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*Miami-Florida European Union Center of Excellence*

## **Can the Eurozone Survive?**

**Jonathan Gosper**



**Vol. 12, No. 4  
May 2012**

**Published with the support of the EU Commission**

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# Is This the End of the Eurozone?

By Jonathan Gosper\*

As financial and economic turmoil continues to rock the Eurozone nations and even threatens to undermine the political stability in the region, it may be helpful to recall the circumstances that helped bring about the formation of the European Union and the common currency of the Eurozone. While issues of trade, finance, and economics were at the heart of many of the agreements upon which the European Union was founded, there were larger issues about a shared future for Europeans that went beyond fiscal concerns. As the economic conditions in Europe and the rest of the world appear to have brought the Eurozone to the brink of collapse, the question at hand is whether the strength of the euro and the economies of the Eurozone nations will be able to withstand the forces that threaten not just the economic ties among the nations of the Eurozone and the EU, but that also strain the historical, cultural, and political foundations on which those economic ties were forged.

## I. Historical Background

As the United States, the Soviet Union, and the nations of Europe shook off the ashes of World War II, it was clear that new lines of power and influence had been drawn. It was the dawn of the “Superpower” age, with the U.S. and the U.S.S.R. emerging from the conflagration as the dominant global forces. While allied with the U.S., Europe fairly cowered in the shadow of the Soviet Union. The dream of a unified Europe was no longer just a dream; for many, it seemed a necessity. Recognizing that a unified Europe could compete politically and economically with the ideological enemy of Communism, political and business leaders began to forge the alliances and draw up the treaties that would eventually lead to the European Union. The political union at the heart of the EU has been remarkably solid, but the economic union has been rocked by unforeseen turbulence. Despite the best efforts of those who forged this alliance, the current state of the euro and the Eurozone threatens to destroy the EU itself.

Though this union would be a political one, at its heart it was an economic partnership: a unified economy built around a common currency would eliminate the trade barriers that currently divided one nation from another (McCormick, 2010). The strength of the new alliance drove the euro to prominence; it is now among the most important currencies in the world, and the economic activity within European Union is the world’s biggest market (McCormick, 2010). The planners who developed the European Union and the euro designed the alliance and the currency to withstand the stresses and shocks of turbulent markets and the turbulence of political shock and stresses. Despite having been designed with the best of intentions, however, the euro and the European Union have, in their relatively brief lives, faced a series of challenges the likes of which had not- and perhaps could not have- been foreseen.

The euro serves as a tangible symbol of the European Union. From the outset, those whose planning and organizing would eventually manifest as the European Union understood

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that financial concerns were fundamental to the success of a unified Europe. The union itself was built around business partnerships as much as it was built on political partnerships (McCormick, 2010). Nations who were interdependent on each other financially would be unlikely –or, for all practical considerations, unable- to wage war on each other (McCormick, 2010). The prototypical partnerships underpinning the European Union were based on commerce and trade; the most important trade partnerships also happened to involve the fundamental materials of war. Steel, coal, and energy are all commodities that serve as critical components of military action; countries which operate in partnership where these material are concerned are unlikely to have any interest in attacking each other; in a sense, they would be attacking themselves (Tavlas, 2004).

## II. Common Currency, Common Goals

The adoption of a common currency by the member nations of a unified Europe certainly seemed like a logical step towards solidifying that union (Tavlas, 2004), while if each member nation of a unified Europe had a different currency, that “union” would be little more than nominal (Hitchens, 2005). Though any number of political alliances could be (and were) formed, disunity in the financial sector would have very real, practical implications. A common currency for a European Union potentially solved many problems. Trade among nations with different currencies can be hampered in several ways, the most obvious of which has to do with exchange rates. Around the world, individual currencies constantly ebb and flow in terms of value; though these fluctuations are often relatively minor, they do mean that the exchange of one currency for another is not something that can be done instantaneously (Anon, 2005). In every transaction involving the exchange of one currency for another, or more specifically, the sale of goods valued in one currency to a purchaser paying for those goods with a different currency- requires the calculation of the rate of exchange between the two currencies (Anon., 2005).

In the financial world, time is money, and anything that slows a financial transaction will add cost to that transaction. This is exactly why some currencies that are considered to be relatively stable in value –such as the dollar- are used as a common medium of exchange among many nations whose primary currency is not the dollar (Marzinotto, 2011). Those nations must still deal with exchange rates between their currency and the dollar, but their overall international trade can still be conducted in the common *lingua franca* of the market in which they conduct business. The adoption of a common currency among the member nations of the Eurozone allows them to forego the constant exchange of individual currencies with an outside common currency (such as the dollar) or with the range of different currencies of other nations (Marzinotto, 2011).

An adjunct to the way the currency commonality can facilitate the ease with which transaction can take place, and exchange can be largely avoided, is that a common currency makes the flow of transactional information smoother and more efficient (Anon., 2005). A common currency means that the prices of goods and services can be easily understood and considered when decisions are being made. It is critical for trade partners to understand the price and value of trade commodities; where international trade among nations with different currencies is concerned, the exchange of information regarding value and price is not instantaneous (McCormick, 2011). Calculating price information is another operation that takes time; in the financial sector, anything that slows the processing of information is a net negative. Just as the exchange of currencies can add cost to a transaction, so too can the exchange of information.

The European Union was designed to eliminate most of the trade barriers that stood between member nations (Krok-Paskowska, 2005). While the adoption of a common currency

could –and eventually did- eliminate many of the elements that added friction to the smooth flow of wealth and information, there were also political measures taken that further lessened potential stumbling blocks. Products that had to meet certain national standards, for example, might be difficult to import or export among some nations. If beer made in the Netherlands did not meet German standards for beer, then that beer could not be sold in Germany. The trade restrictions pursuant to this transaction, when lifted, could –and did- allow beer from the Netherlands to be sold in Germany. Multiply the elimination of this type of trade restriction across virtually all extant trade barriers, and it becomes easy to see how valuable the adoption of a common currency could be to a unified Europe (McCormick, 2010).

### III. The euro: the Dream and the Reality

The group of nations that have adopted the euro is known, collectively, as the “Eurozone.” Joining the Eurozone initially involved the meeting of certain “convergence criteria” (McCormick, 2010); these criteria specified the financial expectations and limitations imposed on each nation that wished to adopt the euro. In order to become a member of the Eurozone, each nation was expected to hit certain economic targets; these criteria were primarily related to the amount of debt each nation held, the ration of this debt to GDP, and the amount of future debt each member nation could take on (McCormick, 2010). As the original target date for the transition to the euro approached, a concern arose among several nations that not all nations would be able to meet the goals of the convergence criteria. In the face of this looming problem, the Stability and Growth Pact was drawn up (Anon., 2009). This agreement among Eurozone members asserted the responsibility of member nations to meet the convergence criteria or risk serious penalty; the pact appeared to ease the tensions imposed by the impending adoption of the euro, and on January 1<sup>st</sup>, 1999, the process of converting from the individual currencies of the Eurozone nations to the common euro currency began (Anon., 2009).

While the adoption of the euro was not without its problems, the transition was, on the whole, remarkably smooth. As the European Union was cemented by the euro, the economy of the EU became the largest market in the world, and the euro itself became one of the world’s leading currencies (McCormick, 2010). Not every member nation of the EU has adopted the euro, but most have, and barring unforeseen circumstances (such as the ones that currently threaten to derail the euro) the entire EU will likely use the common currency at some point in the future. Just as it was the economic partnership that in large part gave the EU its political stability, however, it is the current state of economic disarray that threatens to tear that political unity asunder.

### IV. Stumbling Blocks

Perhaps the greatest blunder committed by the EU was the acceptance of Greece into the union (Maurizio, 2011). Ignoring their own standards as delineated in the Stability and Growth Pact, the EU allowed Greece to join the EU despite the fact that Greece did not meet those standards (McCormick, 2010). Further complicating the issue was the fact that Greece’s avowed financials were actually much worse than even the poor figures to which they had attested when they joined (Lorca-Susino, 2011). The economic and political malfeasance committed by Greece in order to gain entry into the EU had serious consequences; the euro and the entire EU economy were badly shaken by the effects of Greece’s economic turbulence (Lorca-Susino, 2011). Their membership in the EU has been problematic from the start, and the EU has had to make various concessions and proffer billions of dollars in bailouts to Greece not just to keep that nation afloat, but to ensure that a sinking Greece does not bring down the entire EU with it (Maurizio, 2011).

The economic woes in Greece have been the greatest single threat to the euro and to the EU to date, though the worsening economic situations in other nations are also starting to tear at the fabric of the EU. In recent months the political and financial leadership of the EU member nations have taken measures both large and small in efforts to shore up and stabilize Greece's economy and to address the overarching problems faced by the EU. Despite the best efforts and best intentions of all involved, however, each step, in the end, appears to be too small, too incremental, and too safe to have any significant impact on the overall economic picture in the EU.

The seemingly-endless series of crises in Greece have probably been the biggest issues that the Eurozone has faced, but Greece is not the only nation in the Eurozone that is experiencing economic troubles. None of the Eurozone nations are exactly burgeoning economically at the moment, and some, such as Spain and Italy, are experiencing economic turmoil that threatens to rival that of Greece. The efforts to assist and even bail out Greece have been ongoing, yet every unit of foreign currency that pours into Greece seems to simply disappear into a financial abyss (Ohlenburg, 2011). Fairly recent attempts to shore up the Greek economy, and to ostensibly avoid seeing the kinds of problems that Greece has faced start happening in other nations, have failed completely, and many economists are pessimistic about the idea of attempting further bailouts (Ohlenburg, 2011). Though there are no mechanisms in place for the ejection of a nation from the EU, some both from within and from outside Greece are suggesting that the nation be ousted (perhaps only temporarily) from the Eurozone to avoid the potential "contagion" of Greece's troubles reaching other members of the Eurozone (Javier, 2011).

#### V. More Questions than Answers

The situation in the Eurozone is extraordinarily complex; as such, there are no easy answers or quick fixes. Attempting to determine what should be done to right the ship of the EU economy is an equally difficult proposition; for every problem faced by the EU and the Eurozone there are multiple answers about how to address that problem. Some economists believe that it is simply time to give up, asserting that the euro is doomed, while others insist that there are critical measures to be taken that, while possibly painful for the average European, could salvage the economic and political unions buttressing the European economy (Maurizio, 2011).

Efforts to assess the economic situation in the EU are hampered by the fact that circumstances are shifting so quickly: what seemed plausible and even helpful one week might seem implausible and even dangerous the next, while what seemed impossible yesterday is now possible today. One recent development is that the European Central Bank has hinted that they are perhaps willing to step in to resolve the debt crisis (Ewing, 2011). Further intimations have recently come from French president Nicolas Sarkozy and German chancellor Angela Merkel that there is a political consensus coalescing around the idea of an agreement that might spur the ECB to act (Ewing, 2011).

A proposal to strengthen the Stability and Growth Pact that would give the more stable of the Eurozone nations the power to vet and approve the national budgets of those member nations that are experiencing trouble is gaining traction; such an agreement might be enough to convince the ECB to intervene on behalf of the euro (Ewing, 2011). Speaking about the consequences, of inaction, Sarkozy said "the disappearance of the euro would make our debt unmanageable" and create "a loss of confidence that would lead to paralysis and the impoverishment of France" (Ewing, 2011). Mario Draghi, the recently-installed head of the European Central Bank, expressed a willingness to intervene in the European debt crisis, suggesting that the economic

and political partnerships underpinning the EU could survive if the proper steps are taken (Ewing, 2011).

“What I believe our economic and monetary union needs is a new fiscal compact — a fundamental restatement of the fiscal rules together with the mutual fiscal commitments that euro area governments have made,” Draghi said recently. Such a compact is “definitely the most important element to start restoring credibility. Other elements might follow, but the sequencing matters.” Draghi tempered his assertion by insisting that, even under these conditions, any assistance from the ECB should be “temporary and limited” (Ewing, 2011). The political and economic implications involved in the suggestions from Sarkozy are significant, and may serve to derail any possible agreements. As laid out thus far, the proposed agreement to allow member nations such as Germany to oversee the budgets of other member nations would represent a significant abdication of national sovereignty for those nations; as such, there is no guarantee that all parties would agree to those provisions.

There is also no guarantee that such agreements, or the proposed actions from the ECB, will be enough to stem the flow of blood seeping from the wounded European economy. While the focus has been on Greece’s economic problems, that is not the only nation experiencing economic troubles. Along with Greece, both Spain and Italy are seeing their debts piling up as their economic growth dwindles. Some economists are predicting that Italy is, in fact, on the verge of collapse, and that there are few, if any, measures that could be taken to prevent it (Ricci, 2011). If Greece were to default, assert some economists, the EU could ultimately absorb the costs and the losses, while a collapse of Italy would present a situation that is too big to be absorbed, and that could bring about the collapse of the entire European economy (Ricci, 2011).

## VI. Common Currency, Common Sense

While the situation in the EU is currently tumultuous, it is not unreasonable to hope that this crisis will be surmounted and that the EU will survive. There is no question that the current economic troubles are quite serious, but there is also no question that the member nations of the EU –and the individual citizens of those nations- are heavily invested financially, politically, and emotionally in maintain the union. The economy is the main problem faced by the EU at the moment, but economics are also at the heart of the “union” in the European Union. The adoption of a common currency had a significant psychological impact on the citizens of Europe (McCormick, 2010). Just as trade between nations in the EU was simplified and streamlined by the adoption of the EU, so too has travel between the nations been simplified as tourists do not have to deal with constantly-fluctuating exchange rates among different currencies. Individuated currencies served as a reminder of the differences between those of different nationalities; the adoption of the euro has highlighted that which European citizens have in common (McCormick, 2010).

The adoption of the euro has created a larger psychological impact as well, as the member nations of the EU now have a vested interest in the economic success not just of their own nations, but of the other member nations as well (McCormick, 2010). The upshot of this psychological effect means that the member nations have, thus far, demonstrated their willingness –within reason- to bail out those nations that are currently flailing. The situation in the Eurozone is changing not just from day to day, but literally from hour to hour. As the EU inches closer to the precipice, however, more and more political and economic leaders –who may have simply been waiting to see what action was taken by others- are now coming forward with suggestions and proposals that could help avoid disaster. Even the U.S. has expressed its willingness to help; the Federal Reserve Bank recently allowed the EDC to hold billions on U.S. dollars against the service of debt that shored up the euro for approximately seven days (a

lifetime during a crisis of this magnitude) (Maurizio, 2011). The EU and the U.S. have had a bit of a rocky relationship over the years as the foreign policies of the two political powers diverged significantly in the aftermath of U.S. occupations in the Middle East (Larive, 2011). Despite these differences, the EU and the U.S. are economically intertwined; the collapse of the EU would have significant and dire consequences not just for EU members, but for the U.S. as well.

It is entirely within the realm of possibility that by the time this paper is read some sort of conclusion will have been reached, or some incident or incidents that carry the air of finality will have transpired, that will render all of the speculation and discussion contained herein entirely moot. In the face of all of the available evidence, a sense of foreboding, of impending doom, hangs over the EU like a storm cloud. Through the gathering storm, however, signs of light are emerging. The recent comments from political leaders such as the French President and the German Chancellor, as well as the pronouncements from the leader of the ECB, are the first real signs of hope for the euro and for the EU that have come along in months.

As the EU leaders gather to discuss ways to save the union and fend off the potential collapse of the Eurozone, another bright spot has emerged. In a recent interview, the Minister of Economy for Bulgaria, Traicho Traikov, announced publicly that the tiny nation fully intends to follow through on its bid to enter the EU. Since 1997, claims Traikov, Bulgaria set about to align its national budget with the specific requirements of the EU's convergence criteria. Despite being one of the poorest nations in the region –and it will be the poorest in the EU if it is allowed to join- Bulgaria has done the remarkable: it has not only met the criteria specified by the EU, it has exceeded them. For almost every year since 1997, Bulgaria has actually run a budget *surplus*, an amazing accomplishment in these trying economic times. If Bulgaria is the future of the EU, then perhaps the future does not look so bleak after all. Yes, there are still many things that could go wrong. Waving away those dire warnings, minister Traikov claims not to be worried about the future of the EU. His final comment on the fate of the European Union? “I think common sense will prevail.”

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