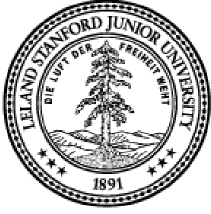

Stanford – Vienna
Transatlantic Technology Law Forum
A joint initiative of
Stanford Law School and the University of Vienna School of Law

European Union Law Working Papers

No. 6

The European Sovereign Debt Crisis: How the EU Legal Structure Limits and Shapes Responses

Elizabeth Espinosa

2012

European Union Law Working Papers

edited by Siegfried Fina and Roland Vogl

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Suggested Citation

This European Union Law Working Paper should be cited as:
Elizabeth Espinosa, The European Sovereign Debt Crisis: How the EU Legal Structure Limits and Shapes Responses, Stanford-Vienna European Union Law Working Paper No. 6, http://ttlf.stanford.edu.

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Abstract

This paper discusses the European Sovereign Debt Crisis and how the structure of the European Union affects the ability of the bloc to respond to and implement a solution to the crisis. It begins with an overview of the EU structure and applicable law, then lays out the background of the debt crisis in the countries worst impacted up until the time of writing (April 9, 2012). Finally, the paper discusses EU efforts to address the crisis and analyses the ways in which the structure of the bloc acts as an impediment to an effective and long lasting solution.

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I. Introduction

Since 2009, the European Union has been struggling to address its growing sovereign debt crisis, caused by the enormous debts of its weakest economies. The sovereign debt crisis originated with the rapidly growing debts burdening its weakest economies: Greece, Ireland, Portugal and Spain. Since its beginning, the crisis has begun to spread to much larger economies, including Italy and France. A series of bailouts and other measures have failed to solve the crisis, which is still haunting the EU and worrying global investors. Nine EU States are now in recession, including Denmark, which demonstrates that the crisis has spread outside the Eurozone.[1] The EU is now facing the very real possibility of a long European recession, as investors lose faith that the EU will be able to solve the crisis.

This paper will examine the impact and limits that the EU structure and legal institutions place on its ability to respond to the crisis. I will argue that the EU's structure and legal framework erect a number of serious barriers to an effective solution to the sovereign debt crisis.

II. EU Law and Structure

a. Overview of Applicable EU Law

The EU is based on several fundamental treaties, primarily the Treaty on the European Union and the Treaty on the Functioning of the European Union, that lay out the relationships between States and institutions within the bloc and dictate how the EU will function. The EU has also developed a body of law to support the implementation of its treaties and to govern its institutions and policies.

[1] Charles Duxbury, "Nine and Counting as Denmark Joins EU's Recession Club," Wall Street Journal, March 30, 2012, available at http://blogs.wsj.com/eurocrisis/2012/03/30/nine-and-counting-as-denmark-joins-eus-recession-club/.

The Treaty on the Functioning of the EU (TFEU) requires that States conduct their economic policies in a way that advances, not hinders, the common objectives of the EU.[2] States are also required to coordinate their economic policies with the European Council, which has the power to draw up broad guidelines for national economic policies, as well as the powers of surveillance over national economic policies to determine whether or not they adhere to the guidelines.[3] Article 122(2) of the TFEU authorizes the Council to provide financial assistance to a Member State when it is "in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control".[4] The Council is only required to notify the European Parliament of the decision to offer assistance. Parliament's approval is not required. The ECB and all national central banks are prohibited from providing overdraft facilities or any other type of credit facility to EU entities or national or local governments under Article 123. The banks are also prohibited from purchasing national debt instruments, such as bonds, directly from Member States.[5]

The TEFU gives the Council power of surveillance over Member States' national debt burden and budgets, with the goal of minimizing budget deficits.[6] If the Council determines that a Member State's deficit has become "excessive", it has the power to make policy recommendations to that State tailored to reduce the deficit. If the State refuses to take those

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[2] Art. 120, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[3] Art. 121, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[4] Art. 122(2), Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[5] "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments." Art. 123, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[6] Art. 126, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.

steps, the Council can require compliance within a certain time period, and if that expires, can make its recommendations and findings public, and even impose certain sanctions and fines.[7]

b. Economic and Monetary Coordination

EU Member States coordinate their economic policies through the economic and monetary union (EMU). Coordination is somewhat tighter between the 17 Eurozone states. The EMU contains guidelines that the Member States have agreed upon in order to address economic issues that they all face. In its 1997 Resolution on economic policy coordination states that all members share an economic policy, including those outside the Eurozone and that all Member States must participate in the development of coordinated policies.[8] However, the members of the Eurozone can, and do, meet separately to address issues particular to the shared currency. The Council of Europe and the European Central Bank (ECB) represent the EU at the international level to the extent allowed in the founding treaties.[9]

The EU has issued a number of guidelines for economic policies within the bloc. For example, the Stability and Growth Pact, mandates that Member States keep their national budgets as close to balanced as possible, with every effort to achieve a budget surplus. In the Pact, Member States also agreed to prevent budget deficits of greater than three percent.[10] However, a number of states have violated this policy and the EU has been unable to prevent

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[7] Art. 126, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[8] Resolution of the European Union on Economic Policy Coordination (1997), available at http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/l25022_en.htm.
[9] Id.
[10] Resolution of the Amsterdam European Council on the Stability and Growth Pact (1997), available at http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/l25021_en.htm.

these violations, despite its stated right to facilitate the "strict, timely and effective functioning" of the Pact.[11]

c. EU Economic Policy Making

The Eurozone is a monetary union composed of the 17 States that use the Euro. In order to be a part of the monetary union, States must meet certain criteria to ensure the convergence of their economies. There are a number of institutions that run the single currency system, primarily the European Central Bank and the Council of Economic and Finance Ministers (Ecofin), which sets economic policies. Ecofin is composed of the economic and finance ministers of each of the Member States, as well as budget ministers, if applicable, when budgetary issues are discussed.[12] Ecofin ministers meet once a month and are responsible for developing EU policies on economic coordination, the euro, financial and capital markets and external relations with non EU countries. They also oversee economic surveillance and have oversight of Member States' budgets and domestic economic policies.[13] Ecofin makes policy decisions by qualified majority either in consultation or in a joint decision with the European Parliament. Fiscal policies must be decided on unanimously.[14] Ecofin is also responsible for developing and adopting the EU budget with the European Parliament. The Eurogroup, which is composed of the Member States that are part of the Eurozone, typically meets the day before the Ecofin meetings to deal with issues specifically relating to the euro, though the group is not a part of Ecofin. When the Council is

[11] Id.
[12] Council of the European Union, *Economic and Financial Affairs*, available at http://www.consilium.europa.eu/policies/council-configurations/economic-and-financial-affairs.aspx?lang=en.
[13] Id.
[14] Id.

discussing issues and policies that relate to the euro or the EMU, the ministers from the non Eurozone Members do not have a vote.[15]

Members who are not a part of the Eurozone are expected to maintain economic policies that are consistent with the Growth and Stability Pact, though they have flexibility to allow for national responses to economic difficulties.[16]

d. European Central Bank

The European Central Bank was established by treaty and its powers and responsibilities are laid out in the ECB Statute. The ECB's primary task is maintaining price stability within the Eurozone. It is also responsible for supporting the economic policies of the EU. The ECB is responsible for several basic tasks. First, it defines and implements monetary policies for the EMU, in line with the primary objective of maintaining price stability. The ECB is responsible for steering short term interest rates in a way that advances that objective. The ECB's Governing Council makes monetary policy decisions for the Bank, and has developed instruments and procedures to facilitate that task.[17] Second, the ECB is responsible for holding the official foreign reserves for the Eurozone States and managing those investment portfolios. It does this with emphasis on liquidity and return on its investments.[18] Third, the ECB conducts foreign exchange operations, including foreign exchange interventions and other commercial transactions. Fourth, the ECB works to promote the smooth functioning of payment systems.[19] In addition to these main functions, the ECB has the authority to supervise credit institutions to promote stability.

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[15] Id.
[16] Id.
[17] European Central Bank, available at http://www.ecb.int/ecb/orga/decisions/govc/html/index.en.html. Title VIII, Chap. 2, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.
[18] Id.
[19] Id.

The ECB is run by its Governing Council, which is composed of six Board Members and the heads of each national central bank within the Eurozone. It sets monetary policy and interests rates for the Eurozone countries.[20]

The ECB is created as an independent institution and is required to remain free of the control of any other EU institution and from the control of the national governments of each Member State. This means that the ECB cannot request instructions from another institution or a national government, and those entities must not attempt to influence the policies and actions of the ECB. The ECB is also prohibited from giving loans to EU institutions or national entities, something that has become problematic during the sovereign debt crisis.

III. The Sovereign Debt Crisis and the EU Response

a. Greece

In October of 2009, George Papandreou, then Prime Minister of Greece, announced that his predecessor had concealed the true level of Greek debt, which had reached $400 billion.[21] A strong euro and extremely low interest rates throughout most of the previous decade had allowed Greece to easily borrow increasing amounts. The Greek budget deficit was 15 percent of GDP in 2009, violating the EU Growth and Stability Pact budget deficit criterion, which required that Member State's budget deficits not exceed three percent of GDP.[22] Investors were shocked by Papandreou's announcement and Greece's cost of borrowing soared, making it extremely difficult for the government to roll over its debt burden to the next year and plunging the country

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[20] Id.
[21] Matthew Saltmarsh, "As Europe Rebounds, Greece Gets Left Behind," New York Times, November 19, 2009, available at http://www.nytimes.com/2009/11/20/business/global/20drachma.html?ref=greece.
[22] CIA World Factbook, *available at* https://www.cia.gov/library/publications/the-world-factbook/geos/gr.html. Rachael Donadio and Niki Kitsantonis, "Greece Struggles to Stay Afloat as Debt Piles On," New York Times, December 11, 2009, available at http://www.nytimes.com/2009/12/12/world/europe/12greece.html?ref=greece.

into a financial crisis.[23] In late 2009, the major credit ratings agencies downgraded Greece's credit rating.[24] EU leaders feared that a disorderly Greek default would lead to chaos in the global markets and that a default that would trigger payments on collateral debt swaps (CDS) on Greek debt, and cause a huge hardship on the banks holding the CDSs.[25]

In early 2010, the EU negotiated the first of a series of bailout packages for Greece to prevent it going into default.[26] On May 2, 2010, the EU agreed to an EUR 80 billion aid package for Greece, with an additional EUR 30 billion from the IMF, that would be disbursed between the time of the agreement and June 2013.[27] In order to receive the bailout, Greece agreed to implement a number of harsh austerity measures that were highly unpopular among the Greek population, including reducing the number of public sector workers and cutting the pay of those who remained.[28] Despite the bailout and austerity measures, Greece continued to sink further into a recession and its borrowing costs rose even higher. The EU required additional rounds of austerity measures in order to receive further installments of the bailout in 2011 that barely passed in the Greek parliament in the face of violent protests. In October 2011, the EU reached the outlines of an agreement with the banks holding Greek debt to reduce the value of a portion of it by 50 percent. But the austerity requirements for this reduction sparked more protests, and

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[23] Id.
[24] Matthew Saltmarsh, "Credit Agencies Downgrade Debt Linked to Greece and Dubai," New York Times, December 8, 2009, available at http://www.nytimes.com/2009/12/09/business/global/09downgrade.html?ref=greece.
[25] Landon Thomas Jr., "Bond Holders Put Pressure on Debt Laden Nations," New York Times, December 13, 2009, available at http://www.nytimes.com/2009/12/14/business/global/14deficits.html?ref=greece. Stephen Castle and Matthew Saltmarsh, "Europe Weighs Possibility of Debt Default in Greece," New York Times, January 28, 2010, available at http://www.nytimes.com/2010/01/29/business/global/29bailout.html?ref=greece.
[26] Landon Thomas Jr. and Stephen Castle, "European Union Moves Toward Bailout of Greece," New York Times, February 28, 2010, available at http://www.nytimes.com/2010/03/01/business/global/01union.html?ref=greece.
[27] European Commission, The Greek Loan Facility, available at http://ec.europa.eu/economy_finance/eu_borrower/greek_loan_facility/index_en.htm. Stephen Castle and Matthew Saltmarsh, "Europeans Reach Deal on Rescue for Greece," New York Times, March 26, 2010, available at http://query.nytimes.com/gst/fullpage.html?res=9B05E4D9113DF935A15750C0A9669D8B63&ref=greece.
[28] Stephen Castle and Matthew Saltmarsh, "Europeans Reach Deal on Rescue for Greece," New York Times, March 26, 2010, available at http://query.nytimes.com/gst/fullpage.html?res=9B05E4D9113DF935A15750C0A9669D8B63&ref=greece.

in November 2011, Papandreou stepped down.[29] Lucas Papademos, an economist and a former vice president of the European Central Bank, was selected to replace him. He assembled a government of national unity that promised to approve a new bailout package that was being negotiated.[30]

The outline of the deal had been agreed to in October 2011, but working out the details took months of tense negotiations.[31] Any bailout package needed to be agreed upon by all of the Eurozone States. The negotiations were extremely difficult, because while all of the EU leaders agreed that Greece must be kept from bankruptcy and default for the good of the bloc as a whole, their opinions on how to achieve this varied widely, with Germany in particular insisting on additional austerity measures and budget cuts.

The EU and Greece reached an agreement on the second bailout in late February 2012, finalizing the details after five o'clock in the morning on February 21, following 13 hours of last minute negotiations.[32] On March 14, 2012, the EU approved the new bailout package of up to EUR 130 billion, including 28 billion from the IMF. The bailout will be released in a number of tranches, or installments. As of April 2012, the EU has authorized the disbursement of the first tranche, at a total of EUR 39.4 billion. These tranches will only be released if Greece observes qualitative performance criteria and a positive assessment of the policy criteria agreed to by the

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[29] Id. Landon Thomas Jr., "A Greek Political Scion Undone by Economics," November 7, 2011, available at http://www.nytimes.com/2011/11/08/world/europe/prime-minister-george-papandreou-of-greece-undone-by-economics.html?ref=greece.
[30] Jack Ewing, "New Greek Leader Trusted but Untested," New York Times, November 10, 2011, available at http://www.nytimes.com/2011/11/11/world/europe/new-greek-leader-lucas-papademos-trusted-but-untested.html?ref=greece.
[31] Steven Erlanger and Stephen Castle, "Europe Agrees to Basic Plan to Resolve Euro Crisis," New York Times, October 26, 2011, available at http://www.nytimes.com/2011/10/27/world/europe/german-vote-backs-bailout-fund-as-rifts-remain-in-talks.html?ref=greece.
[32] Stephen Castle, "Europe Agrees on New Bailout to Help Greece Avoid Default," New York Times, February 21, 2012, available at http://www.nytimes.com/2012/02/21/world/europe/agreement-close-on-a-bailout-for-greece-european-finance-ministers-say.html?pagewanted=1&ref=europeansovereigndebtcrisis.

EU ministers and in a Memorandum of Understanding with the Greek Government.[33] If the bailout is successful, the EU hopes that it will reduce Greek national debt to 116.5 percent of GDP by 2020.[34] The bailout requires a permanent EU team to monitor implementation of the deal's austerity measures. The deal also requires harsh spending cuts to health care services, the military and local governments, and details specific changes that must be made to the Greek tax system.[35]

Simultaneously with the bailout negotiations with the Greek government, the EU and Greece were negotiating with the banks holding Greek debt to induce them to accept a debt exchange deal that included a "haircut", or a loss, on the debt. As a part of Greece's sovereign debt restructuring deal, bondholders will take an approximately 75 percent haircut on their bonds, as the deal was contingent on a write off of EUR 107 billion in Greek debt.[36] In February, after the EU and Greece reached agreement on the second bailout, Standard & Poor lowered Greece's sovereign credit rating to selective default (SD) because the deal retroactively inserted collective action clauses into Greek bonds. S&P viewed this as de facto restructuring of its debt that would reduce creditors' borrowing power in an upcoming debt exchange.[37] S&P said that if

[33] European Commission, The Greek Loan Facility, available at http://ec.europa.eu/economy_finance/eu_borrower/greek_loan_facility/index_en.htm. Stephen Castle, "With Details Settled, a 2nd Greek Bailout is Formally Approved," New York Times, March 14, 2012, available at http://www.nytimes.com/2012/03/15/business/global/greece-gets-formal-approval-for-second-bailout.html?ref=europeancentralbank.
[34] Stephen Castle, "With Details Settled, a 2nd Greek Bailout is Formally Approved," New York Times, March 14, 2012, available at http://www.nytimes.com/2012/03/15/business/global/greece-gets-formal-approval-for-second-bailout.html?ref=europeancentralbank.
[35] Stephen Castle, "Europe Agrees on New Bailout to Help Greece Avoid Default," New York Times, February 21, 2012, available at http://www.nytimes.com/2012/02/21/world/europe/agreement-close-on-a-bailout-for-greece-european-finance-ministers-say.html?pagewanted=1&ref=europeansovereigndebtcrisis.
[36] Stephen Castle, "With Details Settled, a 2nd Greek Bailout is Formally Approved," New York Times, March 14, 2012, available at http://www.nytimes.com/2012/03/15/business/global/greece-gets-formal-approval-for-second-bailout.html?ref=europeancentralbank. Sarah Carlson, Alastair Wilson and Matt Robinson, "Greece's Successful Bond Exchange Removes Key Uncertainty, But Risk of Default Post Exchange Remains High," Moody's Weekly Credit Outlook, March 12, 2012, available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_140541.
[37] Augustino Fontevecchia, "Greece in Selective Default, S&P Says", Forbes, February 27, 2012, available at http://www.forbes.com/sites/afontevecchia/2012/02/27/greece-in-selective-default-sp-says/.

a sufficient number of creditors accepted the terms of the debt exchange, the selective default would be considered to be "cured" and the credit rating could be raised again.[38] The ratings agency expressed the concern that if enough creditors did not accept the terms of the deal, Greece would be in danger of a outright payment default because of insufficient access to market funding. Shortly after S&P's downgrade, Moody's also downgraded Greece from "Ca" to "C".[39] Moody's also viewed the exchange as a default, as investors would be taking a loss of over 70 percent on the value of the bonds.[40] By the time the bailout deal was officially approved, enough creditors had agreed to the terms of the debt exchange to avoid an outright default.[41] By April 5, Greece announced that 97 percent of creditors had agreed to the terms of the deal and would be accepting the 75 percent haircut in exchange for a new package of debt securities.[42] There is a deadline of April 20, 2012, for the remaining three percent of investors to accept the deal. Greece has threatened to default on any bonds that are not exchanged.[43]

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[38] Standard & Poor's, "Greece Ratings Lowered to 'SD' (Selective Default)", February 27, 2012, available at http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245329471786.

[39] Moody's Investors Service, "Moody's Downgrades Greece to C from Ca," March 2, 2012, available at http://www.moodys.com/research/Moodys-downgrades-Greece-to-C-from-Ca--PR_239375. Sarah Carlson, "Greek Bond Pact Confirms Seniority of Eurosystem's Sovereign Debt Holdings," Moody's Weekly Credit Outlook, available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_140156.

[40] Moody's Investors Service, "Moody's Downgrades Greece to C from Ca," March 2, 2012, available at http://www.moodys.com/research/Moodys-downgrades-Greece-to-C-from-Ca--PR_239375. Sarah Carlson, "Greek Bond Pact Confirms Seniority of Eurosystem's Sovereign Debt Holdings," Moody's Weekly Credit Outlook, available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_140156.

[41] Sarah Carlson, Alastair Wilson and Matt Robinson, "Greece's Successful Bond Exchange Removes Key Uncertainty, But Risk of Default Post Exchange Remains High," Moody's Weekly Credit Outlook, March 12, 2012, available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_140541.

[42] Landon Thomas Jr., "97% of Investors Agree to Greek Debt Swap," New York Times, April 5, 2012, available at http://www.nytimes.com/2012/04/06/business/global/greece-says-97-percent-of-bondholders-agree-to-swap.html?ref=europeansovereigndebtcrisis.

[43] Brian Blackstone and Todd Buell, "Greece Feels Collateral Damage from Bank," Wall Street Journal, February 29, 2012, available at http://online.wsj.com/article/SB10001424052970204520204577250771606659952.html?KEYWORDS=european+sovereign+debt+crisis. Landon Thomas Jr., "97% of Investors Agree to Greek Debt Swap," New York Times, April 5, 2012, available at http://www.nytimes.com/2012/04/06/business/global/greece-says-97-percent-of-bondholders-agree-to-swap.html?ref=europeansovereigndebtcrisis.

b. Ireland, Spain and Portugal

Aside from Greece, the countries suffering the most from the sovereign debt crisis are Ireland, Spain and Portugal. While Ireland and Portugal have received bailouts, Spain's economy is much larger and is too big to bail out, making it imperative to prevent Spain's situation from becoming as serious as Greece's problems are.

Although Irish spending was under control and they were not running budget deficits remotely approaching the Greek deficit, its economy found itself in trouble with the real estate bubble burst after several decades of rapid economic growth that allowed the housing bubble to grow. The banks were highly levered and held large amounts of debt. In 2009, the Irish economy shrank over seven percent, and remains in recession. The government slashed spending repeatedly, and unemployment rose dramatically. Ireland's budget deficit rose to 14 percent of GDP, and the cost of borrowing soared to levels only surpassed by Greece.[44] The Irish strongly objected to receiving bailout funds and resisted, leading to a long negotiation over an aid package.[45] However, in November 2010, the EU approved a EUR 67.5 billion bailout for the Irish government.[46] Other EU leaders were very insistent about providing a bailout, in an attempt to prevent contagion to other weak economies within the bloc. After the bailout was approved, the Irish Prime Minister, Brian Cowen, stepped down, becoming the first of several political casualties of the debt crisis. His party was ousted from power in a subsequent election.[47] Current

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[44] Sarah Lyall, "Irish Wince as Budget Proposal Cuts to the Bone," New York Times, December 9, 2009, available at http://www.nytimes.com/2009/12/10/world/europe/10ireland.html?ref=ireland.

[45] Stephen Castle, "Finance Ministers to Set Irish Bailout Terms," New York Times, November 27, 2010, available at http://www.nytimes.com/2010/11/28/business/global/28euro.html?ref=ireland.

[46] Stephen Castle and Liz Alderman, "Europe Approves Irish Rescue and New Rules on Bailouts", New York Times, November 28, 2010, available at http://www.nytimes.com/2010/11/29/business/global/29euro.html?ref=ireland.

[47] Landon Thomas Jr., "Irish Leader to Dissolve Government After Budget," New York Times, November 22, 2010, available at http://www.nytimes.com/2010/11/23/business/global/23euro.html?scp=8&sq=ireland%20&st=cse.

economic data is showing signs of a recovery beginning in Ireland.[48] However, the austerity measures have been difficult for the small country and progress is likely to be slow.[49]

In contrast to Ireland, Portugal's economy had been weak for some time before the financial crisis and its debts had been gradually increasing. When the debt crisis hit, Portugal's interest rates began to rise and its government enacted several rounds of austerity cuts while the economy fell into a recession. In March 2011, the Portuguese Prime Minister, Jose Socrates stepped down and his party was defeated in June 2011 elections. Its interests rates remained high, and in May 2011, the Portuguese Government asked the EU for a EUR 78 billion bailout package. Because Portugal had been enacting austerity measures on its own and requested the bailout, it was much easier for EU leaders to reach an agreement on a rescue deal in this case.[50] Despite enacting the measures requested by the EU, Portugal's deficit is still increasing and its borrowing costs rising because its economy is shrinking as it falls further and further into a recession that many blame on the harsh austerity measures.[51]

Like Ireland, Spain had experienced an economic boom in the years leading up to the financial crisis in 2008. When the bubble burst, Spain fell into a recession and its unemployment level soared. Its deficit reached 11.2 percent of GDP in 2009, and borrowing costs began to rise.

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[48] Eamon Quinn, "Ireland Minister Upbeat on Recovery," Wall Street Journal, April 6, 2012, available at http://online.wsj.com/article/SB10001424052702303299604577327322799986772.html?KEYWORDS=Ireland+.
[49] Jenny Paris, "Austerity Medicine Proves Hard to Swallow," Wall Street Journal, April 4, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/04/austerity-medicine-proves-hard-to-swallow/?KEYWORDS=Ireland+. Liz Alderman, "In Ireland, Austerity is Praised, but Painful," New York Times, December 5, 2011, available at http://www.nytimes.com/2011/12/06/business/global/despite-praise-for-its-austerity-ireland-and-its-people-are-being-battered.html?ref=world.
[50] Raphael Minder, "Portugal Agrees to $116 Billion Bailout," New York Times, May 3, 2011, available at http://www.nytimes.com/2011/05/04/business/global/04portugal.html?ref=portugal.
[51] Patricia Knowsman, "Portugal Banks Borrowing from ECB Hits High," Wall Street Journal, April 9, 2012, available at http://online.wsj.com/article/SB10001424052702303772904577333351470909224.html?KEYWORDS=european+sovereign+debt+crisis. Landon Thomas Jr., "Portugal's Debt Efforts May Be Warning for Greece," New York Times, February 14, 2012, available at http://www.nytimes.com/2012/02/15/business/global/portugals-debt-efforts-may-be-a-warning-for-greece.html?pagewanted=1&ref=global-home. Jenny Paris, "Austerity Medicine Proves Hard to Swallow," Wall Street Journal, April 4, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/04/austerity-medicine-proves-hard-to-swallow/?KEYWORDS=Ireland+.

The Spanish Prime Minister, Jose Luis Zapatero, passed an austerity package designed to cut the deficit to six percent in 2011, but investors were not reassured and interest rates continued to rise, leading to the ouster of Zapatero's government in 2011. Zapatero was replaced by conservative Mariano Rajoy, who also introduced deep budget cuts.[52] However, in early April 2012, Spain's borrowing costs rose again following an unsuccessful debt auction in which the Spanish government sold less bonds than they had hoped. This led to new worries from investors and other governments that the crisis was worsening again.[53]

c. Italy and France

As the debt crisis deepened, it began to spread to large economies including Italy and France, that are much too big for the EU to bail out. Their borrowing costs also increased significantly, particularly in Italy.

Italy became a significant cause of concern to the EU, as it is the bloc's third largest economy.[54] Its debt reached 120 percent of GDP, making it second only to Greece within the Eurozone. Despite a budget surplus, interest payments were increasing at a rapid rate and are approximately 16 percent of GDP, causing fear among investors that Italy would eventually be

[52] Raphael Minder, "Spanish Voters Deal a Blow to Socialists Over the Economy," New York Times, November 20, 2011, available at http://www.nytimes.com/2011/11/21/world/europe/spanish-voters-punish-socialists.html?hp=&pagewanted=print.

[53] Jenny Paris, "Austerity Medicine Proves Hard to Swallow," Wall Street Journal, April 4, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/04/austerity-medicine-proves-hard-to-swallow/?KEYWORDS=Ireland+. Raphael Minder and Jack Ewing, "Spain Jolts Euro Zone Back On Alert," New York Times, April 4, 2012, available at http://www.nytimes.com/2012/04/05/business/global/european-central-bank-leaves-interest-rates-unchanged.html?pagewanted=1&sq=Spain&st=cse&scp=3. Liz Alderman, "After Brief Calm, Europe Again Worries Over Debt," New York Times, January 5, 2012, available at http://www.nytimes.com/2012/01/06/business/global/06iht-rates06.html?ref=spain. Victor Mallet, "Shaken Spain Seeks to Restore Confidence," Financial Times, April 8, 2012, available at http://www.ft.com/intl/cms/s/0/ba81bd28-816f-11e1-b39c-00144feab49a.html#axzz1rXIQb2IK.

[54] CIA World Factbook, Italy, available at https://www.cia.gov/library/publications/the-world-factbook/geos/it.html.

unable to meet its debt obligations.[55] Italy's debt is nearly EUR 800 billion, which is more than Greece, Ireland and Portugal combined.[56] Consequently, should Italy get into as much trouble as Greece, the EU would be helpless to bail it out. After failing to implement fiscal reforms for too long, Silvio Berlusconi was forced to step down in 2011, after finally passing a $75 billion deficit reduction package.[57] He was replaced by technocrat and former European Commissioner Mario Monti, who will lead until the economy has been stabilized and new elections are held. Monti survived a confidence vote and managed to pass a package of drastic spending cuts and tax increases that were deeply controversial among the Italian population and within the parliament.[58] Although Italy managed to reduce borrowing costs with an auction of government bills in December 2011, its interests rates remained high, and its credit rating was downgraded two notches.[59] Italian costs of borrowing have continued to rise in early 2012.[60]

While France is in much better condition than Italy at least for now, its borrowing costs have also been rising. France's economy is plagued by several issues, including the fact that government spending dominates the economy to a much greater extent than in any other EU State.[61] Additionally, its exports have been decreasing and France is losing competitiveness to

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[55] Liz Alderman and Matthew Saltmarsh, "Worries Rise over Spain and Italy Debt," New York Times, August 2, 2011, available at http://www.nytimes.com/2011/08/03/business/global/pressure-builds-on-italy-and-spain-over-finances.html?ref=italy.
[56] Id.
[57] Rachael Donadio and Elisabetta Povoledo, "European Debt Crisis as Berlusconi's Last Stand," New York Times, November 8, 2011, available at http://www.nytimes.com/2011/11/09/world/europe/support-for-berlusconi-ebbs-before-crucial-vote.html?ref=italy.
[58] Rachael Donadio, "Italy's Leader Unveils Radical Austerity Measures," New York Times, December 4, 2011, available at http://www.nytimes.com/2011/12/05/world/europe/mario-monti-of-italy-calls-cabinet-to-consider-austerity-measures.html?ref=italy.
[59] Liz Alderman and Rachael Donadio, "Downgrade of Debt Rating Underscores Europe's Woes," New York Times, January 13, 2012, available at http://www.nytimes.com/2012/01/14/business/global/euro-zone-downgrades-expected.html?_r=1&ref=global-home.
[60] Christopher Emsden, "Italian Bond Yields Rise Above LTRO Levels," Wall Street Journal, April 3, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/03/italy-bond-yields-rise-above-ltro-levels/.
[61] Steven Erlanger, "As French Vote Nears, Sarkozy is Haunted by Grim Economy," New York Times, January 15, 2012, available at http://www.nytimes.com/2012/01/16/world/europe/frances-gloomy-economic-outlook-haunts-presidential-race.html?pagewanted=1&sq=Sarkozy&st=cse&scp=2.

Germany. There are high levels of unemployment and growth is near zero.[62] In early 2012, its credit rating was cut from AAA for the first time in French history. At the same time, S&P downgraded Italy and seven other EU countries as well, saying that the EU was moving too slowly to strengthen the EMU and because it thought that Europe was moving toward another recession.[63] France is now cutting spending and raising taxes to keep its deficit under control.[64] Like Italy, France's economy is much too large for the EU to bail out, so the emphasis is on preventing it falling into such dire straights in the first place. Adding to the complexity, France is in the midst of a hotly contested presidential election, with each candidate accusing the other of policies that would destroy the economy.[65] It remains to be seen whether France's credit rating will recover or if it will follow the others and slide further.

d. EU Contingency Fund

In an effort to reassure investors and stabilize the market, the EU created a European contingency fund of EUR 500 billion following the first Greek bailout. EU leaders hoped that the fund would never actually be used but hoped that its existence would calm markets and allow borrowing costs to decrease. The fund would allow any State experiencing a "severe financial disturbance" caused by events beyond the control of the State to receive financial assistance.[66] The fund would provide a loan or a line of credit to the struggling State. In order to receive aid

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[62] Steven Erlanger, "As French Vote Nears, Sarkozy is Haunted by Grim Economy," New York Times, January 15, 2012, available at http://www.nytimes.com/2012/01/16/world/europe/frances-gloomy-economic-outlook-haunts-presidential-race.html?pagewanted=1&sq=Sarkozy&st=cse&scp=2.

[63] Liz Alderman and Rachael Donadio, "Downgrade of Debt Rating Underscores Europe's Woes," New York Times, January 13, 2012, available at http://www.nytimes.com/2012/01/14/business/global/euro-zone-downgrades-expected.html?_r=1&ref=global-home.

[64] Steven Erlanger, "As French Vote Nears, Sarkozy is Haunted by Grim Economy," New York Times, January 15, 2012, available at http://www.nytimes.com/2012/01/16/world/europe/frances-gloomy-economic-outlook-haunts-presidential-race.html?pagewanted=1&sq=Sarkozy&st=cse&scp=2.

[65] "Briefing: The French Election, An Inconvenient Truth," Economist, March 31, 2012 (31).

[66] EU Regulation No. 407/2010, available at http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/ec0009_en.htm.

from the fund, the State would make a formal request and the EU would evaluate its specific needs and develop a Memorandum of Understanding that contained all of the terms of the assistance. The European Commission would oversee the disbursement of funds.[67]

However, throughout 2010, interest rates continued to rise and the fund failed calm the markets. As fears grew about larger economies like Italy and France, the fund did little to reassure investors, as it is not large enough to bail out the largest EU Members. EU leaders discussed ways of levering the fund to increase its size and potential reach. Germany remained staunchly opposed to increasing the size of the rescue fund until March 2012, when Merkel agreed to allow the fund to increase to approximately EUR 700 billion.[68] Responsibility and risk for the fund will now be spread around the EU more evenly, rather than placing a disproportionate burden on Germany.[69] However, despite the increase, there are still fears that the fund is insufficient to be an effective firewall should Italy or Spain truly need a bailout.[70]

e. Role of the ECB in the Crisis

During the global financial crisis beginning in 2008, the ECB followed the example of the US Federal Reserve and cut interests rates to near zero and began buying the government bonds of countries hit particularly hard. However, in April 2011, the ECB raised its interest rates for the first time since 2008, to address what critics called an "imaginary" threat of inflation. It

[67] Id.
[68] Matthew Dalton, "Euro Zone Lifts Firewall," Wall Street Journal, March 30, 2012, available at http://blogs.wsj.com/eurocrisis/2012/03/30/euro-zone-lifts-firewall/. Peter Spiegel, "Eurozone Boosts Rescue Fund to [EUR]700 bn," Financial Times, March 30, 2012, available at http://www.ft.com/intl/cms/s/0/d22c7204-7a5a-11e1-9c77-00144feab49a.html#axzz1rXIQb2IK. Peter Spiegel, Ralph Atkins and Quentin Peel, "Merkel Set to Allow Firewall to Rise," Financial Times, March 25, 2012, available at http://www.ft.com/intl/cms/s/0/85911faa-767f-11e1-8e1b-00144feab49a.html#axzz1rXIQb2IK.
[69] FT Reporters, "Eurozone Acts to Quell Contagion Fears," Financial Times, March 30, 2012, available at http://www.ft.com/intl/cms/s/0/d5bf9054-7a73-11e1-9c77-00144feab49a.html#axzz1rXIQb2IK.
[70] Richard Milne, "Eurozone Firewall Talk Fails to Quell Fears," Financial Times, March 26, 2012, available at http://www.ft.com/intl/cms/s/0/c1ad2b64-775b-11e1-827d-00144feab49a.html#axzz1rXIQb2IK.

also stopped buying national bonds. Economists warned that this would threaten weaker economies, but the ECB declared that its strategy was perfectly consistent with the level of growth the EU was experiencing at the time.[71] However, it was forced to reverse this course when growth slowed across Europe and borrowing costs, particularly in Italy and Spain, began to climb to dangerous levels. The ECB lowered interest rates again in the Fall of 2011 and they have remained low since then.[72]

In contrast to the Federal Reserve, the ECB's ban on loans to Member States prevent it from acting as a lender of last resort. A number of economists and investors have called on the ECB to begin offering loans, but the Bank's chairman, Jean Claude Trichet, refused, saying that was the role of political leaders.[73] After Trichet stepped down, the new Chairman, Mario Draghi, refused to begin buying up national bonds on a massive scale, as many were hoping he would do. However, the ECB began quietly offering national banks emergency loans in January 2012, despite previous policy statements. The loans have provided Member States with hundreds of billions of euros at an incredibly low interest rate that the banks can then use to buy national bonds themselves. The loans enabled governments, particularly of large states like Spain and Italy, to sell large amounts of bonds at much lower interest rates than they had been forced to pay in previous months, as investors seemed reassured that this measure would stabilize the markets.[74] The ECB provided another installment of cash in February, allowing national banks to continue buying up bonds. While the amount of the initial loans was less than many were hoping for, it seems to have been a start toward calming markets and lowering borrowing costs.

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[71] Jack Ewing, "European Bank Raises Rates for First Time Since 2008", *New York Times*, April 7, 2011.
[72] Tom Fairless, "ECB Leaves Main Rate Unchanged," Wall Street Journal, April 4, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/04/ecb-leaves-main-rate-unchanged/.
[73] Jack Ewing, "Debt Crisis Highlights Bloc's Structural Weakness," February 8, 2010, available at http://www.nytimes.com/2010/02/08/business/global/08iht-euro.html?ref=greece.
[74] http://www.nytimes.com/2012/01/21/world/european-central-bank-eases-euro-crisis-a-bit.html?sq=ecb&st=cse&scp=5&pagewanted=print.

However, this is not a miracle cure for the crisis, and the EU still faces a steep challenge in achieving an economic recovery. While investors seem slightly more confident overall, costs of borrowing in Spain edged up slightly in early April, leading to fresh worry over a worsening of the crisis.[75]

IV. EU Challenges and Limitations

a. Structural and Legal Limits

A great many of the challenges facing the EU as it responds to the sovereign debt crisis stem from the fact that it is made up of 27 Sovereign States. This structure means that any actions taken will be slowed and complicated by the governments of individual States. Despite the coordinated economic policies and the fact that each State gave up certain elements of its sovereignty when it joined the EU, each is still a sovereign political entity with domestic leaders, legislatures, laws and policies that must be followed. This makes developing and implementing an effective policy to ease the crisis very complicated. Unlike a single state addressing an internal problem, the EU requires collective action by its 27 members to address the debt crisis. Major policy changes, or anything that would increase the power of the EU, require the approval of all Members, many of whom are required to get ratification from their own legislatures or even hold a national referendum depending on the implications of the policy. This can drag out a process for months, or even years, as in the case of the Lisbon Treaty, when the infamous Irish "no" vote nearly derailed the treaty entirely. Reaching an agreement on the bailouts for Greece

[75] "Markets Mixed on Fears About Europe", New York Times, April 5, 2012, available at http://www.nytimes.com/2012/04/06/business/daily-stock-market-activity.html?ref=europeansovereigndebtcrisis.

and Ireland and the creation of the contingency fund also required extensive negotiations between EU Members, to develop a strategy.

The structure of the EU makes these difficulties essentially unavoidable, absent perfect agreement among the Members. Each government of the Eurozone had to agree to the bailouts, meaning that rather than one political process, there were 17, and that there were 17 parties with a strong say in the outcome. Additionally, until recently at least, the risk of the bailouts were disproportionately born by the larger economies within the EU, particularly Germany, which then imposed harsher conditions in order to reach an agreement. Of course, each State also has its own opinion on which strategy is best that is shaped by a combination of factors, including different economic theories supported by various leaders and conflicting national interests. All of this results in an incredibly cumbersome and slow negotiating process that is exacerbated by the lack of an ultimate authority with strong enforcement power.[76]

The common currency also creates a layer of complication to dealing with the crisis. First, it increases the degree to which a domestic economic crisis impacts the rest of the EU. While a serious economic crisis in one state can often affect its neighbors, the common currency and resulting economic integration exacerbates the effect, meaning that a severe recession or a default in Greece would have serious repercussions across the Eurozone and the rest of the EU.[77] Second, the common currency limits what steps can be taken to address Greece's problems. Greece cannot take any steps to alter its own fiscal policy in response to the crisis, because the Eurozone has a single fiscal policy. Any actions must be taken by the Eurozone as a whole, which is made more difficult by the fact that fiscal policies that would benefit Greece would be

[76] Jack Ewing, "Debt Crisis Highlights Bloc's Structural Weakness," February 8, 2010, available at http://www.nytimes.com/2010/02/08/business/global/08iht-euro.html?ref=greece.
[77] Alex Brittain, "Spector of Long Recession Hangs Over Eurozone," Wall Street Journal, April 4, 2012, available at http://blogs.wsj.com/eurocrisis/2012/04/04/specter-of-long-recession-hangs-over-euro-zone/.

detrimental to Eurozone States that are not experiencing the same economic crisis. The situation has triggered calls from several prominent Greek economists and politicians for Greece to leave the euro and return to the drachma.[78] They argue that a return to the drachma and a default would be painful in the short term, but in the long term, it would allow Greece to better recover from the crisis and lead to faster economic growth.[79] This position has not gained significant support, but its proponents do highlight the limitations that come with a common currency.

The ban on loans from the ECB to national governments and private institutions has become particularly problematic during the sovereign debt crisis, as it prevents the ECB from becoming a lender of last resort in the way that the U.S. Federal Reserve is in the United States. The provision has also prevented the ECB from buying up massive amounts of national bonds in an attempt to help stabilize borrowing costs. The ECB's loans to national central banks seem to be the only way around this provision, as the text of Art. 125 of the TFEU does not prohibit the ECB lending directly to national central banks.[80] However, despite the loophole, the ECB is still very limited, as it cannot step in to bail out a struggling private bank or to give loans directly to a national government. The ban on directly purchasing debt instruments from Member States means that the ECB can only buy national bonds on the market, rather than at debt auctions.

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[78] Arnab Das and Nouriel Roubini, "A Divorce Settlement for the Eurozone," Financial Times, April 2, 2012, available at http://www.ft.com/intl/cms/s/0/dc5be3fa-7cac-11e1-8a27-00144feab49a.html#axzz1rXIQb2IK.
[79] Id.
[80] "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments." Art. 123, Treaty on the Functioning of the European Union, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF.

While the ECB's solution does appear to be making progress and may ultimately be successful, the TFEU does significantly limit the options that the bank has available to it.[81]

b. Politics and National Interests

Just as in domestic politics, competing interests play an enormous role in the ability of the EU to make a decision and enact a policy. Despite the economic coordination and increased integration within the bloc, national interests are not always aligned within the EU. Each state has its own priorities and concerns, and deals with its own internal politics. These differences are exacerbated by the range of development in different EU States, which translates into different powers and interests. The newly admitted Former Soviet States face very different problems than Germany does, or than France does. As a result, policies that benefit more developed countries could hurt those still developing and vice versa. For example, as the largest economy in the EU and one of the few experiencing fairly healthy growth, Germany is reluctant to provide significant assistance to troubled States, because it knows that it will be responsible for the largest share of any financial contributions. Angela Merkel worries that if she is too quick to bail out Greece and provide a safety net for other states, she will lose the support of her constituents at home who object to their tax money going to support those they see as fiscally irresponsible.[82] Consequently, Merkel has pushed back strongly against increasing the contingency fund and has refused to sanction bailouts without harsh austerity measures that are deeply unpopular in Greece.[83] Additionally, many economists argue that the austerity policies are actually causing

[81] Jack Ewing, "Debt Crisis Highlights Bloc's Structural Weakness," February 8, 2010, available at http://www.nytimes.com/2010/02/08/business/global/08iht-euro.html?ref=greece.
[82] Judy Dempsey, "As Guardian of the Euro, Merkel Faces a Difficult Domestic Balancing Act," New York Times, March 3, 2010, available at http://www.nytimes.com/2010/03/04/world/europe/04iht-germany.html?ref=greece.
[83] Id.

more harm than good because dramatically cutting spending slows growth, deepens recessions, and delays recovery.

The politics have also played a large role in Greece's response to the crisis. The population is strongly against the austerity measures that have been forced through in order to receive the bailout money and there have been many violent protests across the country, though primarily concentrated in Athens. The protests made it much more difficult for the Greek government to convince the parliament to ratify the bailout packages that the EU agreed to after painful negotiations. Members of Parliament rightly worried that supporting the bailout could lead to their own ouster from power in the next election.

Given everything discussed above, the sovereign debt crisis has taken on elements of a political crisis as well.[84] Since the crisis began, it has led to the ouster of governments in Ireland, Greece, Spain, Portugal, Italy, Romania and Finland. The political changes in these States have led to delays and difficulties in implementing and agreeing on domestic economic reforms. The successor governments are also well aware that they could enjoy very little time in power if their actions prove too unpopular. The repercussions have been felt in the rest of the EU as well. Other governments and leaders know that their positions could quickly become precarious. These internal and personal interests on the part of various EU leaders has made it significantly more difficult for the EU to agree on economic policies to contain and reverse the crisis, as each leader is out for his or herself, first and foremost.

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[84] Steven Erlanger, "Euro Debt Crisis is Political Test for Bloc," New York Times, February 5, 2010, available at http://www.nytimes.com/2010/02/06/world/europe/06europe.html?ref=greece.

V. Conclusion

The EU remains deep in the midst of a serious sovereign debt crisis, despite the bailouts and austerity measures that it has implemented. While there are glimmers of a recovery in some States, others are still struggling or even sliding further into recession. Doubtless it will be a long and difficult road before the EU economy is stable and growing again.

I believe that the EU's structure and legal framework place serious obstacles in the way of a successful recovery that are unavoidable as long as the EU continues to exist in its current form. The crisis has served to highlight just how difficult it is to take collective action as a group of Sovereign States without a higher authority that can make decisions and enforce policies. In addition to these unavoidable structural barriers, the EU has limited the power of the ECB to undertake measures to ease the crisis itself. Preventing direct loans or purchases of national debt eliminates a number of options that national central banks would be able to exercise.

The crisis has also demonstrated how a domestic crisis in one country can spread and impact then entire EU through the shared currency. While there is economic coordination within the Eurozone, at the moment it is functioning as a monetary union composed of numerous economies. Each national economy can have a profound impact on the economies of all of the other Eurozone States, and the structure of the Union hampers the development of an effective solution. In my opinion, the crisis has highlighted the dangers of a monetary union without a political union and with only a partial economic union. The effects of an economic crisis can spread rapidly and only be halted with great difficulty.

The EU's structure places legal limits on the steps that it can take to calm the crisis without fundamental structural changes or amendments to the founding treaties. It remains to be seen whether the actions it can take will be sufficient to prevent a deep recession.