, a pension reform act was enacted by the Spanish government. The act was based on Toledo Pack to reform pension and insurance sector. Toledo, a world heritage, is in Spain.

[36] Reis, Ricardo (2013) "*The Portuguese. Slump and Crash and the Euro Crisis".* http://www.google.com/amp/s/www.brookings.eds/bpea-articles/the-portuguese-slump-and-crash-and-the-euro-crisis/amp.

expansion in Portugal. An increase in demand pushed wages high in comparison of productivity level. That brought loss at competitiveness.

The low value of saving is another reason that increased Portugal's external current account disequilibrium. From 1990-2008 only Ireland was the country that maintained its reasonable amount of conservation. The lack of saving widen the gap of the Portuguese economy and affect its competitiveness and further growth of the economy. The share of Portugal's exports shrunk, mainly its stock of goods.

In Portugal, the public sector, as well as private sector debt, was high before the beginning of the crisis as the condition of the economy was weak. All the prime factors led the economy into a deep recession and the growth rate is very low. Per capita GDP grow only by five percent during 2000-2008.

Some of the sectors of the economy, such as apparel and footwear, faced challenges/competition from China. The Portuguese government had invested heavily in infrastructure but on the other hand, it failed to improve the skill of the needy population i.e., the youth population. In 2008, its current account deficit touched 12.6 percent of GDP. Similarly, public debt was also not as high as other Euro areas member states, but it was above the criteria laid down by the Maastricht Treaty. When the country entered the Eurozone, its real Effective Exchange Rate (REER)[37] was over valued. The structural problems in Portugal worsen the exchanger, and the unemployment rate rose to 15.4 percent in 2012.

The Debt-GDP ratio, which was 76 percent in 2009, rose 100 percent in 2010-2011 and 112 percent in 2012. The following figure presents the picture of the public debt ratio of Portugal between 2005 to 2014.[38]

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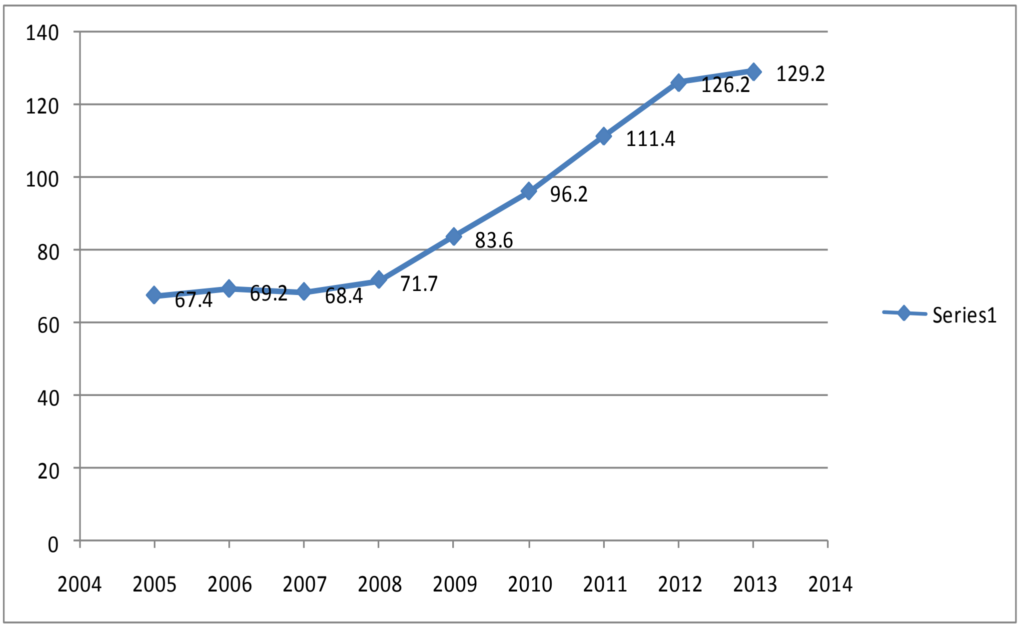
37 It is the weighted average of country's currency against several foreign currencies. Increase in REER means export becomes more expensive and import become cheaper.

38 Berend, Ivan T (2013) "*Europe In Crisis: Bolt from the blue"* Routledge. New York p. 31.

Figure No. 2.3

Portugal Public Debt Ratio



Source: *oecd.org*

Portuguese economic condition was deteriorating day by day. In May 2011, Troika (The European Commission, The European Central Bank, and The International Monetary Fund) approved € 78 billion worth bailout package for Portugal. Also, in May 2011, a memorandum of understanding signed between the Portuguese government and Troika. The MOU means that the Portuguese government would have to choose austerity oriented economic program.

The crisis hit all sectors in Portugal, ranging from construction, economic, employment, and social industry. In Portugal, the unemployment rate increased by 8.3 percentage points between 2007 Q4 and 2012 Q4, reaching 16.7 percent.[39]

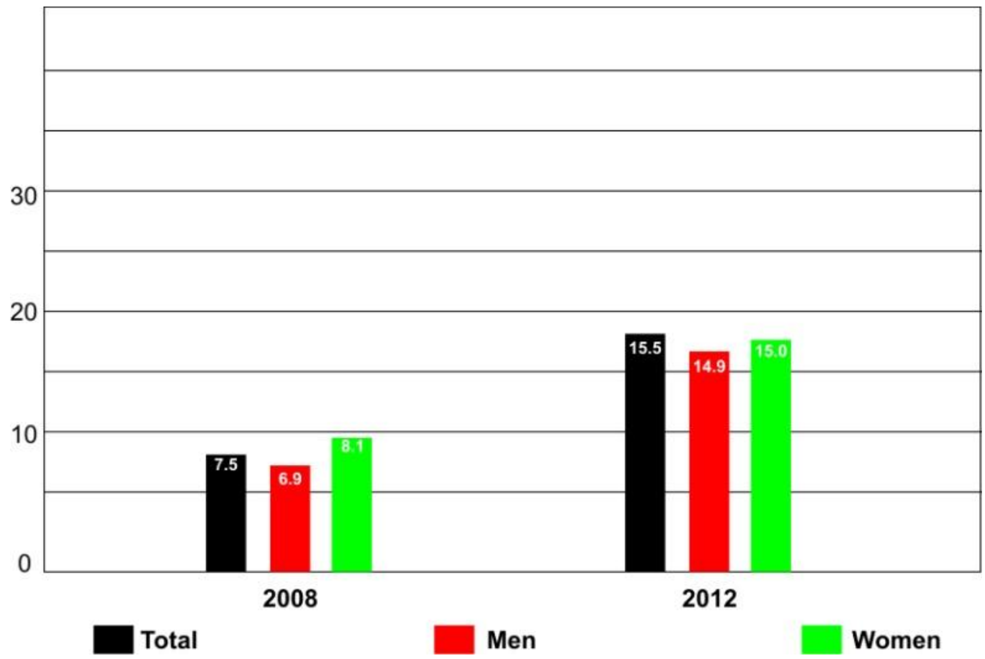
Portugal was under the strict condition of austerity that why wage cut was necessary. However, on the impact of austerity, some other reports suggest that unemployment in 2012 was 15 percent. In the given figure we can quickly assess that in comparison to 2008 the unemployment rate in 2012 was very much high. In the same year, it was

[39] Bank of Portugal (Banco de Portugal) (2016) Output and Unemployment, Portugal 2000-2012. Working paper. http://bportugal.pt/paper/output-and-unemployment/pdf.

almost 15 percent. The most affected segment of society due to unemployment was the young generation, as was in Spain, where it was 37.5 percent. Youth with lower education level particularly were hit hard. Due to austerity measures, the Portuguese government had to reduce expenditure on social benefits resulting in budget cuts on education. However, in the European Union, it was quite clear unemployment was due to austerity policies.

Figure No. 2.4

Unemployment rate in Portugal 2008 and 2012 (Percentage)[40]



The impact on social sector schemes such as pension also felt the blow of austerity policy. Before the crisis, every country in Europe spend a high volume of its GDP on pensions. But after or during the crisis, the governments had to curtail the budget on such schemes. New pension reforms were brought in. Two additional pension payments were cut by the government that meant almost a 15 percent reduction in all pension.

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40 Busch, Klous, Hermann, Christoph; Hinrichs, Karl, Schul Ten; Thorsten (eds.2013) "*Euro crisis, Austerity Policy and the European Social Mode"l*. Friedrich-Ebert-stiftung. International Policy-Berlin. http://www.library.fes.de/pdf-file/id/ipa.

In the recent decade, Portugal had increased the budget on healthcare to feed its universal national health services. The beginning of the crisis led the government to cut funds for this sector. It is estimated that total expenditure on healthcare would fall one percent of the GDP. The austerity also pushed the Portuguese government for the privatization of many state assets.

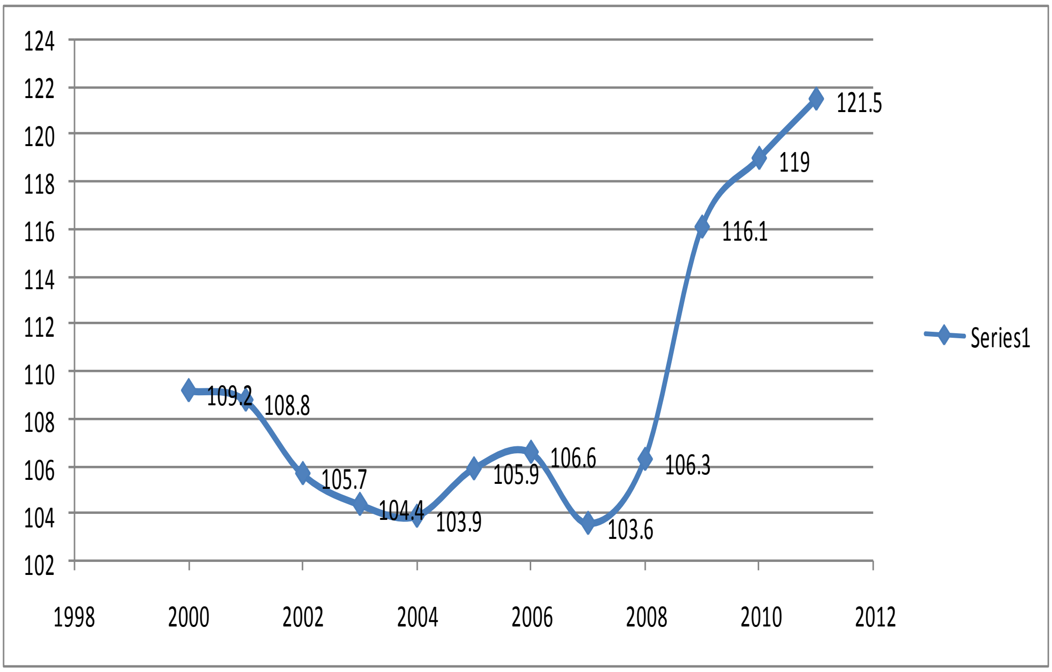
3.16 ITALY

Italy is the founding member of the European Union and joined the Eurozone of January 1, 1999, since its inception. Before joining the Euro area, *Lira* (the official Currency) was in circulation in Italy. For the global meltdown of 2008, there were large investment banks in the center. The capital inflows from North (Northern Europe) has triggered rapid growth in peripheral economies of South, such as Greece, Portugal, Spain and Italy. In Greece, much of the inflow of money accumulated in government debt and government exploited it improving risk profile. In Spain, the money was recycled in the property market and construction. But the story of Italy was different. Since 1990's Italy's economic growth had been slow. The reluctance of the Italian government was also responsible for attracting inward investment. Since the Italian government's debt was so massive, it triggered a financial collapse of incalculable scale, though only the Debt-GDP ratio was not the one reason for the crisis.

Gross national debt, which was 121.5 percent of GDP in 1995, had declined to 120.3 percent in 1996. The successive governments in Italy tried to control the debt level, which was exceeding the limit. In 2010 the Gross National Debt was 119.0 percent of the GDP. Again in 2011, the debt level reached 121.5 percent. GDP, out of 121.5 percent of total debt, half was held within the country by Italian. But a significant amount was held by international investors. When the crisis hit Italy, investors from abroad were skeptical about Italian credibility of its sovereign rating. The rating agencies such as Fitch and Standard and Poor's downgrade Italian stability ranking.

Figure No. 2.5

Italy's Gross National debt in Percent of GDP



Source: imf.org

During the 1990's, Italy's Debt-GDP ratio was also high, but the European Union never took it seriously. If the EU had followed the debt ceiling, laid down by the Maastricht Treaty, Italy had never been in the Eurozone. German policymakers such as former Chancellor **Helmut Kohl** ignored the concerns raised by former Bundesbank president **Hans Tietmeyer** regarding Italian economic condition.

Knowing the fact that it was not possible for Italy to follow the convergence criteria in 1997, it pressed the European Commission to focus on three percent deficit-to-GDP criteria as the key indicator. The then Prime Minister **Silvio Berlusconi** also tried to conceal the fiscal deficit data from the Italian public.[41]

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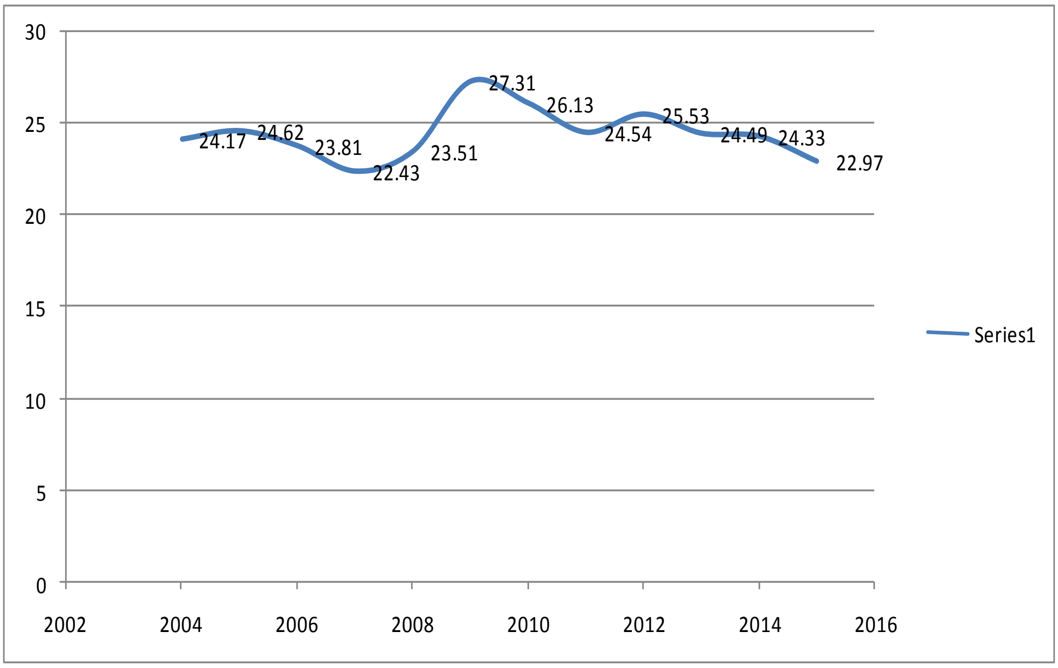
[41] Erber, Georg (2011) "*Italy's Fiscal crisis"*, Inter economics, Germany. Volume 46, November/December 2011, Number 6. pp. 332-339. http://archive.intereconomics.eu/year/2011/06/italys-fiscal-crisis.

Italy did well in capital formation and education. But on the governance level, it failed. Most measures taken to restore good governance did not come out with any fruitful results. Poor regulation, vested business interests, lack of investment have increased the country's vulnerability for slowdown. An International Monetary Fund report on Italy's shadow economy, also known as the 'black economy' finds that it stood at 19.8 percent in 2017.[42] Year-wise growth of Italian shadow economy has been given in the graph.

Figure No. 2.6

Development of Shadow Economy In Italy (2004-2015)



Source: IMF.org

The government's fiscal health got worse after entry into the Monetary Union, and this led to a decline in competitiveness. The victory of Silvio Berlusconi, the center-right coalition in the 2001 election, promised that the government would pursue the policy of tax cut. Until 2004 the government debt was on its downward condition, but soon it reverted to an upward trend. The trend has been halted between 2006-2008, but then

[42] IMF Working Paper (2018) *"Shadow Economic Around the world: what did we Learn over the Last 20 years?"* https://www.IMF.org/˜/media/files/publications.)

it picked momentum and debt reached to 121.5 percent. The budget took a turn for the worse. In 2007, the economy showed a sign of losing its speed. The growth rate declined.

Troika approved a bailout package for the ailing economy. Italy had to follow strict norms regarding its fiscal policy. The debt borrowed by the Italian government shall be charged with interest. Prime Minister **Mario Monti** took steps to fix the Italian problems as proposed in austerity measures the government raised taxes and proposed spending cuts. The proposal to increase in retirement age was put forth by the government. Structural reforms were initiated in order to correct the loopholes of the previous fiscal adjustment programme. The value-added tax (VAT) was also increased.

Some of the above case studies of different countries in the Eurozone throw light on various reasons in those countries. One thing is clear that all the nations were exceeding their debt level, as mentioned in convergence criteria. There was a huge difference in the Debt-GDP ratio. High inflation rate further deteriorated the fiscal condition. The government in the Euro area was also struggling with current account deficits.

After discussing the case studies of specific Euro area countries, we would try to analyze different dimensions of the crisis as we know that only one aspect is not enough to describe the phenomena. There may be more than one dimension that can better explain the phenomena. In the following discussion, we would try to find out the distinct factors that led the crisis to happen.

3.17 Economic Dimension

The economic dimension is an essential aspect of understanding the Eurozone crisis. This dimension includes high indebtedness, banking crisis, current account imbalances. These are the main factors that led to the crisis to happen. Some of the Eurozone member states were highly indebted, even surpassing the convergence criteria limit. The Debt-GDP ratio has increased sharply. The total government debt [43] of the Euro area was 84.6 percent in 2010 that increased 89.7 percent in 2012, 89.9 percent in 2015. However, in 2017 it declined to 86.8 percent.[44] In Euro area countries, the government debt was highest in Greece, which stood at 146.2 percent in 2010 that increased all-time high 176.1 percent in 2017.

In Italy, the third-largest economy of the Euro area, the government debt was 119.4 percent in 2010, which increased 131.2 percent in 2017.[45] In Portugal, it was 96.2 percent in 2010, which rose 126.2 percent in 2012, with a decline of 124.8 percent in 2017. Germany, the biggest economy of the Euro area, its government debt was 81.0 percent in 2010, reduced to 63.9 percent in 2017.[46] Estonia, Latvia, Lithuania are the countries in the Euro area whose debt level was less than fifty percent mark. The table presents the government debt level in different Euro area countries.

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43 Government debt can be measured in terms of per capita or ratio of GDP. The size of government debt provide information regarding size of economy. Increase in government debt level may impact the interest rate level. It may also hamper government investment. High level of government debt impact economic growth and discourage capital accumulation, empirical evidences suggested.

44 Government debt slightly up to 86.6 percent of GDP in Euro area (2018) News Release. Euro indicators. https://ec.europa.eu/eurostat/documents.

45 General Government Gross Debt Annual Data (2017). https:// ec.europa.eu/eurostat/tgm/table.do?=table&init=&language=en&p code=teina 225 & plugin=1

46 Ibid.

Table No. 1.8

General Government Gross Debt-Annual Data								
Region/Country	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Euro Area (19)	84.6	86.6	89.7	91.6	91.8	89.9	89.1	86.8
EU (28)	78.8	81.4	83.8	85.7	86.4	84.4	83.3	81.6
Austria	82.7	82.4	81.9	81.3	84.0	84.8	83.0	78.3
Belgium	99.7	102.6	104.3	105.5	107.6	106.5	106.7	103.4
Cyprus	56.8	66.2	80.1	103.1	108.0	108.0	105.5	96.1
Estonia	6.6	6.1	9.7	10.2	10.5	9.9	9.2	8.7
Finland	47.1	48.5	53.9	56. 5	60.2	63.6	63.0	61.3
France	85.3	87.8	90.6	93.4	97.9	95.6	98.2	98.5
Germany	81.0	78.6	79.9	77.4	47.5	70.8	67.9	63.9
Greece	146.2	172.1	159.6	177.4	178.9	175.9	178.5	176.1
Ireland	86.0	110.9	119.9	119.7	104.1	76.8	73.4	68.4
Italy	115.4	116.5	123.4	129.0	131.8	131.6	131.4	131.2
Latvia	46.8	42.7	41.2	39.0	40.9	36.8	40.3	40.0
Lithuania	36.2	37.2	39.8	38.8	40.5	42.6	39.9	39.4
Luxembourg	19.8	18.7	22.0	23.7	22.7	22.2	20.7	23.0
Malta	67.5	70.1	67.7	68.4	63.7	58.6	50.3	50.9
Netherland	59.3	61.7	66.2	66.7	67.9	64.6	61.9	57.0
Portugal	96.2	111.4	126.2	129.0	130.6	128.0	129.2	124.8
Slovakia	41.2	43.7	52.2	54.7	53.5	52.2	51.8	50.9
Slovenia	38.4	46.6	53.8	70.4	80.4	82.6	78.7	74.1
Spain	60.1	69.5	85.7	95.5	100.4	99.3	99.0	98.1

***Source**: https://ec.europa.eu/eurostat.*

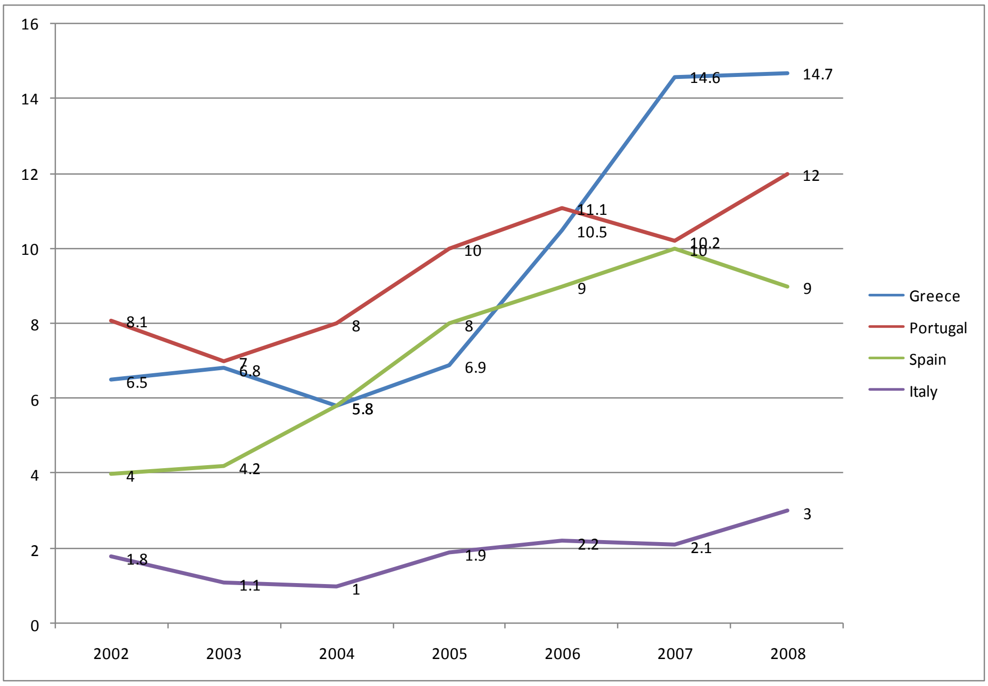
The above table clearly shows that most of the Eurozone countries were exceeding the Debt-GDP ratio. The considerable debt amount in some Eurozone countries made it impossible to service their sovereign debt without further increasing their financial obligation to their bondholders. In some countries, government debt is still high. The debt in Euro area countries neither domestic nor external. Euro area people held the most public debt. More of this debt held by outside issuing country yet it was deferent from the domestic debt of countries owing their currencies. Issuing country not have full control over the currency in which debt is denominated. That's why, in the Eurozone, debt can be divided into 'domestic' and 'foreign'. The public debt in Eurozone was not subject to currency mismatch combined with external debt. The government can pay their debt in the same currency in which they collect their revenue.

Growing current account deficits in the Eurozone also led to the crisis. The current account imbalances among the countries who participated in the Eurozone would not be a significant concern in the monetary union; it was the perception prior to the creation of the Euro area. It was also of the view that in a convergence process, diverging current position account is a natural phenomenon. Before the crisis, the existing account in the balance of Greece, Italy, Portugal, and Spain were on a high level. Some authors argued that it was the common currency 'the Euro' which made current account imbalance within the Euro area, worse. Common currency eliminated exchange risks and created a hollow expectation about economic convergence among core and periphery countries. Low-interest rates attracted capital flow from the core, which invested in patty works that want to yield results and thus resulted in current account deficits with loss of competitiveness. The Euro area countries were unable to devalue their currency to improve competitiveness as the countries were following the norms of a single currency. Instead, the states were forced to decrease prices, using deflationary macroeconomic policies. Such types of policies led to recession, increased unemployment. The following graph presents a picture of the current account deficit of some of the Euro area countries. In the year 2008, the current account deficit in Greece was the highest 14.7 percent of the GDP, whereas it was 12.0 percent in Portugal, 9.0 percent in Spain, and 3.0 percent in the same year.

Figure No. 2.7

Current Account Deficits of Euro area

(Percentage of GDP)



Source: https://www.rabobank.com

In 2016 steadily improving the condition of economy the current account surplus was 3.3 percent of the GDP in the Euro area. In the year 2015, it was 3.2 percent. The deficit was recorded in the oil trade balance. As a result of price development, the imports and exports in the Euro area declined relative to GDP in 2016. The GDP deflator in 2016 increased. The bilateral trade in the Euro area stood at 2 percent of GDP in comparison with non-Euro area countries in 2016. Among the Euro area countries, Germany contributed current account surpluses in the year 2016. It's (Germany) current account surpluses were 2.4 percent. Government deficit in the Euro area and European Union decreased in relative terms in 2016. The current account balance as a percentage of GDP in the Euro area in the quarter first in 2017 was 3.2 percent, and in quarter fourth it was 3.1 percent.[47]

[47] News Release by Eurostat (2018) https://ec.europa.eu/eurostat/news/news-release.

Table No. 1.9

Balance of payment euro indicator for Euro area 19

(Billion Euro)

Euro area (19)	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Current account balance	87.6	77.6	115.7	105.9	111.1
Balance of trade in services	18.0	19.0	28.2	28.7	27.4
Balance of trade in goods	75.6	83.1	92.6	94.2	90.5
Balance of primary income	26.2	18.4	33.3	17.7	24.6
Balance of Secondary income	- 32.1	- 42.9	- 38.5	- 34.6	- 31.3
current account balance as percentage of GDP	3.2%	2.8%	4.1%	3.7%	3.9%

Source: ec.europa.eu/eurostat

Several economists argued that it was the banking crisis that led to the Eurozone crisis. For example, **Joseph Stiglitz** mentioned *"blame should be centrally placed on the banks and the investors. The banks were supposed to be the expert of risk management. They not only did not manage risk, they created it"* like Stiglitz another economist **Gary Gorton** said *"the current crisis has its roots in the transformation of the banking system. The banking system metamorphosed in the last 25 to 30 years and this transformation re-created the condition for a panic"*[48]

In the euro area, the process of liberalization had started long before the adoption of the single currency the euro. European banks had participated overwhelmingly in global banking while following the path of financial innovation. All this integrated European financial market with foreign financial markets. Also, adoption of the Euro made interest rates lower and with the abolition of exchange rates among Eurozone members easy access to foreign markets.

[48] Berend, Ivan T (2013) *"Europe in Crisis: Bolt from the blue?"* Routledge, New York, p. 61-62.

European bank has invested heavily in the United States. The financial transaction between Europe and the United State has increased rapidly. The share of European Union securities holding by the United States individual was around 42 percent for equities and 53 percent of assets, totaling 1.8 trillion[49] US dollars. When the financial crisis hit the United States, it was the European banks that bore the brunt. Not only Swiss, French banks but German banks also who suffer losses. Among OECD countries[50], the German banks acquired the highest leverage rates. Deutsche bank loses substantial assets. It is estimated that European banks were holding around 1 trillion US dollar toxic assets[51] , among them German banks were in the lead role along with PIIGS countries i.e. Portugal, Italy, Ireland, Greece and Spain.

Banks faced a serious liquidity problem. The government had to come forward to rescue the banks. The write-down of banks in Euro area estimated € 500-800 billion equivalent to ten percent of Euro area GDP. During 2012 the Non-performing loans[52] ratio in the Euro area was 7.5 percent. However, in the European Union, a significant decline has been recorded in NPL. In 2017, the ratio for European Union stood at 3.7 percent as compared to the world which was 3.74 percent. The increase in non-performing loans during crisis was a matter of concern for the European Union. A progress report was prepared on the Non-performing loans by the European commission in which it showed the non-performing loans in the European banking sector declined. To tackle the problem of NPL, the European Commission presented a proposal in March 2018 in which banks will require to set aside funds to cover for losses on loans that has the probability to become non-performing assets.

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[49] Cafruny, Alan W. and Talani, Leila Simona (2013) *"The Crisis of the Eurozone in* Cafruny", Alan W and Schwartz, Herman M (eds) Explaining the Global Financial crisis- Viva Books. New Delhi p. 22.)

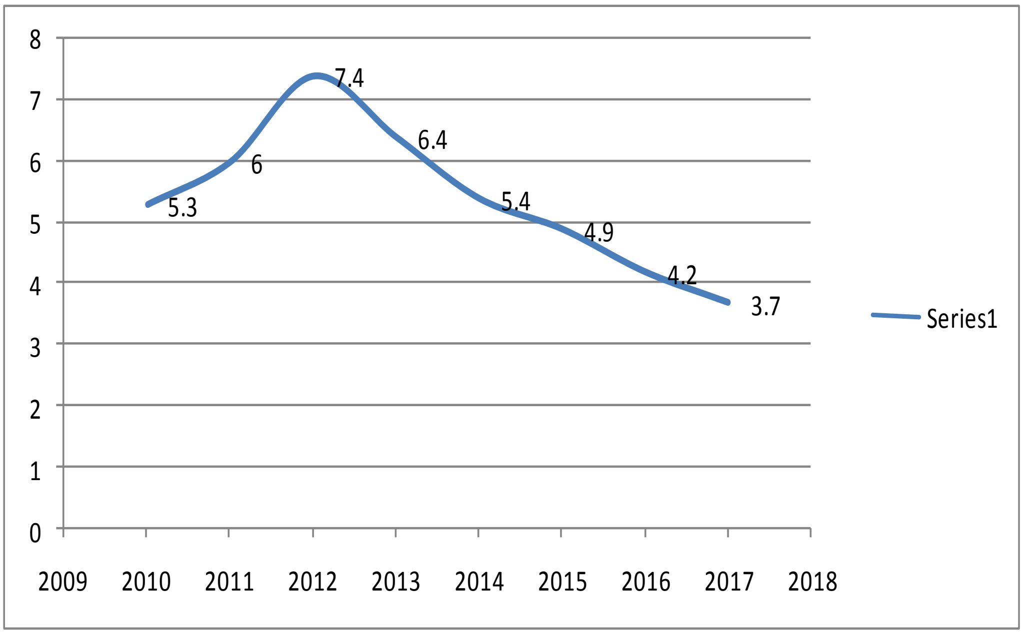
[50] Since its inception in 1961 the Organization for Economic Cooperation and Development, promotes and develop social & economic policies. It is a form of 36 industrialsed countries. The main aim of OECD is to promote free trade, make economies strong and contribution in development its member states.

[51] The asset which experienced significant drop in value & lack an active market where they can be sold. Subprime mortgages considered as a toxic asset.

[52] Non-performing loans are such type of bank debts that are unlikely to be repaid by borrower.

Figure No. 2.8

Non-performing Loans to Gross Loans (percent) European Union



Source: www.ebf.eu/facts-and-figures/non-performing-loans/

Bank in Eastern Europe and Baltic states such as Estonia, Latvia, Lithuania borrowed from hard currency banks for their business before the crisis.

Latvia and Lithuania also moves towards the International Monetary Fund for credit financing. Both are export dependent-economies. Estonia was also in trouble but did not approach to IMF. Estonia launched austerity programme. The banks in Sweden were in heavy financial stress because, as we know that Latvian banks had borrowed from Swedish banks, now were unable to repay the loans to their creditor banks. The crisis has started in the banking sector. To counter the liquidity crisis, the government in the Euro area followed expansionary fiscal and monetary policies. There were some other reasons behind the banking crisis in the Eurozone that have played an important role in the crisis which are as follows:

- Due to lack of a banking authority, the Euro area member countries retain the responsibility for bank resolution, bank supervision.

- For their financial needs, firms in the Euro area were much more dependent on the banking system.

- A large share of the debt was held by Euro area domestic banks that were issued by the respective national government in their portfolio. All this made bank balance sheets vulnerable to doubt about sovereign solvency.[53]

3.18 MARXIST DIMENSION

The recent global meltdown has attracted much attention to the reasons and consequences of the crisis. Marxist approach is different which focused on structures and dynamics of capitalism rather than policies, actors and institutions. The main thrust of these Marxist scholars stresses more an structural nature of the crisis. In their discussion, the root cause of the crisis was the decade of the 1970's when capitalism's boom entered into the crisis. The 1970s and 1980 opened a new chapter in Europe as well as in capitalism. It was the time when industrialization was on its peak in the western world that led the financialization of deregulated markets and speculative market systems. All these facts realized the European leaders to establish a monetary union that could work towards the monetary integration of the union. The neoliberal economist designed and established such a system in the European Union.

All the driving forces that had advanced European integration hitherto have how pulling it back. The free European market, single currency and of course the single market that brought huge profits to Europe have now become a nightmare. It appears as a never-ending crisis. Scholars argue that the crisis hit Europe is a failure of capitalism and it failed in its mission to provide a better solutions. It ruined the state economy. The Marxist scholars argue that only Marxian economy based system can provide the solution for today's inherent financial crisis.

The causes of the financial crisis in today world can be traced in neo-liberal policies of finance and over accumulation process. A key factor that led the European crisis to

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[53] Gibson, Heather D; Palivas, Theodore, and Tavlas, George S (2013) "*The Crisis in the Euro area. An Analytic overview*". Special conference Paper. Bank of Greece. www.bankofgreece.gr/bogekdoseis/

happen was the formation of the European community and the Euro. The formation of the European Union in 1992 was the dream project of European policymakers based on human rights, capitalism and democracy. By forming the EU, it was of the view of European leaders that the whole process would promote free trade and boost the economy as enshrined in **Adam Smith's** theory. The father of modern economies and a great proponent of **'laissez-faire'** in his book ***'The Theory of Moral Sentiments'*** he gave the idea of an invisible hand in which he proposed free market to regulate Whole the process of European project run smoothly benefitting the member states. The project went a step further with the formation of Euro area and a single currency 'the Euro'. But the 2008 financial crisis put a question mark on the success of Europea single currency model. Greece, Portugal, Spain, and Italy were the hardest-hit countries in the Eurozone owing to these crisis. **Shambaugh** commented that *"Eurozone currently, is facing three fundamental crisis, the banking crisis, growth crisis, and the sovereign debt crisis".*

There are different types of theories that represent the market economy. For example, Liberalism emphasis that there should be a little role played by the state to regulate the market. Liberal economic theories consider national currencies like goods and services and advocate for free trading in open market. Neoliberalism believes zero-intervention of the states and advocates free-market concept. Liberal aspects of capitalism suggest that free market would provide a stable financial system. Marx believed that it is the class system that prevails rather than states or markets.

The peculiarities of the Eurozone crisis are the consequences of the transformed contemporary capitalist market system. The initial response on the part of operative capital in Europe was a combination of rationalization and automation at home and relocation especially of labour-intensive production process to low wage countries: the new international division of labour. The French and German industries consistently advocated the accumulation strategy based on spatial fixes. Secondly, the creation of the European monetary Union was also the key ingredient of the accumulation strategy of Franco-German nexus. The big banks in France also expanded their activities in Eastern Europe. The highly skilled and low paid labour force in Eastern and Central Europe provides western European business with an ideal platform from which to deepen its internal division of labour and open a new offensive on the global market.[54]

The grip of finance on the European political economy strengthened massively mostly in those economies in Europe where financialization compose the core of the response to the problem of over accumulation. The another factor pursued by money capital in most European countries was over-investment in the real estate sector. It was found mostly in Spain, Ireland. In these countries, house prices skyrocketed. On the over accumulation, **William I. Robinson** argues that "the main reasons of the global capitalist crisis was the combination of factors centered on over accumulation and contradiction of state power…he painted that the global capitalist economy experienced a period of hyper-accumulation in the 1980's and 1990's but stagnated by the turn of the century. Transnational capitalist and elites turned to two major mechanisms for unfolding surplus and sustaining accumulation in the face of chronic stagnation financial speculation and militarized accumulation."[55] The mercantilist policies followed by some northern EMU countries, particularly Germany was based on the relative suppression of domestic demand through wage restraint.

It is undeniable that the real depreciation that has occurred in Germany has had an enormous impact on trade flows. It increased German export outside while decreased imports. While southern countries registered huge losses and current account deficits. As for the introduction of Euro the single currency is concerned, it was a German idea that imposed on peripheral countries despite declining competitiveness and lack of structural reforms.

The foremost value of capitalism is competition. The neo-liberal and capitalist paradigm that was constructed within the European Union clearly differentiates the unequal distribution of the market system and a major gap between most developed core countries and underdeveloped southern peripheries.

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54 Overbeek, Henk (2012) "*Sovereign Debt crisis in Euroland: Root Causes and implication for European Integration*". The International Spectator Vol. 47, No. 1, March 2012, p. 34.

55 Berberoglu, Berch (2014) "*The Global Capitalist crisis and its Aftermath : The Causes and consequences of the Great Recession of 2008-2009*", Ashgate Publishing Limited-England.

Rosa Luxemburg in her. *The Accumulation of Capital* extended the analysis of a specific national economy developed by Marx. She argued that, as a mode of production, capitalism in western European countries had emerged within and adjacent to the pre-capitalist sets of relations. Private enterprise really depended for it's proceeded with development in pre-entrepreneur social orders. These gave markets to merchandise from advance entrepreneur nations and wellsprings of modest work.[56]

There is no doubt about the fact that it is the core countries of the Euro area who accumulated most of the profit. It was only the peripheries who were the big losers. The causes of the crisis in the Euro area are multidimensional and systematic. The Marxist interpretation emphasis only on the factor of inequality and over-accumulation that prevailed in Europe. It shows that the capital system of the market never leads to an equal distribution of wealth. Rather it widen the gap between haves and haves not. The core and peripheral countries of the Euro area the best example of it.

3.19 Default Design of the European Monetary Union

The Eurozone crisis consists of many and different dimensions. The inherent contradiction in the formation of the European Monetary Union is also one of them. The main purpose of the formation of EMU was to coordinate the economic and fiscal policies of member countries. The EMU also involves a common currency. Since its inception, it was clear that EMU lacks basic criteria. EMU had the absence of such a type of mechanism that could stop divergent economic development among member states. The structural crisis has its roots in the defunct design of the European Monetary Union and its convergence criteria. The Convergence Criteria was adopted in 1993. To qualify in the European Monetary Union, a member state would have to follow certain conditions enshrined in convergence criteria. The criteria include:

[56] Hobden, Stephen and Jones, Richard Wyn (2011) "*Marxist Theories of International Relations"* in Baylis, John, Smith, Steve and Owens, Patricia (eds). The Globalization of World Politics. Oxford University Press. New York. p.135.

- achievement of an annual rate of inflation that is not more than 1.5 percent point above the average of the three best achievers,

- observance of normal ERM fluctuation margin for the previous two years.

- a sustainable fiscal position; the government debt may not exceed 60 percent of GDP and government deficit may not exceed 3 percent of GDP.

- long term interest rates that do not exceed the average for the three best-performing EC states by more than 2 percentage points.[57]

Further Stability and Growth Pact's (SGP) provision are binding for European Union member states. The Stability and Growth Pact came into force in 1997 and become operational in 1999.

The main element of Stability and Growth Pact were:

- governments will aim to achieve a balanced budget;

- countries breaching the budget deficit, exceeding three percent, will be liable for a fine up to 0.5 percent of GDP.

- However, if there are exceptional circumstances, such as natural disasters or a decline in GDP of more than two percent in one year, the fines will not be applied.

- Where the drop in GDP is between 0.75 percent and two percent ECOFIN will decide the application of the fine by Qualified Majority Voting (QMV).[58]

When the crisis hit the Eurozone economies in 2008, the countries couldn't manage their monetary policy as it was under the sole authority of the European Central Bank. Before the crisis, the countries in the Eurozone could manage their own monetary policy. But after becoming a part of EMU they had to left their monetary sovereignty.

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57 Masson, Paul R and Taylor, Mark P (1993) *"Currency Union a survey of the issues"* in masson, Paul R and Taylor, Mark P (eds) Policy issues in the Operation of Currency Union. University of Cambridge. New York. p. 30.

58 Laursen, Finn (2013), "*The Eurozone Crisis and other Policy Challenges in the EU* " in Laursen, Finn (ed) the EU and the Eurozone crisis : Policy Challenges and Strategic Choices. Ashgate. England. P. 10.

Also, these countries could issue debt in their own currencies. By doing this, these countries could assure/guarantee that there could not be any shortage of cash, and this cash would always be there to pay out bondholders at maturity. They all had the power to compel the banks to provide liquidity at such juncture.

The Convergence Criteria and the Stability and Growth Pact rules were breached multiple times without any form of punishment. In the year 2005, the pact was revised. Germany and France, the biggest economies in Eurozone breached the criteria but never penalized.

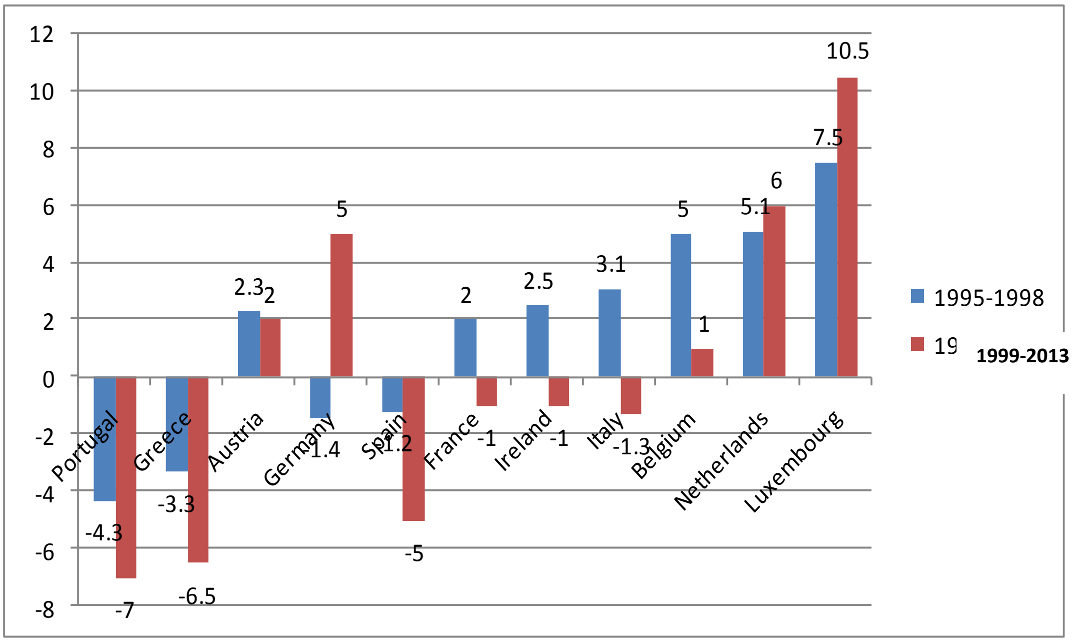
The European economies have become closely integrated, including sharing a common currency but the European Union did not have a continent wide institutional mechanism which could deal with problems related to economies. It is said that Eurozone is a Monetary Union without a Fiscal union. Eurozone contains a type of central bank but not a treasury. It is a treasury which can address solvency matter like in the United States. A central bank can only provide liquidity. Unlike the Federal Reserve in the United States, the European Central Bank cannot act as a lender of the last resort as its charter precludes it from providing direct-financing to the government. Therefore national debt is the sole responsibility of the member states but on the other hand, no one in charge of the common currency- this crucial task is left to dozen of regulators across continents.[59]

The European Central Bank was thus prevented from rescuing the member countries at the time of crisis. The Maastricht treaty's restriction on the European Central Bank has made it impossible to implement unified monetary policies due to inflationary differentials in the Euro area. The European Central Bank "One-size-fits-all" monetary policy exacerbated asymmetrical relations between law and high inflation countries.

[59] Sharma, Shalendra D (2014) *"Global Financial Contagion: Building a Resilient World Economy After the Supreme Crisis",* Cambridge University Press. New York. p. 11.

Figure No. 2.9

Average current Account in Euro area Member Economies Prior and after the creation of the EMU (as a percentage of GDP)



Source: https://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.cejsh-aace73bd.

The above figure shows the average current account balance in Euro area member countries prior to and after the creation of the European Monetary Union. The prior period is 1995-1998 and the after period is 1999-2013. The figure shows that before the joining of the European Monetary Union Portugal and Greece's current account deficits were high in the Eurozone. It was 4.3 percent and 3.3 percent[60] of GDP respectively. On the other hand, Luxembourg and Belgium recorded external surpluses. But the scenario got changed after the adoption of the Euro. The current account condition of Portugal, Greece, and Spain deteriorated, on the other hand after becoming a part of EMU Germany registered surpluses.

We analyze three different and main perspectives (not limited to that) of the Eurozone crisis. Three different aspects present solid reasons that led the crisis to happen. First, the economic perspective- that includes high indebtedness and banking crisis. The

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[60] Lichy, Marta Wajda (2016) *"Correcting excessive external Imbalances in Euro area Economies"* https://cejsh/icm.edu.pl/cejsh/element/bwmeta1.element.cejsh-aace73bd.

countries that were facing the budget deficits particularly, peripheral economies the high-level sovereign debt was also held by them.

We have collectively discussed the key dimensions of the Eurozone crisis. The first one was economic which include high indebtedness and a banking crisis. The second one was Marxist and the third was defect design of the European Monetary Union. All the factors played their own role outbreak of the crisis in Euroarea. The banking crisis and high indebtedness reinforced each other and present a particular challenge before the European policy makers. Southern Euroarea countries were admitted to the EMU despite knowing the fact that the counties were not abiding by the EMU rules and running in fiscal deficits and current account imbalances. The lack of rescue mechanism and the lender of the last resort manifold the problem. The heavy investment in American housing market by European banks without any security guarantee worsen the scenario. The Marxist dimension held responsible neo-liberal policies and over-accumulation by European countries, for the crisis. The gap between rich and poor got widen as the European society were heading towards neo-liberal and capitalist societies. In his book, "*Capital in 21st Century",* Thomas Piketty, elaborated that, '*inequality not only in United States but also in Europe increased sharply .The trend in future likely to go on .The huge profits gained by Europeans through the neo -liberal agenda have now coming to shrank".*

After the crisis the main focus was on how to rescue the affected countries? Bank had to bailed out. It is estimated that in Germany, wealth inequality gap has been widen however Germany was less affected country due to its labour market reforms that had been introduced in the year of 2000.For the most differentiated region which has rich countries like France and Germany on the one hand and poor countries like Greece on the other hand ,it is challenging task to adopt a single currency also where member states have different macro-economic conditions, it is quite difficult to form a single monetary policy for EMU like currency union. However, the different dimensions, whether it is economic or Marxist, the tension erupted in Euroarea was the result of a decade long accumulation within European Monetary Union. The "*Convergence Criteria"* which sets condition for a member to qualify for Euroarea membership has been breached a number of times even by Germany and France but those big economies simply let go without penalising."*The Stability and Growth Pact"* which set limit for debt and fiscal deficit for a country were never followed in a proper manner. The pact was renegotiated in 2005 and 2016 but the rules were less strict than it were earlier. The low interest rates which were the results of single currency flooded Eurozone area with cheap money in property market but the worse things were that the counties cannot devalue the Euro as the single currency. The same thing happened with Portugal and Ireland. Among the Euroarea countries Germany benefited most due to low interest rates as the country initiated the labour reforms and improved productivity that increased countries competitiveness in international markets. Southern economies spends money on social sector and on consumer spending. A significant amount went to real estate sector. Euro converted the Eurozone into a single financial market but national central banks and other regulatory bodies remained important organ in the Euroarea. In that fragmented regulatory atmosphere it has become very confusing as ultimately who would govern the monetary policy and who would be held responsible for the failure of economic policies and who would sort out the problems.

3.20 Rescue Efforts by European Governments

The previous section has explained the three dimensions of the Eurozone crisis. The Interdependence between banks and sovereign led the scathy circle in Euroarea that present the crisis to happen. The creditworthiness of banks and sovereign fell sharply. The private investors alien themselves to invest in sovereign and bond market

The Government's in European Union particularly Germany and France, took different measures to tackle the menace. The debt crisis in Greece posed a threat to destabilise Euroarea banks. The budget deficits of other periphery countries in Euroarea required cutback in their budget spending amid declining economic activity. To stop further contagion impact, the member countries announced a package of €750 billion on 10 May 2010 and a separate bailout package worth €110 billion were also announced in 2010.

"*European Financial Stability Facility"* was the mechanism created during the crisis in 2010 and the total purchase which approved for "*EFSF"* was €750 billion and divided into three parts of which largest amount €440 billion was to be funded through a special purpose vehicle that was guaranteed by participating European Monetary Union states. Another part would come from European Union budget amounting€60 billion, the rest €260 billion would come from "*International Monetary Fund"*. It was a temporary mechanism. Chancellor *Angela Merkel* reluctantly supported the rescue package while France welcomed the step A German newspaper, *Bild Zeitang,* wrote in an article, "*European Union cannot be converted into a "transfer union".*[61]

The European Central Bank as it's lead role provided massive liquidity to troubled Eurozone banks. Greece received two bailouts but the second package was with strict austerity and "*haircut".(*a haircut is a reduction in an asset's value)."*Euro plus pact"* was signed in 2011 in which European Commission was given control over member states economic policies. In 2012,"*European Stability Mechanism"* was set up and can be considered the IMF of Eurozone .The amount *ESM* was originating € 500 billion but in future it can be increased according to needs of the member states. The main task carried out to rescue the European economies by the European Central Bank that extended the significant amount of € 442 billion as one year loan in a single liquidity operation to Euroarea banks as emergency funding for period of one year.

"*Long Term Refinancing Operation"* a low interest rate emergency loan for 3 year to the financial sector, ease the effect of the crisis. The main aim of the above mechanism is to prevent a collapse of banking sector that was happened in United States and the low interest rates provided by the *LTRO* ease the effect of the crisis.[62] *The ECBs* prime focus was on providing liquidity for smooth functioning of banking operations and following the ECBs President *Mario Draghis* commitment to preserve the Euro, a new plan called "*Outright Monetary Transaction"* came into existence. The ECB makes purchase in secondary, sovereign bond market bond issued by Euroarea member countries with certain conditions.

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[61] Desai, Padma, (2011) *"From Financial Crisis to Global Recovery".* Columbia University Press, New York.pp.92-93.

[62] Sharma, Shalendra D,(2014)" *Global Financial Contagion: Building a Resilient World Economy after the Subprime Crisis". Cambridge University Press, New York.p.148.*