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# Economic Conditions of the Economic and Monetary Union Crisis

## Introduction

As everything indicates the global financial and economic crisis which transpired in 2007, with the collapse of the mortgage market in the United States, is slowly going into history after several long years which were difficult for states and societies. The effects of the crisis, compared to the Great Depression in the 20ties and 30ties of the 20th century, will be felt for a long time in different parts of the world. The discussion about the causes of the crisis will be held in the future engaging new generations of scientists, politicians and focusing the attention of sensation seeking media of those times. For Europeans and the European Union the global financial and economic crisis was a small earthquake which not only deepened the existing socio-economic problems, but also highlighted in a bright way their causes, turning public attention to numerous pathologies in the area of both national and the Community finance and economy which had been previously ignored by leaders of European countries and the European Union.

According to the author, in discussing the crisis that today affects the Community and the euro zone we should more effectively reach out to the real, deep-seated reasons than be satisfied with the explanations based on often superficial analyzes of visible manifestations of the crisis. In the author's opinion when undertaking this subject we also need to refer to the theoretical foundations of economic integration thus creating proper conditions for a discussion on the problems of European economic and monetary integration.

The purpose of this study is draw attention to the economic, fiscal conditions of the European crisis, the crisis of the Economic and Monetary Union (EMU) and the euro zone, as

well as its relationship to the theoretical foundations of economic and monetary integration.

The basis for the present theoretical, analytical study are Community's documents and economic development strategies, statistical materials, as well as Polish and foreign authors' studies related to these issues[1].

### 1. The Economic and Monetary Union in times of crisis

The construction of the Economic and Monetary Union is one of the biggest challenges for European integration and countries forming the European Communities and the European Union. Increasing in recent years problems associated with economic integration, monetary integration within the Community, reflected in the functioning of the euro zone, are the result of the impact of various factors and series of events which had to lead to the current difficulties. It seems that they were inevitable in the presence of too far-reaching intrusion of the Community's political elites and decision-makers in European finance and economy, both at national and the Community level, which we have been able to observe in a special way in recent decades. Regardless of this, the processes of globalization have large, undisputed impact on economic and monetary integration and the functioning of the euro zone, which we clearly find watching their impact on economies of the Member States of the European Union after 2007.

Speaking of the EMU crisis and financial difficulties of euro zone countries it should be strongly emphasized that they are not caused by the global economic and financial crisis with which the world has been struggling since 2007. The crisis created certain specific, extreme in many areas conditions conducive to the deepening of the inherent deficiencies and the resulting financial and economic problems of European countries. The crisis of European countries is primarily a problem of their imperfect financial policy and debt growing for a long time. The euro zone crisis, which is today of interest to everybody in a special way, would most probably appear sooner or later in this group because of political and economic conditions characteristic for European countries. The causes of the crisis in the euro zone are both outside and inside the European Union, including the inside of some Member States, whose culture of management of finance and economy leaves much to be desired and has not so far taken into account the principles of healthy economy, the realities of free market and globalization.

[1] The study was prepared in the summer of 2013.

The global financial and economic crisis, which occurred after 2007, stroke primarily the European Union Member States included in the so-called PIIGS group, namely Portugal, Italy, Ireland, Greece and Spain[2]. Their problems resulted, in the main part, from inadequate fiscal policy realized for a long time. The European Union itself and its decision-makers had acquiesced to it for a long time, by giving priority to political, if not ideological reasons (success of European integration, the Community's territorial expansion) over economic reasons, they had tolerated abuse in fiscal policy of some countries, and even the use of "creative reporting". As we already know it could improve the macro-economic indicators, but only on paper. Such an approach, of course, could not be used indefinitely.

The progressive increase in spending in several euro zone Member States in relation to their actual budget revenue or financing current obligations from the sale of state bonds had over time undermined the economic stability in these countries and, indirectly, the balance in the whole Community, particularly in the euro zone. The convergence criteria established in the *Maastricht Treaty on European Union* (TEU)[3], and then confirmed in *the Lisbon Treaty* (TFUE)[4] had been routinely disregarded. Unofficial consent of managerial bodies of the European Union to violating fundamental convergence criteria had had in time to lead to a crisis of the Community finances and make the vision of bankruptcy of some European countries real, as exemplified by Greece.

Temporary corrective solutions, introduced by the Community under the influence of the dangerously developing situation in the euro zone after 2007, such as the cancellation of part of the debt of Greece, or the transfer of financial support to Portugal and Ireland in exchange

[2] The composition of the European countries group threatened by insolvency has been modified in recent years PIGS (Portugal, Italy, Greece, Spain); PIIGS (Portugal, Italy, Ireland, Greece, Spain); PIIGGS (Portugal, Italy, Ireland, Greece, Great Britain, Spain).

[3] The Treaty on European Union (consolidated version), Official Journal of the European Union, C 326/13 (26.10.2012), the Treaty on the Functioning of the European Union (consolidated version), C 83/47 (30.03.2010), the source: www.eur-lex.europa.eu.

[4] A condition of a county's entry into the euro zone is the fulfilment of nominal and legal convergence criteria. **Nominal convergence criteria**: stability of prices, public finances, interest rate, exchange rate. **Legal convergence criteria**: institutional, financial and personnel independence of the central bank, ensuring by the State the compliance of national legislation with the Treaty on the Functioning of the EU (TFEU) and the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB), consistency of the objectives of the central bank with the objectives of the EU - art. 127 (1) TFEU and art. 2 of the Statute of the ESCB and the ECB. Monetary and fiscal convergence criteria of particular interest to us stipulate that inflation cannot be higher than 1.5 percentage points than the average rate of inflation in three EU countries where inflation is the lowest; the state debt cannot exceed 60% of GDP; the state budget deficit cannot be higher than 3% of GDP; long-term interest rates cannot exceed by more than 2 percentage points average interest rates in three EU countries with the lowest inflation; the exchange rate must be stable over the past 2 years before the accession to the euro zone (fluctuations must not exceed ± 15% of the fixed initial value, the introduction of the currency to the Exchange Rate Mechanism ERM II).

for leaving the mentioned pathology of financial and economic policy, as well as attempts at reformatory activities were, as shown by the future, only ad hoc, temporary, partly propaganda measures, with very limited possibilities to influence the financial, social or economic situation of causing difficulties Member States of the Community. Paradoxically speaking, as critics of these "rescue" actions for the selected members of the euro zone thought, some of these actions, such as debt relief, could even legitimize fiscal policy of some countries which was erroneous and simultaneously unfair to other members of the Community, and for which their governments, and namely their politicians, did not in practice bear any responsibility.

In the face of the ineffectiveness of emergency rescue operations in the euro zone and deteriorating financial and economic situation of its countries, which were strengthened by the deepening global crisis, it became obvious that we needed much more far-reaching, coordinated and institutionalized solutions by the Community and its most important institutions. In order to save the euro zone and its common currency and, indirectly, the European Union itself, it became necessary to introduce rules and institutional forms of cooperation at the Community level, which could effectively ensure the financial, economic stability of euro zone members and further, effective control over finances within the euro zone and the whole Community.

It should be emphasized here that the problem for the euro zone was not only bankrupting Greece, but the real (not excluded at that time) possibility of the bankruptcy of another European country or countries, especially any of big countries, such as Spain or Italy, the collapse of which neither the euro zone, nor the European Union itself could rather bear. A serious threat to the European Union was also a loss of credibility, a loss of credibility of euro area countries and the depreciation of the single currency, which would happen in the event of insolvency of any of its states, not to mention a group of countries. In the first years of the crisis it was not merely a hypothetical situation given the scale of complexity of problems of the euro zone countries after 2007, not just of the financial, economic, but also of political nature, and especially taking into account social problems of certain Western European democracies caused by the crisis.[5]

Difficulties which the European Union experienced in the first years of the global financial and economic crisis were a big problem for the whole Community which could indicate a failure of its ambitious project related to the construction of the Economic and

[5] For example, unemployment in Spain had been growing steadily since 2008, and reached the level of 27.16% in the first quarter of 2013.

Monetary Union. The crisis pointed to one of the weakest parts of the European Project to which the leaders of the Community and its Member States have never officially confessed, namely it revealed poor macroeconomic stability of many Member States of the European Union, including the so-called Old Union countries. Adherence to the fiscal convergence criteria, which, as it turned out, had been neglected for years, should have been a fundamental duty not only for countries of the euro area, but also for other members of the community who had or still have plans to join the euro area. Euro area countries should have set an example in this respect for other members of the European Union, meanwhile, as the times of crisis have shown, it was in them where the "disease" of the Community's finance started. As it turned out, consent to the pathology in this area flowed from the executive core of the European Union and its key officials who, for example, must have known about the forgery of macroeconomic statistics by Greek authorities.

Proposed at a later time, at the Summit of the European Council in Brussels in December 2011, emergency solutions for the EMU and the euro area which included financial penalties, consolidation, budgetary control and increasing supervisory powers of the European Commission, despite being important solutions for the future of the EMU and the euro area, were heavily belated solutions. As early as in 1999, at the time of the introduction the euro currency into cashless circulation, most of euro zone countries did not meet the fiscal criteria.

In this context, there is a legitimate question about the importance of the convergence criteria for the EMU and the sense of introducing the single euro currency in countries which in macro-economic terms had not been prepared for it. Historically speaking, strict enforcement of the convergence criteria at the stage of the EMU creation would ensure maintaining fiscal stability of the whole euro zone and most likely the avoidance of the current crisis in this group of countries. It was not difficult to predict that weak macroeconomic stability in many Member States of the European Union and growing public debt in relation to GDP in these countries would inevitably lead to the destabilization of the euro zone, debt problems of many countries and consequently to serious financial problems throughout the Community.

## 2. The theoretical basis of European economic and monetary integration

Serious financial problems faced by the European Union and its Member States, including euro zone countries, put into question not only the success of economic and monetary integration within the Community, but also the future of the whole process of integration on the Old Continent. The blame for the current economic difficulties of the

European Union, including the problems of the euro area, is most often put on politicians, accusing them, after all rightly in many cases, that they unlawfully indulged for a long time in excessive interference in economy and finances of the Community and its Member States, and for a variety of reasons tolerated the pathological behavior of policy makers from different countries of the Community (the already invoked flagship example of Greece). The history of European integration of recent decades shows numerous examples of such destructive actions, but, according to the author, it should be considered whether apart from mistakes made by the political elite and no less dangerous relinquishment of many necessary legislative and organizational activities, we should take a look at the theoretical foundations of integration in the context of initiatives taken by European countries over the past decades to look for the causes of the current difficulties of the EMU, including the difficulties experienced by the euro zone.

Economic integration of countries, an exceptional example of which is the realization of European integration since the second half of the twentieth century in the framework of the European Communities and then the European Union, is in political, social and economic dimensions a complex and long-term process. Integration is inherently a process of linking together different elements and creating a new, permanent whole from them. We are used to linking the concept of integration with economic integration of countries and regions in which the merging of economies and the emergence of a new economic entity is achieved through the elimination of various barriers.[6] It is important that in the case of the European Communities and the European Union in the process of economic integration we meet not only the operation of the market mechanism, but mainly the implementation of policy of a group of countries and building by them the institutional system supporting this process, as well as determination in the pursuit of full socio-economic integration and the creation of a well functioning economic entity. Monetary integration of countries of the Old Continent is special and at the same time one of the most important manifestations of European integration.[7]

The integration process of interest to us is, as already stressed, a long-term process. Countries participating in it go through certain interrelated stages of integration, which illustrate the progress of the integration process. We have in mind a free trade area, a customs

[6] See A. Budnikowski, Międzynarodowe stosunki gospodarcze, Warszawa: PWE 2006, p. UZUP.
[7] See Baldwin R.E., Wyplosz C., *The Economics of European Integration*, London: Mc Graw-Hill Education 2006.

union, common market, an economic and monetary union and full economic integration[8]. The ultimate goal of so understood integration of countries, implemented in Europe under the European Communities and the European Union is the creation of a multi-national socio-economic organism resembling a national state with national economy and a national currency (foreign policy integration issues and common security policy are not the subject of our interest in this study). At each of these stages of integration of countries we encounter all sorts of difficulties which are barriers to the integration process. Not only the effectiveness of integration but also its success depend on overcoming them.

One of basic assumptions of the EMU, which the European Union and its Member States try to implement is the resignation from issuing of national currencies by selected countries and eventually replacing them with a single currency. A consequence of this fateful decision was, on the one hand, the limitation and gradual elimination of independent monetary policies of the Member States with simultaneous transferring them under the control of transnational institutions, on the other hand, far-reaching limitation of the possibility to regulate the condition of economy in individual countries of the monetary union by the possibility to influence the national currency exchange rate by the state authorities. After the resignation from the state currency, in the hands of the authorities there remain other tools and mechanisms by means of which it is possible to regulate the balance of the market, but one of the most important mechanisms conditioned by the ownership of the national currency is missing[9]. The construction of the euro zone was connected with the adoption of such a strategy by selected Member States of the Community which from 2002 resigned from having their own national currencies and decided to replace them with the new euro currency. The consequence of this logistically complicated and expensive procedure of transition to the new, common currency, was the dramatic reduction of the financial, economic sovereignty of European countries entering the euro zone. Along with this move, they transferred their monetary policies under the control of the European Central Bank.

The construction of the EMU is a matter of interest both from a theoretical and a practical point of view. Contemporary scientific economic theories refer to it, among which we should

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[8] The creator of the classification of institutional forms of economic integration among countries was an American economist of Hungarian origin Bela Balassa (1928-1991), see B. Balassa, *The Theory of Economic Integration*, Homewood, Illinois: Richard D. Irwin 1961.

[9] A good example that shows how important it is for a state to have the national currency is Poland, which fared relatively well during the global financial and economic crisis and the depreciation of the zloty against key currencies such as the dollar or the euro meant that export activity of Polish companies was maintained at a high level thanks to which they were able to survive the most difficult years of the crisis.

mention the theory of optimum currency area[10] and the theory of endogenous optimum currency area criteria.[11]

The theory of optimum currency area (OCA), by R.A. Mundella, P.B. Kenena and R.I. McKinnona, assumes that it is the largest geographical area whose economic efficiency is maximized when the area shares a common currency[12]. In turn, the theory of endogenous optimum currency area criteria, by JA Frankel and A.K. Roseassumes assumes that the readiness to abandon the national currency by a state to adopt the common currency brings greater benefits than stiffening the exchange rate and simultaneously it removes one of the main barriers to economic development, which is the barrier associated with the foreign exchange risk, which ultimately allows for turnover growth as a result of the so-called trade creation effect.

The lack of sovereign monetary policy and the national currency, as already noted, results in grave consequences for economy of a country participating in the experiment of building a monetary union. It should be noted that a state's resignation from sovereign monetary policy as a tool to restore financial and economic equilibrium, especially important in times of a financial turmoil, recession or crisis, as is currently the case, can be beneficial to this state only in the conditions of strict compliance with certain macroeconomic criteria. The point is that the lack of the possibility to regulate national economy by means of a variable exchange rate means that any economic shocks for this state and its economy - in this case euro zone members - must be adjusted with the help of other available mechanisms which can influence the market balance (for example, by the flexibility of employees' salaries or prices of goods and services, by trade). Without independent monetary policies and their own currencies, countries have severely limited possibilities to influence their finances and economy, which is particularly important at such times like at present, and in addition in special conditions created by globalization.

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[10] See R.A. Mundell, *A Theory of Optimum Currency Areas*, "The American Economic Reviev", Vol. 51, No. 4, 1961, pp. 657-665; P.B. Kenen, *The Theory of Optimal Currency Areas. An eclectic view*, [w:] Monetary Problems of the International Economy, Edited by A.K. Swoboda, R.A. Mundel, Chicago: University of Chicago Press 1969; McKinnon R.I., *Optimum Currency Area*, "The American Economic Review", Vol. 53, No. 4, 1963, pp. 717-725; H.G. Grubel, *The Theory of Optimum Currency Areas*, "Canadian Journal of Economics", Canadian Economics Association, vol 3(2), p. 318-324, May 1970.

[11] J.A. Frankel, A.K. Rose, *The Endogeneity of the Optimum Currency Area Criteria*,"Economic Journal", Royal Economic Society, Vol. 108(449), pp. 1009-25, July 1998; P. De Grauve, *Economics of Monetary Union*, Oxford: Oxford University Press 2012; P.R. Krugman, M. Obstfeld, *International Economics. Theory and policy*, Boston: Pearson Addison-Wesley 2009.

[12] OCA criteria are: the mobility of production factors among countries of the monetary union, the degree of openness of economies, diversification of economic structures, the flexibility of prices and wages, financial market integration, similarity of inflation rates, fiscal policy integration, integration in the sphere of economic policy.

Some economists, for instance Paul De Grauwe, analyzing economic policy and macroeconomic data of euro zone countries, in general question the legitimacy of recognizing the euro zone as an area meeting the requirements of the OCA, despite the introduction of the common currency in this area.[13] In such a case it would be easy to explain the problems experienced by the EMU and the euro zone. Indicated problematic issues in relation to them are here, among others, serious developmental disparities among members of the monetary union and euro zone enlargement policy of adding other countries taking into account not so much a healthy economic calculation and free market but also politics and aspirations of European leaders.

As regards the first of the above mentioned issues, it is an undisputable fact that the European Union Member States, including euro zone countries are highly diversified both in terms of their level of economic development and macroeconomic stability. Consequently, the immunity of individual members of the euro zone to so called asymmetric shocks, which are among the greatest threats to the stability of the single currency area, is also diverse. The functioning of the monetary union means in practice coping with various types of economic asymmetries caused, among others, by inflation, the labor market situation and the ability to create and expand GDP. These developmental disproportions of euro zone members result mainly from distinctness of characteristics and differences in potential of their economies.

As regards the second issue, to which we directed attention, that is the policy of gradual territorial expansion of the monetary union by accepting new members into the euro area, it is, according to critics of European economic and monetary integration, more conditioned politically than economically. With this approach, the enlargement of the euro area by accepting other Member States, at least initially, is not beneficial, because the increase in the number of members of the euro zone results in further deepening of development disparities in this area. Meanwhile, the purpose the EMU should be mainly the quest for superiority of benefits over costs arising from economic and monetary integration of its members, which can be obtained in the case of the least diverse, coherent structure consisting of a minimum number of components (states). With this approach, the European Union would act contrary to its own interests and to the disadvantage of the EMU.

According to before mentioned Paul De Grauwe, as well as other prominent economists, including J. A. Frankel or A.K. Ros, extremely important factors eliminating the negative impact of development disparities of EMU members on the stability and functioning of the

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[13]See Borowiec J., *Unia ekonomiczna i monetarna: historia-podstawy teoretyczne-polityka*, Wrocław: Wydawnictwo Akademii Ekonomicznej im. Oskara Langego 2001.

OCA are trade (its level), labor market flexibility and the level of correlation of business cycles in the Member States of the group. The higher the correlation of business cycles, labor market flexibility and trade level, the greater is the advantage of benefits over costs arising from the functioning of the OCA.

The crisis in the euro zone is now one of the most serious problems faced by the European Union and its Member States and it is by no means only by members of the euro zone. This crisis endangers the process of European integration and the European Union itself, and, therefore, must be positively overcome by the Community. There is no doubt that the success of European integration, including the finalization of the process of creating the EMU, today depends to a large extent on overcoming the problems associated with the functioning of the euro area and the success of the single European currency without which it will be impossible to achieve the level of full integration. Only then will it be possible to realize the ideas of common European foreign policy and common and truly effective security policy; the ideas crowning the work of Old Continent integration.

Overcoming the financial crisis in the European Union and the stabilization of the euro zone are today priority tasks for all Member States of the Community and for the vast majority of European elites focused on continuing and deepening of integration. This is an extremely difficult task as indicated by strenuous but so far limited in effectiveness activities undertaken by leaders of the European Union. We direct particular attention to some of them here.

### 3. The calendar of rescue and stabilization activities (2008-2013)

The European Union's first attempt to respond to the global financial crisis was the European Economic Recovery Plan presented on 29 October 2008 by the European Commission[14]. The aim of this initiative was to rebuild a climate of mutual confidence in markets, to encourage banks to resume a loan action to support investment and to create conditions conducive to the creation of new jobs in the European Union. The future of the EMU and the euro area did not seem promising because of the dramatically deteriorating budgetary situation of some European countries, such as Greece, Ireland, Portugal and Spain, and especially disastrous economic data pertaining to the situation of the first of these countries, which resulted in a sharp fall in confidence of financial markets to the European Union, the euro zone and the single European currency.

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[14] *Communication from the Commission to the European Council. A European Economic Recovery Plan*, COM(2008) 800 final., Brussels 26.11. 2008, COM(2008) 800 final.

In the second half of 2009 particular concern in the Community was caused by the financial situation of Greece, which was confirmed by its gradually audited financial data. They revealed the fact that Greek authorities had been falsifying official economic statistics submitted by the state to Community institutions[15]. Alarming information about Greece led in late 2009 to a drastic downgrade of Greek bonds by major rating agencies[16]. In April 2010, Greek authorities were forced to ask the European Union and the International Monetary Fund (IMF) for financial aid. The seriousness of the situation meant that in May 2010 the Community together with the IMF presented the first aid program for bankrupting Greece amounting to the amount of 110 billion euro.[17]

The threat of a dramatic deterioration of the situation in the euro area (with the possibility of its breakdown), as well as pressure from financial markets and political pressure within the European Union itself forced the Community to undertake far-reaching interventional and organizational actions designed to inhibit the growing debt crisis of euro zone countries. The focus of financial markets and investors was then on Greece and Greek bonds. Exclusion, exit of Greece from the euro zone or its bankruptcy were out of the question for the obvious reason which was the interest of creditors of this state. In the event of bankruptcy of Greece the greatest loss would be borne by German, French and American banks, which had already invested huge funds in Greek bonds. In addition, an effective "bugbear" for Community leaders and leaders of European countries was a real vision of spreading the crisis to other euro zone countries, such as Spain, Portugal or Ireland. That is why, in May 2010, the Council of the European Union (ECOFIN) adopted special protective measures to ensure the financial stability of the European Union in the form of the *European Financial Stabilization Mechanism*, *EFSM* and the *European Financial Stability Facility, EFSF,* equipped with appropriate intervention funds[18]. The EFSM and EFSF were conceived as financial

[15] See reports based on Eurostat data: *Report on Greek Government Deficit and Debt Statistics*, European Commission –January 2010, EC, Brussels, 8.1.2010 COM (2010) 1 final; *Report on the EDP Methodological Visits to Greece in 2010*, European Commission Eurostat, Directorate C: National and European Accounts.

[16] In November 2009, Fitch rating agency downgraded Greece to A-, soon after that other agencies, that is Moody’s and S&P, acted similarly.

[17] See *Aid programs for Greece, Ireland and Portugal*, the study of the Foreign Department of the Polish National Bank (http://www.nbp.pl/publikacje/integracja_europejska/programy_pomocowe.pdf; data dostępu: 10.07.2013).

[18] Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, Official Journal of the European Union, L 118/1 (12.5.2010); European Financial Stability Facility. Société Anonyme. Registered Office: 43 Avenue John F. Kennedy L-1855 Luxembourg. Statuts Coordonnes suite à un Constat d’ Augmentation de Capital du 6 décembre 2011 –n № 280 (http://www.efsf.europa.eu/attachments/efsf_articles_of_incorporation_en.pdf; data dostępu 1.07.2013). EFSM i EFSF otrzymały odpowiednio 60 i 440 mld euro.

instruments designed to provide support to euro zone Member States in a difficult financial situation[19].

In September 2010, the European Commission presented for consideration on the Community forum a proposal of six legislative acts (five regulations and one directive forming the so called "six-pack") designed to improve the management and control of the Community finances. Attempts to undertake effective initiatives stabilizing the euro area finances were a reaction to the deepening financial crisis, which touched its other Member States. In November 2010, an assistance program for Ireland in the amount of nearly 85 billion euro was presented, and in December of the same year the European Council decided to set up a permanent bailout mechanism for euro zone countries - the *European Stability Mechanism, ESM*.

The first attempt to coordinate the activities of the Community in the conditions of the global financial and economic crisis was the Euro Plus Pact (EPP) presented at the meeting of the European Council on 24-25 March 2011.[20] Although it did not take on the form of a separate document, it became a basis for the later legal and organizational solutions having fundamental importance for stabilizing finance and economy of the Community, especially for repairing the situation in the euro zone. The EPP enabled the finalization of work on the so called "six-pack", the implementation of the fiscal treaty (*the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*) and the European Stability Mechanism (Annex 2 to the EPP). The Euro Plus Pact became a signpost for the beginning reform of the European Union institutional system and the convergence of macroeconomic policies of its members. A financial aid program for the next endangered euro area Member State, Portugal, in the amount of 78 billion euro was presented in May 2011.

The implementation of the ESM required the introduction of major treaty changes[21]. On July 11, 2011 17 member states of the monetary union signed an agreement establishing the European Stability Mechanism, which was to be ratified by the end of 2012.[22]

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[19] The EFSM and EFSF issuing bonds, then bought by private investors, are financial intermediaries between financial markets and the Community Member States which ask for financial aid in the form of loans. Both initiatives differ only in the way of repayment security. The security for the EFSM bonds is the EU budget and in the case of the EFSF these are guarantees of euro zone countries.

[20] See Conclusions of the European Council meeting dated 24-25 March 2011, EUCO 10/1/11 REV 1, Brussels 20.04.2011 (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/PL/ec/120311.pdf; date of access 1.08.2013).

[21] The establishment of the ESM was enabled by the amendment of Art. 136 of the Treaty on the Functioning of the European Union (TFEU), in March 2011 the European Council decided to add a paragraph to this article allowing euro area countries to create a mechanism protecting the stability of the euro area as a whole.

[22] See *Information on the new rules of functioning of the European Financial Stability Facility (EFSF) and the*

The ESM was conceived as a fundamental mechanism in the framework of the Community strategy to restore financial stability of economies of euro area countries. Its aim was to ensure financial stability within the euro zone by bailout for economies of countries facing serious difficulties. The ESM was to break the so called deadly trap, that is, the relationship between the growing debt of governments and the difficult situation of financial institutions. Undertaking stabilizing actions at the Community level was then justified because of the interdependence of economies and problems of euro zone countries. The deterioration of the financial situation of one of the Member States affected the deterioration of the situation of other countries and their economies, threatening to burst the whole euro zone (that is why, Greece's bankruptcy and exit from the group was so much apprehended, as pointed already).[23] Also in July 2011 the second aid program for submerged in crisis Greece, amounting to approximately 150 billion euro, was presented.

After nearly a year of difficult negotiations, on 28 September 2011, the European Parliament (EP) adopted a package of six legislative acts proposed by the Commission, colloquially called the "six-pack" (five regulations and one EU directive)[24]. Particularly important was the "six-pack" directive - *EU Council Directive 2011/85 of 8 November 2011 on requirements for budgetary frameworks of the Member States*[25]. It was a revolution in the

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*future shape of the European Stability Mechanism (ESM)*, the Foreign Department of the Polish National Bank, Warsaw, August 2011, p. 3 (http://www.nbp.pl/publikacje/integracja_europejska/info_efsf_esm.pdf; date of access: 10.07.2013). In connection with the establishment of the ESM, the already existing European Financial Stability Facility (EFSF), providing financial support to the euro area countries in raising funds to finance their own liabilities, was not immediately liquidated when its functions were taken over by the ESM and managed its obligations until their total pay off.

[23] The objectives of the ESM were to be implemented with the help of funds raised from the issuance of medium and long term debt securities with a maturity up to 30 years. These instruments were secured with the capital amounting to 80 billion euro to which the euro area Member States were to contribute by the end of 2014 (eventually the ESM was to have a stabilizing capital of 700 billion euro, the majority of which was to be the capital available on request in a situation requiring intervention).

[24]On November 23, 2011 a package of 6 legal acts was published in the Official Journal of the EU: 1. Regulation of the European Parliament and of the (EU) Council No 1173/2011 of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area 2. Regulation of the European Parliament and of the (EU) Council No 1174/2011 of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area 3. Regulation of the European Parliament and of the (EU)Council No 1175/2011 of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies 4. Regulation of the European Parliament and of the (EU) Council No 1176/2011 of 16 November 2011 on the prevention of macroeconomic imbalances and their correction 5. (EU) Council Regulation No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the excessive deficit procedure 6. Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

[25] *EU Council Directive 2011/85 of 8 November 2011 on requirements for budgetary frameworks of the Member States*, EU Official Journal, L 306/41, 23.11.2011 (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0041:0047:PL:PDF; date of access: 10.07.2013).

sphere of the Community finance, granting to the Commission for the first time extensive authorization that gave it power over euro zone countries. The Directive introduced the supervision over public finances of the Member States, as well as mechanisms for the prevention and correction of excessive macroeconomic imbalances. As a result, the Commission obtained the possibility to impose budgetary discipline on the Community members and to demand euro zone countries to reduce excessive budget deficits and public debt. The European Union management bodies wanted to discipline countries, especially those which, disregarding the Maastricht criteria, exceeded the budget deficit and debt thresholds. This problem concerned the majority of euro area countries.[26] Moreover, the Commission also gained the ability to impose financial preventive penalties when it acknowledged that a State neglects the established limits of public debt and deficit.[27]

Very important for repairing the situation of the EMU and the euro zone was the European Council summit in Brussels on 8-9 December 2011. Representatives of the European Union Member States made decisions which were fundamental for restraining the spreading financial and economic crisis.

One of the major achievements of Community leaders was agreement on the need to introduce a new fiscal pact in the form of an international agreement binding members of the Community, as well as the early entry into force of the ESM. Consent to the new fiscal pact gave the Union an opportunity to deepen integration, and in particular to improve financial discipline and support the convergence process. The fiscal pact was intended to mobilize the Community members to strictly comply with rigors of budget deficit and debt which were more stringent in times of crisis. The idea was to strengthen the fiscal discipline and economic policy coordination in the euro zone strengthening the Stability and Growth Pact of 1997 and to create a more effective macroeconomic surveillance. They were to strengthen the budgetary surveillance ex ante and provide greater credibility to budgetary work within the euro area. The planned treaty provided for the introduction of further, detailed solutions to uphold healthy financial policy, concerning, among others, improving the operation of the excessive

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[26] For example, in 2010 only 3 of 17 euro area Member States met the Maastricht criteria. These were Finland, Luxembourg and Estonia.

[27] In accordance with the provisions of the Directive, after the initiation of the excessive imbalance procedure, the European Commission has the right to request a Member State to pay a deposit in the amount equal to 0.2% of its GDP. If the state accused of excessive imbalance has not complied with the recommendations of the European Commission a deposit becomes a fine and is forfeited. Old EU Member States, such as Germany, France and Italy, however, left a door open in case such penalty was to reach them in the future. The finance ministers of the EU Member States may block the opening of the excessive imbalance procedure by qualified majority.

deficit procedure, introduction of regulations related to the implementation of a balanced budget to constitutions or other high-ranking legal acts of the Community Member States.

Taking care of the credibility of the European Union and the stability of the euro area, the European Council sought to convince financial markets and investors that it treats the defense of the euro currency very seriously, which was expressed in the concern for the fastest entry into force of the ESM (pointed to the middle of 2012). For greater effectiveness of actions, decisions within the ESM were to be made by qualified majority. The admission of the private sector to the Greek debt reduction program and placement of respective provisions in the ESM were important information for the International Monetary Fund (IMF) engaged in financial matters of the Community. The amount of funds engaged by the Community[28], and the confirmation by the summit participants of the ability to assign subsequent sums to support the resources of the IMF in the combat with the crisis seemed to guarantee the effectiveness of plans to stabilize the situation in the euro zone. All activities undertaken by the European Union were necessary not only because of concern about economic growth and Community members' rising debt, but mainly because of the urgent need to restore confidence of financial markets to the Community, the euro area and its currency.

In January and February 2012, EU leaders obliged finance ministers of euro zone countries to settle the details of the second bailout program for Greece. It was essential because of the urgent necessity to launch this support by mid-February. At that time the problems of Greece and the case of its debt cancellation were not coming out of front pages of European and world press. On February 2, 2012, 17 euro zone countries signed a refined version of the Treaty establishing the European Stability Mechanism (ESM).[29]

On 2 March 2012, the Member States of the European Union (25 EU countries except Great Britain and the Czech Republic), including euro zone members, signed *The Treaty on Stability, Coordination and Management in Economic and Monetary Union*, the so-called fiscal pact (FP). Main reason for its enforcement was the disregard of the convergence criteria and the settlements of the Stability and Growth Pact by the majority of the members of the Community. In February 2012, an excessive deficit was observed in 23 of 27 EU countries.[30] The problem of an excessive deficit was addressed in the "six-pack", noting, among other

[28] It was 500 billion euro from the European Financial Stability Facility and the European Stability Mechanism.

[29] The Treaty entered into force on 27 September of the same year launching so much needed financial stabilization mechanism for the European Union members. All 17 euro zone countries ratified the agreement in a short time, that is by 3 October 2012, see http://www.european-council.europa.eu/home-page/highlights/european-stability-mechanism-treaty-signed?lang=en (date of access 1.07.2013)

[30] See *Monitor of nominal convergence*, ed. Ministry of Finance of the Republic of Poland, Department of Financial Policy, Analysis and Statistics No. 4(2012).

things, the principles of the creation of national budgets, the rate of expenditure growth and the pace of public debt reduction. The aim of the FP was to force maintaining budgetary balance in the Member States of the Community, as well as better control of the Council of the European Union and the European Commission over the state of public finances of countries and better coordination of economic policy of the Community.[31]

On 27-28 June 2012 in Brussels the European Council summit was held, during which important decisions were made regarding the future of the EMU, namely the decision was made to create a schedule of the Community action leading to the actual economic and monetary union.[32] The interim report titled *Towards effective economic and monetary union* prepared at the meeting of the European Council on October 12, 2012 was established as a result of a series of meetings and consultations of representatives of all EU Member States, Members of the European Parliament and its President (conducted in September 2012).[33] It referred to those areas which, according to European leaders and parliamentarians, required improvements in order to develop effective policy of implementation of the real EMU and to prepare the final report, which was scheduled for December 2012. According to the participants of this substantive debate, which was important for the stabilization of the situation in the Community and the future of European integration, the prerequisites for building the real EMU are: integration of the financial sector in the Community (bank union), integration of budgetary policies (fiscal union), integration of economic policies (economic union) and integrated management in the Community connected with the increased participation of the Community institutions in it, especially of the European Parliament (political union). On October 8, 2012, on the occasion of the Euro group meeting, the operation of the EMN was inaugurated, which was the most important component of the Community stabilization strategy aimed to ensure the financial balance of euro area countries.[34]

On November 28, 2012 the European Commission issued an official statement on deepening the EMU, adopting a plan of short, medium and long-term measures for the deep

[31] It was agreed that the Fiscal Pact shall enter into force on 1 January 2013 after an earlier ratification by minimum 12 euro area Member States. The agreement also established the principle of organizing summits of the euro area with the participation of countries that do not participate fully in the EMU and are not members of the euro zone.

[32]See http://www.european-council.europa.eu/council-meetings?meeting=f09c58bc-2f8e-41a7-b2f8-22eb4f31fcbf&lang=pl&type=EuropeanCouncil (date of access: 1.08.2013).

[33]See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/PL/ec/132860.pdf (date of access 1.08.2013).

[34] See report from the inauguration of the ESM on 8.10.2012 on the website of the Council of the European Union (http://www.consilium.europa.eu/homepage/highlights/the-european-stability-mechanism-%28esm%29-inaugurated?lang=pl; date of access: 11.07.2013).

and genuine economic and monetary union, presenting "a vision of a strong and stable structure in the area of finance, taxation, economy and politics."[35] The final report of that document – *Towards a genuine economic and monetary union*, published on 5 December 2012 presented the schedule of activities leading to the completion of the EMU (3 steps).[36]

The year 2013 was important for the European Union and the euro area due to the entry into force of the fiscal pact. Thanks to the determination of the Community and its management bodies and political consensus between the Member States, a success was achieved, as everything indicates, in controlling the worst risks associated with the possibility of spreading the debt crisis to other European countries such as Spain or Italy. Apart from Greece, these countries are able to function without external financial assistance of the Community. Bond yields of the before mentioned PIIGS countries ceased to grow. The recession and economic crisis, however, still constitute a challenge for both the European Union and individual euro area countries. In some of them social attitudes are very bad and sometimes close to the society's pain tolerance, and especially for some of its groups (e.g. young citizens of Spain deprived of life chances by the economic crisis).

It should be noted that pessimistic scenarios for the euro zone were strengthened in recent years, largely due to the insufficient efficacy of multibillion-dollar aid programs designed for its members at risk of bankruptcy. After the first assistance programs from 2010 addressed to Greece (05.2010, 110 billion euro) and Ireland (11.2010, 85 billion euro), the following year it was necessary to support also Portugal and to grant subsequent sums for Greece, in 2012 it was decided to support the endangered banking sector in Spain.

When it comes to Greece and the broader problems which its debt generates, the situation has not changed fundamentally until now. For many economists, Greece is already bankrupt, which, however, will never be officially admitted for political and economic reasons by either leaders of this country counting on more help, or leaders of the European Union. Greece's creditors have long come to terms with the scale of their losses from Greek bonds. Many of hitherto activities undertaken by executive bodies of the Community and international financial institutions ware aimed not so much to rescue the Greek state and its citizens from

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[35] See *A Blueprint for a deep and genuine Economic and Monetary Union (EMU)*: *Launching a European debate*, European Commission Press Release dated November 28, 2012, http://europa.eu/rapid/press-release_IP-12-1272_pl.htm (date of access 1.08.2013).

[36] Stage 1 (2012-2013): Ensuring fiscal sustainability and breaking the link between banks and sovereigns; Stage 2 (years 2013-2014): Completing the integrated financial framework and promoting sound structural policies; Stage 3 (post 2014): Improving the resilience of EMU through the creation of a shock-absorption function at the central level, see *Towards a genuine economic and monetary union* (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/PL/ec/134201.pdf, date of access: 1.08.2013).

the effects of insolvency but rater to reduce losses of creditors of this state, namely German, French and American banks. However, the fact is that despite the impressive support Greece received from the so-called Troika (the European Union, the European Central Bank, the International Monetary Fund), in the first and second aid program, reformatory measures of Prime Minister Andonis Samaras's government and their effects (from 20.06.2012) still do not seem to be satisfactory for European top leaders and politicians, and especially for investors and financial markets.[37] On August 20, 2013, German finance minister Wolfgang Schäuble confirmed the predictions of international financial circles that it will be probably necessary again to grant the third aid package for submerged in crisis Greece, albeit likely on a smaller scale than was the case in the first and second aid program for this state. These plans were confirmed by German Chancellor Angela Merkel, adding, however, for purely diplomatic and political reasons, that the Greek government makes promising progress in reforms, and that at present it is difficult to talk about the scale of the next bailout.[38] The probable size of the necessary financial support for Greece will be known at the turn of 2013 and 2014, or in the first half of 2014. This is also not precluded by European Commissioner for economic and monetary affairs Olli Rehn.[39] The issues of cancellation of a part of Greek debt or prolongation of the repayment period suggested by Rehn arouse emotions in financial circles and are unlikely to be accepted by Chancellor Angela Merkel, according to whom it could jeopardize the economic stability of the European Union.

### 4. The future of the Economic and Monetary Union - hopes and fears

The majority of the Member States of the European Union for many years disregarded the obligation to comply with the Maastricht criteria, including those relating to the limitation of excessive budget deficits. Mutually agreed upon principles were not even followed by community leaders, by such countries as Germany and France, not to mention the countries of southern Europe traditionally less rigorously treating restrictions of the Community financial policy. Until recently the European Commission had not had appropriate means of effective persuasion, nor had it been strong-minded enough to discipline the European Union Member

[37] It is considered to be so, among others, because of the sluggish privatization, not providing expected revenue; still not changing, substantially low efficiency of tax collection; or too modest scale of redundancies in the public sector.

[38] Statements on this issue of Chancellor Merkel and other politicians from the CDU currently ruling in Germany are of course conditioned by the election campaign before the September election to the German Bundestag (22.09.2013).

[39] See AFP news, tagesschau.de (http://www.dw.de/niemiecki-minister-finans%C3%B3w-o-grecji-konieczny-b%C4%99dzie-kolejny-pakiet-pomocowy/a-17037740, date of access: 23.08.2013).

States, including euro zone members in budgetary matters. Opportunities for doing so appeared only after 2008 with the introduction of appropriate legislation and mechanisms of stabilization which were influenced by both the global financial and economic crisis and the crisis of the Community's finances. With the entry into force of the regulations of the "six-pack", the European Commission obtained the right not only to give opinions on national budgets, but also to control the processes taking place in real economy. It should be seen as an important advance in the management of the European Union and its finances, forming - as everything indicates - the preparation for possible introduction in the future of central management of finance and economics with the help of Community legislation and penalties connected with the relevant legal acts.

Despite the new powers obtained by the European Commission we can – in the author's opinion - still have some reasonable doubts as to whether they will be able to effectively discipline the members of the European Union and the euro area to properly observe the budgetary and financial discipline. It seems that at the present stage of integration the mentioned solutions may still prove insufficient and ineffective in the situation in which the Commission officials give commands to leaders and governments of the Community Member States on whom the election of the President of this key institutions of the Community depends. The Commission's persuasion possibilities can also be temporarily limited due to the political and electoral calendar which functions in various European Union Member States. During the election, politicians, regardless of the option, are willing to make exaggerated promises to society. Their implementation, even partial, is connected most commonly with increasing public spending or resigning from unpopular sacrifices associated with reformatory activities. Election promises are therefore "financed on credit" and often implemented by authorities' consent to excessive budgetary deficit. For this reason, one can be concerned whether the Community managing bodies will indeed be able to effectively control fiscal policies of the Member States and in particular euro area countries by means of the new legal instruments or other regulations and mechanisms implemented in the future.

You cannot also forget that on the European political scene there are Eurosceptics and their number systematically increases, and there are even opponents of both European integration and the European Union itself, who, when faced with difficulties, primarily blame the Community for everything in a populist way. These circles propose to move away from integration in favor of national interests of individual European countries, which is no less dangerous for Europe than huge budget deficits of some countries. Supporters of the anti-European and anti-integration policy can effectively impede the use of wrought today

mechanisms of integration and financial and economic stability in the European Union and the euro zone.

One of the most important for the European Union and the euro area consequences of the still experienced financial crisis, debt crisis, was a decline in confidence of investors and financial markets to the Community and fiscal policy of euro area countries as well as the European currency. The instability of the financial sector, as well as the slowdown in the world trade in the crisis years most difficult for European countries and their economies, 2008-2010, were not conducive to rebuilding trust in the EU and the euro area, as well as to activities aimed at the economic revival of the Community. Stronger economic integration of the European Union Member States would enable the Union to faster overcome the crisis, as well as to more effectively respond in the future in similar situations and to support economic growth, which is so desperately needed by the EU, its economy and citizens. Rebuilding this trust, as well as the entrance on the path of sustainable economic growth will be very difficult and can take a long time in the current situation. Meanwhile, the European Union and the euro area have no time to be wasted. Currently, bloodless, but exhausting for Community members battle is being fought for the future of the EMU and the single euro currency as well as the future of united Europe.

In order to give a developmental boost which would break the run of bad luck of European economy at the end of the global financial and economic crisis the Community adopted for implementation in 2010, a new, highly ambitious European Union growth strategy "Europe 2020", which, according to the author, presents a real chance for development and greater competitiveness. It replaced an earlier Community development strategy, the Lisbon Strategy, which resulted in a failure (2000-2010). The European Union cannot afford another defeat and wasting opportunities for development offered by the successful implementation of the strategy "Europe 2020". That is why, it is important to ensure effective implementation of the provisions of this strategy. For citizens of the European Union, discouraged by problems and deteriorating living conditions, particularly important seem to be actions resulting from the essential objectives of the strategy which are focused on creating new jobs. The need for such action was recognized by the European Commission mobilizing in recent years the EU Member States to implement budgetary policy conductive to economic growth, to facilitate access of banks and SMEs to financing sources, to support competitiveness in economy, to fight with unemployment, to limit social effects of

the crisis and to modernize public administration[40]. Achieving these objectives will probably not be possible without thorough structural reforms.

To improve the situation in the euro zone it is equally important to continue reforms aimed at improving the regulation of financial markets and increasing investor protection. In this context, it is extremely important to strengthen supervision over credit rating agencies to make them more responsible for the published forecasts. On January 1, 2011 the European Securities and Markets Authority, ESMA, located in Paris was brought into existence, whose tasks include the supervision over the activities of credit rating agencies, the construction of a new system of supervision of these agencies and the monitoring of their compliance with law and of the methods they use in the assessment of banks and related procedures. These actions are aimed at preserving stability and increasing the predictability of activities on financial markets, which is a very important element in the fight with the now ending and possible future fiscal crises. Solutions proposed by the European Commission in this field slowly influence the reduction of investors' excessive confidence in rating agencies' assessments, enforce more frequent evaluation of debts of countries and the increase of the independence of ratings and greater accountability of the agencies for violations of provisions of Community law. [41]

**Final remarks**

Adopted in recent years, legislative and organizational measures aiming to stabilize the finances of the Community are, as it seems, an effective counterweight to the crisis of over-indebtedness of the Member States of the Community and the euro area. The financial and economic crisis of 2007-2013, and the numerous problems associated with the functioning of the EMU were paradoxically an impetus for the European Union to revise its existing financial policy and to undertake appropriate reformatory action. The scale and complexity of the problems made it necessary to carry out reforms at both the Community and the Member State levels. It can be assumed that if it was not for the debt crisis of the European Union members there would not probably be any fundamental change in the ways of managing the Community or the transformation of the consciousness of leaders of European countries regarding the need to respect the treaty provisions with regard to financial and budgetary matters. Today, no one doubts that one of the main causes of the crisis of the EMU and the

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[40] See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Region*s "Annual Growth Survey 2012" , COM (2011) 815 final.
[41] See the European Securities and Markets Authority. *Annual Report 2012,* Paris: ESMA 2013 (http://www.esma.europa.eu/system/files/esma_2013_00620000_pl_tra.pdf; date of access: 15.07.2013).

euro zone was the disregard for the fundamental economic criteria by individual Member States. The new philosophy of financial and economic management of the Community, developed in response to the crisis, lies primarily in a prominent increase in the degree of financial and economic interdependence of the European Union members, more effective monitoring of activities of the Member States and their governments and promoting greater shared responsibility for the future of European integration, and therefore also for the future of the EMU, the euro zone and the common European currency.

The euro zone crisis has shown very clearly that the EU Member States must necessarily make use of all available both legal and organizational measures to strengthen economic and political integration within the Community. An important effect of this "enhanced awareness" of the members of the European Union in matters presented in the study is a political consensus pointing to the need for cooperation of all members of the groups for the common good and shared interests, as well as the conviction about the need to apply applicable treaty provisions by absolutely all countries without exception. They stand guard over financial and economic stability of the European Union and the euro zone which gains importance and gradually widens the reach of its territorial impact.

The indicated direction of the stabilization and development action was initiated by the regulations of the "six-pack", which can now be considered as a first step towards the creation of a central European government that would take over control over finances and economy of the European Union. It would be a milestone in the deepening of European integration, not only in the financial and economic but also political dimension, and in prominent strengthening of the euro area through the establishment of uniform fiscal and economic policy. The European Union would become a federal state with its own central bank and its own government, which in the long term would enforce harmonization in the area of foreign policy and the creation of a new security system with joint military forces. It seems that we are getting closer to actions, which may give impetus to the Community for such deepening of European integration. Paradoxically, the financial crisis which is just being overcome by the European Union, can contribute to a significant progress in integration. So far, however, we can see that the road to deeper integration will be difficult and it will require a transformation of public awareness and a new approach of Western political elites, who so far have had problems with forcing through fundamental reformatory solutions and convincing citizens in their own countries to them. Some fears can be felt about the European Commission, which would be the future government of the Community. Its position is still not as strong as Community law would indicate. The situation in this regard will not change substantially as

long as the Commissioners are politicians owing their positions to the heads of governments of the European Union Member States.

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