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THE EUROPEAN UNION DEBT CRISIS AND THE EUROZONE'S SURVIVAL

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Abstract. *Debt crisis in the European Union is the result of the inability of some countries to gain control over growing debt, which created tremendous pressure on the stability and survival of the common European currency, Euro. Concerns over the risks of growing public debt and budget deficits of some countries of the European Monetary Union, caused the reaction of financial markets that punish countries with debt problems in the form of increased prices of their additional borrowing. Poor control of defined rules implementation has led to excessive borrowing countries to challenge the achieved stability and integrity of the Eurozone. A debt crisis in the European Union discovered that the model of economic growth based on the financing of consumption through borrowing in the long term does not give positive results.*

Analyzing the potential danger of possible Eurozone collapse, EU leaders have concluded that the costs of such a scenario are extremely high. An agreement was reached to form a rescue fund for member states whose debt problems could threaten the survival of this monetary union.

Key Words: *debt crisis, Euro stability, financial markets, Eurozone breakdown, financial bail out*

INTRODUCTION

Debt crisis occurs when countries are unable to meet contractual obligations on loans received from foreign commercial banks, governments of some countries and other financial institutions which means they are unable to return their debts to various creditors from whom they had borrowed. In a situation where financial obligations to creditors exceed the level of financial income from foreign trade activities, it is clear that there is a problem of indebtedness. Debt crises have been known since ancient times but the debt crisis that has engulfed some members of the European Union (EU) is threatening to become a serious economic and political problem for the united countries in Europe. Economic

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and financial crisis has shaken the foundations of European construction, more precisely its strongest and most visible symbol of success - the common currency Euro. The European Union as a significant integration of European countries, a respectable economic and trading power in the international area (add up all the Member States), found itself in one of the most serious crisis since its inception.

Today when we talk about monetary union, the majority of people assume the European Monetary Union (EMU), the Eurozone, because the Euro, as one of the world's most important currencies, is in the permanent focus of the market and the public. Euro today is just one of many examples of monetary integration in the world, and its uniqueness is that this is the first case that the countries that are market-oriented democracy within the rule of law decided to implement a single currency. The Maastricht Treaty, signed in 1992, allows membership in the Eurozone only for EU member states. No country can join the Eurozone if it is not a member of the European Union. All member states of the European Monetary Union before getting into the union had to fulfill certain conditions and fulfill them consistently: starting from at least two years before entry, at the time of entry and later, all the time while in the EMU. European Monetary Union rules stipulate that countries that wish to belong to the monetary union must meet two sets of conditions, called the convergence conditions. The first group of conditions is a legal convergence, which implies that monetary union member states should adapt their legislation to the regulation of the monetary union. This requirement is met by changing the appropriate legislation, to comply with the provisions of the monetary union. The second group of criteria consists of economic criteria. To access the planned monetary integration, member states had to meet certain requirements in order to satisfy the economic criteria laid down. These criteria relate to the fact that:

- Inflation (as measured by the Consumer Price Index) in the country to join EMU must not be higher than 1.5 percent compared to the average inflation rate in three EU countries with the lowest inflation. Even after the occurrence of the Eurozone, the reference is to take data from all EU member states, not only from countries that joined the EMU
- The budget deficit must not exceed 3% of gross domestic product (GDP) of a country. However, a violation of this requirement is not currently exceeding the one-time fee of 3%, and a situation in which the deficit is still not within these limits is acceptable when it steadily decreases over the period to reach the required 3%
- The public debt must not exceed 60% of gross domestic product (GDP) of a country
- Currency fluctuation of ± 15% stipulated by the ERM2 (Exchange Rate Mechanism 2) must be appreciated during the two years before the introduction of the third degree of EMU, without devaluing its currency against the other currencies of EU countries
- Long-term nominal interest rates during the year shall not deviate more than 2 percentage points compared to the interest rate in the three most successful countries in the European Union (three countries with the lowest interest rates)

According to the official view, Eurozone countries have to comply with all five criteria at all times, while other members of the European Union (other than in the Eurozone) are recommended to comply with them. The exception to this rule is the budget deficit to which not only members of the Eurozone, but also all other members of the European

Union must comply, with the exception of Great Britain. The only difference between members and non-Eurozone countries in terms of budget deficits is that non-members can not be penalized, but a member can. In case of exceeding the budget deficit they, apart from financial penalties, can not receive funds from various funds that exist within the European Union.

OCCURRENCE AND CHARACTERISTICS OF THE DEBT CRISIS IN GREECE

The Greek economy has functioned as a relatively closed economy for decades, with characteristic large public sector. State revenues mainly come from services (tourism, shipbuilding), and during the years Greece has been facing falling industrial production and exports. After joining the EMU, Greece always had a large budget deficit, public debt, current account deficit and the decline in competitiveness. At the same time Greece as a country delayed in implementation of necessary structural reforms of the tax and pension system, labor market and other important areas. The crisis in Greece has occurred as a result of the large borrowing in international capital markets to finance the budget deficit and current account deficits. Debt crisis in Greece has internal and external causes. The most important internal factors that led to the debt crisis are very high government spending, tax evasion and poor collection of budget revenues. Main external factors that led to high accumulation of foreign debt are undoubtedly easier access to external capital markets at a lower rate after joining the EMU, and poor application of EU rules concerning public debt and budget deficits. The global economic crisis that occurred in 2008 accelerated the presentation of problems of the Greek economy and the debt crisis, primarily because of problems in world capital markets that have become volatile, illiquid and concerned about the poor macroeconomic indicators in the country.

INTERNAL CAUSES OF THE CRISIS IN GREECE

In the period 2001-2008, Greek real GDP grew at an average annual rate of 3.8% which is higher than the growth of real GDP for the whole Eurozone, which amounted to 1.7% [8]. High growth in real GDP in that period is the result of growth of personal consumption (a big money offer through loans at low interest rates) and public investment financed from public funds, and European Union funds. In the same period the average annual Greek budget deficit was 5% of GDP as opposed to the entire Eurozone, where it amounted to 2% for the same period. Greek annual average current account deficit during this period amounted to 9% of GDP, which is extremely high compared to the deficit in the Eurozone, where it amounted to 1%. Greece's government deficit, financed primarily by borrowing in international capital markets, in years increased the public debt of this country. The reliance on external borrowing to cover budget deficit and current balance of the country's economy led to a situation of high sensitivity of the capital markets.

During this period, government expenditure increased by 87% while state revenues increased by only 31%, causing a budget deficit above 3% which is the maximum that the rules of EMU allow. High government spending is due to wasteful and inefficient state administration, very expensive pension and welfare system, tax evasion and a general lack of will to maintain fiscal discipline. Poor collection of tax revenues in the analyzed period generated very high budget deficit in Greece. This country has a big problem with the tax evasion and the gray economy that stands at 25-30% of GDP, which is extremely high share of illegal economic flows that make up the lower income in the country [4, page 15]. Another cause of internal crisis to which we should point refers to the structure of the industry in Greece and the decline of international competitiveness. Low productivity and relatively high earnings are important factors affecting the declining competitiveness of Greek products abroad, which ultimately affects the decrease in exports and current account deficits. After joining the EMU in 2001, earnings in Greece were growing annually at a rate of 5%, nearly double the annual earnings growth across the Eurozone. At the same time, Greek exports grew at an annual rate of 3.8% which is significantly less than other Eurozone members' exports. To reduce the Greek deficit in the current balance, it is necessary to significantly increase productivity, reduce wages and increase savings in this country.

EXTERNAL CAUSES OF THE GREEK DEBT CRISIS

By joining the Eurozone in 2001, Greece took advantage of the benefits of monetary union in terms of ease of access to capital markets where confidence in the countries using the Euro as their common currency exists. Greece took the opportunity of borrowing money at lower interest rates than they would have been able to borrow if they remained outside the Eurozone. Although this country used a significant advantage at the capital markets, situation like that lead Greece to constant borrowing that accumulated very high public debt. If the financial markets had reacted in time and prevented the country from constantly borrowing on favorable terms, Greece may have been forced to reform their public finances earlier. Greek debt crisis causes can be sought in the lack of implementation and control of defined rules application regarding the amount of the budget deficit and public debt in the Eurozone. Impunity for countries that violate the rules encouraged Greece to borrow in order to increase their already high budget deficit and public debt.

In 2009 the newly elected government of Greece has revised the state of public finances and found that the budget deficit for 2009 amounted to 12.7% of GDP rather than 6.7% of GDP as originally published. In April 2010, Eurostat, the statistical agency of the European Union, after the first revision of Greek macroeconomic data increased the budget deficit for 2009 to 13.6% of GDP. In November 2010, Eurostat carried out another revision of the Greek budget deficit and determined the final height of deficit for 2009 in the amount of 15.4% of GDP. [5] After the release of this information, investors have become very nervous and worried about Greece's ability to repay debt obligations that amounted to 54 billion Euros due only in year 2010. Rating agencies reacted immediately by lowering the credit rating which meant that Greece will have to pay a higher interest rate with the additional debt. It is obvious that at this time France and Germany, as the leading economies in the European Monetary Union, were not ready to save Greece by buying its bonds at lower interest rates, and that the country surrendered to the influence of financial markets that drastically punished Greece for their poor state of public finances. The data supporting this claim is the fact that before the disclosure of the bad condition of public finances, the yield on ten-year Greek bonds was 10-40 basis points higher than German bonds, and after the publication of data on the Greek bond yields rose to 400 basis points, which at that time was a record. High yield on Greek bonds indicated a decline in investor confidence in the economy of this country. After auditing the budget deficit by Eurostat in April and November 2010, the budget deficit for the previous year further increased; there was a new reaction of capital market where the difference between yields on ten-year bonds of Greece and Germany rose to the record of 650 basis points. [4, page 17] The table below confirms this and indicates the movement of interest rates on long-term Greek bonds traded in the secondary securities market. The movement applies only to the year 2010and by month.

Table 1. Interest rate on Greek government bonds in 2010

Year 2010	February	March	April	May	June	July	August	September	October	November	December
Interest rate	6.46	6.24	7.83	7.97	9.10	10.34	10.70	11.34	9.57	11.52	12.01

Source: http://epp.eurostat.ec.europa.eu

The new government of Greece, which began to operate in October 2009, was trying to restore investors' confidence in the Greek economy and its ability to properly service its obligations. Determination of the new government was reflected in the fact that they immediately started rearranging the public finances and in that sense there has been a reduction of excessive government spending and increase of taxes in the hope that it will cheer up investors, and selling government bonds to raise money for the payment of due obligations. However, due to the global economic crisis, investors have become very cautious in terms of additional debt for already heavily indebted countries. As the Greek government was unable to raise funds for paying its due obligations, this country required help from other EU countries and the IMF (International Monetary Fund). If the European Commission and the IMF had not approved the emergency financial bailout, Greece would probably have had to declare inability to pay its due obligations, or set off in the process of restructuring its debt. The overall situation in Greece and in the financial markets caused this country to officially request financial assistance on April 23rd, 2010. Financial aid package consisted of the EU loan of 30 billion Euros in 2010 at an interest rate of 5% per year and the IMF loan of 15 billion Euros. The whole package of assistance for a period of three years (2010-2012) is about 110 billion Euros. Assistance plan was approved on the basis of a detailed plan to reduce the budget deficit during this period and the beginning of huge reorganization of the economy of Greece.

We can see that the approved funds are not provided for free but at a certain interest rate, which indicates that there is no free help today even in a situation where a country is in serious crisis. The financial bailout was approved to the Greek government according to strict implementation of a sharp and precise plan for a drastic reduction in budget deficit and public debt. The plan consisted of the following: increase VAT (Value Added Tax) from 19% to 21%, increase excise taxes on fuel, cigarettes, alcohol and luxury goods, increase taxes on workers' wages, salaries to be frozen for public sector workers, pension reform to be started, reform tax system in property tax for individuals and companies, increase control of the funds collection for social security and pension insurance. All these moves were aimed at reducing government expenditure and increasing budget revenues which in the final results should reduce the budget deficit. The projection was as follows: the budget deficit in 2010 - 8.7% of GDP; 2011-5.6% of GDP; 2012-2.8 and 2013-2% of GDP. [7, page 3] To achieve these objectives, Greece has to implement structural reforms, which are primarily long-term oriented. Essentials are: the reform of pension and health systems and the reform of complete public administration. Especially important is pension reform, which was one of the more generous in Europe and is a significant strain on Greek budget.

Although European officials accepted the Greek plan for resolving the debt crisis through fiscal consolidation process, nobody thought about the other side of the story and other potential hazards. Specifically, the proposed measures in terms of tax increases and drastic reduction in government spending can lead to a decline in economic activity, rising unemployment in the country, increasing illiquidity in the economy and push the country into recession. The recession in the country will not increase budget revenues by charging higher taxes because of declining economic activity. So now, the Greek government, on the one hand, found the problem of reducing the deficit through a restrictive fiscal policy and on the other hand is supposed to stimulate the economy to work better, which can be achieved by expansionary fiscal policy. It is important to note that Greece, having joined the Eurozone, has no longer possibility for an independent monetary policy and there is no possibility for currency devaluation for solving the problem in the current income or to increase the money supply and stimulate the economy so that it remains available only to the instruments of fiscal policy. There is no magic solution to this situation, because it can also lead to the restrictive and expansionary fiscal policy. The Greek government is committed to a restrictive fiscal policy and the only question is how long the government of this country will have the support of citizens for the implementation of this policy, which undoubtedly leads to a recession in the country.

DEBT CRISIS IN IRELAND

Debt crisis in Ireland has completely different causes from previously discussed debt crisis in Greece. Before the explanation of the factors that led to the debt crisis in Ireland, what must not be forgotten is that this country was very successful in creating a favorable business environment and attracting foreign direct investments between 1987 and 2000. In the mid 80s in the poorest country of the European Community, there was a creation of fiscal consolidation measures that were an important factor in creating stable and favorable economic conditions in Ireland. Deregulation in the financial industry and low rates of corporate income tax were just some of the factors that have caused a huge inflow of foreign direct investments and increased the indebtedness of the country abroad. During this period, average annual GDP growth rate stood at 6.8% while unemployment fell from 16.9% to 4.3%. At the same time, the export of Ireland has increased significantly. Economic progress of the country has significantly increased the standard of living. Wage growth in Ireland in the above-mentioned period was doubled compared to the average wage growth in the Eurozone. But such a rise in earnings of workers with the constant rise in inflation over time reduced the competitiveness of the Irish economy.

Solid GDP growth in Ireland has led to increased demand for all forms of credit. An increase in demand for loans is caused due to economic expansion and rising living standards. After entering the Eurozone too many soft loans with low interest rates appeared on the market. Low short-term and long-term interest rates contributed to a credit boom, with the strong demand for loans, especially mortgages. This contributed to the growing indebtedness of the economy and population on the basis of mortgage loans. However, demand for other types of loans has increased so that the demand and consumption continued to grow. It was particularly interesting to invest in real estate because of the favorable tax policy in this area. In fact, in Ireland there is no tax on the property where people live, and the payment of interest on the mortgage is deducted from citizens' incomes. [6, page 8] Creating this enabling environment through a variety of tax benefits resulted in strong demand for mortgage loans on real estate investments. There was a multiple increase of property prices due to rising demand. In the period 1994-2006, average house prices in Dublin rose by 500% and one in five employees in Ireland worked in the construction industry. The Irish government has not reacted to the trend of growth in real estate demand in that country, primarily because the budget of the country has also increased income from charging higher fees and taxes for residential construction, real estate sales and increase in other forms of consumption. Higher tax revenues and budget surpluses have caused the increase in public wages and increased spending on social protection. Despite positive macroeconomic indicators of the Irish economy in 2007, there was a rupture bubble in the housing market and a fall in asset prices in the market, leading to losses of banks in respect of approved mortgage loans. Because of bad balance sheets of some banks, there was a crisis of liquidity in the banking sector, the slowdown in lending to the economy and state intervention in the rescue of the financial system of the country. In 2009, the rescue was carried out in Irish banks for a total of 3.5 billion Euros. All of this indicates that the crisis in Ireland was caused by the debt crisis in the banking sector rather than by excessive government spending and lack of competitiveness of the economy, like in Greece.

The three largest banks in Ireland (Anglo Irish, Bank of Ireland and AIB) approved the large amounts of mortgage loans, relaxing standards in terms of borrowing eased the citizens and the economy on favorable terms. Money for the approval of these loans came in from abroad at very reasonable rates. The largest creditors of the credit expansion in Ireland were the English, French, German and Belgian banks that have placed loans and investments totaling 500 billion Euros on the market of Ireland. Movement of capital from these countries to Ireland's economic point of view was logical because capital goes where it can be fertilized by a favorable economic situation in a country. What will the banks' losses be due to the inability to collect the loan has yet to be determined but it is certain that there will not be small. The problem of bad mortgage loans is reflected in the inadequate assessment of credit risk borrower by individual banks and poor control of the use of loans.

If Ireland remained outside the Eurozone and with its own currency, the country's monetary authorities could regulate the level of loans that would be offered to corporate and retail level over the reference interest rate and reserve requirement set by the central bank of any country. In this way a country could affect the regulation of credit expansion. However, by joining the European Monetary Union, Ireland and other member states lose their sovereignty in monetary area, so that the monetary policy of EMU countries is now in authority of the European Central Bank. As in the case of Greece, after joining the monetary union, Ireland has had better access to financial markets around the world where it could borrow at favorable interest rates and terms, as a result of high trust in the credibility of EMU and its organs. Easier access to capital markets has further affected the growth of public debt and debt of Ireland in the world.

For a long time, fiscal policy has been taken in Ireland as an example of a well-managed policy primarily because of the budget surplus in this country between the mid-'90s until 2006. After 2007, when the budget revenues were almost equal to budget expenditures, it lead to a significant deterioration in public finances of Ireland. Collapsing of bubble in the housing market price leads to a drastic reduction of state revenues due to falling economic activity, primarily in construction, the sector which participated in GDP of Ireland with almost 20%. The problem with the tax revenues in Ireland was a result of poor tax structure, where each year taxes by VAT and income tax on citizens, who are considered as stable tax sources, were reduced, and on the other hand there were increases in tax revenue from corporate income tax and capital gains. Public expenditures had a constant growth due to the rise of public sector employees. In the period 2001-2008, the number of employees in the public sector increased by 15.5%. All this caused the budget deficits in 2008 to amount to 7.3% of GDP and 14.4% of GDP in 2009.[8] In September 2008, the Irish government has announced that it officially entered a recession (fall in GDP in 2008 was 3.5% in 2009 even 7.6%), which will lead to a large increase of unemployment in the country (in 2008, the unemployment was 6.3%, in 2009-11.9%, in 2010-13.5%). Ireland has become the first Eurozone country to go into recession. The crisis in Ireland was influenced by the global economic crisis that has engulfed the world in 2008. In April 2009, the Irish Government proposes the establishment of a national agency to take over one part of the bank's mortgage loans that are not reimbursable and to allow these banks an improvement of their liquidity that will help the recovery of economic activity in the country. The costs of saving banks with growing budget deficits threatened to increase Ireland's public debt. Public debt in this country has increased from 25% of GDP in 2007 to 65.5% of GDP in 2009. Financial markets following the publication of macroeconomic data on the Irish economy reacted in a similar way as with the Greek crisis, raising interest rates on Irish government bonds. However, unlike Greece, the financial markets did not punish Ireland so much because interest rates rose less than in the case of Greece. There is also an interest rate on the secondary securities market.

Table 2. Interest rate on Irish government bonds in 2010

Year 2010	February	March	April	May	June	July	August	September	October	November	December
Interest rate	4.73	4.53	4.76	4.86	5.31	5.32	5.30	6.14	6.42	8.22	8.45

Source: http://epp.eurostat.ec.europa.eu

Ireland, after the outbreak of the global financial crisis and the bursting bubble in the housing market, promised to protect banks from losses but it turned out that it could not do it without international aid. This move by the Irish government was justified because the failure of big banks would lead to the collapse of the country's financial system. In November 2010, Ireland formally requested financial assistance from the European Union and the IMF. The amount of assistance is estimated at 85 billion Euros of which 22.5 billion is provided by IMF, and the rest is provided by the European Union from its funds. Also, part of the assistance is provided through bilateral loans from Britain, Denmark and Sweden. Of the total aid, 50 billion is used to fund the budget, 10 billion to recapitalize banks and 25 billion Euros to cover the losses of banks and their restructuring. Acceptance of financial assistance to overcome the problem of repayment of public debt is a very unpopular move, from the standpoint of the political support of voters to the governments of those countries that accept such assistance. No help is free from the aspect of interest rates paid by the country to receive funding, as well as from the standpoint of rigorous austerity measures that the country needs to implement in order to arrange the situation in their public finances. Implementation of measures prescribed by the IMF and the EU is also a requirement for obtaining financial assistance. These austerity measures are very unpopular with most people because they are related primarily to the reduction of budget expenditures of a country. Reducing government expenditure will mostly affect workers in the public sector which will be the first to freeze or reduce wages and abolish various benefits and savings measures do not exclude any layoffs. Increasing revenue can be ensured only by increasing taxes and if that measure will be implemented in the countries, further political support to the government by the voters will be a big question mark. Such a savings plan has caused outrage in Ireland population. Savings plan in this country includes reducing social benefits, reducing the number of civil servants and the introduction of new taxes. All these measures aim to reduce the budget deficit in coming years. As a part of the savings corporate income tax which is 12.5%, will not be increased in this country. Many of the Irish people see low tax rate as a symbol of independence, and the low corporate tax rate, on the other hand, irritates many other countries with higher tax rates. Saving measures will undoubtedly lead to a decline of living standards in Ireland and will increase uncertainty for future generations.

RISK OF DEBT CRISIS IN OTHER EUROZONE COUNTRIES

After the rescue of Greece and Ireland, the debate among member countries in the Eurozone continued about the future of European monetary integration and survival of the common currency. The uncertainty that prevailed in Greece regarding the bankruptcy or help to overcome financial difficulties had a significant impact on financial markets in the world. The European common currency has been greatly shaken and there was a decrease of its value against the most important currency in the world, the U.S. Dollar. Financial markets have reacted only to the disclosure in connection with the Greek and Irish budget deficit and public debt, but the uncertainty spread to the bond markets of other countries in the Eurozone, notably Spain, Portugal and Italy. Similarly to Greece and Ireland, these countries have borrowed significantly from the previous period of credit boom and low interest rates. However, due to the emergence of the global economic crisis in 2008, there is a crisis of illiquidity at capital markets around the world. Investors are becoming very nervous about the possibility of repayment of due debts of these countries and the sustainability of public debt. This concern is first reflected in the financial markets where interest rates on government bonds of Spain, Italy and Portugal followed the direction of interest rates increasing for Greek and Irish government bonds. Additional borrowing in these countries has become considerably more expensive. But it is not only the increased cost of borrowing that is a problem that occurs in those countries with high budget deficits and public debt. An additional problem is to find investors who are, in conditions of reduced capital, ready to engage in increased risk of buying the securities of those countries which have financial difficulties. This risk consists in predicting the poor look of economic growth in these countries. Should economic growth in those countries be in the future at a level that will allow regular servicing of their current debt? The problem of debt in the Eurozone is far greater than the debt of Greece or Ireland. The public debt of Greece is up to 300 billion Euros, which today represents only 4.23% of total public debt of all countries in the Eurozone. The question is how in the future France, Germany and Italy will finance their public debt which for these countries respectively at the end of 2009 amounted to: 1489 billion, 1760 billion and 1763 billion Euros. The public debt of the Eurozone at the end of 2009 amounted to 7092 billion Euros. [8]

It has long been a controversy whether Portugal is the next country of Eurozone which could seek financial assistance from the EU and the International Monetary Fund. Although the government in Lisbon stubbornly refused such an opportunity because they thought that they can borrow in financial markets to fund their budget deficit, which at 2.9% of GDP in 2008 jumped to 9.3% of GDP in 2009, the latest information tells us that Portugal officially requested assistance from the EU. Namely, the Portuguese bank and the company recognized that their rating is lower than ever, which caused deterioration of the conditions of additional borrowing required for the normal functioning of the entire economy. After analyzing the overall economic situation in the country and finding that the state is running out of money for the payment of due obligations, Portugal was forced to seek financial assistance. The total package of financial assistance to Portugal consists of 80 billion Euros, while according to some estimates only this country will need 15 billion Euros in next 3 months for the payment of overdue obligations. One of the causes of Portugal's financial problems is the low economic growth in the past decade, averaging 0.7 percent per year. In the same period the government in Lisbon had accumulated huge debts to finance a Western European standard of its citizens. Finally, the government of Portugal has lost the confidence of lenders, and investors demanded huge interest on loans to the country which they regarded as risky.

Spain could be the next country of Eurozone that may request assistance from the EU and the IMF to resolve its financial problems. The problem in Spain comes in recent years due to low economic growth, high unemployment (highest in the Eurozone) and the growing budget deficit. In addition to high budget deficit, a big problem for Spain is the high indebtedness of the private sector, especially the banking sector, which according to some forecasts is as high as 178% of GDP. Specifically in Spain and in Ireland there is excessive borrowing by banks and on that basis the placement of cheap loans which citizens and businesses invested in real estate, areas in which, due to increased demand, came enormous price increases. The scenario is the same as in Ireland, because there is a collapse of the housing market, a drastic fall in prices in this market, which brings the bank's major problems due to inability to collect approved mortgage loans (the problem of bad loans). The danger for the Eurozone will be much higher if it proves true that Spain can not properly service its obligations because it is the fourth largest economy in the Eurozone, so the influence of Spanish debt crisis on the common currency crisis will be far greater than is the case with Greece, Ireland or Portugal. The first help to Spain to overcome the crisis was provided by China. Large jobs have been contracted between Spanish and Chinese companies, which will undoubtedly improve the economic activity in Spain, while the Spanish government bonds continue to be purchased off by China. Chinese activity in the Spanish market has calmed financial markets, especially after the announcement that other world economies will help Spain by buying its government debt.

One of the most pressing problems in Spain is certainly high unemployment with 11.3% in 2008 that jumped to 20.1% in 2010. A large number of unemployed persons who on that account receive some social assistance is undoubtedly a burden for the economy and budget of this country. The budget deficit was in Spain in 2008 amounted to 4.2% of GDP and in 2009 amounted to 11.1% of GDP. Spain is a country that does not have a high public debt, even more so since from 2000 until today it did not exceed 60% of the GDP of the country, which even fits into the convergence criteria. The question is why international financial institutions and rating agencies put into question the ability of Spain to regularly service its debt, although this country has a high public debt, and budget deficit occurs only in 2008 and 2009. In the period 2000-2008, Spain did not have a high budget deficit and in some years it achieved a surplus in state budget. Whether it is the issue of some political game or a purely economic outlook deteriorating economic situation in Spain, we can only suspect. The fact is that the liquidity of some other countries with weaker economic indicators at this time is without predicament.

Italy, although a founding member of the EU and the Eurozone since its inception, also faces the danger of failure of regular servicing of its obligations. The public debt of Italy is the first in the total amount in the whole Euro area, amounting to 1763 billion Euros in end of 2009. Such an enormous debt in Italy has been due to low economic growth rates in recent years. The average GDP growth rate in the period 2000-2007 amounted to 1.5%, while Italy had a negative GDP growth in 2008(-1.3%) and in 2009 (-5.0%). Due to low economic growth, Italy has constantly borrowed to be able to finance their imbalance in public finances. Current EU policy regarding the debt crisis in the Eurozone is related to the prevention of further spread of the problem of indebtedness to other countries in the monetary union. In fact, Germany and France, as the two largest economies in the Eurozone, exercise pressure on those countries that have financial difficulties to accept the assistance of the EU and possibly the IMF in order to prevent instability in financial markets that could threaten the long-term common currency. On the other hand, the countries with difficulties are not so eager to decide to accept financial aid because of the economic and political factors. Economic reasons for refusal of aid are reflected in the stringent austerity measures that the country must take if it accepts help. These measures, on the one hand, can help a country to reduce the level of its indebtedness, but on the other hand these measures can push countries into major problems because governments reduce spending by reducing domestic demand that may lead a country to recession. Savings plan for long-term dynamics of economic growth can be very uncertain and negative. Therefore, the budget savings on the one hand slows economic growth creating more concern in financial markets that are primarily reflected in higher prices to obtain additional capital. However, on the other hand, the sustainability of high budget deficits and public debt of countries are not possible in the long run and would endanger the survival of EMU and the single currency. So the austerity measures in putting public finances of indebted countries are necessary to establish long-term mechanisms for the functioning of monetary union. Grooming public finances will increase investors' confidence and will facilitate the financing of state under favorable conditions. There is no single solution to all the problems and it is very important to make decisions that serve the interests of the country and the interests of European Monetary Union.

There is no doubt that the countries of PIIGS (Portugal, Italy, Ireland, Greece and Spain) have big problems in the field of fiscal policies, which lead to high budget deficits, high public debt, current account deficit, low or negative GDP growth and high unemployment rate (Spain). All indicators presented and related to these countries undoubtedly increase the risk of repayment obligations due, by the inability to obtain additional funds for deficit financing, or obtaining funding for a lot less favorable conditions and at higher prices. When someone makes a question about solvency of a country and when credit rating agencies reduce the assessments to a state, then the financing of the budget becomes more expensive, which again reflects the creditworthiness of countries. So, all this is a vicious circle. But here raises the question of why France is not in the group of these countries, a country that has similar problems as the countries of PIIGS. Table number 3 carries out comparative analysis of these indicators between countries PIIGS, which in the opinion of the EU and the IMF have financial difficulties and are under more rigorous conditions in financing their debt and France, a country which in the opinion of the EU and the IMF does not have such problems. Only 2008 and 2009 will be taken into account. The analysis will cover the budget deficit, public debt, real GDP growth, the current state of balance and unemployment in each country.

Table 3. Budget deficit, Public debt, GDP real growth, unemployment rate and current account

	Budget deficit (% of GDP)		Public debt (% of GDP)		GDP growth		Unemployment rate		Current account	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Spain	-4.2	-11.1	39.8	53.2	0.9	-3.7	18.1	20	-23.7	-14.2
Italy	-2.7	-5.3	106.3	116	-1.3	-5	6.7	7.8	-14.1	-4.3
Portugal	-2.9	-9.3	65.3	76.1	0	-2.5	7.7	9.6	-6	-4.5
Greece	-9.4	-15.4	110.3	126.8	1	-2	7.7	9.5	-10.3	-8.2
France	-3.3	-7.5	67.5	78.1	0.2	-2.6	7.8	9.5	-9.6	-14.6

Source: http://epp.eurostat.ec.europa.eu

It is known that France is the most important foreign trade partner of Germany, and the official publication of weak macroeconomic data for France will enforce financial markets to react and to lower the credit rating of this country. Situation like that would increase interest rate for French debt whose financing will become more difficult and expensive and could be a problem for paying claims of France to Germany which has considerable export in this country. There is no doubt however that the economic outlook and political influence of France is on a higher level than the countries of PIIGS and today in the world there exists more confidence in the economic strength of France. But France today is the second economic power in the Eurozone, which accounts for 22% of the total

GDP of the monetary union. Bringing into question the solvency of France can be a big problem for the Eurozone in terms of its survival and allocation of huge financial resources for its rescue. Although a debate is currently running about whether France deserves a lower credit rating on the basis of its macroeconomic indicators, which would lead to paying higher interest rates on government bonds, the authorities in Paris have already embarked on structural reform of public administration and pension system. The aim of these reforms is aimed at reducing the budget deficit and public debt in the coming years so that the country would not lose the confidence of financial markets and investors who buy government bonds financed by the French budget deficit in the country.

IMPACT OF DEBT CRISIS IN THE EUROZONE TO THE WORLD ECONOMY

Some of the significant financial support for the excessive indebtedness in Eurozone is offered by the most economically developed countries, especially China. China has already said it is ready to help European economies that are at risk to fall into a debt crisis and to buy government bonds directly to Greece, Portugal and Spain. China is now the second most important EU trading partner after the United States, but on the other hand the EU is the most significant importer from China, so it is not a surprise that there is willingness of China to purchase government bonds of countries that have financial difficulties and the signing of major economic agreements that will help its important trading partners. The deepening crisis in Europe would hurt China, now the second largest economy in the world that has massive foreign exchange reserves, mostly in U.S. Dollars. It is estimated that China today has about 700 billion Euros in the European securities, which means that China controls more than 10% of Eurozone's government debt. China is also a significant buyer of the U.S. national debt. China believes that for the stability of world economy, the existence of at least two leading world currencies is necessary, but the stability of Euro is very important for China for other reasons. In fact, prolonging the economic depression in Europe and the possible disintegration of the Euro area would threaten direct interest of China - 25% of its products are exported to Europe. Greece, Portugal and Spain are relatively small trading partners of China, but their financial disaster would hit Germany which is a very important trading partner for China. Germany today provides China with luxury cars, investment in industry and technologically advanced goods. Chinese financial transactions with EU member states include investments in sectors like ports and telecommunications, where investors from other countries are reluctant to enter.

There is no doubt that clear economic and political interests hide beyond the financial involvement of China in Europe. On the one hand, China is trying to procure products for the growing middle class. Thanks to the huge foreign exchange reserves, which amount to 2850 billion Dollars, China can afford that. Most of China's foreign exchange reserves derived from its huge trade surplus and savings, which is quite contrary to the situation in many European countries. However, on the other hand, by buying European products and bonds China saves herself. In fact, the Chinese currency, the Yuan, is linked to the U.S. Dollar, so when the Euro falls against the U.S. currency, Chinese products are becoming too expensive in Europe. Europeans buy more Chinese goods than Americans. In addition, if the Euro is ''weak'', Chinese products could threaten, for example, the German, who would then become cheaper. Therefore, China pays for a strong Euro and the stable European economy.

As for the U.S. and the consequences of the crisis in the Eurozone economy to the strongest one in the world, the fact is that instability in the Eurozone provides the value fall of Euro, as a common currency of united countries in Europe. If the euro weakens against the U.S. Dollar, that leads to more expensive American products in Europe and cheaper European products in the United States. As the EU buys 25% of U.S. exports and on that basis is a significant trading partner for the United States, further weakening of the Euro will reduce imports from the United States, which will further worsen the already huge trade deficit in the strongest world economy. In the end, that will lead to a decline in economic activity in the United States. In this case, United States do not correspond to the crisis in the Eurozone and the further weakening of the Euro. The decline in Eurozone economic activity leads to the weakening of trade relations between the two partners which can greatly affect the U.S. economy.

On the other hand, increasing the volatility of European currency and the uncertainty of its survival may discourage investors from continuing investing capital in the European economy and the migration of this capital in the U.S., so in this case the U.S. can match the increased instability in the Eurozone. Trough its appearance and stability over the past years, the Euro has endangered U.S. dollar in terms of inviolable world reserve currency, since most countries prior to the appearance of Euro held their foreign exchange reserves just in the U.S. dollar. Euro is becoming increasingly important as a currency in the portfolio of foreign exchange reserves of central banks around the world. The argument in favor of strengthening the importance of the Euro as a reserve currency is the instability of the Dollar (due to an excessive U.S. current account deficit). If the U.S. wants to maintain its current position in the world, it is essential that their best "export" product, the Dollar, is still represented in international transactions and foreign exchange reserves of central banks. In this regard, the U.S. can match the instability of the common European currency.

CONCLUSION

In order for Euro as a common currency of EMU member countries to be stable, it is necessary that within the Euro area there exists a general level of economic and political stability, fiscal stability, the stability of inflation and interest rates and a positive current balance in balance of payment for the majority of countries inside the Eurozone. The main criterion that was not met within the EMU and which threatened the stability of European currency the most, is the fiscal criteria. High budget deficits and public debts of some countries have undermined the stability of the Euro and led to a decline in its value in relation to other important currencies in the world.

In recent months, both in economic and in political debate it is increasingly being questioned whether the debt crisis is so deep that it can lead to the disintegration of the European Monetary Union. Just the thought of the possibility of dissolution sounds pretty scary, considering that this project has been running on for years and decades and that so much has been invested in the idea. However, immediately after the outbreak of the debt crisis in Greece, a thinking of a possible shutdown of this country from the European monetary union started. Proponents of such ideas considered that highly indebted countries to the Eurozone should be excluded from the monetary union (or even separated from those countries in the Eurozone that are not highly leveraged), for they, with their excessive spending and borrowing, cause disruptions in financial markets and affect the instability and depreciation of the common currency. However, the probability that an indebted country be excluded from the Eurozone is minimal, especially as the cost of such proceedings would be far greater than any benefit. No country wants to leave EMU because the interest rates and exchange rates of a country which has withdrawn, would have much larger fluctuations, and the country itself could only borrow money at much higher interest rate which would certainly affect economic growth in such a country. Neither does the European Monetary Union itself have too much interest in the exclusion of certain countries, because the excluded country with their accumulated economic problems got into the recession that would affect the economies of other European countries. Also, a prospective collapse of the Eurozone common currency-the Euro, would be a suffered defeat, and defeat would be a victory for U.S. Dollar - the Dollar has become indispensable to all international currency transactions. Europe would lose its impact compared with China and the United States. In addition, there could be more tension in the relationship between the Eurozone member states, so that, ultimately, the whole European Union would be threatened. We see that the possible dissolution of the European Monetary Union will not be liable to member states and even within the EU. One possible solution of the debt crisis in the Eurozone countries is that the countries increase their competitiveness by raising productivity, freeze real incomes, reduce their over-consumption and increase their fiscal discipline. This is not a painless process, besides, it would not be very short, but is the only right one.

Debt crisis of the European Union, and potential Greek financial collapse, imposed a new negotiation mediator on the Eurozone - International Monetary Fund (IMF). The financial package of assistance to vulnerable members of the Eurozone is approved under the influence of this international monetary organization. By joining the IMF in the reform program of Greece, the EU faced a new relationship with this international financial institution. Given that the IMF is an institution that has a lot of experience in solving problems of countries with financial difficulties, their involvement in resolving the debt crisis of individual countries within the Eurozone is no wonder. The great reluctance of European Union leaders in terms of granting financial aid to Greece and other Eurozone countries has opened the door to the IMF and its role in resolving the debt crisis in Europe, which puts into question the economic and political credibility of the Eurozone. However, despite the involvement of IMF in overcoming the financial problems the Eurozone, European Union officials argue for the creation of a European equivalent of the so-called IMF. European Monetary Fund, which would independently cope with situations like the Greek debt crisis. There is agreement in the European Union that for the Eurozone stability an institution is necessary that has the experience of the IMF and necessary mechanisms for better coordination and monitoring of national economies and the possibility of intervention in the financial market. As the IMF on the world stage, so would the European Monetary Fund (EMF) be a last resort for members of the Eurozone that get into financial crisis. Therefore, the EMF would, above all, take care about monetary stabilization by the most precious established financial discipline. The establishment of the European Monetary Fund should be superior to the option of calling on the IMF in resolving future financial problems of the Eurozone.

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DUŽNIČKA KRIZA U EVROPSKOJ UNIJI I OPSTANAK EVROZONE

Miloš Todorović, Jovan Bogdanović

Dužnička kriza u Evropskoj uniji je posledica nemogućnosti nekolicine zemalja da uspostave kontrolu nad rastućim dugovanjima, čime se stvorio ogroman pritisak na stabilnost i opstanak zajedničke evropske valute, evra. Zabrinutost nad rizicima rastućeg javnog duga i budžetskog deficita pojedinih zemalja Evropske monetarne unije, uslovila je reakciju finansijskih tržišta koja su kaznila zemlje sa dužničkim problemima u vidu povećanja cene njihovog dodatnog zaduživanja. Slaba kontrola primene definisanih pravila je dovela do toga da prekomerno zaduživanje zemalja dovede u pitanje postignutu stabilnost ali i integritet Evrozone. Izbijanjem dužničke krize u Evropskoj uniji, došlo se i do saznanja da model ekonomskog rasta koji se zasniva na finansiranju potrošnje kroz zaduživanje, na dugi rok ne daje pozitivne rezultate.

Analizirajući potencijalne opasnosti od eventualnog raspada Evrozone, lideri Evropske unije su zaključili da su troškovi takvog scenarija izuzetno visoki. Postignuta je saglasnost o formiranju fonda za spašavanje država članica čiji bi dužnički problemi mogli da ugroze opstanak ove monetarne unije.

Ključne reči: *dužnička kriza, stabilnost evra, finansijska tržišta, raspad Evrozone, finansijska pomoć.*