THE GREEK DEBT CRISIS: THE WEAKNESSES OF AN ECONOMIC AND MONETARY UNION

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INTRODUCTION

Throughout the 20th century and into the 21st, the world has seen a surge in globalized business practices, which has inevitably led to the increased interest of countries in foreign affairs. Today, every country, including the United States, is in some shape or form reliant on

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another. The interconnectedness and interdependence of the world's economies has led to one inescapable conclusion: that no one country can afford to ignore the happenings of another. For this reason, the massive debt crisis which has engulfed all of Greece (the "Greek Debt Crisis") has threatened the stability of the euro in not just the Eurozone,[1] but the entire European Union. This in turn poses an indirect threat to the United States, which has significant ties to Germany, Great Britain, France, and Spain.[2] As such, we as Americans cannot afford to ignore such a crisis, even if it is half a world away.

Although some may argue that the Greek Debt Crisis was caused by the United States' Financial Crisis of 2008,[3] the reality is that the bankruptcy of the Lehman Brothers Holdings, Inc. was simply the tipping point for Greece's already struggling economy. Moreover, Greece was setting itself up for a financial meltdown long before it adopted the euro in 2001. Sadly, it was a combination of the euro and the poor legal framework of the Economic and Monetary Union ("EMU") that allowed Greece to hide its financial difficulties and leave the entire European Union vulnerable to the sovereign financial troubles of every Eurozone state. As a result, the debt crisis of Greece acted as a contagion to other struggling Eurozone state economies, including Ireland, Portugal, Spain, and Italy.[4] This contagion has thus developed into the debt crisis of Europe (the "European Debt Crisis"), and what could potentially become the fall of the EMU if corrective actions aren't immediately taken.

With Greece's second bailout package still looming, this Comment seeks to understand how such a large scale crisis could have happened

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1. The term "Eurozone" refers to the 16 Member States of the European Union that have adopted the euro as their state's official currency. Except for Great Britain and the Netherlands, every state which joins the European Union ("Member State") is required to adopt the euro as its state's official currency upon meeting various convergence criteria and implementing certain budgetary policies.

2. *See* The New York Times, *Data Points: An Overview of the Euro Crisis,* www.nytimes.com/imagepages/2011/10/22/opinion/20111023_DATAPOINTS.html (Oct. 22, 2011).

3. *See e.g.* European Central Bank, Press Release, *Lessons from the crisis*, www.ecb.europa.eu/press/ key/date/2010/html/sp101203.en.html (Dec. 3, 2010).

4. *See* Louisa Fahy & Rishaad Salamat, The Independent, *Ireland can weather impact of Greek 'storm': Corrigan*, www.independent.ie/business/irish/Ireland-can-weather-impact-of-greek-storm corrigan2154177.html (Apr. 27, 2010) (discussing impact on Ireland, Portugal, and Spain); *see also infra* pt. IV.A. (discussing certain impacts on Italy, Spain, and Portugal).

by examining the various underpinnings of the EMU dating back to its inception. Section I of this paper examines the history of EMU, including why a single monetary union project was taken on by Europe. Section II analyzes the three stages of EMU, focusing on the shortcomings of each. Section III of this paper timelines the key dates in the Greek Debt Crisis, noting where particular responses from European institutions remain questionable. Section IV considers the impact of the Greek Debt Crisis on Europe as a whole, discussing the specific weaknesses of the EMU's legal framework, how they played a key role in the European Debt Crisis, and commenting on some of the most recent measures that were developed to prevent such a crisis from reoccurring.

I. *The Historical Background of Economic and Monetary Union*

The brutal and unrelenting conditions brought on by the Great Depression and World War II left a painful scar on all of those who lived through the era's harsh times. But even at a time when the impact from the blow could still be felt among the world's economically depraved nations, the post-World War II atmosphere was one of international unity that was founded in one common, but strong, goal: never again would the world experience an economic crisis of such magnitude. Politicians from a few European States were further "convinced that the only way to prevent another war in Europe was to unite those countries economically and politically."[5]

In 1944, ten months prior to the end of World War II in Europe and nine months prior to the signing of the United Nations Charter, the International Monetary Fund ("IMF") and the World Bank were

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5. European Central Bank, *The European Central Bank*, *History*, *European Union*, *Milestones of European integration (1950-2009)*, http://www.ecb.int/ecb/history/ec/html/index.en.html (accessed Mar. 1, 2012) [hereinafter *ECB History*]. European leaders placed a heavy emphasis on

> [T]he need for reconciliation between Germany and France, the two main continental powers and the primary antagonists in three European wars within the previous century. At the same time, integration and the construction of supranational institutions were seen as the best means for integrating into capitalistic and democratic Western Europe[,] the new Federal Republic of Germany . . . .

Michael J. Baun, *An Imperfect Union The Maastricht Treaty and the New Politics of European Integration*, 11-12 (Stanley Hoffmann, ed., Westview Press, Inc., 1996).

created at the Bretton Woods Conference.[6] The creation of the IMF and the World Bank may have, perhaps, been an initial inspiration for an economic and monetary union in Europe, as the 1950's witnessed the first efforts in Europe to remove trade barriers and to investigate the possibility of currency coordination through the European Coal and Steel Community.[7] However, the greatest contribution to the unity of Europe was unquestionably the Treaty of Rome in 1957, which established the European and Economic Community.[8] Overall, the Treaty of Rome abolished all internal tariff barriers to trade among the member countries and established a customs union for trade with nonmember countries.[9]

Years later at the European Council Summit of 1969, European Community leaders produced the Werner Report.[10] Although unsuccessful in implementing a single European currency, the Werner Report has been credited with permeating the idea of forming an economic and monetary union throughout the European Community.[11] Functionally, the Werner Report outlined "a [three-step] course of action towards making a continental currency and economic union a reality."[12] Despite its execution being hindered by the subsequent oil crisis of the 1970's, in addition to the conflicting domestic policies of the European nations, the Werner Report nevertheless "remains one of

6. Andreas F. Lowenfeld, *The International Monetary System: A Look Back Over Seven Decades*, 13 J. Int'l Econ. L. 575, 575-77 (2010). "For three weeks in July 1944, . . . representatives of 44 nations assembled at a grand hotel in Bretton Woods, New Hampshire, to create the [IMF] and draft the rules for the post-war international financial system." *Id.* at 575.

7. K.C. Ashmore, *A Continental Currency, Federal Europe, and the Importance of a More Perfect Union*, 11 Currents Int'l Trade L.J. 45, 45 (2002). Initially proposed by French Foreign Minister Robert Schuman in 1950, the countries of France, West Germany, Belgium, Italy, Luxembourg, and the Netherlands created the European Coal and Steel Community ("ECSC") in 1951. *ECB History*, *supra* n. 5. The ESCS Treaty sought to integrate the coal and steel industries of Western Europe, signifying "the first successful unified European economic body, created solely in law, independent of its member nations' control." Ashmore, *supra* n. 7, at 45; *ECB History*, *supra* n. 5. Additionally, attempts were made to create a unified European defense community ("EDC"). The EDC Treaty was signed in 1952. Ashmore, *supra* n. 7.

8. Ashmore, *supra* n. 7.

9. Baun, *supra* n. 5, at 13.

10. *Id.* at 15.

11. Ashmore, *supra* n. 7, at 45; *ECB History*, *supra* n. 5.

12. *Id.*

the early instances where the European member nations created and ratified a plan that prompted working collectively in a federation."[13]

More importantly, the Werner Report was the foundation for its 1988 predecessor, the Delors Report.[14] Formerly adopted in 1989, the Delors Report provided the blueprints for promulgating a three-stage plan to create and implement an EMU in Europe.[15]

II. *The Three Stage Process of Economic and Monetary Union*

The three respective stages of the process to EMU sought to 1) abolish all restrictions placed on the movement of capital among the Member States, 2) establish the European Monetary Institute ("EMI") and the European Central Bank ("ECB"), and 3) commence an irrevocable fixing of exchange rates of the currencies of all participating Member States and thus implement a single continental currency, the euro.[16] As each stage posed its own set of challenges for the Member States, the various benefits, risks, and objectives that were considered during the negotiations with respect to each stage has played a significant role in the Greek Debt Crisis that has been felt throughout the whole of Europe. Stage one set the foundation for an EMU that both emphasizes national sovereignty and relies on friendly negotiations too heavily. Stage two encompassed a hasty transitional phase to a single currency. Finally, stage three failed to establish a true economic union.

A. *Stage One: Cohesion, Cooperation, and Sovereignty*

As agreed upon, all restrictions on trade and capital were lifted (in principle) on July 1, 1990, officially commencing stage one of EMU.[17] Overall, stage one consisted of extensive preparations for stages two and three of EMU through various negotiations and agreements, which were later formalized into the Maastricht Treaty on European Union ("Maastricht Treaty"). Stage one procedures placed a great deal of emphasis on the desire for "economic and social cohesion and solidarity among Member States" in order to make the transi-

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13. Ashmore, *supra* n. 7, at 45; *see generally ECB History*, *supra* n. 5.
14. Ashmore, *supra* n. 7, at 46.
15. *Id.*
16. *ECB History*, *supra* n. 5, at http://www.ecb.int/ecb/history/emu/html/index.en.html#stage1.
17. *Id.*

tion to a single currency as smooth as possible.[18] For example, in a 1990 Amendment to a Council Decision, regarding the cooperation of the central banks of the Members States, the Council of the European Communities stated:

> [T]he realization of the first stage of economic and monetary union will focus on completing the internal market and in particular on removing all obstacles to financial integration, on strengthening the process of coordination of monetary policies, on intensifying cooperation between central banks on other matters falling within their competence and whereas, in this connection, consideration should be given to extending the scope of the central banks' autonomy.[19]

Stage one progressively led up to the signing of the Maastricht Treaty in Maastricht, Holland on February 2, 1992, although it did not take effect until November 1, 1993.[20] The Maastricht Treaty would set the stage for how to implement stages two and three of EMU, introducing items such as the Protocol on the Statute of the European System of Central Banks and of the European Central Bank and the Protocol on the Statute of European Monetary Institute.[21] Additionally, it would introduce new forms of intergovernmental cooperation regarding foreign defense, justice, and home affairs.[22]

Even during this initial stage, the primary motivation behind EMU has always been clear: achieve price stability.[23] However, foreign and defense policies had remained a fundamental part of national sovereignty and were not ready to be abandoned by Member States.[24] As such, great caution was taken when drafting the provisions on intergovernmental cooperation whilst discussing a "European identity" that could make assertions on the international scene. Initially, under the original provisions of the Maastricht Treaty, the European Union was

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18. Treaty on European Union, 92/C OJ 191/5 (July 29, 1992) (available at http://www.ecb.int/ecb/legal/pdf/maastricht_en.pdf) [hereinafter "Maastricht Treaty"].

19. Council Decision, 64/300/EEC (Mar. 12, 1990) (available at http://www.obtr.co.uk/europaenhancer/Enhancer.pl?ojref=CELEX:31990D0142:EN:HTML&ojpdf=OJ:L:1990:078:0025:0026:EN:PDF&format=).

20. Maastricht Treaty, 92/C OJ 191/1.

21. *See id.*

22. *Id.*; Baun, *supra* n. 5, at 3.

23. *See* Rosa M. Lastra, *Legal Foundations of International Monetary Stability* 186 (Oxford University Press 2006).

24. Baun, *supra* n. 5.

not given any authority to conclude international agreements.[25] Rather, the European Council was to play a dominant role in implementing the provisions of the Maastricht Treaty, although its decisions typically required a unanimous vote.[26]

All-in-all, a split was created between the idea of a "European Community" and a "European Union." Only the European Community, which "encompass[ed] the economic policies and core activities of the organization," had international legal personality.[27] The European Union, on the other hand, was a "larger body comprising the same membership" with powers that "include[ed] co-operation in criminal law policy, defen[s]e and foreign affairs."[28] Although the European Union covered a broader range, its powers were only to the extent that Member States had agreed to "cooperate" with one another, and thus had no legal personality.[29] Therefore, it would seem that under the Maastricht Treaty areas covered by the European Union, but not the European Community, could not be equally enforced or regulated by a supranational authority. This posed an unforeseen problem for the European Community: if the policies within the scope of the European Community were to be legally binding, how then were they to be enforced if matters of foreign policy were not equally overseen by a supranational authority? Moreover, how could a Member State be forced to abide by the rules agreed upon regarding economic policies?

After evaluating the policies behind the negotiations that led to the achievement of stage one – the signing of the Maastricht Treaty – the desire among the Member States to stay sovereign becomes much more noticeable. During the initial stages of EMU, Member States had favored internal governance procedures over entities associated with a "European identity" and reinforced the notion of Member State cooperation by focusing solely on the initial "how to" phase of financial integration. Moreover, this stage sought to establish price stability by placing a strong emphasis on friendly negotiations in monetary policy only, and thus failed to truly consider the importance of foreign and macro-economic policies.

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25. *Id.*
26. *Id.*
27. Pavlos Elefttheriadis, *The Idea of a European Constitution,* 27 Oxford J. Legal Stud. 1, n. 2 (2007).
28. *Id.*
29. *Id.*

B. *Stage Two: The Hasty Transition*

As of January 1, 1994, stage two of EMU had begun.[30] Overall, the main goal of stage two was "to ensure the convergence of the economies of the Member States;" a task that would fall mostly to the EMI, and eventually to its successor, the ECB.[31] During the negotiations of stage two, matters concerning the powers of the EMI and when the ECB should be established were heavily disputed. Prior to the Maastricht Treaty, it had been decided that the ECB would be modeled after the German Bundesbank.[32] "This outcome reflected not only Germany's direct influence and bargaining leverage but also the predominance in Europe of German monetary norms and values."[33] As such, many of the disputes were centered on Germany's demand for 1) a two-speed approach to EMU and 2) strict economic convergence criteria.

Germany's reasoning for a slower approach to full EMU was the result of two perceived and equally dangerous risks if full EMU was achieved too hastily. First, Germany wanted to prevent a split in authority between the national central banks and a European institution.[34] As such, Germany did not want the ECB to have any authority until the end of stage two; rather, it argued that the EMI should "operate only as a think-tank or consultative body."[35] Second, Germany foresaw "that the incorporation of weaker, deficit-prone countries in EMU would lead to political pressures for more relaxed monetary policies by the ECB and expensive bailouts," which Germany would likely be forced to fund.[36] For this reason, Germany supported EMU that only involved those countries that were fully ready, which could be determined by looking at economic performance and stability.[37] If a country was not presently ready to join, Germany argued that it could

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30. *ECB History*, *supra* n. 5, at http://www.ecb.int/ecb/history/emu/html/index.en.html#stage1.

31. Josephine Steiner, Lorna Woods & Christian Twigg-Flesner, *EU Law*, 7 (9th ed., Oxford University Press, Inc. 2006).

32. Baun, *supra* n. 5, at 61.

33. *Id.* "If the meaning of hegemony is the exercise of dominance through the voluntary acceptance by other countries of the rules and norms of behavior established by another, then Germany's role in European monetary affairs at this point in time can be accurately termed 'hegemonic.'" *Id.*

34. *Id.* at 64.

35. *Id.*

36. *Id.* at 66.

37. Baun, *supra* n. 5, at 66.

simply "join later, once [it] had made the necessary improvements in [its] economic position."[38]

Many other countries, however, did not want to take the extra time needed to properly handle such a delicate matter as combining the currencies and national banks of eleven countries into one single currency controlled by the ECB. France, for example, favored a single-speed approach in which the EMI would have more significant powers, including more political weight and influence, so it could regain regional control over the EMI's decisions.[39] Furthermore, countries including France and Italy wanted a firm guarantee that EMU would be achieved, regardless of whether all countries were economically ready.[40] This view reflected the typical attitude held by most Member States, in which state representatives were solely looking to enhance their state's power in the European Union.

Nevertheless, the Member States conceded many of Germany's demands in the Maastricht Treaty. First, it was established that a two-speed approach would take place with stage two of EMU revolving around the functioning of the EMI.[41] Second, the EMI would have no actual authority over national central banks, but would coordinate monetary policies of Member States, make the necessary preparations for full EMU in stage three, narrow the exchange rate fluctuations, and strengthen economic convergence.[42] Third, at the end of stage two, it was further agreed that the "national central banks would become independent of political authority," the EMI would liquidate, and its officers would form the ECB.[43]

However, the Maastricht Treaty further stipulated that in the event that a majority of the Member States did not meet certain criteria for economic convergence as of 1996, or a two-thirds vote for economic convergence did not pass the European Council, "EMU would automatically come into existence in 1999 with the participation of all

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38. *Id.*

39. *Id.* at 65. Specifically, "France wanted the EMI to have a president and a vice president who were appointed by EC governments from outside the committee of central bankers. France also wanted to give the EMI its own capital reserves and independent role in foreign-exchange intervention." *Id.*

40. *Id.* at 69.

41. *Id.*

42. Baun, *supra* n. 5, at 74; *ECB History*, *supra* n. 5.

43. Baun, *supra* n. 5, at 74; *ECB History*, *supra* n. 5.

countries meeting the economic criteria, even if these countries constituted less than a majority."[44]

Even though stage three was inevitably delayed until 1999, the negotiations which set the foundation for stage two reflect the hastiness of all but one of the Member States to rush into EMU. Germany was the only country that saw the risk of an EMU that was established too hastily and the danger of letting unstable, deficit-prone countries join the EMU. And today, as it correctly predicted two decades ago, it is one of the major countries involved with funding the bailout of Greece.

C. *Stage Three: A Monetary Union with Economic Policy Coordination*

On January 1, 1999, stage three of EMU commenced whereby eleven Member States officially adopted the euro as their state's currency, even though it was not physically introduced into circulation until 2002.[45] The primary goals of the stage three included: 1) the irrevocable fixing of conversion rates, 2) the introduction of the euro, 3) the establishment of the European System of Central Banks ("ESCB"), and 4) the entry into force of the Stability and Growth Pact ("SGP").[46] Thus far, each stage has been heavily focused on preparing for and establishing a monetary union. However, due to a general fear of losing national sovereignty, little emphasis had been placed on the establishment of economic union. As reflected by the SGP and the multilateral surveillance provisions of the Maastricht Treaty, the Member States failed to set a firm foundation for an economic union.

Before discussing stage three any further, the terms "monetary union" and "economic union" should be defined. Monetary union is the "real transfer of sovereign responsibilities from the national to the supranational arena in the monetary field."[47] As such, in the Eurozone today "there is one currency, one monetary policy and one central bank."[48] Economic union, on the other hand, does not encompass this concept of oneness. Rather, it is viewed as "economic policy coordination, since Member States – participating or not in the monetary

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44. Baun, *supra* n. 5, at 74.
45. *ECB History*, *supra* n. 5.
46. *Id.*; Lastra, *supra* n. 19, at 195.
47. Lastra, *supra* n. 23, at 200-01.
48. *Id.* at 200.

union – are still in charge of their fiscal policies . . . and retain other important national prerogatives with regard to their 'economic policies' . . . ."[49] Moreover, through the establishment of the ECB, the ESCB, and the euro, each stage of EMU contributed to a financial integration, and thus a monetary union. However, the Maastricht Treaty's general outline for a multilateral surveillance of the Member States and the SGP set the foundation for economic policy coordination and not an economic union.

When stage three commenced, a monetary union between the 11 Member States was created, but without any "corresponding transfer of fiscal powers to a supranational authority."[50] During the negotiations of the Maastricht Treaty, Germany had argued that a monetary union would struggle to survive without increased fiscal and political integration.[51] As one author commented, this view by the German Economists "contrasted with the view of the 'Monetarists', who thought that monetary union could proceed ahead without any such transfer. [Charles] Goodhart note[d] that 'most of the Monetarists also hope[d], however, that monetary unification would accelerate the transfer of fiscal powers.'"[52] Moreover, the dispute came down to whether the Member States should be sanctioned or publicly reprimanded for ignoring Community recommendations or maintaining excessive deficits.

In the end, the Maastricht Treaty tended to lean more towards public reprimands, stipulating in numerous areas that particular reports, recommendations, opinions, etc. may be published or otherwise made available to the public.[53] To implement this concept of public pres-

49. *Id.* at 201.

50. *Id.*

51. *Id.*

52. Lastra, *supra* n. 23, at 201 (quoting Charles AE Goodhart, *The Central Bank and the Financial System*, 181 (Cambridge: MIT Press, 1995)).

53. That being said, Article 104c of the Maastricht Treaty provides that where the Council has issued a recommendation to a Member State, regarding measures to be taken to reduce deficit, and the Member State has failed to comply with such decision, the Council may choose to take the following four measures:

> – to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
> – to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
> – to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;

sure, the Maastricht Treaty called for a system of multilateral surveillance, whereby the Council could monitor the economic developments of the Member States and the Community, as well as the consistency of the Member States' economic policies with the Commission's broad guidelines as adopted by the Council.[54] As such, each Member State would be responsible for adopting an "economic policy . . . based on the close coordination of Member States' economic policies"[55] and must forward to the Commission "important measures taken by them in the field of their economic policy . . . ."[56] In theory, when a Member State exceeds the deficit minimum or fails to follow a Council recommendation, the threat of this knowledge being made public to its neighboring Member States will pressure it into making the necessary changes.

The Maastricht Treaty, however, was not conclusive on the procedures for controlling budget deficit, and called for further planning during stage two. Originally, the Maastricht Treaty provided that "budget *discipline* would be made compulsory through the excessive deficit procedure, [while] a separate procedure involving 'multilateral surveillance under Article [103] would allow for the voluntary *co-ordination* of member states' economic (i.e. fiscal) policies."[57] Therefore, to supplement the Maastricht Treaty's provisions on budget discipline and multilateral surveillance, the Member States agreed to the SGP, which consisted of a Resolution of the European Council and two Council Regulations.[58]

One the primary goals of the SGP focused on "the strengthening of the surveillance of budgetary positions and the coordination of economic policies."[59] Under the SGP, Member States would be committed to budgetary balance over time.[60] In doing so, they would be required to present annual updates of their stability programs to the

– to impose fines of an appropriate size.

Maastricht Treaty, Art. 104c(11) No C 191/13.

54. *See id.* at Art. 103(3) No C 191/12.

55. *Id.* at Art. 3a(1) No C 191/6.

56. *Id.* at Art. 103(3) No C191/12.

57. Paul Beaumont & Neil Walker, *Legal Framework of the Single European Currency* 78 (Hart Publishing 2000).

58. Lastra, *supra* n. 23, at 260.

59. *Id.*; *see also* Council Regulation 1466/1997 of July 1997 *Strengthening of the Surveillance of Budgetary Positions and the Surveillance and Coordination of Economic Policies*, [1997] OJ L209/1.

60. Lastra, *supra* n. 23, at 262.

Council and the Commission.[61] "These program[s] provide information on how countries intend to meet the budgetary objectives and, in particular, the medium-term goal of a budget close to balance or in surplus."[62]

Overtime, however, the SGP would prove to be ill-effective. Breaches of the SGP were recurrent and little was done to sanction or reprimand a Member State for its breach. As such, "[t]he fiscal rules appear to have had little effect in the way many countries behave."[63] Simply put, the threat of peer pressure and the system of multilateral surveillance did not have enough legal force to require a Member State to abide by the rules of the European Union. "When push comes to shove, a government will always favor the interests of its domestic population over foreign creditors[.]"[64]

III. *The Greek Debt Crisis*

Long before the euro became the official currency of Greece in 2001, the country had been in a constant economic struggle, caused mainly by the nation living well beyond its means.[65] As the country transitioned into the single currency of the EMU, the Greek socialist economy has sought to protect and provide for its citizens at the expense of the other Member States' pockets. Through deceptive accounting policies, in conjunction with the EMU's strict adherence to sovereignty, Greece was able to disguise the numbers of its actual GDP, deficit, and debt for nearly a decade. Though European agencies have been quick to respond, the methods in which they have responded remain questionable.

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61. *Id.* at 265.

62. *Id.*

63. *Id.* at 266.

64. Landon Thomas, The New York Times, *Given Greek Deal, Investors May Reconsider Sovereign Debt* (Feb. 24, 2012) (available at http://www.nytimes.com/2012/02/25/business/global/as-greek-restructuring-looms-bondholders-think-twice-about-other-sovereign-debt.html?pagewanted=all).

65. *See* The New York Times, *World, Europe, Greece*, http://topics.nytimes.com/top/news/international/countriesandterritories/greece/index.html (last updated June 20, 2012) [hereinafter *Greece News*]; BBC News, Business, *Q&A: Greek debt crisis*, www.bbc.co.uk/news/business-13798000 (last updated Mar. 2, 2012).

Since the 1970's, poor economic policies have stunted the growth of the Greek economy.[66] Limited natural resources, low levels of industrialization, and a high degree of government control over numerous sectors of the economy through state-owned banks and industries, have no doubt contributed to the nation's lack of growth.[67] Economic policies during the 1980's resulted in high inflation debt payment problems.[68] The government's response to this problem was a $1.7 billion loan from the European Union in 1985, which then lead to "[i]nefficiency in the public sector and excessive government spending[,] causing the government to borrow even more money."[69] Although efforts were made to revitalize the economy through privatization, whereby the Greek government would reduce the number of state-owned businesses, the 1990's nevertheless saw a slump in the Greek economy.[70]

After the Maastricht Treaty was signed in 1992, Greece's government had to reform its economic policy to become eligible to join the EMU in 2001.[71] After twenty years of reporting inflation rates in the double digits, as if by miracle, Greece was able to reduce its inflation rate to below 4% by the end of 1998, averaging 2.6% by 1999.[72] This was the lowest rate the country had seen in 26 years; not bad for a country that had government debt exceeding 100% of GDP in 1992.[73] No one questioned this amazing feat, but rather applauded Greece's "successful plan of fiscal consolidation, wage restraint, and strong drachma policies."[74] As a result of this miraculous turnaround, Greece joined the EMU in January 2001, thus adopting the euro and having its economy governed by the ECB.[75]

According to the Commission Recommendation for the 2001 Broad Guidelines of the Economic Policies of Member States and the Com-

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66. *Encyclopedia of Nations*, *Greece – Overview of economy*, http://www.nationsencyclopedia.com/economies/Europe/Greece-OVERVIEW-OF-ECONOMY.html (accessed Mar. 8, 2012) [hereinafter *Encyclopedia of Nations*].

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Encyclopedia of Nations*, *supra* n. 66.

72. *Id.*

73. *Id.* "[B]y the end of 1998, public sector external debt was US $32 billion, with overall government debt at US $119 billion (105.5% of its GDP)." *Id.*

74. *Id.*

75. *Id.*

munity ("2001 Recommendation"), Greece was to prepare for its ageing population through wage developments, continuing budgetary consolidation, and reforming of its pensions system.[76] The 2001 Recommendation additionally noted that an acceleration of Greece's investment in construction was to be expected for the 2004 Olympic Games in Athens, and that such activities would be further boosted because of the lower interest rates brought on by the adoption of the euro.[77] In other words, Greece would be taking on more loans to invest in construction to prepare for upcoming Olympic Games, especially since the loans would be subject to lower interest rates due to the euro.

Undoubtedly, with no one to enforce the 2001 Recommendation or monitor whether Greece was following through on its promises, Greece took on significant debts without making any policy changes.[78] In comparison to the year 2000, government expenditures on both employee compensation and social benefits had more than doubled by 2009: employee compensation increased from 14.3 million to 31 million, while social benefits increased from 20.2 million

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76. *Commission Recommendation for the 2001 Broad Guidelines of the Economic Policies of the Member States and the Community*, at 29-30, COM (2001) 224 final (Apr. 25, 2001) (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2001:0224:FIN:EN:PDF) [hereinafter *2001 Recommendation*].

77. *Id.*

78. In a subsequent resolution, the European Parliament iterated the following points with the regard to the 2001 Recommendation:

> 2. *Calls on* the Member States to base their economic policies on the objectives and specific measures agreed by the European Council in Lisbon and developed further by the European Council in Stockholm, including the agreements concluded in connection with European economic coordination;
>
> 3. *Urges* . . . Member States to design their economic policies in such a way so as to fully incorporate sustainability requirements and to live up to [its] commitments . . . ; and
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> . . .
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> 9. *Points out* that not all Member States exploited the opportunity for sustainable budget consolidation [in 2000] and . . . *cautions* against any slacking efforts . . . .

European Parliament resolution on the Commission's recommendation for the broad guidelines of economic policies of the Member States and the Community for 2001, Eur. Parl. Doc. (COM 224) 158-59 (2001) (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2002:034E:0157:0160:EN:PDF) (emphasis added). Moreover, the European Parliament does not have the authority to force the Member States to implement the European Commission's 2001 Recommendation.

to 49 million.[79] Total revenue, on the other hand, had only increased by 29.5 million – a number that barely covered the 28.8 million increase in social benefits, notwithstanding the 16.7 million increase in employee compensation.[80]

Suspicions of fraudulent practices initially caught the attention of the EMU in 2004 when Eurostat performed a financial audit of Greece.[81] The report went back seven years, eventually concluding that between 1997 and 1999 Greece had in fact exceeded the 3% deficit maximum requirement for EMU membership qualification.[82] Obviously, this invoked a response from other Member States that Greece had failed to meet the accession criteria and had entered the Eurozone by falsifying its deficit numbers.[83] Nonetheless, Greek officials brushed off the accusation by simply stating that the difference in numbers was caused by a change in accounting methodology, which took effect in 2000.[84] Thus, under the previously used accounting system that was enforced from 1997 to 1999, Greece had – supposedly – met all of the accession criteria.

As the commotion regarding a Greek fraud scandal died down, all eyes began to turn toward the stability of the global economy. In its December 2005 publication of the Financial Stability Review, the ECB warned of the financial imbalances of the global market.[85] These reports continued through 2006 and 2007.[86] By 2008, the ECB had begun to take measures to prevent the oncoming storm, but to no

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79. Eurostat, *Government finance statistics Summary tables – 2/2011 Data 1996 – 2010*, 13 (2011 ed.) (available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-EK-11-002/EN/KS-EK-11-002-EN.PDF).

80. *Id.*

81. Eurostat, *Report by Eurostat on the Revision of the Greek government deficit and debt figures* 4 (Nov. 22, 2004) (available at http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/GREECE/EN/GREECE-EN.PDF).

82. *Id.*

83. *Encyclopedia of Nations*, *supra* n. 66.

84. *Id.*

85. European Central Bank, Press Release, *Publication of the December 2005 ECB Financial Stability Review*, http://www.ecb.europa.eu/press/pr/date/2005/html/pr051208.en.html (Dec. 8, 2005)

86. European Central Bank, *Timeline of the financial crisis*, *Key dates of the financial crisis (since December 2005)*, http://www.ecb.europa.eu/ecb/html/crisis.en.html (accessed Mar. 3, 2012) [hereinafter *ECB Timeline*].

avail.[87] On September 15, 2008, Lehman Brothers filed for bankruptcy, marking the beginning of the 2008 global financial crisis.[88]

In June 2009, the ECB launched its first covered bonds program in an effort to, in part, "improve market liquidity in important segments of the private debt security market."[89] The purchases amounted to 60 billion which were spread across the Eurosystem.[90] Not surprisingly, investors that took part in the covered bond program – particularly those invested in Greek bonds – did not welcome the news that "the new government of Prime Minister George A. Papandreou had discovered that its conservative predecessor had falsified budget figures, concealing a swollen debt that was growing rapidly in the wake of the global economic meltdown. Greece was quickly frozen out of the bond markets . . . ."[91]

In April 2010, Greece formerly sought financial support, as Papandreou linked Greece's economy to a "sinking ship."[92] The following month the euro area countries and the IMF agreed to a 110 billion loan package.[93] Although the country took measures to reduce its budget deficit, increasing taxes and cutting public employees' wages by 10%, it nevertheless continued to miss deficit targets.[94] Despite Greece's sinking into a deeper recession, a February 2011 statement by the European Commission, the ECB, and the IMF (collectively referred to as "the troika") reported that the Greek economic program was on track and the troika's collaboration with Greece's government continued to be based on mutual trust and respect of the government's decision-making process.[95]

Amidst massive protests in the streets of Athens, a second bailout was agreed to on July 21, 2011.[96] The second bailout would provide an extra 109 billion of government money, while private sector bondholders would contribute approximately 50 billion by mid-2014.[97] The austerity package that came along with the second bai-

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87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.*
91. *Greece News*, *supra* n. 65.
92. *ECB Timeline*, *supra* n. 86; *Greece News*, *supra* n. 65.
93. *ECB Timeline*, *supra* n. 86.
94. *Greece News*, *supra* n. 65.
95. *ECB Timeline*, *supra* n. 86.
96. *Id.*; *Greece News*, *supra* n. 65.
97. *Greece News*, *supra* n. 65.

lout included more cuts, tax increases, and sales of public companies.[98] In addition, the parties agreed to allow some of the Greek bondholders to swap their bonds for loans with longer maturities and European guarantees.[99] Overall, banks would take a 20% loss rather than a 60% discount that the Greek bonds were trading at.[100]

By September, however, relations with Greece were not as friendly as "European officials angrily stormed out of meetings in Athens, saying that Greece was failing to live up to austerity promises it had made for the first package."[101] On September 27, 2011, before the troika would permit the next $11 billion installment to be handed over, Greece had to pass a massively unpopular property tax.[102] Three weeks later on October 20, 2011, the Greek Parliament approved another round of austerity measures, consisting of more wage and pension cuts, layoffs, and changes to collective bargaining rules.[103] This time, protests turned violent as "[t]ens of thousands marched through Athens on the second day of a general strike."[104]

With no signs of improving, Greece sank deeper into a recession. On October 27, 2011, Eurozone leaders decided to increase the second bailout to 130 billion, and persuaded private banks and insurers to accept a 50% loss on their Greek bonds.[105] Political and social unrest plagued the country during the November and December months of 2011.[106] The troika seemingly had a hand in the replacing of Greece's leaders as protests became increasingly larger and more violent.[107]

Finally, after months of debate Greece secured the second bailout worth 130 billion in February 2012.[108] The costs of the bailout, however, are far and wide. Under the newest austerity package, Greece had to cut government spending by 1.5% of GDP, including more cuts in pensions and additional layoffs.[109] To make the Greece economy more competitive, it must cut the costs of doing business in

98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Greece News*, *supra* n. 65.
103. *Id.*
104. *Id.*
105. *ECB Timeline*, *supra* n. 86; BBC News, *supra* n. 65.
106. *Greece News*, *supra* n. 65.
107. *Id.*
108. *Id.*; *ECB Timeline*, *supra* n. 86.
109. BBC News, *supra* n. 65.

Greece.[110] So the labor market will be more flexible, the troika specifically stated that Greece must dramatically cut "the minimum wage and [must] scrap [the] habit of paying a 'holiday bonus' equal to one to two months' extra pay."[111] Meanwhile, interest rates on loans from Greece's 2010 bailout would be reduced.[112]

For the private sector bondholders, the cost of the second bailout came out to a 75% "haircut," or loss, on their holdings.[113] In late February 2012, in an effort to restructure its debt Greece passed a law that gave the government the right to impose a loss of as much as 75% on any bond governed by Greek law.[114] Because 92% of Greece's outstanding bonds are governed by Greek law, this one act could erase 107 billion euros from its total debt burden of 373 billion.[115]

This time, to ensure the agreed upon reforms in the austerity package are carried out a team of monitors will be based in Athens.[116] Perhaps European leaders are finally starting to realize that one cannot expect bad habits to stop on their own, especially if they have developed over a long period of time. The lesson learned: for corrective measures to be effective a supervisory role typically must be in place, as well as careful monitoring and disciplinary action for lack of compliance.

IV. *Weaknesses in Legal Framework & New Measures*

The impact of Greece's first bailout in April 2010 was felt throughout the European Union. In less than a week, it had caused Portuguese, Irish, and Spanish bond yields to jump as investors questioned the countries' ability to reduce budget deficits and avoid the fate of Greece.[117] It wasn't long before the contagion took effect, and developed into the European Debt Crisis. The already struggling countries were hit the hardest. On November 21, 2010, Ireland officially sought

110. *Id.*
111. *Id.*
112. *Greece News*, *supra* n. 65.
113. Thomas, *supra* n. 64.
114. *Id.*
115. *Id.*
116. BBC News, *supra* n. 65.
117. Fahy, *supra* n. 4.

financial support.[118] Less than five months later, on April 6, 2011, Portugal formally requested financial aid.[119]

In the wake of a European Debt Crisis, light has been shed on the weaknesses in the legal framework of EMU. Naturally, this prompted the need for reform. As such, a series of new measures were developed out of this disastrous storm.

A. *The Failures of the Legal Framework*

First, and most significantly, the EMU's biggest problem was grounded in the reality that the European Union had not prepared for the possibility of a sovereign debt crisis.[120] This is exemplified through the Maastricht Treaty, whereby government bailouts are specifically prohibited.[121] In addition, the Lisbon Treaty of 2007 had further provided a "no-bailout" clause, which stated that "[t]he Union shall not be liable for or assume the commitments of central governments."[122] As a result, in order "to allow the Greek bailout, the 'no-bailout' clause was overruled and the Lisbon Treaty's 'exceptional occurrences' clause was used instead."[123] Under the exceptional occurrences clause, "[w]here a member state is in difficulties or is seriously threatened with difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, union financial assistance to the member state."[124]

Second, when the ECB issues bonds, they are typically structured to be governed by local laws, rather than one supranational law. Therefore, when Greece was forced to take drastic measures to reduce its deficit in February 2012, it made the decision to change its laws so as to permit the Greek government to impose a loss of as much as "75%

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118. *ECB Timeline*, *supra* n. 86.

119. *Id.*

120. *See* European Central Bank, *Sound money, sound finances, a competitive economy – principles of a european culture of stability*, http://www.ecb.europa.eu/press/key/date/2012/html/sp120227.en.html (Feb. 27, 2012). "The architecture of the Economic and Monetary Union (EMU) had been designed without a proper framework to manage a sovereign debt crisis . . . ." *Id.*

121. *See* Stephen Clarke & Claire Daley, *The Eurozone Crisis* 4, http://www.civitas.org.uk/eufacts/download/TheEurozoneCrisis(Oct2010).pdf (Oct. 2010).

122. Lisbon Treaty of 2007, Art. 125; s*ee also* Clarke *supra* n. 121, at 4.

123. Clarke, *supra* n. 121 at 4.

124. Lisbon Treaty, Art. 122.

on all investors who owned bonds governed by Greek law."[125] The implications of Greece's drastic move are far reaching as it now poses the risk that other struggling countries might do the same.[126] For instance, "[m]ore than 97% of the outstanding bonds of Spain, Italy, Portugal, and Belgium are governed by local law. In theory, these countries could enact legislation similar to Greece's and thus pass on the cost of reducing their debt to well-heeled bondholders, rather than to retirees and civil servants."[127]

Third, the SGP has been breached so many times with little or no repercussions, Member States may refuse to recognize its legal personality. In March 2012, Spain announced that it had made the "sovereign" decision to adjust its deficit-reduction target.[128] This announcement came from the Spanish prime minister, who simply stated that "he was acting within guidelines because Spain still intended to hit the European Union's public deficit goal of 3 percent of G.D.P. in 2013."[129] Although the SGP has been reformed twice to impose stricter sanctions for breaking the rules,[130] its credibility has nevertheless been diminished and its future is uncertain.

Although each of these failures played a significant role in causing the Greek Debt Crisis, and the subsequent European Debt Crisis, the European Union has worked to develop new measures to correct and prevent them from reoccurring.

B. *New Measures*

To combat the contagion from spreading any further into Europe, the European Union responded to the crisis with a series of new measures. The most significant of these measures included: 1) reforming the SGP; 2) establishing the European Financial Stability Facility (EFSF); 3) creating such institutions as the European Systemic Risk Board (ESRB) and the European System of Financial Supervisors; and 4) formulating the Basel III Agreement.[131]

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125. Thomas, *supra* n. 64.
126. *Id.*
127. *Id.*
128. Stephen Castle, The New York Times, *Spain Adjusts Deficit-Reduction Target at European Summit* (Mar. 2, 2012).
129. *Id.*
130. *See infra* pt. IV.B.1. discussing the reforms made to the SGP.
131. Clarke, *supra* n. 121 at 6.

1. *Reforming the SGP*

After the SGP took effect, many of the Member States had difficulty following its rules. When it was breached in 2003 by both France and Germany, the largest economies in the Eurozone, the Commission did not take any significant action against them, which thus made the SGP look weak.[132] For this reason, the SGP was suspended and later reformed in 2005 to allow more flexibility.[133] Nevertheless, the SGP was again challenged in 2007 when France "looked to revitalize the French economy outside the SGP framework."[134]

As the economy started to sour toward the end of the decade, the SGP became more susceptible to breach. "In 2009 alone, 14 Eurozone states breached EU rules limiting public debt and annual budget deficits . . . ."[135] As it has been widely recognized, the SGP did not accomplish its goal and thereby "contribute to fiscal policies consistent with membership of a single currency."[136] Moreover, "[p]eer pressure to correct imbalances was largely absent."[137] As such, the 2011 reforms to the SGP have sought to tighten control, making it difficult for Member States who breach the rules of the SGP to avoid financial sanctions.

2. *The European Financial Stability Facility*

In May 2010, in response to the growing concern as to the instability of the euro, the 16 Member States that make up the Eurozone set up the EFSF, a Eurozone-wide fund.[138] The EFSF was meant to "remove the fear that weak Eurozone states wouldn't be able to repay their debt."[139] As such, the money raised can only be lent to Eurozone member states.[140]

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132. Civitas, *EU Facts: Stability and Growth Pact*, www.civitas.org.uk/eufacts/FSECON/EC10.htm (last updated Apr. 12, 2012).
133. *Id.*
134. *Id.*
135. Clarke, *supra* n. 121, at 2.
136. European Central Bank, *ECB: Economic governance and financial stability*, http://www.ecb.europa.eu/press/key/date/2011/html/sp111013_1.en.html (Oct. 13, 2011).
137. *Id.*
138. Clarke, *supra* n. 121, at 5.
139. *Id.*
140. *Id.*

The EFSF raises funds by selling bonds to investors guaranteed by euro-area members.[141] "If a country does draw funds from the EFSF, the IMF will begin an investigation and the country will no longer have an obligation to contribute to the facility."[142] Overall, the EFSF acts as a safety net for the 16 Eurozone states.[143]

3. *The European Systemic Risk Board & the European System of Financial Supervisors*

Following the creation of the EFSF, the European Union sought "to implement wider reforms to reach a long-term solution."[144] In an effort to improve economic governance, one solution involved the formation of the ESRB.[145] The purpose of the ESRB will be to monitor risk across the entire European financial system from 2011.[146] It will advise bodies that it deems risky, and if the advice is not followed it will proceed to inform the European Council.[147]

A second solution to improving economic governance is to revamp European financial regulation, through the use of three new European supervisory agencies operating under the ESFS.[148] These new agencies include the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority.[149] Beginning in 2011, the ESFS has been working with national bodies to supervise individual financial institutions.[150]

4. *The Basel III Agreement*

To prevent another global financial crisis, in September 2010 the Bank for International Settlement agreed to impose new, stricter rules on banks.[151] "The new rules (known as the Basel III Agreement) aim to prevent banks from incurring major losses in financially hard

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141. *Id.*
142. *Id.*
143. Clarke, *supra* n. 121, at 5.
144. *Id.*
145. *Id.*
146. *Id.*
147. *Id.*
148. Clarke, *supra* n. 121, at 6.
149. *Id.*
150. *Id.*
151. *Id.*

times."[152] To accomplish this goal, all banks will be required to increase their capital ratio from 2% to 7%.[153] This way, during a financially difficult time banks may reduce their capital ratio to 4.5%.[154] However, should a bank choose to make this reduction, it will be forced to restrict the bonuses and dividends it pays out until it returns to the regular 7%.[155]

Banks will have until 2019 to fully implement the Basel III Agreement.[156] That being said, the Basel III Agreement only sets the minimum standard that all banks are required to comply with.[157] Should a national government choose to set a higher standard, it will be permitted to do so.[158]

CONCLUSION

As the 2012 year continues, time will only tell whether the European Union's new measure will be successful in saving Greece from a default and stabilize the European Monetary System. The legal framework of the EMU as set out in the Maastricht Treaty, set it up for failure and allowed the struggling countries, such as Greece, to jeopardize the economic stability of the European Union. Although sovereignty is a fundamental right of all states, the Members States should have realized there were trade-offs with regard to sovereignty when they elected to form an EMU.

Overall, this Comment concludes that the European Union's Member States can no longer afford to think only inward. That is, the European Union is too interconnected to not be involved in the Member States' domestic affairs. When the Member States agreed to form the EMU, and with it a single currency, they failed to realize what their true role as a Member State would be in the larger European Union. With regard to EMU, when considering what is best for their countries, the answer may no longer lie at the sovereign level, but rather at a supranational level. Furthermore, those who oppose supranational authorities interfering at the state level may find themselves only causing more long-term harm to their country. European govern-

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152. *Id.*
153. Clarke, *supra* n. 121, at 6.
154. *Id.*
155. *Id.*
156. *Id.*
157. *Id.*
158. Clarke, *supra* n. 121, at 6.

ments, at both the state and supranational levels, need to step back and truly consider what is best for the people in the end. If greater supranational powers are the answer, so be it.