

The Eurozone Crisis:
A Near-Perfect Case of Mismanagement

Charles Wyplosz
The Graduate Institute, Geneva and CEPR

1. Introduction

For nearly three years, from early 2010 to late 2012, the Eurozone has lived on the brink of breakup. The banking and financial systems became fragmented, gravely impairing the effectiveness of the common monetary policy. Policymakers have appeared as clueless in the face of a recession of unprecedented depth and length. Elected Heads of Governments have been summarily pushed to resign by their pairs. The European Commission has given the impression of being unable to reconcile deep disagreements, leaving one country, Germany, in charge of masterminding policy responses. Even with enhanced powers, the European Parliament has remained passive. As the intensity of the crisis has receded, policymakers have declared victory prematurely and studiously ignored the risks of a legacy of huge public debts.

The crisis did not erupt in clear skies. It was years in the making. Warnings were not heeded. Poor institutions, whose weaknesses had been carefully described, were left untouched or superficially patched. When the crisis finally revealed these cracks, policymakers chose to avoid any deep questioning. It is only at the insistence of the ECB, quite late in the game, that a banking union was set up, but only partially so. It is only under ECB pressure that a new fiscal discipline regime – the fiscal compact – was set up but poorly implemented. It is often said that a good crisis should never be wasted; in many respects, this one has been wasted. The result is a wave of Euro-skepticism whose deleterious effects will be felt for many years to come.

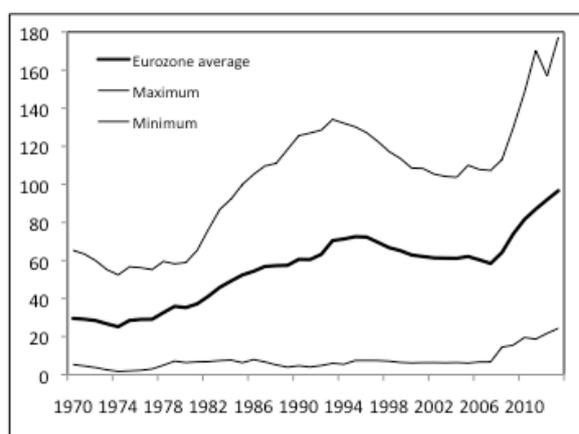
Even now, five years later, major disagreements about the source and unfolding of the Eurozone crisis remain. A popular and entrenched narrative emphasizes competitiveness issues. It portrays the periphery economies as unable to operate in an integrated market. Excessive production costs are described as the cause of the crisis even though the evidence tells a different story (Wyplosz, 2013b). Current account balances are then misinterpreted as driven by labor costs and as a cause of the crisis, while they are a symptom of excessive spending driven by either fiscal indiscipline or excessive credit growth (European Commission, 2009; Lane and Peels, 2012; Wyplosz, 2013a). This paper aims at offering a consistent narrative of the crisis.

It takes as its starting point the view that the sovereign debt crisis is due to fiscal indiscipline, as described in Section 2. Section 3 presents the decisions taken when the Greek crisis broke out. These measures were presented as “unique and exceptional”, only to shape the management of the following crises. Section 4 analyses the long period during which the crisis spread. The turnaround finally occurred at end-2012 when the ECB took the steps that it should have taken earlier, as explained in Section 5. This does not mean that the crisis is over, however; Section 6 explains that the legacy of large public debts constitutes a threat that is currently ignored. The concluding section attempts to interpret these policy failures.

2. Before the Crisis: Fiscal Indiscipline

With few exceptions, the Eurozone countries share a long history of fiscal indiscipline. During the period 1970-1995, average public indebtedness has more than doubled as a percentage of GDP, as Figure 1 illustrates. Over the next ten years, the average debt ratio has declined, but modestly. Following the onset of the global financial crisis, the increase has been swift, as in many other developed countries.

Figure 1. General government public debts (% of GDP)



Note: Eurozone average is unweighted, original 12 member countries.

Source: 1970-1989: Historical Public Debt Database, IMF; 1990-2013: AMECO, European Commission

Averages conceal many important details, which Table 1 fills. Two countries, Germany and Luxembourg, were virtuous during the 1970s and 1980s but Germany's unification proved to be very costly in the 1990s. On the other hand, three countries (Belgium, Ireland, and the Netherlands) were not virtuous over the first period but then made serious corrections. In the years that followed the adoption of the euro, six countries (Belgium, Finland, Ireland, Italy, the Netherlands and Spain) also successfully drove their public debts down by large amounts. In contrast, three countries (France, Greece and Portugal) never seriously dealt with their public deficits, and that observation applies to Germany as well since the early 1990s. During the global financial crisis, all countries saw their public debts rise, in some cases (Ireland and Greece) in an explosive manner. The same occurred during the sovereign debt crisis (2009-2013), with several cases of doubling or near doubling of the debt ratio (Greece, Ireland, Portugal and Spain).

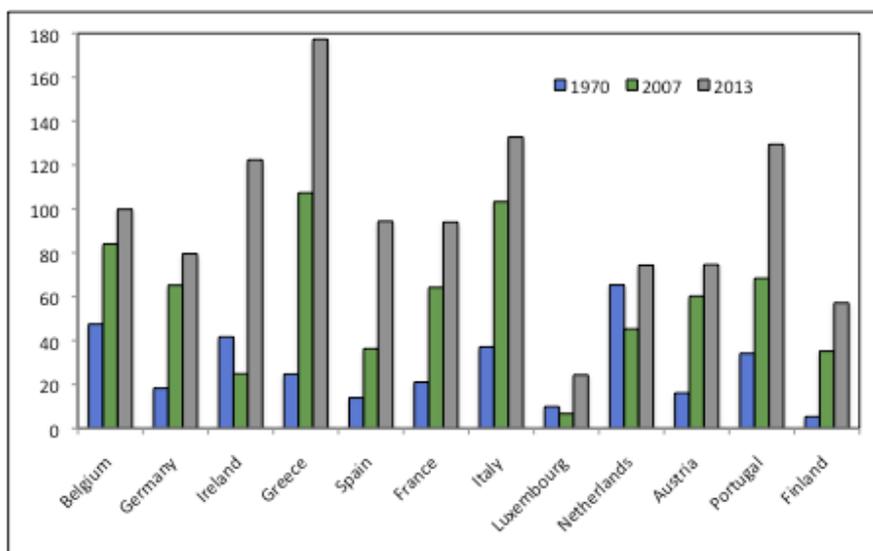
Table 1. Changes in the debt to GDP ratio (%)

	1970-1990	1990-1998	1998-2007	2007-2009	2009-2014
Austria	40.0	8.2	-4.2	8.9	5.2
Belgium	78.1	-8.3	-33.2	11.7	4.8
Finland	8.7	34.3	-13.2	8.4	16.9
France	14.2	24.4	4.6	15.0	16.9
Germany	-18.3	21.0	4.7	9.3	2.7
Greece	47.0	22.9	12.8	22.4	47.3
Ireland	50.4	-39.0	-28.2	39.6	55.8
Italy	57.2	20.1	-11.1	13.1	17.3
Luxembourg	-5.2	2.4	-0.4	8.9	9.9
Netherlands	11.5	-11.1	-20.4	15.5	14.5
Portugal	19.1	-1.5	16.6	15.3	42.9
Spain	28.7	21.5	-27.9	17.7	44.9

Source: see Figure 1.

The evolution of the last six years dwarfs the earlier increases, but massive debt build-up during a period of historical hardship is not untoward. What is less understandable is a continuing stream of deficits over complete business cycles. This is what lies behind the upward debt ratio trends observed in nearly all Eurozone countries (Figure 2).

Figure 2. Debt ratios in 1970, 2007 and 2013



Source: see Figure 1.

A debt build-up is often described as adverse to growth because it imposes a high debt burden. This is true but when debt becomes large, there is a much more pressing risk. Like any asset, public debts are susceptible of being subject to self-fulfilling crises. A characteristic of most financial crises is that they are long in coming and are often triggered by an unexpected event. The occurrence of the crisis, then, is not really surprise but the timing of its occurrence is.

The Greek case is a case in point. By 2007, the debt was above 100% of GDP and yet the risk premium relative to German bonds was negligible. It is commonplace today to blame markets for their shortsightedness. Indeed, at the time, the ECB often expressed uneasiness with what it saw as a lack of market-driven discipline. This was a case of a “good equilibrium”. Investors did not take seriously the risk of a debt default, and they were right. Absent the global financial crisis, there was a distinct possibility that Greece could have continued to serve its debt, quite possibly an even higher one. The financial crisis, however, reduced risk appetite and investors started to question this benign scenario. Once doubts settled in, the risk premium started to rise and to make the debt less stable, especially as the GDP growth rate took a dive. This intensified investors’ unease, leading to further increases in the risk premium, and so on. The Greek debt situation shifted to a “bad equilibrium” when it was revealed that deficit accounting has been doctored. The risk premium became as excessively large in 2010 as it had been previously too small.

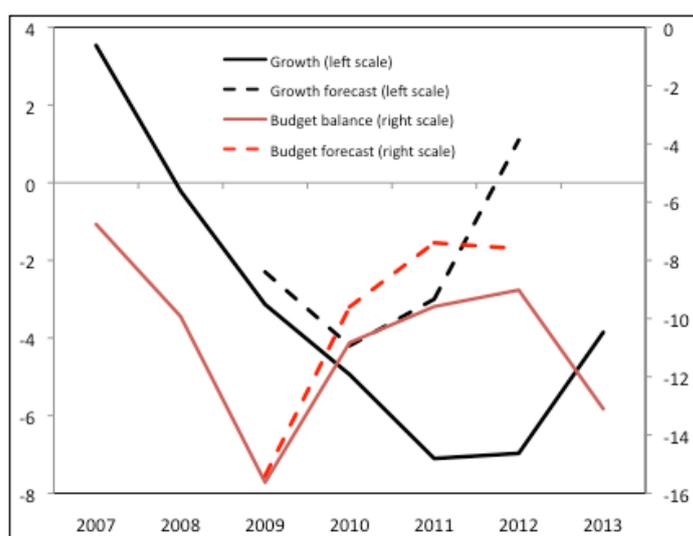
Multiple equilibria, which make self-fulfilling crises possible, are a defining characteristic of financial markets. This is a classic case of market failure. It is driven by shifting market expectations. Expectations are neither right nor wrong; they represent the “average view” of investors regarding future developments that may or may not materialize. Policymakers always lament this instability; instead, they should take the existence of multiple equilibria into account and act accordingly. The combination of a market failure (multiple equilibria) and of a policy failure (rampant fiscal indiscipline) allowed the crisis to erupt. Indeed, the crisis had been in the making for quite a while.

The upshot is that large public debts are bad, particularly because they constitute a risk of a self-fulfilling attack. The attack may or may not ever occur, but the risk is there, hidden when the equilibrium is “good”. Large public debts are an accident waiting to happen. Policymakers should avoid large debt buildups and, when debts are big, they must ensure that the accident will not happen. In the Eurozone, they failed on both accounts.

3. Greece: The Mother of the Eurozone Crisis

The economic situation deteriorated rapidly after the onset of the global financial crisis. As the growth rate rapidly turned from positive to negative, the budget sharply deteriorated, as can be seen in Figure 3. What put Greece on the market’s radar screen was the recognition by the government newly elected at end 2009 that its predecessor had doctored the deficit figures. This triggered a self-fulfilling process. Given the deteriorating situation, the Greek government was losing market access and could not, therefore, deal with the crisis on its own.

Figure 3. Greece in the crisis years



Source: AMECO, European Commission and European Commission (2010)

This was a classic situation. Either Greece would get external help or it would default. The normal process in this case is to apply for IMF support and associated

conditionality, which could possibly include a partial default. But, early on, the ECB came out with the “two no” position: no recourse to the IMF and no default. This effectively blocked any solution, when one takes into account that the European Treaty has a no-bailout clause that prohibits assistance by governments (art.125) and by the ECB (art.123).

Something had to give, and all three blocking points were circumvented. First, in May 2010, the IMF was called in, but within the new Troika arrangement. Second, the arrangement also drew in the ECB and member governments against the spirit – if not the letter – of the no bailout clause. Finally, a default, under the euphemism of Private Sector Involvement (PSI), was organized at end 2011, wiping out some 75% of GDP worth of Greek public debt.¹ Even though it was presented as voluntary, it was a default. In the event, it ruined the unprepared Cypriot banks and led directly to the Cyprus crisis some two years later. These decisions have shaped the crisis.

First, the Greek package was presented as “exceptional and unique”. In fact it has become the blueprint for the subsequent packages. The political leaders believed that they were not creating a precedent, only to be trapped by it later on.

Second, until then, the IMF had never accepted to be the junior partner of rescue operations. Instead, the well-established procedure was for the IMF to lead negotiations and craft a package. If the costs exceeded its resources, including the lending ceiling, the IMF would then call upon friends of the country to contribute additional bilateral resources, but these resources were only disbursed with its agreement. This was a standard and time-tested practice. In 1998, it had rejected the Japanese offer to create an Asian Monetary Fund to deal with the spreading East Asian crisis, precisely because it wanted to be in charge alone. Historians will have to explain the reasons that led to such a radical change, but it is now acknowledged that it was not a felicitous one, as detailed below.

Third, the effective violation of the no-bailout clause is of historical importance. From the start of planning for the common currency, it was clear that fiscal discipline was a key requirement (Delors Committee, 1989). The chosen solution was the adoption of the Stability and Growth Pact and the no-bailout clause. For well-understood reasons (Eichengreen and Wyplosz, 1998; Wyplosz, 2013a), the Stability and Growth Pact was bound to fail, leaving the no-bailout clause as the only safeguard against the deficit bias. The power of the clause depends entirely on its credibility, which provides incentives for governments to be fiscally disciplined. The fact that the clause was pushed aside the very first time when it become binding means that its credibility has been shattered and, therefore, that it has no incentive power. Effectively, the Eurozone has no effective fiscal discipline mechanism in place and restoring the no-bailout clause credibility is nearly mission impossible.²

¹ One of the most staggering mistakes was the “Deauville walk”. Upon return from their walk by the sea, Chancellor Merkel and President Sarkozy pre-announcement the future debt write-down. Warning ahead of time is a financial market cardinal sin and it did send markets into a tailspin.

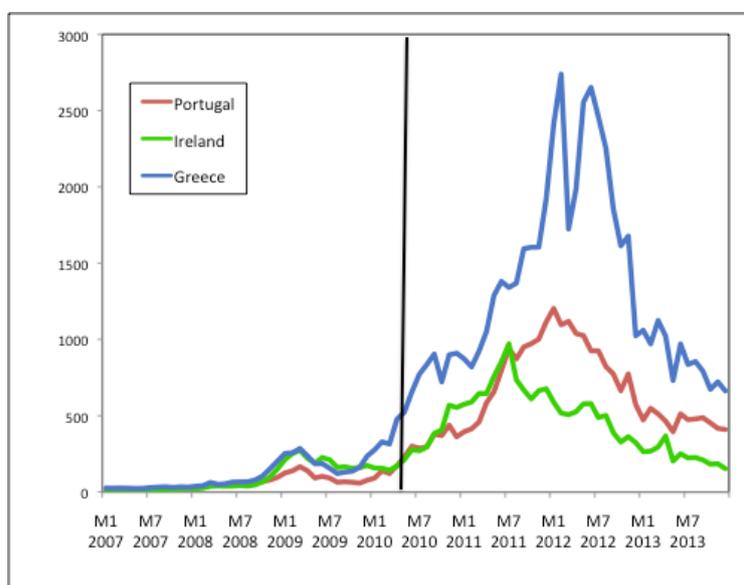
² The 2012 reforms of the Stability and Growth Pact, including the two pack-six pack legislation and the fiscal compact, massively increase the weight and complexity of the bureaucratic process. It does not change any of the fundamental weaknesses of the Stability and Growth Pact, *inter alia* its incompatibility with national sovereignty in budgetary matters. It may affect behavior on the margin, as it has in the past, but it cannot be decisive, as it should be.

Fourth, the approach to the bailout package evidenced a surprising lack of understanding of the nature of financial crises, at the government level, at the Commission and even at the ECB. In early 2010, suggestions were made that Greece would be offered a € 10 billion loan. A few weeks later, the figure was raised to € 20 billion. In the end, the May 2010 package provided € 110 billion, followed by a new loan of € 130 billion in 2012, and more might be coming. In addition, the loans initially carried high interest rate, suggestive of a punishment intent. The impact on debt build-up was disastrous. Eventually, these interest rates were lowered.

Fifth, the conditions attached to the loans, which also shaped subsequent programs, imposed terse austerity fiscal policies. Given the deepening recession in Greece, it came as a shock that a severely pro-cyclical stance would be required.³ In the tense debate that followed, the Troika argued that the multipliers were very small, possibly negative. This belief was formalized in the Fall of 2010 optimistic forecasts, as seen in Figure 3. Subsequently, the IMF, which signed on these forecasts, has acknowledged its mistake (Blanchard and Leigh, 2013).

Fifth, the discarding the no-bailout clause was justified by the urgent need to prevent contagion. As we know all too well, contagion still occurred. In fact an argument can be made that the austerity program alarmed the financial markets even more. This can be seen in Figure 4, which displays the interest rate spreads over the German bonds.

Figure 4. Interest rate spreads on 10 year government bonds



Note: the vertical line indicates the date of the Greek bailout (May 2010).

Source: *International Financial Statistics*, IMF.

³ The IMF had officially acknowledged that similar policies imposed during the Asian crisis had been misguided.

Finally, the creation of the Troika is difficult to understand from a political viewpoint. For decades, the IMF has assumed the role of bad cop, leaving behind its programs a trail of deep resentment. The Troika visibly put the European Commission in the front seat. Not only this led to disagreements with the IMF, which even let it be known that it found the program too harsh, but it also left a legacy of resentment that will not disappear. In contrast with the IMF, which leaves the scene once the program is over, the European Commission will remain engaged with all member countries. In addition, by assuming the role of bad cop, the Commission has contributed to the emergence of a popular anti-Europe sentiment that is unlikely to go away. The long-run political consequences could well be considerable.

In the same vein, the ECB has found itself in a position to impose conditions on governments. This runs counter to its staunch – and fully justified – attachment to the principle of central bank independence from member governments. Independence, however, needs to go both ways. By undermining national budgetary sovereignty, the ECB has put itself in a delicate position. The argument that the ECB must defend the principle of monetary dominance – the fact that monetary policy should never be called upon to plug the public sector budget constraint – does not justify the ECB membership in the Troika as part of a program that involves central bank loans to member governments, even if they are indirect, in contradiction with the no-bailout clause.

4. Contagion: Muddling-Through

The worst period of the crisis is between the Greek bailout and mid-2012, when the ECB made its moves, as described in Section 5. During this period, the European Council met at frequent intervals (about every other month) to deal with a continuously worsening situation, well illustrated in Figure 4. Each meeting was presented before and after as a major success, which would bring the crisis to its end. In fact, most of them were quickly followed by a new ratcheting up of risk premium because the decisions taken were not addressing market anguish.

Table 2 lists all the Summits that took place during the acute phase of the Sovereign Debt Crisis, indicating for each one the decisions taken regarding the crisis. With few exceptions, the statements published after the meetings indicate a continuous focus on austerity policies and the need for countries under Troika programs to abide by their commitments.⁴ The few relevant decisions include the creation of the European Stability Mechanism (December 2010), the debt reduction for Greece (July 2011) and the decisions to create the Single Supervisory Mechanism (June 2012) and the Single Resolution Mechanism (December 2012). Although the statements frequently refer to the gravity of the situation, actual decisions are remarkably few and far apart.

Most importantly, many decisions were either irrelevant or even counter-productive. Several Summits attached considerable importance to the strengthening of the Stability and Growth Pact. Even if one is willing to accept that they have succeeded –

⁴ A constant theme, developed at every single meeting, is the Europe 2020 program to boost growth and employment. At some point, the statement reflects frustration with this litany: “However, efforts undertaken to date remain insufficient to meet most of these targets” (European Council, March 1-2 2012).

a view strongly rejected in Section 3. – this is a long run issue that was irrelevant for the crisis. The leaders seem to have believed that the markets were spooked by the lack of fiscal discipline and that reinforcing the pact would calm them down. In fact the markets were spooked by the legacy of high accumulated debts and the urgent need for a return to growth in order to avoid a damaging decline of the denominator of the debt to GDP ratio. The markets correctly saw the fiscal consolidation requested by the Commission – a.k.a. austerity – as preventing growth and aggravating the debt problem.

Much the same applies to the creation of the temporary European Financial Stability Fund (EFSF), and of its permanent successor, the ESM, by the Eurogroup of finance ministers . They believed that bailouts were exactly what the markets wanted to see. Yet, neither the EFSF nor the ESM had any lasting effects on the risk premia. These were resources provided by the public sector to governments that the private sector was unwilling to support any more. It was most unlikely that the markets would be reassured by increases in the stock of debt, especially by creditors likely to enjoy seniority, either formally (the IMF and the ECB) or informally.

Table 2. European Summits, May 2010 – End 2012

2010	May 7	Greek bailout
	June 17	Europe 2020, work on fiscal consolidation
	September 16	"Maintain momentum on the reform of European governance"
	October 28-29	More on governance, no decision
	December 16-17	Creation of European Stability Mechanism (ESM)
2011	February 4	None
	March 11	Lending capacity of ESM set at € 500 billion
	March 24-25	Adoption of Six Pack concerning fiscal discipline
	June 23-24	New program for Greece
	July 21	Ban on short selling
	October 23-26	PSI for Greece, Bank capital requirement, Two Pack for fiscal discipline, Euro Summits at least twice a year
	December 8-9	Fiscal compact
2012	January 30	None
	March 1-2	None
	March 23	"We want Greece to remain in the euro area"
	June 28-29	Single Supervision Mechanism (SSM), part of Banking Union
	October 18-19	ECB in charge of SSM; ESM allowed to lend to banks
	November 22-23	None
	December 13-14	Single Resolution Mechanism (SRM), part of Banking Union

Note: some meetings were restricted to Eurozone members. The table only reports decisions regarding the Euro area.

Source: compiled by the author from European Council (<http://www.european-council.europa.eu/>).

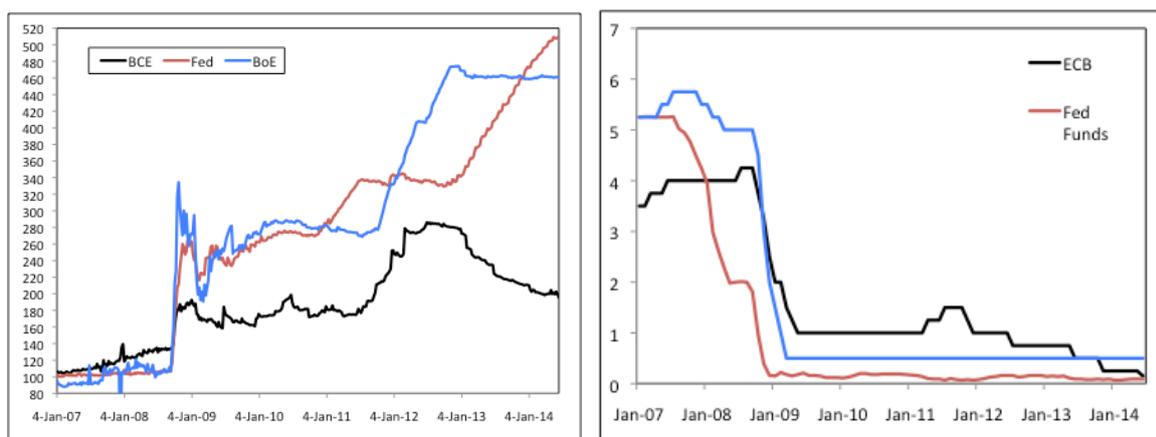
The governments were not just misunderstanding markets, they did not even listen to investors. A self-fulfilling crisis comes to an end either after a crash or when market expectations are changed. Policies can change market expectations only if they address market concerns, on their terms. Progressively, the stock of debts under suspicion (the three bailed-out countries *plus* Spain and Italy) reached some € 3000 billion. The late creation of the ESM, with a maximum lending capacity of € 500 billion, was again not of an adequate order of magnitude. While policymakers were concerned about flows (annual budget deficits), the markets were worrying about the stocks of debts.

This criticism applies to the ECB as well. During the period under review, it has kept its interest rate higher than the Federal Reserve and the Bank of England, even raising it in mid-2011 when the crisis was getting worse. Similarly, throughout both the financial crisis and this phase of the Sovereign Debt Crisis, the ECB has expanded its balance sheet but much less than the two other central banks. During both periods, the ECB has made it clear that its objective was to deliver price stability and that it was incompatible with acting as a lender of last resort, either to banks or to governments. This has led de Grauwe (2012) to explain why the debt crisis has only affected Eurozone member countries: in other developed countries, the markets have never doubted that central banks would never accept a default on their public debt. The ECB too has opposed defaults, including the Greek PSI, but it did not take the measures required to rule them out. On the contrary, by calling for rapid fiscal stabilization, the ECB reinforced market fears and, therefore, contributed to the spread of the crisis throughout the Eurozone.

Figure 5. The ECB, the Fed and the Bank of England

Central bank assets
(Index: 100 = Jan. 2007)

Policy interest rates



Sources: European Central Bank, Federal Reserve and Bank of England

5. Turnaround: The ECB Against Governments

The acute phase of the crisis ended between end of 2011 and mid-2012 (Figure 4). It can be traced to two key actions of the ECB. At the end of 2011, the ECB announced the Long Term Refinancing Operation (LTRO), a fixed rate full allotment program of lending to banks. As noted above, markets look at stocks. By December 2011, the balance sheets of the ECB had spent nearly € 500 billion, the total lending capacity of the ESM. By March 2012, it had spent another € 500 billion (Figure 5).

Then, during the Summer of 2012, the ECB announced the Outright Market Transactions (OMT) program. The significance of this program is that it commits the central bank not to amounts, but to prices. The unlimited ability of a central bank to absorb or sell assets is what creates the possibility of controlling asset prices or interest rates. The markets were influenced by the size of the LTRO but that could never be the definitive weapon because it was not targeting any price. The quantum step of the OMT program was to announce that the interest rates on crisis countries had to go down. By famously pledging to buy bonds in “whatever it takes” amounts, the ECB finally acted as a central bank. Without spending one euro (so far), the ECB has turned the situation around.

Even the OMT program, is not exempt of criticism, though. The interest rate target has not been announced and the ECB has conditioned its interventions to countries that are under a Troika program. Limits to unlimited actions undermine the intention. The reason for these limitations is most likely related to growing chasm between the ECB and (some) governments. The ECB considered that it could not go farther.

All indications are that the ECB, possibly under its new leadership, finally grasped the nature of the crisis and of the necessary policy responses, while governments continued to favor the muddling-through approach that had failed so far. This obviously put the ECB at odds with the governments. Of great interest is that before each of its two “knock down” punches, the ECB presented the governments with urgent central bank requests.

First, as it was preparing the LTRO, the ECB told government that the Eurozone needed a “fiscal compact” that would make fiscal discipline a national constitutional responsibility. Decentralizing fiscal discipline had been advocated earlier (Wyplosz, 2012) as the way of avoiding the conflict between the Stability and Growth Pact and national sovereignty. The ECB can act as lender of resort to governments only if it has solid reasons to expect that fiscal profligacy will never be seen again. At any rate, its request was promptly satisfied. Within weeks, a new treaty (The Treaty on Stability, Cooperation and Governance, TSCG) was adopted. It requires national legislation and budget rule. Unfortunately the treaty is vague and its implementation falls short of what is needed.

Next, before launching the OMT program, the ECB called for a banking union, one of the glaring oversights of the Maastricht Treaty, which makes it impossible for the ECB to act as lender of last resort to banks. Indeed, a central bank needs to have real time knowledge of the situation of banks that require support. Such knowledge rests with the supervisor. But national supervisors are known to tread very carefully when national champions are in difficulty, which is bound to prevent timely and accurate communication. Here again, the governments immediately approved the idea. It then

took months to create the Single Supervision Mechanism (SSM) and many more months – along with constant ECB proding – to adopt the Single Resolution Mechanism (SRM). Both are notably insufficient.

6. The Public Debt Legacy

The decline in risk premia indicates that the financial markets are no longer acutely worried about public defaults or a breakup of the Eurozone. The crisis, however, has left a legacy of high public debts. In fact, public debts are higher now than they were before the crisis, considerably higher in several cases. The decline in risk premia does not indicate that the markets are reassured about debt sustainability; it simply means that they regard the ECB as likely to act as lender of last resort. However, this commitment is both vague and conditional. As noted earlier, and it has never been tested. A new phase of acute market pressure is therefore plausible.

The official response remains as misleading as ever. They delude themselves by not looking at the existing stock of debt, relying instead on continuing austerity policies to reduce the flow of new debt. The process of debt reduction that they envision is likely to take decades (Eichengreen and Panizza, 2014). Once again, the political leaders show no sign of understanding the pressing danger of a recurrence of contagious self-fulfilling crises.

The only way of eliminating the threat of renewed market panic is to reduce the debt stocks. Barring rapid and unexpected inflation, which the ECB would never condone, the only solution is to restructure public debts where they are evidently too large for comfort. There are two good reasons to reject this solution. First, some public debts are owed to governments, to the ECB and to the ESM. A debt restructuring would impose losses to these creditors. This would amount to debt burden sharing among Eurozone countries, which the less indebted countries adamantly reject for perfectly understandable reasons. Second, during the crisis, national public debts have migrated to the books of national banks. A debt restructuring of the appropriate size would threaten the survival of banks and require new cash injections, financed by fresh public borrowing. This would nullify the debt restructuring effort. A solution, the PADRE plan, has been advocated in Pâris and Wyplosz (2014). It involves the purchase by a specially created agency of large amounts of all public debts. The agency would then swap these bonds into zero-interest rate perpetuities in exchange for an equivalent (in present value terms) transfer to the agency of seigniorage income to be received on the relevant horizon. This would involve no cost to banks and no transfers among Eurozone countries. In effect, it would simply guarantee that the restructured debts will be paid for by future generations in each country. In practice, it would remove from the market place the excessive debt stocks that stand to trigger self-fulfilling crises.

7. Conclusions

The Eurozone crisis occurred because the institutional setup was imperfect. The wrong concept of fiscal discipline allowed some public debts to increase dangerously before the crisis while the inability of the ECB to act as lender of last resort to banks, due to the absence of a banking union, led to explosive debt surges in some countries.

The incredible lack of comprehension of the crisis by political leaders led to contagion and a deep depression for three years. It was only when the ECB became active in 2012 that the crisis came under control.

Some of the institution flaws have been dealt with, but partially so. The fiscal compact (TSCG) does not fully decentralize fiscal discipline and has been weakly implemented. The Banking Union leaves many banks outside the SSM and the SRM; it is also far too complex to be efficient. At least, steps have been taken in the right direction. Further steps are urgently needed but it is likely that it will require a new crisis for governments to take action.

On the other hand, governance has gravely deteriorated. Existing institutions have been unable to design timely and adequate policy responses. The Commission has limited itself to impose pro-cyclical austerity policies and to try to increase its power. Important changes have been proposed by other bodies (the ECB, the Eurogroup or national governments). The “Community method” has given way to inter-governmentalism of the worst kind. Indeed, the vacuum has been filled by the emergence of one country, Germany, as the effective leader. This is a highly truncated form of inter-governmentalism. It is an ineffective form because any country will always use its influence to advance solution that meets its interests, which is what Germany has done. It is also politically dangerous since other public opinions are bound to resent the situation. The dramatic economic and social impact of the crisis has left a disastrous perception of what Europe is. The costs could well be momentous in the long run.

References

- Blanchard, Olivier and Daniel Leigh (2013) “Growth Forecast Errors and Fiscal Multipliers” Working Paper WP/13/1, IMF.
- De Grauwe, Paul (2012), “The Governance of a Fragile Euro Area”, *Australian Economic Review* 45(3): 255-268.
- Delors Committee (1989) *Report on Economic and Monetary Union in the European Community*, Brussels: Committee for the Study of Economic and Monetary Union.
- Eichengreen, Barry and Charles Wyplosz (1998) “The Stability Pact: Minor Nuisance, Major Diversion?”, *Economic Policy*: 67-113.
- Eichengreen, Barry and Ugo Panizza (2014), “A Surplus of Ambition: Can Europe Rely on Large Primary Surpluses to Solve Its Debt Problem?” CEPR Discussion Paper 10069.
- European Commission (2009) “Competitiveness Developments within the Euro Area”, *Quarterly Report on the Euro Area*, 2009(1): 18-49.
- European Commission (2010) *European Economic Forecasts*, Autumn.
- Lane, Philip R. and Barbara Pels (2012) “Current Account Imbalances in Europe”, *Moneda y Credito* 234: 225-261.
- Pâris, Pierre and Charles Wyplosz (2014), “PADRE 2.0, Politically Acceptable Debt Restructuring in the Eurozone”, The Graduate Institute, Geneva.
- Wyplosz, Charles (2012) “Fiscal Rules: Theoretical Issues and Historical Experiences”, in: A. Alesina and F. Giavazzi (eds) *Fiscal Policy After the Crisis*, Chicago University Press.
- Wyplosz, Charles (2013a) “Europe’s Quest for Fiscal Discipline”, *European Economy Economic Papers* 498, April.
- Wyplosz, Charles (2013b) “Eurozone Crisis and the Competitiveness Legend”, *Asian Economic Papers* 12(3): 63-81.