The Failure of the Lisbon Treaty to Mitigate the Eurozone Economic Malaise

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The Failure of the Lisbon Treaty to Mitigate the Eurozone Economic Malaise

By: Matthew G. Frias

Supervisor: Professor Peter Steiner

PPE 301: Honors Research Paper

28 April 2011
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ABSTRACT

The primary currency operating in the European Union, the euro, became a reality on January 1\textsuperscript{st}, 1988.\textsuperscript{1} On January 1\textsuperscript{st}, 2002, euro bills and coins became legal tender in select “Eurozone” member states. By 2008, the euro was the currency of 15 countries and 320 million people.\textsuperscript{2} The adoption of the euro had a multifaceted purpose – to pull Europe together economically and politically, ending the incessant battles over who could devalue their currency the fastest and debilitate their neighbor. In addition, this currency was supposed to nobly finish the generations-long effort to establish lasting peace and shared prosperity to a frequently war-torn continent.\textsuperscript{3}

However, the currency’s creators ignored the difficulties a shared currency would invariably encounter. In this paper, it is argued that the Lisbon Treaty’s glaring lack of a discussion of protections for the Eurozone states, improvements to financial oversight, and stipulations to expand the E.U. economic institutions were counterproductive in mitigating the current crisis and helping the resulting recovery efforts. Although Treaty formulation was before the 2008 crash, ratification was well after, and E.U. policymakers already understood during this period that Europe’s institutions needed were insufficient to make a common currency sustainable.

Hence, it is asserted that policymakers’ untimely non-economic focus in crafting the Lisbon Treaty’s subject matter indirectly prevented future Eurozone stability because of the lack of resulting improvements to the Union’s economic institutions and fiscal oversight mechanisms. The latest data is included in this report to show how the Eurozone is floundering in 2011. Furthermore, case studies on Eurozone states Portugal, Spain, Greece, and Ireland will be used as evidence in the paper to illustrate the dire economic situation that could have been better addressed and possibly mitigated by a more comprehensive Lisbon Treaty.

\textsuperscript{1} Ladrech, page 32
\textsuperscript{2} Karolewski, page 35
\textsuperscript{3} Ladrech, page 148
CHAPTER 1: INTRODUCTION & ARGUMENT OVERVIEW

For the past few years, the European Union’s “Eurozone,” the collection of seventeen member states that adopted the euro currency, has been facing a currency crisis. This crisis largely stems from the monumental debts of its weakest states’ economies, such as Greece and Portugal, or those most damaged by the global recession, like Ireland and Spain. This economic predicament is a result of several factors, several of which were preventable. These causes will be addressed through a lens examining the Lisbon Treaty, the newest ratified accord governing the E.U., and its role in perpetuating the Union-wide economic malaise.

The E.U. vies with the United States for the title of the world’s biggest economy, with each accounting for about 20% of global gross domestic product. However, there are concerns stemming from the current European sovereign debt crisis that the E.U.’s hegemonic economic status may be coming to an end. This is partially because the debt crisis is posing great risks to many of the continent’s banks, which have generally invested great sums of money into government bonds. Additionally, the crisis forced implementation of austerity measures from the state governments which resulted in deep government spending cuts. An example of the direness is how the E.U. and the external International Monetary Fund put together several bailout packages for Greece, one of the main culprits in the sovereign debt disaster.

It is argued in this paper that the Eurozone mess directly relates to the flaws of the Lisbon Treaty. During its formulation, proponents claimed that it was necessary for the E.U. to “modernize and reform” in order to reach the Union’s full potential. After all, the twenty seven-state E.U. was operating with rules designed for a 15-member state Union. However, there

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4 Krugman, pages 1–4
5 Bache, pages 9, 100
6 Europa.eu; Ladrech
7 Bache, page 9
were insufficient provisions relating to safeguarding the Eurozone from internal and external negative fiscal influences. It is contended in this work that the economic hazards are the largest threats to European unity, particularly in the euro area. Instead, there was a misplaced focus on less pressing topics such as climate change, energy security, and international terrorism.

While one of the major objectives for policymakers with the Treaty was to “increase efficiency in the decision-making process” by streamlining the E.U. institutions, there was not enough emphasis placed on safeguarding the economies within the Eurozone.\(^8\) The contention is that there were signals before and during the Lisbon Treaty ratification that were not addressed in the accord, partially because of a focus on then-misplaced national sovereignty concerns.\(^9\) This argument is supported by following case studies of Portugal, Spain, Greece, and Ireland.

What may be most perplexing is how the leaders of the E.U. institutions and the key E.U. governments consistent claim, even before Treaty ratification, that they “will do whatever is necessary to protect the euro.”\(^10\) However, there were insufficient measures within the Treaty; hence, there are only reactive measures to stop the fiscal hemorrhaging that further economic and political integration. It is asserted that the following should have been recognized by the Treaty:

- Far more euro area oversight on economic strategies of member state governments
- The creation of new economic institutions to assist the ECB in executing its functions
- Standardized and more guidance for the peripheral euro area economies with austerity plans
- Standardized and codified rules for future bailout agreements in the Union
- Possible restructuring of future bailout agreements to guarantee bigger sacrifices by bank shareholders and bond holders rather than E.U. taxpayers
- Tougher EU regulation of the entire financial services industry
- Increase in the financial aid available to help countries in difficulty
- Reductions in the interest charged on financial aid to the euro area states in crisis
- Harsher sanctions against those deliberately undermining the agreed euro conditions
- Further economic unification within the euro area
- Stipulated pressure on the stronger euro area economies to expand domestic demand

\(^8\) Krugman, page 7
\(^9\) Karolewski, page 111
\(^10\) Palmer, page 1
CHAPTER 2: METHODOLOGY ADOPTED

The approach used in this paper is a blend of argumentative-style thesis and illustrative essay. All arguments in this paper are approached with the objective of showing a link between the Lisbon Treaty’s insufficient monetary policy discussion, the crises in the Eurozone, and the resulting fragmented E.U. responses. Four member states, all of which are unequivocal examples of the current problems, were selected to illustrate and reinforce the paper’s thesis. Various tools, such as graphs, diagrams, and charts, are used to convey the author’s argument.

There are limitations to this study because of the evolving nature of the subject matter. Firstly, the targeted data and statistics used to compare and contrast the economic health of the chosen states pre-Treaty and post-Treaty were hard to obtain due to conflicting reports. Secondly, peer reviewed journals were seldom used because of a paucity of analysis and findings on the Eurozone’s latest economic developments. Periodicals were also utilized sparingly because of the lack of peer reviewed information obtained to verify their findings. Finally, a reporting slant was often used in order to concisely communicate the most recent economic problems in the Eurozone together with perceived Lisbon Treaty omissions.

While all arguments in this paper are put forth from a Treaty-centric lens, the current state of the Eurozone will be highlighted with the most up-to-date information available drawn from a variety of sources, again in reporting style. In addition to the discussion of what are perceived to be the Lisbon Treaty’s most harmful omissions, emphasis will be placed on the four aforementioned states because of the urgency policymakers have in reactively addressing the sovereign debt crisis created in large part by these four. The paper will also discuss the current problems and future of the euro. Projections that may be proven false are offered on how the debt crisis will affect the contours of the Eurozone and the collective unity of the E.U.
The Lisbon Treaty was designed to reinforce the Union’s capacity to act through strengthened external coherence, a broadened range of internal policies, more effective delivery of results and policy achievements, and up to date institutions that can function in an enlarged E.U.\textsuperscript{12} The Treaty appears to be successful with respect to its foreign affairs, Union-wide security, and humanitarian agendas. However, it is argued that the Treaty failed in addressing what are the Union’s current concerns: to ensure economic growth and competitiveness, create stronger institutions relevant to the Eurozone (all member states shown above), and protect the currency.

As a result, there were many staggered reactive policies and multibillion euro funds created post-crisis. Made just months post-Treaty, these policies and funds appeared to embarrass the

\textsuperscript{11} Karolewski, page 18
\textsuperscript{12} Castle; Karolewski, pages 100-111
Treaty’s creators. The Union’s senior leaders, working in tandem with the International Monetary Fund (IMF), was considering an overhaul of the 440 billion euro rescue fund earlier this year. In addition, at a separate time and place, the leaders were working on new austerity measures and closer surveillance on struggling states such as Greece and Portugal.

This illustrates two separate points supporting the contention that the Lisbon Treaty was insufficient in the economic policy domain. The first is that the E.U.’s coordination with the IMF, an increasingly close relationship, shows how the Union’s own institutions are not enough. As previously stated, the Treaty was created in part to address any institution deficiencies by streamlining their processes. The problem is that economic institutions were neglected. Furthermore, the creation of an “E.U. IMF” appears increasingly desirable. These two points regarding Lisbon Treaty omissions will be expanded in the ensuing sections.

Another after-the-fact proposal after the debt crisis emerged that will be further discussed in this paper is the anticipated European Rescue Fund of the European Financial Stability Facility (EFSF). The Union is changing the Treaty to create a permanent bailout fund to operate after 2013, and the changes to the current fund could be one part of a far more comprehensive overhaul.

European finance ministers discussed ways to increase the financing capacity of the EFSF and broaden its role to “allow it to buy bonds or extend credit to countries, perhaps to help in future bank restructuring.” However, although European Commission president José Manuel Barroso and Finance Minister Wolfgang Schauble are both advocates of the reactive proposal, the Eurozone’s 17 member states were not united in support of the EFSF changes.

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13 Castle, page 1
14 Brookings Institution, 2010 CUSE Annual Conference
15 Rose and Spiegel, page 324
16 Brookings Institution, 2010 CUSE Annual Conference
17 Alderman, page 22
18 Castle, page 1
Germany, the Eurozone’s strongest economy, was opposed to the idea of increasing the rescue fund and the EFSF’s power.\textsuperscript{19} The differences among Eurozone states’ economic health is most dramatic when comparing Germany to Portugal and Greece. Although shown in detail in later sections of this paper, while Greece, Ireland, and Portugal enacted domestic austerity measures like large governmental spending cuts and tax increases, Germany expanded by 3.6% according to its price-adjusted GDP.\textsuperscript{20}

This illustrates a growing economic divide across the Eurozone, and it is contended that the euro’s survival in its current form and under the Lisbon Treaty’s flawed auspices can no longer be taken for granted. This is because the strongest Eurozone states like Germany are still threatened by their weaker currency allies because their desirable 3.6% growth will be mitigated as its government spends more to keep the euro afloat.\textsuperscript{21} The state’s fellow Eurozone members will also reduce their purchases of German imports, further hurting the manufacturing giant. Germany is an example of member states preferring Treaty-led changes to E.U. institutions instead of an ad hoc approach to combat the recession amid austerity.

While the Treaty did not address the concerns of negative fallout from one Eurozone member state to another, it is asserted that it also did not sufficiently address the ongoing threat of Union-wide bank failures. In the section on the case study of Ireland, it will be discussed how the state needed a bailout because the government arranged to backstop its failing banks, whose financial precariousness overwhelmed the state’s treasury. Spain, another country dissatisfied with the status of the Eurozone and petitioning for a bailout from the E.U., is another example supporting the contention that the Lisbon Treaty needed more emphasis on safeguarding the common currency.

\textsuperscript{19} Krugman, page 17  
\textsuperscript{20} Alderman, page 21  
\textsuperscript{21} Krugman, page 12
The graphic above illustrates how Germany, measured by both aggregate GDP and per capita GDP metrics, is in better fiscal shape than Spain, Greece, and Portugal, the examples used in this paper. The diagram illustrates which of the Eurozone states are least economically powerful, several of which will be detailed in this work. To reiterate, with these weak economic power like Portugal and Greece, their governments must get their states’ costs down by reducing wages, compensation, and income while simultaneously slashing spending and raising taxes.\textsuperscript{22} It is no coincidence that the E.U. finance ministers pledge to increase the banking stress tests’ frequency and the monitoring rules governing bankers’ compensation particularly in these states.\textsuperscript{23}

In exchange for bailout funds, Michel Barnier, the European commissioner for banking, has been appealing to the financial institutions in the least well-off states shown above for:\textsuperscript{24}

- Restraint on pay
- Respect for the austerity measures across the Eurozone states
- Acceptance of far more stringent bank stress tests
- Acceptance of more monitoring of the new capital rules (limits on compensation, etc)

\textsuperscript{22} Krugman
\textsuperscript{23} Castle, page 1; Brookings Institution, 2010 CUSE Annual Conference
\textsuperscript{24} Castle, page 1; Rose and Spiegel
While Mr. Barnier acknowledges that these requests were not mandated by the Lisbon Treaty, Barnier points to the states I will detail. He highlights how Ireland is struggling to avoid bankruptcy while Spain, a booming economy until 2008, now has 20 percent unemployment and faces the “prospect of years of painful, grinding deflation.” The banking commissioner primarily created the aforementioned list for banks within the Eurozone because of the threats to the euro. In addition, Barnier presumably attempts to avoid another bailout funding scenario in the future.

To continue, the E.U. banking commissioner’s quest to protect the euro and avoid future bailout situations is because of the euro itself. Below is a list of the most prominent advantages brought about by the Eurozone and a single European currency:

- No need to change money when one travels into another Eurozone state
- With respect to interstate trade:
  - General positive effects on interstate trade
  - No more uncertainty for importers about what contracts will cost
  - No more uncertainty for exporters about what promised payment would be
- Idealistic notion that a shared currency would strengthen the sense of European unity
- All in all, business becomes simplified and large economic gains result

However, the commissioner’s beliefs on a currency union are contradicted by the deleterious effects of Portugal, Spain, Greece, and Ireland on the rest of the Union. By giving up a state’s independent currency and joining the Eurozone, the state also gives up economic flexibility. Stronger Eurozone states like Germany immediately recognized this, and as a result of not wanting to be automatically exposed to other states’ financial issues, Europe remains not fiscally integrated.

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25 Krugman, page 1
26 Brookings Institution, 2010 CUSE Annual Conference
27 Krugman, page 7
28 Rose and Spiegel, pages 310, 324
29 Karolewski, page 29
30 Rose and Spiegel, pages 323-324
For example, Germany’s taxpayers do not automatically pick up any part of the cost for Greece’s pensions or Ireland’s bank bailouts. The stronger states’ hesitation to fully fiscally integrate is intuitive because of the checkered history of states like Greece.\footnote{Devereux and Sutherland, pages 427-428} Greece has a record of high inflation and debt defaults that long preceded inclusion into the Eurozone. This lack of fiscal integration, Princeton economist Paul Krugman believes, is a potentially fatal flaw of the Eurozone that was not addressed by the Lisbon Treaty. In addition, the Treaty did not sufficiently empower the European Central Bank to force states to enact anti-inflationary measures.

What resulted from the debt crises in the highlighted states was harmful to nearly every economic sector.\footnote{Rose and Spiegel, pages 310, 311} Even sectors perceived to be immune from domestic banking like tourism were impacted. When measuring the 2010 tourism industry’s performance in Greece, Ireland, and Portugal, it was apparent that the weak euro-dollar exchange rate, irresponsible construction boom, and resulting fire-sale prices for hotels and tours were not enough to attract tourists to the four highlighted states.\footnote{Bache; Tunkrova and Saradin} The entire Eurozone was cheaper for Americans, and the best bargains were found in the sovereign debt crisis’ hardest-hit countries. Yet visitors to Ireland dropped to 6.6 million in 2010 from 7.6 million in 2009.\footnote{Alderman, page 11}

Yet, the difficult questions remain: Why did the Lisbon Treaty not include significant measures to control a scenario like we see today? Were the signs of economic crises readily apparent only after Treaty ratification? What are the measures that the Union are forced to create post-crisis? Are these measures enough? In the following sections, the answers will be provided through description of the Eurozone’s current status and thorough explanation of the situations in four of the hardest-hit states.
CHAPTER 4: PRELUDE TO PRESENTATION OF ECONOMIC FACTS

Krugman argues that the greatest threat to a “European federation” the Union policymakers strive for is the failure of the euro. His explanation of the calamities in Greece, Spain, and Ireland confirm the selection of these states as cases meriting further discussion in the paper. To complement the diagrams that are shown in this section, it is important to summarize the pertinent state-specific contexts. This is because the context, provided in this section’s introduction and in the chapters for each state, will provide the causes for the countries’ poor performances on the metrics.

For instance, even before Lisbon Treaty creation, Greece’s conservative government incurred far more debt than it actually reported to the Union. This was during a period of easy borrowing for Eurozone states. Even though there were suspicions from Union officials, the Lisbon Treaty failed to provide stipulations mandating an increase in oversight especially for Eurozone state governments to avoid this situation with Greece in the future.

Nevertheless, Greece’s government changed composition in 2009 and all of a sudden the accounting misreports were revealed. The European Central Bank was surprised because Greece had both a much bigger deficit and substantially more debt than was expected. Greece’s new leaders eventually revealed that over $400 billion was the accurate amount of the debt owed to external creditors. As a result, for the past three years, investors have avoided Greece, which led to lenders losing confidence in the state and subsequent interest rate rises on the debt owed.

While Spain and Ireland are also facing poor economic performance, the causes are very different from those in Greece. State-collected revenue fell for the past three years in Ireland and Spain largely because real estate transactions were primary components for tax receipts. As the real estate bubble burst across the Union, unemployment steadily rose, and so did the cost of unemployment.

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35 Krugman, page 20
36 Krugman, page 14
37 Alderman & Castle; Brookings Institution, 2010 CUSE Annual Conference
benefits that the governments had to pay. For instance, at its height, Spain had a 20% unemployment rate.\textsuperscript{38} Krugman calls these states “European welfare states” because they have more comprehensive entitlement programs to protect their citizens than in America.

This situation of falling revenues and rising unemployment claims made both Spain and Ireland go from budget surpluses to massive budget deficits by 2009. With the E.U. not streamlining financial clean-up procedures for banks in the Lisbon Treaty, the efforts were fragmented for months. The solvency of Irish banks was questioned, along with the smaller Spanish savings banks, during the months between Lisbon Treaty creation and ratification. Yet policymakers did not appear to attempt to change the content of the Treaty to incorporate an increasingly pressing concern. With little coordination with the Union, these member countries used ad hoc plans to keep the banks from collapsing. What resulted was a situation like Greece where investors and lenders lost confidence in Ireland and Spain and the stronger European nations were forced to provide these states with emergency credit lines, averting a Eurozone-wide implosion and reliance on private credit markets.

Krugman predicts that “debt restructuring” will be the painful but necessary path for Greece, Spain, Ireland, and even other Union members like Belgium and Italy.\textsuperscript{39} Debt restructuring is one way the “vicious circle” of falling investor and lender confidence and rising interests costs can end.\textsuperscript{40} If this were to happen in Greece, it would not be a panacea because if the government even were to repudiate all its debt, it would still have to slash spending, raise taxes to balance its budget, and go through a period of deflation.\textsuperscript{41} It is unclear if the Lisbon Treaty could have provided an alternate means for these Eurozone states, but its creators designed the accord with only the most urgent concerns in mind. It is clear that the financial crisis was not sufficiently considered in their calculus.

\textsuperscript{38} Krugman, page 10
\textsuperscript{39} Krugman; Karolewski
\textsuperscript{40} Tunkrova and Saradin
\textsuperscript{41} Karolewski; Ladrech
CHAPTER 5: PRESENTATION & DESCRIPTION OF ECONOMIC FACTS

This graphic shows the economic health of the Eurozone states in comparison to the United Kingdom’s. Additionally, the map above illustrates how Greece and Portugal in particular have failed the metric of national debt as a percentage of GDP in 2009.\(^{43}\) Greece alone had over $400 billion in debt in 2009.\(^{44}\) But the entire Eurozone performed better in 2010 in terms of growth and unemployment rates. Last year, across the 17 nations that adopted the euro, growth was 0.4% on average. Furthermore, the area’s unemployment rate was 10%, 2% below the rate in 2009.\(^{45}\)

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\(^{42}\) bbc.co.uk, In Graphics: Eurozone in Crisis; Eurostat, page 1
\(^{43}\) Ewing and Werdiger
\(^{44}\) Krugman
\(^{45}\) Ewing and Werdiger
Yet Portugal, Greece, and Spain all were below the Eurozone averages for the three aforementioned metrics. As mentioned, Ireland and Greece relied on their Eurozone partners for financial aid. Because of this, the E.U. chiefs like Nichoals Sarkozy and Angela Merkel appeared dissatisfied with the Lisbon Treaty and at the early March meeting of leaders in Brussels, the leaders proposed pushing the euro area towards a de facto economic government.\textsuperscript{46} This is another example of the fragmentation of economic policymaking that the Lisbon Treaty failed to address.

The primary objective of creating a closer-knit euro area is to protect the euro currency. At the meeting, the leaders debated on several policy areas:\textsuperscript{47}

- Increased euro area oversight of the tactics of Eurozone-area state governments
- Increase in financial aid available to help alleviate sovereign debt crisis in states
- Increased regulations on financial market operations in Eurozone
- Decrease in interest charged to the states in difficulty in Eurozone like Greece and Ireland

These topics were identical to those mentioned in the thesis of this paper. To reiterate, the paper’s argument was that the Lisbon Treaty should have been the medium to legalize, commemorate, and enforce these recommendations. The primary objective of creating a closer-knit euro area is to protect the euro currency. This is the most pressing topic for the Eurozone at the moment, so it should have been foreseen by the Union policymakers during the process of Treaty ratification. As a result, Union leaders were unprepared and sluggish in responding to how euro area members like Greece and Ireland pay well over 75\% of their export revenues toward their external debt.\textsuperscript{48} In the chart below, it is evident that under the umbrella of the euro, there is a dichotomy between the strong and weak member states, an issue unresolved by the Lisbon Treaty.

\textsuperscript{46} Palmer, page 1
\textsuperscript{47} Palmer
\textsuperscript{48} Ladrech, page 29
It is no coincidence that the following four case study sections correspond with the four Eurozone states with the worst marks of deficit as % of GDP. In the above chart readers can see how, in ascending order, Portugal, Spain, Greece, and Ireland are the poorest Eurozone states when measured by the 2009 deficit as % of GDP metric. This and the ramifications of this for Union policymakers will be detailed in the next section of the paper.

Briefly, one of the main causes of the current Eurozone currency crisis is that the majority of the 17 zone states have broken their self-imposed monetary rules. Under the convergence criteria mandatorily adopted by all 17 as part of monetary and economic union, the annual government deficit must not exceed 3% of GDP. In addition, as it is shown in the following chart, government debt must not exceed 60% of GDP at the end of the last fiscal year. As the two maps illustrate,

<table>
<thead>
<tr>
<th>Country</th>
<th>Total debt (% GDP)</th>
<th>Total debt (€ m)</th>
<th>2009 deficit (% GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>64</td>
<td>104,667</td>
<td>14.3</td>
</tr>
<tr>
<td>Greece</td>
<td>115.1</td>
<td>273,407</td>
<td>13.6</td>
</tr>
<tr>
<td>UK</td>
<td>68.1</td>
<td>1,067,819</td>
<td>11.5</td>
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<tr>
<td>Spain</td>
<td>53.2</td>
<td>559,050</td>
<td>11.2</td>
</tr>
<tr>
<td>Portugal</td>
<td>76.8</td>
<td>125,910</td>
<td>9.4</td>
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<tr>
<td>France</td>
<td>77.6</td>
<td>1,489,025</td>
<td>7.5</td>
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<tr>
<td>Slovakia</td>
<td>35.7</td>
<td>22,585</td>
<td>6.8</td>
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<td>Cyprus</td>
<td>56.2</td>
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<tr>
<td>Belgium</td>
<td>98.7</td>
<td>326,808</td>
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<td>Slovenia</td>
<td>35.9</td>
<td>12,519</td>
<td>5.5</td>
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<tr>
<td>Netherlands</td>
<td>60.9</td>
<td>347,021</td>
<td>5.3</td>
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<tr>
<td>Italy</td>
<td>115.8</td>
<td>1,760,765</td>
<td>5.3</td>
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<td>Malta</td>
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<td>Luxembourg</td>
<td>14.5</td>
<td>5,464</td>
<td>0.7</td>
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SOURCE: Eurostat. All figures for 2009

49 Eurostat Press Office
50 Ladrech; Tunkrova and Saradin; Rose and Spiegel, pages 310, 324
51 Krugman; Rose and Spiegel, pages 310, 324
only two of the Eurozone states, Luxembourg and Finland, abided by both stipulations.\textsuperscript{52} Where was the Lisbon Treaty to propose new enforcement of the convergence criteria?\textsuperscript{53} What happened to strengthening the E.U. institutions and streamlining decision-making across the organizations to prevent systemic and widespread rule infringement?

![Total debt (% GDP)](image)

In examining the two metrics shown in the two above graphics, readers can see the scope of the problem facing Eurozone member state Greece. Greece is the worst offender of the convergence criteria, with debt at 115.1\% of GDP and a deficit of 13.6\% of GDP, numbers well above the 60\% and 3\% limits.\textsuperscript{55} However, the numerical levels of the debt are not the sole issue, which, to be fair, dramatically rose after Lisbon Treaty creation. What was well-known by the

\textsuperscript{52} Bbc.co.uk, In Graphics: Eurozone in Crisis
\textsuperscript{53} Ladrech
\textsuperscript{54} Bbc.co.uk, In Graphics: Eurozone in Crisis
\textsuperscript{55} Tunkrova and Saradin
Treaty’s composers was how perception and past identity of a state influences a state’s prospects for economic recovery.

<table>
<thead>
<tr>
<th>Euro area (EA17)</th>
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<th>2010</th>
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<td>GDP market prices (mp) (million euro)</td>
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<td>9,264,270</td>
<td>8,970,953</td>
<td>9,204,316</td>
</tr>
<tr>
<td>Government deficit (-) / surplus (+) (million euro)</td>
<td>-60,082</td>
<td>-188,988</td>
<td>-568,680</td>
<td>-550,481</td>
</tr>
<tr>
<td>(% of GDP)</td>
<td>-0.7</td>
<td>-2.0</td>
<td>-6.3</td>
<td>-8.0</td>
</tr>
<tr>
<td>Government expenditure (% of GDP)</td>
<td>45.9</td>
<td>46.9</td>
<td>50.8</td>
<td>52.4</td>
</tr>
<tr>
<td>Government revenue (% of GDP)</td>
<td>45.2</td>
<td>44.8</td>
<td>44.5</td>
<td>44.4</td>
</tr>
<tr>
<td>Government debt (million euro)</td>
<td>5,984,848</td>
<td>6,472,881</td>
<td>7,118,276</td>
<td>7,937,207</td>
</tr>
<tr>
<td>(% of GDP)</td>
<td>68.2</td>
<td>69.0</td>
<td>79.3</td>
<td>85.1</td>
</tr>
</tbody>
</table>

When Greece was pledging to the convergence criteria years ago, it was met with skepticism from states like Germany and Luxembourg because of Greece’s reputation. It is argued here that the Lisbon Treaty should have included explicit directions on recession-related topics like bailout packages, enforcement of convergence criteria rules, and monitoring of state government economic strategies. This is because while the scope of the sovereign debt crisis was not known during December 2007, the Treaty could have easily prevented in part the distrust among Eurozone states today.

Additionally, in examining the chart above, it is argued that the deteriorating economic health of the euro area between Treaty formulation in 2007 and Treaty ratification in late 2009 was a tell-tale sign that was not heeded in the accord. The evidence provided in this illustration shows how the aggregate rises in the governments’ deficits and debts coupled with rising government expenditures and declining state revenues were blatant threats to the currency union. In the following sections, the four states with the largest government deficits as a percentage of GDP will be detailed because these states were telling signals for policymakers to enact necessary changes to the euro area governance that were ultimately not made in the Lisbon Treaty.

However, despite the botching by the Lisbon Treaty regarding enforcement and monitoring, the most recent data from the last quarters of 2010 appear promising for the Eurozone, save for the Netherlands, Ireland, and Greece. This graph illustrates how the Eurozone as a whole emerged from recession, but the growth rates are still fragile and below 5% in most states. Across the 17 nations, growth was approximately 0.7% for 2010. Ireland and Greece, which will be detailed shortly, are hindering the currency area’s progress because both turned to their European partners for financial aid.

Jean-Claude Trichet, president of the European Central Bank (ECB), has been fearful of several factors that could stymie further growth in the Eurozone in 2011. He also voiced dissatisfaction with the Lisbon Treaty’s lack of governance during the sovereign debt crisis.

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59 Rose and Spiegel, pages 310, 324
60 Ewing and Werdigier, page 20
Some of the influences he is monitoring with the ECB are:\footnote{Sadeh and Verdun, page 277}:

- 2.2% inflation rate in the zone in the fourth quarter of 2010
- Government spending cuts in Portugal, Greece, and Ireland
- Rising seasonal oil prices
  - Causing a general increase in prices across sectors
- Upcoming revelations a la Greece about underreported national debt levels
  - From Italy and other currency area states

ECB president Mr. Trichet chose to protect the growth by raising the interest rate from 1% to 1.25%.\footnote{Saltmarsh, page 1} This is primarily to keep inflation down, especially among the states suffering most in the sovereign debt crisis. Mr. Trichet’s ECB also dealt with the sovereign debt crisis directly by buying Irish, Portuguese, and Greek government bonds and flooding the financial system with cheap loans to their states’ banks.

Yet, his decisions appear to be opposed by economists in these three states, as they claim that their states will suffer because they already have difficulty borrowing money at reasonable rates. However, it is argued that since the 1% interest rate was an historic low, other Eurozone states have exhibited growth as shown above, and Portugal, Greece, and Ireland already secured their emergency bailout requests, the ECB made the right choice with the interest rate changes.

The ECB has had difficulty monitoring and managing its affairs during the past three years. It is argued that the Lisbon Treaty should have set a better path for Mr. Trichet and the ECB to follow during this historic time.\footnote{Sadeh and Verdun, page 277} For instance, the ECB helped formulate the aforementioned stress tests for banks, but like those in 2010, these tests are expected to be criticized as too lax.\footnote{Saltmarsh, page 2} These tests are also another way the ECB attempts to protect the promising growth shown in the last graphic. The Treaty was a perfect medium to stipulate the conditions for such tests, which were initially
formulated between Treaty formulation in 2007 and ratification in 2009. No discussion of these stress tests is another instance of the myopia by policymakers with the Lisbon Treaty.

Above, we can see two metrics – the latest unemployment data and the average full-time earnings for the Eurozone states. The global recession, while unforeseen at the time of the Treaty’s creation, impacted the unemployment rate across the entire area. The zone’s overall unemployment rate was over 10% in 2010. What we can see from both graphics is how wide the divide is between the stronger and weaker states within the Eurozone. Comparing and contrasting Germany and the Netherlands to Greece and Portugal on both aforementioned metrics will show how far the currency union is from total economic convergence.\(^6^6\) The wide variations in unemployment levels across the member countries, which were similar in range before Treaty ratification, and measures to combat disparities within the Eurozone, ostensibly should have been addressed within the Lisbon Treaty.

\(^{65}\) Bbc.co.uk; Sadeh and Verdun, page 280
\(^{66}\) Tunkrova and Saradin, page 190
The latest unemployment and the average full-time earnings data for the Eurozone states also reflect the disparate effects of Europe’s debt crisis. Many Eurozone states face hard choices between cuts, growth, debt, and democracy. It is argued that partially because of the Lisbon Treaty these choices are not standardized and long-term monitoring of individual states’ monetary strategies is insufficient. As a consequence, the E.U. becomes more fragmented in its currency union. As shown above, Germany and Sweden returned to pre-crash rates of growth while Greece, Portugal, and Ireland remain dependent on bailout packages.

In the next chapter, the analysis will continue on the above data. Furthermore, discussion on the Eurozone’s future “European Stability Mechanism,” its €700 billion bailout fund, the prospect of future bailouts to indebted euro area states, and incoming austerity eras will all continue to show how the Lisbon Treaty in its original state does not address the most pressing concern to the European Union.

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67 Rose and Spiegel, pages 313-316
68 Rose and Spiegel, pages 310, 324
Minor changes to the European Central Bank, detailed in the previous paper, were the only modifications to the E.U. in the Lisbon Treaty that were directly linked to the mitigation of the Eurozone sovereign debt crisis.\textsuperscript{70} As discussed, recently ECB head Mr. Trichet was forced to decide to either keep interest rates at all-time lows or raise the rates. Neither option is perfect – if the ECB kept rates at record lows, Eurozone growth would be protected, but inflation would become a growing concern in the currency area. No guidance was provided from the Treaty. Additionally, property market bubbles and the simplicity to which private banks financed the deleterious property boom in Spain and throughout the area would not be resolved.\textsuperscript{71}
If Mr. Trichet increased the interest rates, the ECB would be faced with austerity measures across the Union, which would dampen consumer and interstate commerce demand. Furthermore, Spain, Italy, and Belgium could be forced to join Portugal, Ireland, and Greece on the list of Eurozone states pleading for a formal E.U. bailout.\textsuperscript{72} Trichet has been vociferous in his displeasure with how the Lisbon Treaty did not stipulate explicit terms or even general guidelines for future bailouts or monitoring assistance for the ECB.

This financial crisis has shown that the ECB needs to be concerned about a litany of economic circumstances, and not just its primary concern of fighting inflation. In addition, it appears as though the ECB and its affiliates are overwhelmed in the midst of this sovereign debt crisis because they have to simultaneously monitor and advise the 17 separate states in the Eurozone.\textsuperscript{73} The Maastricht requirements, the aforementioned convergence criteria, are not doing their job of ensuring that only fiscally sound states join the Eurozone. The Lisbon Treaty made no such updates to these criteria, nor did it enact new guidelines that current currency area participants must follow. From managing interest rates and coordinating multi-billion euro bailout packages to monitoring E.U. fund dispersals, the ECB needs more affiliates.

A suggestion is to create an E.U. institution identical to the International Monetary Fund (IMF).\textsuperscript{74} The IMF is an intergovernmental organization in charge of overseeing the entire global financial system. The institution closely monitors the macroeconomic policies of the member countries, especially the policies that impact the balance of payments and exchange rates. The IMF’s purposes are manifold: it stabilizes international exchange rates, facilitates development

\textsuperscript{72} Boyer, page 1
\textsuperscript{73} The Brookings Institution, 2010 CUSE Annual Conference
\textsuperscript{74} Boyer, pages 3-4
through encouraging the liberalizing of economic policies in lieu of IMF-given loans, debt relief, and aid, and offers loans to the debt-ridden states.\textsuperscript{75}

The argument espoused here is that Europe needs its own IMF because of several reasons, all of which were not memorialized in the Lisbon Treaty. Firstly, the convergence criteria are increasingly a sham, as they are not holding states accountable for their egregious violations of the agreed-upon criteria. An E.U.-IMF would carry out the oversight on recently joined euro area states that is currently lacking. In addition, the ECB needs support in monitoring the Eurozone state governments, and the ECB also demands assistance in coercing the more powerful states in the area like Germany to offer loans to other euro area members at reasonable rates and finance more of the future bailout packages to the debt-ridden states in the South.

The two needs listed above go beyond a need for only an E.U. rating agency because, when coupled with the strain on the ECB, it is recommended that an institution akin to the IMF be formulated. The aforementioned dubious management of the interest rates by the ECB, partially blamed for perpetuating the sovereign debt crisis in Spain and Greece, would be mitigated in the future by this proposed organization. Installing this group of macroeconomic coordinators that will advise state governments on problems with borrowing and investing is necessary. This proposed institution will also allow the ECB to keep its focus on inflationary concerns.

It is asserted that the Lisbon Treaty overlooked this need, and as mentioned, a consequence is that fragmented actions instead of a unified approach to combat the debt crisis emerged.\textsuperscript{76} Aside from the uncoordinated bailout packages, the European Parliament voted in a limited change to the Lisbon Treaty to allow the establishment of the “European Stability Mechanism” (ESM) in

\textsuperscript{75} The Brookings Institution, 2010 CUSE Annual Conference
\textsuperscript{76} The Brookings Institution, 2010 CUSE Annual Conference
the form of a “constitutional amendment.”\textsuperscript{77} This ESM is an intergovernmental, permanent bailout fund for Eurozone members.\textsuperscript{78}

The ESM is the result of a primary change in the Eurozone’s framework of governance of state economic policies. The ESM’s primary purpose is to safeguard financial stability in the euro area during times of Union-wide recessions. However, it is not a blank check written by the ECB for insolvent states to reset their debts. If states are found to be insolvent, the country is mandated to negotiate a comprehensive debt restructuring plan with its private sector creditors, in line with IMF practices, before it can apply for ESM liquidity assistance.

In addition, rules will be adapted to provide for a case-by-case participation of private sector creditors within the ESM, consistent with IMF policies. The language in the Treaty’s amendment is promising because it focuses the ESM on debt sustainability and more effective enforcement measures for the aforesaid convergence criteria in order to prevent future crises from occurring in the Eurozone.

Assistance provided to any euro area state will be based on a stringent program of economic and fiscal adjustment and on a rigorous debt sustainability analysis conducted by the European Commission, ECB, and the IMF.\textsuperscript{79} Aside from supporting the aforementioned point that the euro area needs its own IMF-like agency to assist the ECB, the ESM’s formulation and implementation show how the Lisbon Treaty’s myopia led to problems for the impact of Treaty-incorporated amendments.

\textsuperscript{77} Krugman; europa.eu
\textsuperscript{78} Tunkrova and Saradin
\textsuperscript{79} Hume, page 1
Within the ESM is a permanent 750 billion euro fund that replaces the temporary European Financial Stability Facility (EFSF) bailout fund.\textsuperscript{80} It is argued here that the ESM is direct evidence that the Treaty’s creators overlooked adequate discussion of economic security and stability when formulating the accord. European Council President Herman Van Rompuy justified the changes to the Lisbon Treaty by contending that this permanent mechanism was designed to bail out any member state whose debt problems threaten the area.\textsuperscript{81} The evidence with the aforesaid Greece and Irish Republic emergency bailouts earlier this year support his claim.\textsuperscript{82} The issue is that the Lisbon Treaty should have originally included provisions for this at its onset, rather than wait for piecemeal amendments in the middle of the crisis.

Another issue with the current approach is a lack of unity among policymakers during the drafting of the ESM conditions. Prominent Union leaders like Luxembourg’s Prime Minister Jean-Claude Juncker already oppose any future enlargement of the now-permanent EFSF, and economists from the ECB claim that the new fund is not sufficient to rescue a Eurozone state like Spain if it were to become bankrupt this year.\textsuperscript{83}

Furthermore, part of the funding for the fund comes from the IMF, the aforementioned external body outside of E.U. and Lisbon Treaty jurisdiction. The merits of creating a Union-based IMF-like institution to assist the ECB were just discussed, and it is contended that the ESM and new expanded bailout fund illustrate both the Lisbon Treaty omissions and the benefits of creating this proposed institution.

\textsuperscript{80} Castle; Alderman
\textsuperscript{81} Hume, page 45
\textsuperscript{82} Krugman; Karolewski, page 68
\textsuperscript{83} Europa.eu; bbc.co.uk
CHAPTER 7: FURTHER DISCUSSION OF LISBON TREATY OMISSIONS

The requisite changes to the Lisbon Treaty, the ESM, should have been easier to enact, but the accord’s omissions caused the situation to be otherwise. The Union’s members each had to formally approve the amendment to include the permanent bailout fund, and in order to expedite the deliberative process, the policymakers decided to subject future dispersal funds to “strict conditionality.”

This was the only way states like Germany and Luxembourg coalesced with the rest of the Eurozone in developing the ESM. This condition means that a Eurozone state requiring financial rescue will have to first address its debt or deficit issues through austerity measures. While it remains to be seen if this is a reasonable request, economists like Paul Krugman express doubts on the timing of future delivery of the ESM because of this condition.

84 Europeancentralbank.int
85 Krugman; Karolewski, page 78
The ESM pushes for more economic integration, as it requires the 17 euro-using states to put up 80 billion euro in cash, whereas before with the EFSF loan guarantees were sufficient. In addition, after the passing of the ESM, Mr. Van Rompuy cited a stance already echoed prior to Treaty ratification that a paramount Eurozone priority was to “safeguard the stability of the euro area as a whole” regardless of global circumstances. Both the desire for more economic integration and increased focus on safeguarding the currency were concerns well before the Treaty went into law in late 2009. Hence, it is argued that these provisions for the ESM should have been inserted into the original document in a fashion.

The non-inclusion of economic bailout funds in the original Lisbon Treaty and, as a consequence, reliance on amendments translates to a delay of when the ESM can be put into effect. Mr. Van Rompuy stated that the permanent fund will begin operating in June 2013. This is an issue because states like Portugal, Ireland and Greece already formally requested aid or bailout packages this year. Also, prognosticators from the ECB project Italy and Spain as borderline cases in the upcoming quarters, pending reports on their latest deficit and debt figures. The current temporary EFSF is insufficient to address demand from two more states in this calendar year. This conundrum illustrates the poor timing of a delay until 2013 for the ESM, which could have been avoided if the foundation was in place in the original Lisbon Treaty.

This is a real threat to states like Spain because in January 2011, the yield rose on Spanish bonds – the interest rate which the government pays in order to borrow money. The rising cost of borrowing reflects concern about the Eurozone member’s national economy and banking

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86 Bbc.co.uk
87 Bbc.co.uk
88 Tunkrova and Saradin; Castle
sector.\footnote{Bbc.co.uk; Alderman; Krugman, page 3} Aside from not immediately alleviating the threat of near-future default for the Eurozone states, implementation delays of the ESM led to increased strain on ECB chief Mr. Trichet. The ECB bought billions of euros of sovereign debt to ease the financial pressure on states like Ireland, Greece, and Portugal. In addition, the institution recently doubled its euro reserves, from 5.8 billion to 10.8 billion, in order to complement the temporary EFSF until 2013.

Aside from the aforesaid delay in implementation, the choice to use an amendment to the Lisbon Treaty instead of incorporating economic policy changes into the original accord diluted the end product of the ESM. For instance, the ESM will not be able to buy struggling states’ bonds on a secondary market, thus keeping the ECB as the buyer of last resort.\footnote{Rose and Spiegel}

What also supports the contention that the Lisbon Treaty should have included more economic policy stipulations is that many of the ESM’s features are not recent inventions. The previously mentioned debt sustainability analysis that is conducted by the European Commission, IMF, and ECB has been a staple of past IMF-led assistance programs. In addition, if this analysis reveals a state to be insolvent, the negotiations with the country’s private creditors are again governed under established IMF practices.\footnote{Europa.eu} These standardized IMF negotiation practices will be in tandem with “collective action clauses” (CACs) that provide the legal basis for the process.\footnote{Europa.eu} CACs have a record in the E.U. dating to 2003 when it was recommended by the Ecofin Council at the G10 summit that the euro area members should include collective action clauses in their government bonds issued under foreign law or jurisdiction.\footnote{Europa.eu}
It is argued here that the prior knowledge of IMF processes and mechanisms, legal devices like CACs, and prior use of bailout plans for states through the EFSF are evidence that the Lisbon Treaty should have incorporated more economic policy to the original accord. For instance, today the Union has collective action clauses in all its bond issuances among member states. Additionally, the strain on the ECB and Mr. Trichet was established. Coupled with the increasing reliance on the external IMF, it is argued that the Treaty writers could have foreseen the need for another economic institution to assist the ECB in times of turmoil within the Eurozone.

In the following sections, readers will examine how the economic problems introduced earlier in Portugal, Greece, Spain, and Ireland are manifold and required immediate action by the ECB. Unfortunately, as the past two sections attest, this action was not guided by the Lisbon Treaty. It is not argued in this paper that the accord was to be a panacea for all future Eurozone maladies. Rather, it is contended that the Treaty had opportunities to include economic policy prescriptions, policymakers chose not to, and are now left scrambling to attach diluted amendments that do not fully address underlying causes of the current crises. Help for the ECB, permanent monitoring of state governments’ macroeconomic strategies, an internal credit agency, and an IMF-like institution solely for the Eurozone are some of the recommendations.

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94 Europa.eu
95 Sadeh and Verdun, page 277
CHAPTER 8: ANALYSIS ON THE CRISIS IN PORTUGAL

The recent negative developments in Portugal shown in the above chart are highlighted in this section because the Union’s actions in response illustrate how the Treaty failed in adequately addressing future economic issues. Yet the temporal progression of the deteriorating health of Portugal’s economy, particularly from Treaty creation in 2007 to ratification two years later, was in clear view for the Union leaders before the Treaty was ratified in 2009. This is because the state’s government deficit and debt levels were well beyond the agreed-upon Eurozone criteria previously mentioned.

Portuguese banks, like the Spanish banks discussed in an ensuing chapter, were considered highly vulnerable to a slowdown in economic growth because they contained billions of euros of mortgage debt. Similar to the several discussed economic issues, this concern about the ominous level of mortgage debt and was already foreseen by the ECB well before Lisbon Treaty ratification in late 2009.

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97 Normin and Horobin, page 1
98 Karolewski, page 100
In addition, the availability and amount of liquidity support provided by the ECB to states like Portugal and Spain via the EFSF and the ECB’s smaller “emergency overnight fund” were already question marks in 2009, prior to the accord’s ratification. Olli Rehn, the European Commissioner for Economic and Monetary Affairs, was one of several prominent Union officials drawing attention to this issue pre-ratification. Yet, there were no provisions in the Treaty to improve the ECB or its emergency bailout funds.

The Portuguese liquidity crisis happened to bring this to global attention in 2011, as the state, Ireland, and Greece each requested multi-billion euro aid packages earlier this year. In particular, the Portuguese bailout package is funded:

- Two-thirds contribution from the E.U.
  - Mostly from the EFSF
- One-third contributions from the IMF

Yet, the multi-billion euro bailout plan will not result in Portugal foregoing immediate domestic austerity measures, which according to economist Paul Krugman is bad timing. In order to receive the aforementioned ECB bailout funds, the state was assigned to raise over 7 billion euros to address its debts. This is partially going to come from the raises in taxes and entitlement cuts for the population. This is poor timing because unemployment stands at 11.3% and the domestic economy is contracting at a rate of 1.3% in 2011. Presumably this could have been avoided if a larger fund like the 2013 ESM were codified in the Lisbon Treaty so states in dire need of external or Union assistance could delay or stagger such austerity measures.

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99 Normin and Horobin, page 1  
100 Normin and Horobin  
101 Normin and Horobin  
102 Saltmarsh, page 1
On a broader level, the borrowing costs on Portugal’s debt remained at a level that was on par for Greece and Ireland in 2010, around 7%.\textsuperscript{103} Krugman argues that speculative attacks were partially responsible for the high interest rates paid out on the Portuguese government’s 10-year bonds.\textsuperscript{104} This level was unsustainable for the deficit-ridden states, which resulted in their own bailout requests.\textsuperscript{105}

It appears as though the capital requirements for states in the Eurozone post-admission were too lax, and this is shown with the common denominators for the crises in Ireland, Greece, and Portugal. In addition, because of the currency union that ties together the 17 economies, speculator power can overly influence several vulnerable countries’ economies, as was the case with the three states.\textsuperscript{106} Furthermore, the role of the IMF in several states’ affairs illustrates how and why the E.U. and the ECB could use a similar institution dedicated to the Eurozone. Again, the Lisbon Treaty did not address these problems, just as it remained silent on the other issues illuminated in the previous two sections.\textsuperscript{107}

The Portuguese crisis also shows how even the Eurozone states with comparatively less clout in the area can still impact the euro as a whole.\textsuperscript{108} As mentioned in the metrics section, Germany and northern Europe already emerged from the global recession and exhibit significant growth rates, while southern Europe is in a cycle of debt and deflation.\textsuperscript{109} At first glance, the sovereign

\textsuperscript{103} Saltmarsh, page 1  
\textsuperscript{104} Krugman  
\textsuperscript{105} Minder, page 1  
\textsuperscript{106} Karolewski  
\textsuperscript{107} Saltmarsh, page 1  
\textsuperscript{108} Minder, page 1  
\textsuperscript{109} Traynor, page 1
debt troubles of Portugal, Ireland, and Greece seem inconsequential because the three countries account for less than 5% of the Union’s 12 trillion euro GDP.\textsuperscript{110}

However, the concern is mostly about the permanent loss of international investor confidence in the euro as a currency. This is a function of waning belief in the effectiveness of the ECB and the Eurozone’s rescue measures with the EFSF, larger issues that transcend the Portuguese debt malaise. The current manager of the EFSF, Klaus Regling, repeatedly expressed concern about the loss of investor sentiment since 2008 and the prospect of divestment.\textsuperscript{111}

Again, issues like how Greece and Portugal ran current account trade deficits close to 10% and reliance on EU cash transfers were of concern prior to Treaty ratification. The case of Portugal and how its issues were visible prior to accord ratification show why it remains perplexing that the Union policymakers ignored tell-tale signs and left out sufficient economic policy provisions in the Lisbon Treaty.

\textsuperscript{110} Traynor, page 2
\textsuperscript{111} Traynor
CHAPTER 9: ANALYSIS ON THE CRISIS IN GREECE

While the economic picture of Portugal from 2008-2011 looks bleak, the state’s 75% debt/GDP ratio is not even as high as Greece’s.\textsuperscript{113} Yet it is argued that there are similarities between the two floundering members. This chart illustrates how both states exhibit growth rates well below average in the Eurozone, obtaining the necessary amount of funds to refinance their debts was too difficult without outside assistance from the ECB and IMF, and taxpayers will now be responsible for paying for an even higher level of the national debt.\textsuperscript{114}

Greece’s deficit was 10.5\% of its GDP last year according to the E.U. statistics agency. This deficit eclipsed the 9.6\% target set last fall by the state government and the European Commission. The $160 billion bailout the member state received in 2010 by the IMF and the E.U. was conditionally given in exchange for austerity measures that will be detailed in this section. These actions have the objective of slashing the deficit by 2014. However, the state is projected to exceed the euro zone deficit ceiling level prescribed by the ECB for euro area

\begin{table}[h]
\begin{tabular}{|c|c|c|c|c|}
\hline
\hline
\textbf{Greece} & & & & \\
\hline
GDP (mil euro) & 227 074 & 238 917 & 235 017 & 230 173 \\
Government deficit (-) / surplus (+) (mil euro) & -14 524 & -23 121 & -36 305 & -24 193 \\
\% of GDP & -6.4 & -9.8 & -15.4 & -10.5 \\
Government expenditure (mil euro) & 230 364 & 262 318 & 298 708 & 328 588 \\
\% of GDP & 40.0 & 39.9 & 37.3 & 39.1 \\
Government revenue (mil euro) & 105.4 & 110.7 & 127.1 & 142.8 \\
\% of GDP & 0.0 & 0.0 & 0.0 & 0.0 \\
\hline
\end{tabular}
\end{table}

\textsuperscript{113} Buchelt and Gulati, page 1
\textsuperscript{114} Buchelt and Gulati, page 27
members. Hence, the state is on track to need assistance from the aforementioned ESM when it becomes effective in 2013. Questions remain: Where is the enforcement accompanying the bailout monies given? How can a state remain in the Eurozone when it egregiously violates the convergence criteria and will exceed the ceiling levels for the euro area? What are the penalties for misrepresentation of a state’s economic metrics? It is argued here that these queries were not sufficiently answered in the Lisbon Treaty.

To continue, with Greece, the current expectation from the IMF is that starting in 2014 the country and its taxpayers must come up with cash equal to 8% of its national income to pay its annual interest cost. Bucheit and Gulati state that in a fixed currency zone, where states cannot devalue its used currency, no state has produced that type of percentage just from tax increases and spending and wage cuts.115

To summarize, before receiving the EFSF bailout earlier this year, Greece had several troubling economic issues for several quarters:116

- Since integration into the Eurozone, the state has had years of minimally restrained spending
- Too-cheap lending
- Failure to implement financial reforms of the Union
- Mismanagement of the current account
- Malfeasance with governmental accounting to:
  - Purposeful misreporting/underestimation of national debt levels
  - Purposeful misreporting/underestimation of national deficit
- As a result:
  - Greece was over-exposed to the global crisis
  - The ECB had little time to devise actions other than dissemination of the EFSF
  - The euro was overly susceptible to speculation

The national debt of Greece, now accurately reported as over $414 billion, is bigger than the state’s economy, as illustrated below.117 Needless to say, this would be an egregious violation of

115 Bucheit and Gulati, page 27
116 Bucheit and Gulati, page 16
117 Castle; Alderman
Eurozone convergence criteria if the state were to join the area this year. It also was a major violation of the rarely-enforced Eurozone rules on deficit management. The IMF estimates that this figure was approximately 120% of Greece’s GDP in 2010, which is shown here. Coupled with the 12.7% national deficit and the Eurozone-worst credit rating, Greece significantly damaged the credibility of the ECB, the euro, and Union enforcement institutions.

As shown above, the crisis that necessitated the aforementioned domestic austerity measures and bailout packages for Greece that occurred this year were not unable to be foreseen by the ECB and Union policymakers. Even during the period of underreporting of the levels of debt and deficit, Greece was identified as a state prone to insolvency.

Additionally, the graphic illustrates how Greece was non-compliant with the stipulated convergence criteria it agreed to before joining the Eurozone. Below is another pre-Treaty

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118 Castle; Alderman; http://topics.nytimes.com/top/news/international/countriesandterritories/greece/index.html
ratification report on macroeconomic performance in 2009 that shows how Greece’s economy was a threat to confidence in the euro.

Nevertheless, earlier this year, delivering aid to Greece was not smooth because of powerful opposition from the stronger Eurozone states like Germany. Again, this is due to a lack of stipulated guidance from the Lisbon Treaty. As it stood at the beginning of the year, any European-backed loan package required the unanimous approval of the E.U. member states.

Since any Eurozone member effectively had veto power, there was a real possibility that Greece would not have been able to receive its bailout plan. It is argued that the Greece example illustrates how the Lisbon Treaty failed to mitigate avoidable threats to the security of the euro by insufficient discussion of economic policy, improvements to the Eurozone-related institutions, improved monitoring and enforcement, and streamlining the related processes.

119 Castle; Alderman; http://topics.nytimes.com/top/news/international/countriesandterritories/greece/index.html
CHAPTER 10: OPPOSITION CASE –

ANALYSIS ON THE CRISIS IN SPAIN

Spain was chosen for this paper because, like Portugal and Greece, it is perceived to be another weak link in the Eurozone. However, unlike Portugal and Greece, Spain’s economy and banks have been struggling due to a nationwide property market collapse.\(^\text{120}\) Hence, the Eurozone sovereign debt crisis was not as magnified in Spain. Last year, as a consequence, and partly due to inadequate guidance from the Lisbon Treaty, the state was forced to scramble to save its economy and protect the euro. The direness of the Spanish crisis is illustrated below:

| GDP, government deficit/surplus and debt in the EU (in national currencies) |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|
|                               | 2007            | 2008            | 2009            | 2010            |
| Spain                         |                 |                 |                 |                 |
| GDP (million euro)            | 1 053 537       | 1 086 124       | 1 053 914       | 1 082 591       |
| Government deficit (+) / surplus (+) (million euro) | 20 066 | -45 189 | -117 306 | -98 227 |
| (% of GDP)                    | 1.9             | -4.2            | -11.1           | -9.2            |
| Government expenditure (million euro) (%) of GDP | 39.2 | 41.3 | 45.8 | 45.0 |
| Government revenue (million euro) (%) of GDP | 41.1 | 37.1 | 34.7 | 35.7 |
| Government debt (million euro) (%) of GDP | 380 881 | 433 611 | 561 319 | 638 767 |

In Spain, the housing bubble increased construction from 7.5% to 10.8% of GDP from 2000 to 2006, immediately after the state joined the Eurozone.\(^\text{122}\) Yet in 2009, months before Lisbon Treaty ratification, the bubble burst across the nation and the construction dropped by 87%.\(^\text{123}\) It is argued that this was the primary cause for Spain’s current budget deficit.

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\(^{120}\) Jolly, page 1
\(^{122}\) Jolly, page 11
\(^{123}\) Jolly, page 1
It appears as though any inclusion of economic policy prescriptions to the Lisbon Treaty would not have prevented the Spanish crisis. This is a valid counterexample to the contentions espoused in this paper. Hence, the insufficient monetary discussion in the accord appears to not be a major factor that perpetuated the Spanish malaise.

Yet many economists claim Spain’s problems are mostly associated with the euro because Spain’s inclusion in the Eurozone prohibits it from unilaterally manipulating the three most used kinds of macroeconomic policies – fiscal, monetary, and exchange rates – in order to extricate the state from the housing market-caused slump. These policies are controlled by the ECB. To follow, as previously covered in earlier chapters, the Lisbon Treaty insufficiently discussed changes to the said institution that would have mitigated this monetary crisis.

As a result of the aforementioned policies, when a state adopts a common currency with other states that have higher levels of productivity, this state cannot be competitive with respect to “tradable goods” such as exports and industries that compete with imports. Spain cannot devalue the euro unilaterally in order to make its exported goods more competitive. Hence, Spain became over-reliant on its construction sector, and when the bubble burst it was harmed to a greater extent. Evidence of this is with Spain’s 20% unemployment rate and how despite the upswing in exports during the first quarter of 2011, it is not nearly enough to pull the Spanish economy out of its hole.

Spain also has had rampant tax evasion ever since joining the Eurozone, an issue outside the jurisdiction of the Lisbon Treaty and past Union accords. Fiscal fraud was targeted by the

124 Weisbrodt, page 1
125 Weisbrodt, page 1
126 Weisbrodt
127 Minder, page 1
government in order to increase tax fraud receipts and help balance the national budget. The government, led by head of the Spanish tax agency Juan Manuel Carbajo, collected $13.4 billion from tax fraud receipts last year, which was 23% higher than in 2009 and equaled approximately 1% of the state’s annual GDP.¹²⁸

This helped close the budget deficit last year, but for purposes of this paper’s argument, the Lisbon Treaty’s jurisdiction does not cover this issue of a domestic nature. Hence, the omissions of the Lisbon Treaty did not cause nor perpetuate the tax evasion and lackluster tax fraud collections of past years since Spain entered into the Eurozone. This further illustrates Spain as a counterexample to the paper’s central argument.

Yet, the ongoing delay in assistance given from the IMF and ECB may be an indirectly contributing factor affecting the Spanish economy. Coupled with the inherent problems attached to membership within a shared currency union, these issues could have been included in the Lisbon Treaty.¹²⁹ Yet it is a stretch to place direct blame on the Lisbon Treaty omissions for the current state of the Spanish economy.

It is concluded that, unlike in Portugal and Greece, the current austerity and internal devaluation strategy – a shrunken economy, rising unemployment, lower prices and wages, and a constant exchange rate – implemented by the ECB to cut the Spanish economy’s deficit is a painful but unavoidable result that was not able to be as avoided by improving the Lisbon Treaty according to this paper’s prescriptions.

¹²⁸ Minder, page 14
¹²⁹ Rose and Spiegel
CHAPTER 11: ANALYSIS ON THE CRISIS IN IRELAND

An examination of the Irish fiscal situation post-Treaty creation reveals similarities to all three aforementioned cases. Yet it provides more support for the arguments in this paper than opposition because the state’s economy would have benefitted from the suggestions previously mentioned. Unlike Spain’s conundrum, which resulted from the burst of the real estate market bubble, Ireland’s malaise stems from mismanagement of the banking system.

Although losses in the Irish banking system partially stemmed from the collapse of a similar speculative bubble in the commercial property sector, where billions of euros were borrowed from banks, there were causes to the crisis that could have been prevented by better monetary stipulations in the Treaty. For instance, paltry and infrequent banking stress tests allowed the growth of risk until an 85 billion euro rescue package was delivered a few months ago.\textsuperscript{131}

Similar to the cases in Greece and Portugal, Ireland received bailout funds from the Union and the IMF. In fact, this E.U.-IMF bailout plan was recently deemed insufficient by the ECB, and as a consequence investors were not convinced that Ireland could avoid a massive debt restructuring and partial default that would deepen Europe’s debt troubles.\textsuperscript{132} The ECB has

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|}
\hline
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Ireland & & & & \\
\hline
GDP mp (million euro) & 180,374 & 170,080 & 150,645 & 153,039 \\
Government deficit (-) / surplus (+) (million euro) & 128 & -13,196 & -22,795 & -49,603 \\
(\% of GDP) & 0.1 & -7.3 & -14.3 & -32.4 \\
Government expenditure (\% of GDP) & 36.7 & 42.8 & 48.2 & 67.0 \\
Government revenue (\% of GDP) & 36.8 & 35.5 & 33.9 & 34.6 \\
Government debt (million euro) & 47,391 & 79,637 & 104,782 & 146,074 \\
(\% of GDP) & 25.0 & 44.4 & 65.6 & 96.2 \\
\multicolumn{5}{|c|}{memo: intergovernmental lending in the context of the financial crisis} \\
(million euro) & 0 & 345 & 0 & 0.2 \\
(\% of GDP) & 0.0 & 0.3 & 0.0 & 0.0 \\
\hline
\end{tabular}
\end{table}

\textsuperscript{131} Crimmins, page 125
\textsuperscript{132} Crimmins, page 121
struggled to create adequate stress tests applicable to all Eurozone banks, a development that is increasingly a concern because of the Irish case.

This banking issue is three years running, well before the ratification of the Lisbon Treaty. As with Portugal and Greece, Ireland illustrates that its problems were under the jurisdiction of Eurozone governance. Hence, improvements to the Lisbon Treaty would be effective in mitigating a similar future disaster in the euro area state.

Aside from implementing reliable and consistent ECB-led stress tests and having a similar real estate bubble burst like Spain, Ireland has faced several other economic challenges:\(^\text{133}\) 

- There was a cumulative collapse in property prices of 62% 
- Unemployment rate averaged at 15% from 2009-2010 
- Implementation of a four-year austerity agenda - “National Recovery Plan”
  - Objective is to close Ireland’s multi-billion euro budget deficit
  - Results:
    - Cuts to governmental employee pay
    - Raises in corporation taxes to 12.5%
    - New income tax system
    - Additional taxes on fossil fuel consumption

Ireland’s woes and the resulting fragmented Union response again support the contentions provided in this paper, namely that the Lisbon Treaty did not sufficiently address the threats to the monetary union. The result of inadequate discussion in the accord was a disjointed effort to aid states like Ireland and reliance on external bodies such as the IMF.

In fact, the 150 billion euros of short-term financing from the Irish central bank, IMF, and ECB and the governmental guarantees and capital injections were deemed to be inadequate.\(^\text{134}\) Ireland has petitioned the ECB for another bailout package in 2011 while not showing enough evidence that it is upholding its end of the bargain, the aforesaid National Recovery Plan, to ensure that this situation will not recur in the future.

\(^{133}\) Jolly, page 2; Karolewski; Ladrech 
\(^{134}\) Jolly, page 1
CHAPTER 12: CONCLUDING STATEMENTS

After examining the perils the world’s most important currency union has faced over the past few years, it is necessary to provide projections on the future of the Eurozone. Despite the lack of legal guidance from the Lisbon Treaty, which was discussed in-depth in this paper, there are many encouraging signs for the euro area.

Firstly, the Eurozone unemployment rate fell from 2010 to 2011, as the percentage of people out of work is, on average, below 10%. Secondly, all 17 states showed solidarity in voting for the ESM, the aforementioned permanent bailout mechanism that will go into effect in 2013. Thirdly, a majority of the euro area members agree that the states must adopt binding national fiscal rules that, in some cases like Greece, force state governments to slash deficits to a figure close to the convergence criteria maximum permitted level. Finally, a majority of the states want

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135 Europa.eu
136 Ewing and Bennhold
tougher fiscal discipline manifested in reforms to labor markets, entitlement plans, and public services.

The euro is now unequivocally a top concern for eminent Union heads like German leader Angela Merkel of Germany and French President Nicolas Sarkozy. Merkel in particular has suggested on several occasions in 2011 that the crisis could be the impetus that binds European nations closer together and standardizes the Eurozone’s varied levels of social welfare benefits once and for all. German Finance Minister Wolfgang Schaeuble has echoed Merkel’s desire for lasting Eurozone convergence in economic and social policies in order to avoid another international sovereign debt crisis. This sentiment, while not recently created, is a welcome change from the collective thought during the development of the Lisbon Treaty.

Yet, the divide separating the prosperous euro area states like Germany from the debt-ridden countries like Greece is more noticeable now than ever before. Although the aggregate unemployment rate is a positive sign for the area, this rate diverges widely within the 17 Eurozone states. In addition, the debt-stricken states are now engaging in the aforesaid austerity plans, budget cuts, and debt restructuring, that, while necessary, will not close the per capita GDP gap or provide short-term economic benefits to the citizenry.

The omissions of the Lisbon Treaty detailed in this paper may cause an unintentional result – the member states’ economic ministers are forced to cooperate with one another and shape the monetary policy so all in the Eurozone are protected in the future. This crisis showed that even a small country is “too big to fail” in a currency union. Currency unions like the Eurozone are

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137 Ewing and Bennhold, page 1
138 Taylor, page 1
139 The Brookings Institution, 2010 CUSE Annual Conference
only as strong as its weakest link, and severe economic and financial shocks will expose that state’s and the entire area’s foundation. Economic credibility is so fleeting in a currency union that it must be constantly monitored and supported by institutions like the IMF and ECB. These considerations are why numerous recommendations and additions to the Lisbon Treaty were listed in the introduction.

Finally, it is evident that stronger Eurozone monetary and economic governance resulted from the omissions of the Lisbon Treaty and the disasters in Portugal, Greece, Spain, and Ireland. It is argued in this work that the Treaty’s creators were mistaken in not acting on the signs from states like Portugal and Greece that their economies were not as strong as first believed. Likewise, in the Treaty there was harmful oversight when improvements were made to strengthen institutions and positions like in the E.U. Commission or with High Representative for Foreign Affairs Post and not with the ECB. While the Treaty did not make significant changes to the Eurozone at the time of ratification, it would be advantageous for Union policymakers to realize just how fragile the euro area is and remember to respond to the warning signals when they appear.
BIBLIOGRAPHY


