



CAUSES OF THE OUTBREAK OF THE EUROZONE CRISES: THE ROLE OF THE USA AND THE EUROPEAN CENTRAL BANK MONETARY POLICY

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Abstract

This paper argues that the loose monetary policy of two of the world's most important financial institutions—the U.S. Federal Reserve Board and the European Central Bank—were ultimately responsible for the outburst of global financial crisis of 2008-09. Unusually low interest rates in 2001-05 compelled investors to engage in high risk endeavors. It also encouraged some governments to finance excessive domestic consumption with foreign loans. Emerging financial bubbles burst first in mortgage markets in the U.S. and subsequently spread to other countries. The paper also reviews other causes of the crisis as discussed in literature. Some of them relate directly to weaknesses inherent in the institutional design of the European Monetary Union (EMU) while others are unique to members of the EMU. It is rather striking that recommended remedies tend not to take into account the policies of the European Central Bank.

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INTRODUCTION

The blame for the crisis is mostly put on the US financial sector—greedy and deregulated. Missing in this story is the ECB portrayed as a bystander and the FRB only occasionally accused of doing nothing to burst speculative bubbles. The contribution of this author is to show that loose monetary policy, which drove interest rates to unprecedented lows, encouraged risk taking and ultimately the crisis. In the USA, social policies promoting home ownership played a role but, still, low mortgage rates were possible because of loose monetary policy. In the Eurozone, borrowing by the public sector in some countries (e.g., Greece) and private sector in some others (e.g., Ireland) created the background for the financial sector together with weaknesses in the European Monetary Union.

The present financial crisis, which originated in the USA, has had serious consequences for the entire world economy. It is worthwhile to consider whether the causes of the crisis in the Eurozone were due to only to external factors and the spill-over effect or perhaps resulted from the irresponsible policy on public funds and were caused solely by difficulties in the bank sector. The idea of economic integration, which is often discussed in textbooks, requires that the establishment of an economic and monetary union be preceded by a harmonization of the fiscal policy of the would-be member states. This is because a monetary union is the crowning of a long integration process. However, in the case of the Eurozone, it was decided to ignore the ideas formed by theoreticians of economics and adopt special rules in the form of the Stability and Growth Pact which were to be sufficient to discipline the states that composed the monetary union. Have the rules turned out to be really effective and sufficient to encourage the maintaining of a balanced budget? (Winięcki, 2013, p. 8).

The paper is organized as follows: The first section seeks to outline causes of the crisis. Section 2 presents modifications of an institutional design as reaction to crisis. Section 3 considers whether the lack of fiscal discipline could trigger a crisis. Section 4 contains a comparison of the role and decisions taken by the ECB and FRB. The last section concludes as well as provides a list of observations.

CAUSES OF THE CRISIS

When in 2007 a property market crisis originated in the USA, few economists suspected that it might spread to other countries so fast and that its consequences would be so enduring. A year later there was no doubt that we had to do with a global financial crisis which would adversely affect the European states and regions. European integration and the whole institutional architecture of the EU had to face new challenges. The design of the European integration, which for the last 50 years has been considered a success of the member countries, was to undergo the most serious test in history. In particular, the problem in question is the necessity to reform the most vulnerable parts of the design, namely the uniform market and the monetary union. However, before any appropriate remedy is offered, it is necessary to pinpoint the causes of the financial problems that plague the member states.

There are many causes of the crisis in the Eurozone, from “poor lending to private banks” to the bubble in the real estate market. One of the significant causes that are hardly ever mentioned is a clash of interests between the individual member states and the interest of the whole organization. Viewing the public finances as the only source of the crises has not necessarily been validated by the facts. It is true that in the pre-crisis period such countries as Spain or Ireland could boast an excellent state of their public funds, but Germany, despite failing to meet the Maastricht criteria, was not so badly affected by the crisis. In other words, deficit or national debt are not reliable indicators of vulnerability to crisis.

The primary cause of the crises, which triggered other successive causes, was the fact that the Eurozone had failed to meet the basic conditions to ensure the functioning of the optimum currency area. The implementation of fixed currency rates among the countries that form a currency area necessitates, according to the Mundell theory, meeting some criteria regarding, among other things, mobility of production factors, finance market integration, diversification of production or openness of economy (Mundell, 1961, p. 657-665). Decades of its functioning showed that already at the time of its formation the union did not fulfil the criteria of an optimum currency area because in the case of the occurrence of an economic shock it did not assure

labour force mobility. It had no lender-of-last-resort institution nor did it guarantee compensatory transfers. The countries that intended to join had to give up carrying out their own notional monetary policy in favour of cooperative activities coordinated by the European Central Bank. However, fiscal policy was still under the management of the member countries, which caused other problems. Lack of financial supervision led to disinformation on the financial situation between the states of the Eurozone (e.g. Greece). Fiscal activities of the individual states were not supervised at all as there was no supranational institution authorized to conduct that kind of inspection. Hence the enormous budget deficit and national debt of Greece or Portugal.

Another cause of the crisis in the Eurozone is lack of coherence of the Eurozone which is necessary to guarantee the effectiveness of decisions taken at the central level. However, the member countries differ in respect of fiscal policy (effect of automatic factors stabilizing the overall economic situation), monetary policy (differences in banking systems or the problem of mismatching interest rates with the economic situation of the individual states) as well as in respect of other macro-economic factors (such as, for example, the course of economic cycles or structure of the economy) (Schalck, 2012, p. 25). The data on the crucial economic indicators that are decisive for the coherence of the Eurozone show weak domestic integration of the states. A study that makes use of over 100 various economic, social and political indicators revealed the fact that the Eurozone is the least coherent group of states predestined to create a monetary union (smaller differences occur in the area of the monetary union formed in West Africa named EU MOA (Union Economique et Monetaire Ouest Africaine), which comprises eight countries. At the present time the Eurozone seems to be at an impasse. So, it is impossible to reconcile three goals, the so-called “trinity of irreconcilable goals” (Figure 1), which show the greatest problems the eurozone has to cope with. The first one concerns lack of co-responsibility for national debt. The government of each of the Eurozone states is individually responsible for the debt. None of the countries is allowed to take over responsibility for the debt of another member state. This is a clause known as “no bail-out” (article 125 TEU). It forbids the Eurozone states from giving aid to insolvent members. That means it is hardly possible for a country to run up a debt in currency other than its own.

Getting into debt in a currency that is not quite under control creates favourable conditions for crisis to arise. Another problem concerns the ECB being banned from giving financial aid (strict no-monetary financing). The ECB is not allowed to help financially those countries that are indebted because its mandate forbids purchasing treasury securities of the member states in the primary market. However, this is possible in the secondary market and the ECB has already taken advantage of this possibility buying Greek and Portuguese bonds in 2011 and then Italian and Spanish bonds for a total sum of about E 200 billion. The ECB mandate restriction is an indication of a clear separation between fiscal and monetary policies. The third source of Eurozone problems is banks-sovereign interdependence. While the Eurozone is monetarily integrated, its banking systems are mostly domestic. This gives rise to the so-called “home bias” or domestication, which means that banks keep mainly treasury securities of their own governments and that the latter are too much exposed to the problems of their national banks. This kind of exposure of banks to “their” government and vice versa makes Eurozone public finances more endangered by a solvency and liquidity crisis, especially when bank assets are many times greater than the government tax revenues. The occurrence of when the three goals are unattainable shows the uniqueness of the Eurozone. It is becoming impossible to simultaneously keep a ban on debt financing by the ECB and the banks-public finances interdependence as well as co-responsibility for debt. That being so, it is necessary that one of the solutions be introduced - either a bank of fiscal union or acceptance of unrestricted ECB intervention (Pisani-Ferry, 2012, p. 4-8).

Ireland, enjoying fast development and economic boom for two decades as an EU country, was struck by a financial crisis, which drastically affected the country and its functioning.

It afflicted not only the economic and political elites but also ordinary citizens when the real estate bubble that had been forming from 2002 burst six years later. The cause of the Irish crisis was the fall of the banking system which broke down due to its excessive exposure to cheap loans which were widely available and easy to get after the introduction of the euro. It directly influenced the income of the state when real property taxes diminished showing a big gap between out-of-pocket expenses and receipts.

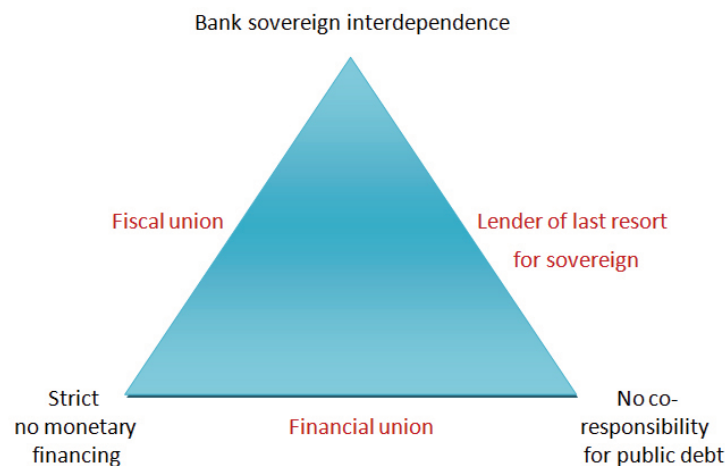


Figure 1. Trinity of irreconcilable goals

Source: Pisani-Ferry, J. (2012). *The Euro Crisis and the New Impossible Trinity*. *Bruegel Policy Contribution*, 2012/01, p. 8

Economists claim that all Ireland's problems were caused by Brussels. On joining the Eurozone Ireland got, as it were, contained in the EU banking system and its ability to take free decisions was limited with regard to the joint interest of all the member states. It was particularly evident during the wave of criticism the activities of the Irish government were subjected to in September 2008, when the guarantee basket was enlarged to a sum of E 440 billion to cover all the deposits and obligations of the banking system. After that, banks and the state had to rely more and more on the ECB in order to get rid of receipts and liquidity gaps which immediately created solvency problems. However, the decision which turned out to be the most painful was that taken by the EU and the MFW which imposes a five-year consolidation programme making the state still more dependent on external economic policy and political activities. The president of Ireland's Central Bank called the Irish crisis "one of the most expensive economic crises in history".

After the crisis prompted by the Internet bubble in 2001-2002, Ireland decided to change its policy of economic growth. Until then the country's economy was based on export but now the government decided to boost the economy falling back on building industry and domestic consumption driven by cheap credit. The number of loans provided by Irish credit institutions increased from 10 percent of GDP in 2003 to 41 percent in 2005. Easy access to cheap money resulted from inaccurate legal regulations and the rivalry among

banks. However, in 2007, the period of long-lasting boom and low unemployment came to an end. A crisis hit and, to make matters worse, it was a three-faceted one. It was a financial crisis sparked by the breakdown of the banking system; a fiscal one triggered by the rapidly expanding spread between current spending and earnings, and finally that of competitiveness. The source of Greece's failure was a fiscal crisis prompted by excessive government spending. In Spain, however, the fiscal crisis only exacerbated the already rampant banking crisis. In today's economies fiscal and banking crises are most often linked together as the banking sector and the state often co-operate. Banks buy national debt supporting the state while governments guarantee bank obligations. When one of the two players gets weakened, the other becomes adversely affected automatically. The Pact of Stability and Growth included in the Amsterdam Treaty was intended to reinforce the resolutions contained in the European Union Treaty (EUT). They oblige the states to keep the budget deficit and national debt steady (below 3 and 60 percent of GDP, respectively) by implementing reporting and excessive deficit procedures. The pact was an attempt to soften the divergence between the monetary policy officially pursued by the ECB and the economic and fiscal policies still carried out by the governments of the member states with all their characteristic regulations and preferences. However, the financial crisis shattered this order which had been building for a long time but was founded on

incorrect assumptions. Namely, in the long run, it was impossible to leave these two areas of the economy in separate centres of power. Besides, the credibility of the whole system with respect to monitoring the deficit and the public debt had been put into doubt before the crisis started. In 2002 Germany and France exceeded the imposed criteria. What is more, they used their prestige and political leverage to avoid sanctions. Such deplorable behaviour gave consent for ignoring the assumed criteria by other member states, such as e.g. Greece, and made them aware of the fact that they should not be afraid of excessive deficit related procedures whose task was to punish insubordinate states with sanctions as the latter could be easily avoided (Wood, 2012, p. 33). The debt crisis of the Economic Monetary Union and the danger of partial disintegration of the Eurozone gave rise to pondering what causes and missing components of the European integration might be responsible for economic problems in both prospering countries and those violating the established rules of functioning. One of the factors prompting the financial crisis was the role and condition of the fiscal integration, in particular regarding the common currency area. Quite a number of economists argue that greater fiscal integration means greater political federalism at the European level by which they mean the institutional aspect and greater importance of the European Parliament. Taking into account historical background, fiscal policy has always been the domain of sovereign states and rulers (Dąbrowski, 2013, p. 6). Discussing the sources of the current crisis enthusiasts of a common currency claim that it is necessary to reinforce political integration or at least strengthen economy-oriented governments (De Grauwe, 2006, p. 3-10). However, monetary union skeptics doubt if any joint, supranational solutions will ever be possible in a Europe dominated by tradition and sovereign national countries.

In all, despite global sources of the economic breakdown, the crisis which engulfed Europe stemmed mainly from the defective structure of the Eurozone, which triggered other crisis prompting factors. The fact that the Eurozone in its present shape does not meet

optimum currency zone standards and is not immune to asymmetric shocks deepened the collapse in the European market. What is more, the fiscal policy of the member states, which has been irresponsible and never checked by any supranational institution, has led to enormous budget deficits and national debts. The high deficits on the current accounts of Greece and Portugal should have been spotted and treated as visual symptoms of an alarming situation that should have been handled by implementing appropriate macroeconomic policy getting the states to economize. Additionally, banking sector problems of some member states brought them to the brink of bankruptcy. In Ireland, excessive credit creation by Irish banks was noticeable in property markets and also in this case some well-timed measures could have been taken to control or slow down the credit activity. Thus the crisis exposed the instability of the now functioning monetary union and proved that there is a necessity to create a fiscal or bank pillar.

INSTITUTIONAL DESIGN: MODIFICATIONS AS REACTION TO CRISIS

The Stability and Growth Pact was to specify the resolutions of the treaty according to which member states were obliged not to allow the state's budget to exceed 3 percent of the GDP (budget criterion) and the national debt to grow over 60 percent of the GDP (fiscal criterion). The Pact also introduced fines for breaching fiscal discipline. According to its resolutions the minimum fine is 0.2 percent of the GDP for a member country, the amount to be increased by 0.1 percent every time the deficit grows by 1 percent above the fixed 3 percent GDP ceiling. However, the maximum fine cannot exceed 0.5 percent of the GDP.

The adopted solution has quite a lot of vulnerabilities. One of them is that if a state does not exceed the 3 percent GDP deficit, it is not subject to any limitations to its budget policy although formally, it should strive to maintain an average time balance in the budget.² What is more, there is no regulation to encourage keeping a balance or generating budget surplus during a boom in

² According to the Maastricht Treaty (art. 104, later art. of the consolidated version of the Maastricht Treaty), the member countries' duty was to keep the deficit of the public finance sector and the National Debt below the "reference valEU" - at the level as in the Maastricht criteria. The Stability and Growth Pact specified and supplemented the treaty resolutions. According to them, the EU countries should strive for keeping, for a medium-long (a few years') period, balanced or positive balances of public finances and basically they cannot allow deficits exceeding 3% of GDP.

the economy. Thus, if there occurs a deficit in the time of boom, then it is likely to reach an unacceptable level during an economic downturn.³ In such circumstances the European Commission is obliged to launch the excessive deficit proceedings. However, decisions concerning fine imposition are of a subjective nature and there are cases when undisciplined countries apply pressure which, most often, results in motions to impose sanctions being rejected.

The outbreak of the crisis and the deteriorating situation of the member states made European leaders work out new aid solutions. The first aid programme was directed to Greece, but met with social disapproval and reluctance to change anything. Excessive bureaucracy, which needed reforms, did not agree to make curative efforts. With time, more and more countries, on account of the alarming situation, had to be offered aid programmes. In the end there appeared an idea to introduce new institutional solutions or some concerning Eurozone economic policy. It became obvious that economic problems in the Eurozone are due not only to the wrong-headed policy of the member states but also to the weaknesses of the institutional design of the monetary union. Thus decisions were taken to bring in some indispensable changes and regulations.

The document accepted in order to save the already hopeless situation of the EU countries was the so-called six-pack, i.e. a set of six deeds describing the rules of balancing the budget, the pace of national expenditure increase and the required pace of deficit reduction.⁴ The European Commission got the right to more closely supervise public finances and macroeconomic indicators of the economies of the EU countries. More comprehensive macroeconomic supervision was to apply not only to the condition of public finance (deficit and National Debt) but also to other unbalances, e.g. those in the current turnover account or competitiveness changes related to price changes and productivity. Most often, loose fiscal policy, whose dire consequences are budget deficit and national debt, also brings about deficit

in current turnover account; they are so-called twin deficits. It was these, that among other things, brought Greece to the brink of bankruptcy.

The recommendations contained in the six-pack aimed at strengthening fiscal discipline in the member countries. In spite of tough forecasts they did not produce the desired results and corrected only part of the imperfections. Analysts, journalists and politicians commented openly on the adopted documents claiming that they were an attempt at restricting the sovereignty of the member states' fiscal policy and, as a matter of fact, finance markets did not respond to the six-pack; it was really difficult to find an analysis of the effects of the newly introduced reforms in any economic magazine in Europe. It was probably due to lack of confidence in the decisions made by politicians and also the result of the conviction that all the firm promises are either not effected or ineffective (Winiecki, 2013, p. 16). Besides, despite the launching of the six-pack, there were still no firm decisions about the fact that fines are of financial nature and in the time of prosperity surpluses should be generated. Financial reporting also needs perfecting as evidenced by cases of data doctoring in Greece (Calmfors, 2012, p. 10).

A few months later it was decided to introduce other requirements in the form of the so-called two-pack. Its purpose was to balance savings and economic growth as well as supervise the budgets of the Eurozone states. These efforts were to prevent budget deficits, thereby preventing another crisis.

A Treaty of Stability, Management and Coordination, generally called the fiscal pact, was signed in March 2012 and took effect in January 2013.⁵ It was signed by 25 EU member states except for the Czech Republic and Great Britain. The treaty made the regulations contained in the Stability of Growth Pact more stringent. It assumed the so-called golden rule, i.e. a rule according to which an annual structural deficit cannot be higher than 0.5 percent of the nominal GDP. The European Commission

³ Such a situation took place in Germany, which was the initiator of the Stability and Growth Pact. Common currency was adopted during a boom in the economy at a 3% GDP deficit. When a downturn occurred, the deficit exceeded the allowable limit. The procedure of excessive deficit was started, but the EFAC decided not to impose any sanctions, which was a signal that the regulations that were adopted might be ignored.

⁴ The Six-Pack came into being on 13.11. 2011. The acts included in it are: the Directive of the European Parliament and the European Union Council No 1173/2011, 1174/2011, 1175/2011, 1176/2011 of 16.11. 2011; the Directive of the European Union Council No 1177/2011, of 8.11. 2011; the Directive of the Council No 2011/85/EU/ of 8.11. 2011.

⁵ Retrieved from: http://european-council.europa.eu/media/639256_-_tscg.pl.12.pdf.

got the right to monitor adherence to the new fiscal rules, which were to be implemented in national law while the Court of Justice became entitled to impose financial fines on the states which would not implement the spending rule. The above regulations of the fiscal pact have been and still are entirely legitimate. A supplement to the financial supervision scheme was to be the European Stability Mechanism supplied with its own means, which had the ability to help the countries in bad financial condition, but, what is important, it could help only those that signed the fiscal pact.

The Mechanism cannot offer direct help to banks, neither has it a bank licence, which means it cannot borrow from the ECB. It is worth noting that while the fiscal policy regulations contained in it are entirely legitimate and indispensable for preventing other slumps, obeying them by the governments of the member states means divesting themselves of a substantial part of their autonomy in favour of the European Commission. It is necessary to watch to see if politicians will be so dedicated because such decisions are not going to be politically popular.

LACK OF FISCAL DISCIPLINE - SOURCE OF CRISIS?

Table 1 lists the years when individual states had a national debt higher than that adopted in the Pact in 2002-2007, i.e. before the outbreak of crisis in Europe. It is easy to see the amount of the national debt in successive years and its average amount for the period before the crisis (2002-2007) and soon after it manifested itself in Europe (2008-2011). The table also shows the number of years when the national debt exceeded the criterion included in the Stability and Growth Pact (the numerator is the length of the period studied). Ten states actually stood out from the rest throughout all this period as their national debt was higher than 60 percent of the GDP, whereas the other 17 had no problem with not exceeding the indicator. However, this study is focused

mainly on two countries, Greece and Ireland. In the period analysed, Greece ran a national debt definitely higher than 60 percent of the GDP. Interestingly enough, it joined the monetary union although it did not meet the convergence criterion.⁶ Ireland, on the other hand, had a national debt at a level lower than 30% GDP in 2002-2007, which made it a model of financial stability. Only after the crisis loomed in Europe, its national debt (as % BDP) rose up to over 44.5 percent since 2008, and in 2011 it was as much as 106.4 percent. In the course of the four years it rose by more than 60 percent. In Greece, in the same period of time, it rose by about 57 percent. In the successive period of time, i.e. in 2008-11, the two countries did not satisfy the criteria included in the Stability and Growth Pact.

In the case of the other criterion, budget deficit, the situation of Ireland and Greece is almost identical to the situations that these countries are in, in the case of their national debt (Table 1). It is in Greece that financial crisis was foreseeable, while Ireland's economic indicators were simply very good. It is worth noting that the average budget deficit in the period before the crises (2002-07) amounted to 0.9 percent of GDP for Ireland and for Greece it exceeded the Stability and Growth Pact sanctioned limit by 2 percent. In successive years, 2008-11, Ireland's budget deficit averaged -16.4 percent of GDP, thus its increase was as much as 15.5 percent during just four years. In Greece it increased to -11.4 percent, that is by 6.4 percent. The crisis was much more harmful to the Irish economy because the country's economic indicators deteriorated much more than the Greek; they had been unsatisfactory for years. The question is why the two countries of totally different economic results were afflicted by the crisis equally hard. Was the cause of the economic slump really the same?

Thus, we have to do with two sources of crisis. The first is a relatively small debt in 2002-2007, then a debt explosion in Ireland in 2008-11 and the other one in Greece, where the debt stayed at a high level for years and after 2008 there were great problems with financing it.

⁶ While joining the Eurozone, Greece did not meet the convergence criteria but thanks to the deliberate policy of the authorities and by simply concealing the condition of the public finances, with the consent of the EU authorities, the country joined the Eurozone. The information announced mentioned only a 3.7% budget deficit. In fact it was running about 13.6% of GDP. Interestingly enough, while joining the common currency area, Greece had an inflation at a higher level than the average for the monetary union countries. Owing to this the interest rates in Greece were negative for a few successive years (Karnowski, 2006, p. 224).

Tabela 1: National debt as % of GDP of the EU countries in 2002- 2011 and the number of years in which the criterion contained in the Stability and Growth Pact was exceeded

countries/ years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	average amount of national debt		numer of years with debt higher than 60% of GDP in years	
											2002-07	2008-11	2002-07	2008-11
EU (27 countries)	60,5	62	62,4	62,8	61,6	59	62,3	74,6	80	82,5	61,4	74,9	5/6	4/4
Belgium	103,4	98,4	94	92	88	84	89,2	95,7	95,5	97,8	93,3	94,6	6/6	4/4
Bulgaria	52,4	44,4	37	27,5	21,6	17,2	13,7	14,6	16,2	16,3	33,4	15,2	0/6	0/4
Czech Republic	27,1	28,6	28,9	28,4	28,3	27,9	28,7	34,2	37,8	40,8	28,2	35,4	0/6	0/4
Denmark	49,5	47,2	45,1	37,8	32,1	27,1	33,4	40,7	42,7	46,4	39,8	40,8	0/6	0/4
Germany	60,7	64,4	66,2	68,5	68	65,2	66,8	74,5	82,4	80,4	65,5	76,0	6/6	4/4
Estonia	5,7	5,6	5	4,6	4,4	3,7	4,5	7,2	6,7	6,2	4,8	6,2	0/6	0/4
Ireland	32	30,7	29,5	27,3	24,6	25,1	44,5	64,8	92,1	106,4	28,2	77,0	0/6	3/4
Greece	101,7	97,4	98,6	100	106,1	107,4	112,9	129,7	148,3	170,3	101,9	140,3	6/6	4/4
Spain	52,6	48,8	46,3	43,2	39,7	36,3	40,2	53,9	61,5	69,3	44,5	56,2	0/6	2/4
France	58,8	62,9	64,9	66,4	63,7	64,2	68,2	79,2	82,4	85,8	63,5	78,9	5/6	4/4
Italy	105,4	104,1	103,7	105,7	106,3	103,3	106,1	116,4	119,3	120,8	104,8	115,7	6/6	4/4
Cyprus	65,1	69,7	70,9	69,4	64,7	58,8	48,9	58,5	61,3	71,1	66,4	60,0	5/6	2/4
Latvia	13,6	14,7	15	12,5	10,7	9	19,8	36,9	44,4	41,9	12,6	35,8	0/6	0/4
Lithuania	22,2	21	19,3	18,3	17,9	16,8	15,5	29,3	37,9	38,5	19,3	30,3	0/6	0/4
Luxemburg	6,3	6,1	6,3	6,1	6,7	6,7	14,4	15,3	19,2	18,3	6,4	16,8	0/6	0/4
Hungary	55,9	58,6	59,5	61,7	65,9	67	73	79,8	81,8	81,4	61,4	79,0	3/6	4/4
Malta	57,9	66	69,8	68	62,5	60,7	60,9	66,4	67,4	70,3	64,2	66,3	5/6	4/4
Holland	50,5	52	52,4	51,8	47,4	45,3	58,5	60,8	63,1	65,5	49,9	62,0	0/6	3/4
Austria	66,2	65,3	64,7	64,2	62,3	60,2	63,8	69,2	72	72,5	63,8	69,4	6/6	4/4
Poland	42,2	47,1	45,7	47,1	47,7	45	47,1	50,9	54,8	56,2	45,8	52,3	0/6	0/4
Portugal	56,8	59,4	61,9	67,7	69,4	68,4	71,7	83,7	94	108,3	63,9	89,4	4/6	4/4
Romania	24,9	21,5	18,7	15,8	12,4	12,8	13,4	23,6	30,5	34,7	17,7	25,6	0/6	0/4
Slovenia	27,8	27,2	27,3	26,7	26,4	23,1	22	35	38,6	46,9	26,4	35,6	0/6	0/4
Slovak Republic	43,4	42,4	41,5	34,2	30,5	29,6	27,9	35,6	41	43,3	36,9	37,0	0/6	0/4
Finland	41,5	44,5	44,4	41,7	39,6	35,2	33,9	43,5	48,6	49	41,2	43,8	0/6	0/4
Sweden	52,5	51,7	50,3	50,4	45,3	40,2	38,8	42,6	39,4	38,4	48,4	39,8	0/6	0/4
Great Britain	37,7	39,1	41	42,2	43,3	44,2	52,7	67,8	79,4	85,5	41,3	71,4	0/6	3/4

Source: Author's study based on Eurostat data, access date: 3.07.2013

The situation in Greece from the moment the country joined the EU was not too promising. After the adoption of the common currency, on account of a low level of interest rates, there occurred a slump in national savings. The worsening economic situation made Greece less attractive to investors. Moreover, the capital borrowed by the Greek government in foreign markets was spent on day-to-day consumption in both private and public sectors instead of boosting the dynamics of export which might finance the debt in the future. The highest expenses were in the government and the local government sectors, where most savings were distributed as social transfers which in no way enhanced the economic growth. Just the opposite, they stimulated consumption in the private sector and consequently led to price increases.

The crisis in Greece resulted from expansive fiscal policy and a propensity for reckless spending. Besides, it is partly the effect of design faults in the eurozone.⁷ Expenses without sufficient income resulted in growing deficit. Such activities had to be backed by a higher exchange rate policy in order to attract foreign investors who would credit Greek debt. With time, however, servicing the debt became too heavy a burden. To make matters worse, the inflow of capital triggered price increases making the goods produced less competitive, which meant worse current turnover account results (Gotz, 2012, p. 73). The growing insolvency risk of the Greek economy caused serious liquidity problems in Greece's banking system and consequently exacerbated the situation of the capital in the country.

Before the crisis the Greek economy had shown inner and outer disequilibria. It is hard to suggest that the overheating of the economy was merely due to the adoption of the euro, but nevertheless this kind of economic "extravagance" would not have been possible without the country's access to the Eurozone. On the side of the expenditures the prodigality was encouraged by the so-called easy and cheap money in the uniform European financial market. On the one hand high public deficits were not triggered by adopting the euro, but on the other hand the rules binding in the Eurozone and the Stability and Growth Act in particular did not anticipate any procedures to prevent deficits from happening. The excessive number of job vacancies, growing number

of social privileges, leaking tax system, far too much red tape and lack of competition spawned more and more problems. However, it was the Greek government that did not take any repair action in the sphere of the economy in order to restore the competitiveness and reduce growing imbalances.

The indebtedness in Greece was not a direct effect of the global economic crisis. It only revealed and intensified the economic problems of the country. The budget deficit kept growing for successive years and excessive expenditure as well as lack of budget strategy combined with inadequate supervision by the union authorities only aggravated the situation of this country (Koczor, 2011, p. 42).

Individual countries suffered from the effects of the crises in varying degrees, but those which could boast dynamic development and model economic indicators in the period preceding the crisis, e.g. Ireland and Estonia (Małkiewicz, 2010, p. 101-102), were afflicted the most. Ireland was the first Eurozone country hit by the crisis. However, the causes of why it occurred in this country were different from those in Greece. The banking system of Ireland failed because of being excessively exposed to cheap credit accessible after the introduction of euro (Gillespie, 2012, p. 125-126). It can be said that it was not sparked by crises in the other parts of the world but was "produced" on the spot. Its source was too low interest rates which lured banks into greater but high-risk investment. Besides, the financing capital did not come from domestic resources nor did it originate from savings but flowed from abroad, which made it still more accessible. It led to consumption and investment increase, particularly in the building sector. Irish authorities allowed banks to make mortgage loans on a large scale. Greater demand sparked price and pay increase, which affected competitiveness, aggravated the situation in the current turnover balance and brought about deficit increase in 2008 which was mostly financed from foreign sources (The highest recorded deficit was in 2010; 16.9 percent relative to the previous year - Table 2). A dynamic property price increase resulted in Irish GDP being largely based on the so-called property bubble. A long-standing boom in the property market became the main cause of the banking crisis. The population of the country, whose living standard equalled and later exceeded the union

⁷ The creativity in the finance ministries before the crisis manifesting itself by applying various bookkeeping methods, well camouflaged borrowing, doctoring the statistics, securitization or currency swap operations contributed to the financial problems in many countries (Irwin, 2009, p. 12- 13).

Tabela 2: Budget deficit as % of GDP of the EU countries in 2002- 2011 and the number of years in which the criterion contained in the Stability and Growth Pact was exceeded

countries/ years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	average amount of national debt		number of years with debt higher than 60% of GDP in years	
											2002-07	2008-11	2002-07	2008-11
EU (27 countries)	-2,6	-3,2	-2,9	-2,5	-1,5	-0,9	-2,4	-6,9	-6,5	-4,4	-1,9	-5,1	1/6	3/4
eurozone	-2,6	-3,1	-2,9	-2,5	-1,3	-0,7	-2,1	-6,4	-6,2	-4,2	-1,9	-4,7	1/6	3/4
Belgium	-0,1	-0,1	-0,1	-2,5	0,4	-0,1	-1	-5,6	-3,8	-3,7	-0,4	-3,5	0/6	3/4
Bulgaria	-1,2	-0,4	1,9	1	1,9	1,2	1,7	-4,3	-3,1	-2	0,6	-1,9	0/6	2/4
The Czech Republic	-6,5	-6,7	-2,8	-3,2	-2,4	-0,7	-2,2	-5,8	-4,8	-3,3	-3,2	-4,0	2/6	3/4
Denmark	0,4	0,1	2,1	5,2	5,2	4,8	3,2	-2,7	-2,5	-1,8	2,5	-1,0	3/6	1/4
Germany	-3,8	-4,2	-3,8	-3,3	-1,6	0,2	-0,1	-3,1	-4,1	-0,8	-2,4	-2,0	4/6	2/4
Estonia	0,3	1,7	1,6	1,6	2,5	2,4	-2,9	-2	0,2	1,2	1,4	-0,9	0/6	0/4
Ireland	-0,4	0,4	1,4	1,7	2,9	0,1	-7,4	-13,9	-30,8	-13,4	0,9	-16,4	0/6	4/4
Greece	-4,8	-5,6	-7,5	-5,2	-5,7	-6,5	-9,8	-15,6	-10,7	-9,5	-5,0	-11,4	6/6	4/4
Spain	-0,2	-0,3	-0,1	1,3	2,4	1,9	-4,5	-11,2	-9,7	-9,4	0,7	-8,7	0/6	4/4
France	-3,1	-4,1	-3,6	-2,9	-2,3	-2,7	-3,3	-7,5	-7,1	-5,3	-2,7	-5,8	3/6	4/4
Italy	-3,1	-3,6	-3,5	-4,4	-3,4	-1,6	-2,7	-5,5	-4,5	-3,8	-2,8	-4,1	5/6	3/4
Cyprus	-4,4	-6,6	-4,1	-2,4	-1,2	3,5	0,9	-6,1	-5,3	-6,3	-2,2	-4,2	4/6	3/4
Latvia	-2,3	-1,6	-1	-0,4	-0,5	-0,4	-4,2	-9,8	-8,1	-3,6	-0,9	-6,4	0/6	4/4
Lithuania	-1,9	-1,3	-1,5	-0,5	-0,4	-1	-3,3	-9,4	-7,2	-5,5	-0,9	-6,4	0/6	4/4
Luxemburg	2,1	0,5	-1,1	0	1,4	3,7	3,2	-0,8	-0,9	-0,2	0,9	0,3	1/6	1/4
Hungary	-9	-7,3	-6,5	-7,9	-9,4	-5,1	-3,7	-4,6	-4,3	4,3	-6,5	-2,1	6/6	4/4
Malta	-5,7	-9	-4,6	-2,9	-2,7	-2,3	-4,6	-3,7	-3,6	-2,8	-3,9	-3,7	3/6	3/4
Holland	-2,1	-3,1	-1,7	-0,3	0,5	0,2	0,5	-5,6	-5,1	-4,5	-0,9	-3,7	1/6	3/4
Austria	-0,7	-1,5	-4,4	-1,7	-1,5	-0,9	-0,9	-4,1	-4,5	-2,5	-1,5	-3,0	1/6	2/4
Poland	-5	-6,2	-5,4	-4,1	-3,6	-1,9	-3,7	-7,4	-7,9	-5	-3,7	-6,0	5/6	4/4
Portugal	-3,4	-3,7	-4	-6,5	-4,6	-3,1	-3,6	-10,2	-9,8	-4,4	-3,6	-7,0	6/6	4/4
Romania	-2	-1,5	-1,2	-1,2	-2,2	-2,9	-5,7	-9	-6,8	-5,6	-1,6	-6,8	0/6	4/4
Slovenia	-2,4	-2,7	-2,3	-1,5	-1,4	0	-1,9	-6,2	-5,9	-6,4	-1,5	-5,1	0/6	3/4
Slovak Republic	-8,2	-2,8	-2,4	-2,8	-3,2	-1,8	-2,1	-8	-7,7	-5,1	-3,0	-5,7	2/6	3/4
Finland	4,2	2,6	2,5	2,9	4,2	5,3	4,4	-2,5	-2,5	-0,8	3,1	-0,4	3/6	1/4
Sweden	-1,3	-1	0,6	2,2	2,3	3,6	2,2	-0,7	0,3	0,2	0,9	0,5	1/6	0/4
Great Britain	-2,1	-3,4	-3,5	-3,4	-2,7	-2,8	-5,1	-11,5	-10,2	-7,8	-2,6	-8,7	3/6	4/4

Source: Author's study based on Eurostat data, access date: 3.07.2013

average, were sure that the increase in the property value would be permanent and investing in real estate would be the safest way to secure their savings (Regling & Watson, 2010, p. 29).

The chief responsibility for the crisis rests with the successive governments of Ireland, which, among other things, through tax deductions from mortgage repayment and other subsidies in the commercial property market, enhanced the formation of the property bubble, which became one of the main factors of the economic growth.

The developing building sector was, through taxes, the source of financing public expenditure. The politicians treated it as strong grounds for ignoring any problems occurring in bank credit and property markets. Such a situation made the government nationalize some financial institutions and try hard to keep the budget deficit under financial control. Drastic cuts in government expenditure precipitated still greater collapse of the country's economy which ran into a spiral of debt.

THE ROLE OF THE ECB AND FRB

What is interesting, not only in small Ireland but also in the United States, is that monetary policy, which is responsible for the property market bubble, turned out to be the cause of the crisis. It is strong financial linkages between European countries and the United States that caused an inflow of crisis-spawning factors into the old continent. European financial institutions were in the possession of the so-called toxic assets of their American partners. Due to this, European financial markets suffered an upheaval similar to that in the United States. However, the activities of the European financial institutions showed greater reluctance to taking risk than those of their counterparts on the other side of the Atlantic. In the case of European countries it was the ECB that played a particularly significant role. The basic task of central banks is maintaining price stability. However, the crucial task of the monetary policy carried out by the central bank of the United States (the Federal Reserve Bank- FRB) is also counteracting and reducing economic crises (Schiu-Scheng Han, 2007, p. 667-688). Thus, it is worthwhile to compare the activities and decisions taken

during the crisis by the ECB and the FRB as both these institutions conducted really loose monetary policy, but its consequences, responsible for the current situation of banks, are much more devastating for Europe, where the crisis still continues, than for the United States.

The policy pursued by the FRB was based on cutting interest rates, which eased access to cheap money which encouraged taking more and more risk-weighted decisions. Thus, the so-called moral hazard was widely practised, which directly led to financial instability. Bankers, inspired by the policies of central banks took large-scale risks knowing that in case of trouble they will be rescued by the so-called Greenspan Put, i.e. a new phenomenon described by The Economist: “Why not take risks if you know that central banks will intervene only in falling, not rising, market?” The ramification of such a policy and other faults was lowering loan issuing standards.

It has been pointed out in economic studies that lingering low interest rates result in lowering lending standards. It has also been proved that the operations of both FRB in the USA and ECB in Europe involving the lowering of mortgage standards adversely affected the economic growth rate of the USA and the EU countries (Winięcki, 2013, p. 3).

An analysis of the decisions concerning interest rate policy taken by the FRB in 1990- 2008 revealed a few significant facts. The data contained in the table (Table 3) indicate that from 2001 the FRB successively slashed interest rates down to as low as 1% in 2003- 04. When interest rates were on the decrease, the number of loans obtained went up, and when the interest rates were getting higher and higher, the rate of “junk” loans obtained dropped (Cognato & Kamiński, 2009, p. 18).

One can distinguish five overlapping cycles of changes in nominal interest rates which have occurred during the last nineteen years in the USA. Three of the cycles were of downward and two of upward nature. The characteristic feature of the changes was a similar lifetime of the downward and upward cycles and the fact that the increase in nominal interest rates was usually accompanied by an increase in real rates. This proves that the FRB policy was credible for the players in the financial markets and read appropriately.⁸

⁸ The effect of the interest rate policy carried out by the authorities can be experienced by economic entities in two ways: directly and indirectly. The first of them consists in the fact that an interest rate reduction may be an incentive for economic entities to enlarge the extent of their activity. However, in the other case, when the interest rate reduction is connected with inflation (real interest rate drop), economic entities can read the authorities' decision as a sign of uncertainty as to the future conditions for doing business, and because of this they reduce the scale of their economic activity (Bednarczyk, Bukowski, Misala, 2009, p. 68).

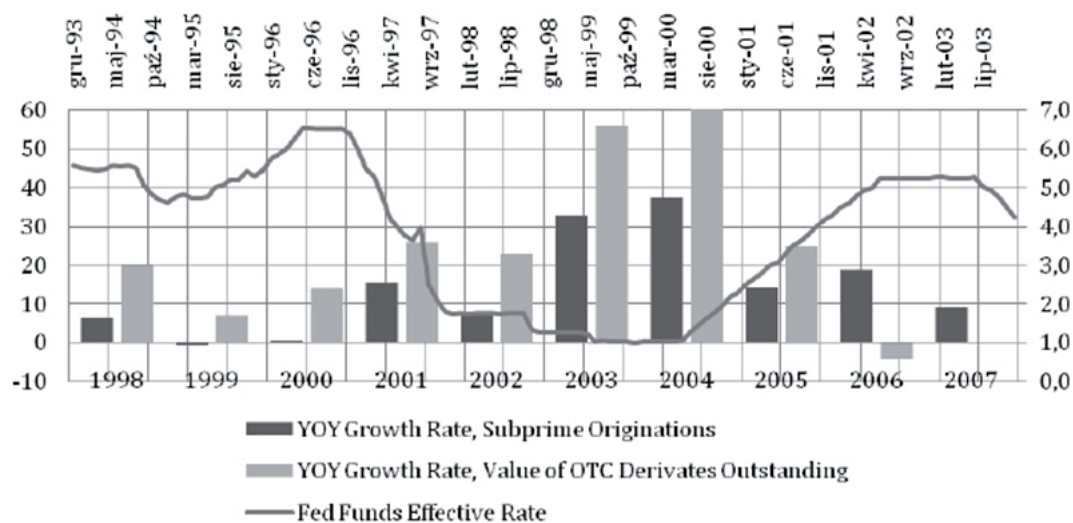


Table 3: Dynamics of changes in the increase in substandard mortgages, derivatives based on them and the active interest rate of federal reserve funds in 1997-2007

Source: Cognato, B., Kamiński, B. (2009). *Globalization and Evolving Nature of Financial Crisis, The Financial Internet Quarterly e-Finanse*, nr 3. Rzeszów: Wyższa Szkoła Infor nr 3

Until the middle of 2004 the FRB conducted a policy of extremely cheap money. However, in the successive period of time the FRB, unobtrusively (by 25 base points) and consistently, continued raising the interest rate. In 2006 it was 5.25%. In this way the nominal interest of federal funds increased fiftyfold during only three years; the lowest level in 2003 was 1%. Such nominal interest rate fluctuation had no precedence in the 1990s. However, the real interest rate grew in 2003-2007 by three percentage points. Similar changes took place in the past but then the economic situation was not so much dependent on the building sector. Consistent interest rate increases from 2004 reduced the expectations of economic entities concerning the housing boom but at the same time brought about a consistent rise of mortgage cost. The withdrawal of the FRB from the cheap money policy pursued in the early 2000s became a source of shock for the American economy and caused one of its greatest slumps (Bednarczyk, Bukowski, Misala 2009, p. 69- 70). The basic strategy of the FRB meant to face the symptoms of the oncoming crisis was providing the economy with money at the lowest possible cost. In the latter half of 2007, i.e. immediately after the appearance of the first symptoms of the crises, the FRB made a decision to start cutting interest rates. Further FRB intervention concerned the adoption of the so-called Paulson plan whose aim was to help the financial sector with capital of \$700 billion. However, the collapse of a few banks brought about a crisis of confidence in

the interbank market. Declining liquidity in this market, a drop in production and consumption as well as debt and unemployment increase triggered a successive interest rate cut. Within fifteen months (from December 2008) the FRB made as many as ten cuts of interest rate reducing it to a 0- 0.25% level, the lowest in history (Bednarczyk, 2009, p. 70- 71).

Central Banks in the USA and Europe rejected the possibility that they might counteract the imbalances occurring in the capital and property markets claiming that they were in no position to assess which price rises were speculations and which were well-founded changes in the market situation. In the case of FRB, compared with other price rise indexes, those concerning property prices were in fact ignored or regarded as almost insignificant, whereas prices of government securities were not at all considered. Whenever a crisis in the financial market occurred, the FRB cut interest rates in order to reduce its effect on the real economy. However, when investors got themselves out of the crisis and started accelerating profiteering mechanisms again, the bank took no decisions to raise interest rates. This way of carrying out monetary policy gave investors the go-ahead for making risky decisions and pursuing the so-called free riding because they knew that the Central Bank would react to protect them from major losses. Besides, due to the bank's policy, money became very cheap and unprecedentedly easily available. The unusually low interest rates in the USA that had been the same from

2001 encouraged risky financial operations, which inevitably adversely affected financial stability.

From 2008, when the first signs of the crisis appeared, the ECB drastically lowered interest rates (Fig.1). The drop was as much as 3.25% between September 2008 and May 2009, which was a reaction to the economic slump in many European countries. From 2010 to the end of 2011 interest rates went up to over 0.5% but from 2012 successive reductions occurred. Thus the ECB, by emulating the FRB's decisions, became equally responsible for the increase in the amount of cheap money in world markets.

European banks, unlike their American counterparts, pursued a very cautious and conservative policy, which tided them over the most critical phase of the crisis. Nevertheless, they are now in a worse situation than American banks, which is probably the effect of the intervention from the ECB and national central banks. The ECB applied, as part of its anti-crisis activities, various instruments, from traditional ones like lowering interest rates to bond purchasing programmes (Securities Market Programme, SMP) or long term credits granted to banks as three-year operations (Long Term Refinancing Operation, LTRO). The 2012 interest rate reduction to 0.75% (Fig. 2) enabled wider access to the so-called quantitative loosening, applied in the United States, which involved the purchase of bonds. While this decision might theoretically discourage keeping assets in the ECB, which was the usual practice of commercial banks and reflected how risky regular bonds were in financial markets, it did not guarantee that the assets

would indeed be directed to the market to reinforce real economy. Moreover, the ECB presidents expanded the rating range and the list of means to secure credits granted by the central banks of the Euro system. It was a further step that made it easier to reinforce commercial banks. Cash injections offered to Eurozone banks by ECB as a medium-time three-year loans (LTRO) let about €1 billion of low interest money into the market. However, while in normal conditions, the bank decides on such loans and takes maturity risk by purchasing treasury bills, which means uses short term deposits to purchase long term assets, the ECB exposes itself to a possibility of a debtor's insolvency, in other words takes credit risk. It is worth noticing that the balance total of the ECB amounts already to about 30% of GDP of Eurozone (about € 3 billion), and in the case of the USA it is 20% of the US GDP.

Trying to do its best to save Eurozone the ECB, according to Mario Draghi, the ECB president, stimulated the temptation of misappropriation of funds (moral hazard) offering financial assets for 1%, which enabled entering projects that were risky but promised a quick profit. LTRO operations or help from the European Stabilization Mechanism (ESM, with a fund of over € 450 billion which could grant loans to indebted countries) brought about further pile-up of problems in the Eurozone. A two-level union, divided into pivotal countries and the others which are opposed to greater fiscal integration, was in the making. Great Britain and then the Czech Republic decided not to sign the fiscal pact, in other words they did not give in to the “policy

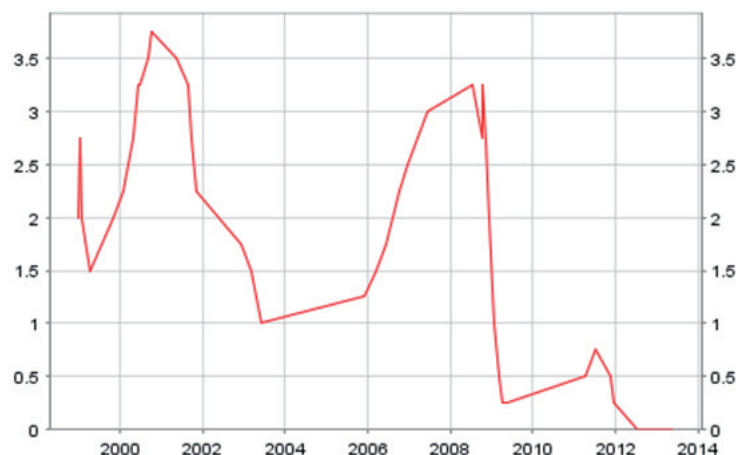


Figure 2: ECB interest rates in 1999-2013

Source: Author's own study based on ECB Statistical Data Warehouse, 23.07.2013

of fear”, as J. Berend puts it, waged by the EU with a view to preventing the successive countries from going bankrupt. In his opinion, this kind of policy, through closer integration and creating new supranational institutions monitoring member countries’ finances, prepares the basis for fiscal unification which will threaten national sovereignty (Berend, 2013, p. 130-131). Conferring a bank licence on ESM, which would enable financing through the ECB and allow it to focus on crisis management and accumulating its assets, would be the best solution. Should this happen, the ECB would do only its traditional duty to maintain the stability of currency. The efforts made by ECB in order to rescue the crisis-afflicted countries, in particular Ireland and Greece analysed in this study, are presented in the figure below (Figure 3).

The main internal factors triggering a debt crisis in a country are: very expensive economic policy (resulting in high budget deficit increasing national debt-to-GDP ratio) and a banking crisis, which also speeds the growth of national debt sparked by either the cost of rescuing banks or more and more frequent signs of recession. However, a debt crisis may also be due to external economic shocks such as a global financial crisis or rapidly worsening terms of trade of an individual country. However, the effect of such shocks can be presented as follows: the wider and stronger the economic gaps of a specific country, the more unbalanced fiscal position

manifesting itself by excess of private debt. This connection between the effect of an external shock and economic weaknesses of a country was noticed during the latest global crisis. Greece, Hungary, Ireland and Great Britain are examples of the countries victimized by debt crisis caused by expansive fiscal policy, whereas Spain, Baltic countries as well as the already mentioned Ireland and Great Britain, experienced problems spawned by speculation bubble in the property market (Balcerowicz, 2010, p. 6). Countries such as Ireland, which controlled public finance also got into the same trouble as “spoiled” countries, for example Greece. In Greece, the crisis was due to too high public expenditure which exceeded income, which increased interest (bonds) and encouraged the influx of foreign capital (loans were taken in international markets). In Ireland, however, low interest rates and easy access to foreign capital resulted in a property market boom (Figure 4) and expansion of commercial credits. Real estate prices in Ireland rocketed over 2005- 2008 up to about 30%, and then slumped by about 60%. The two different sources of crisis contributed to the surge of imbalances in the Eurozone. The EU needs, as follows from Fig. 3, a new deal which would allow for getting out of the dependence linkage between banks and public finance and prevent imbalance upsurge thereby maintaining relative stability in the Eurozone. Some solutions to this issue are suggested by the Six-Pack or the fiscal pact of 2012. The rules and procedures

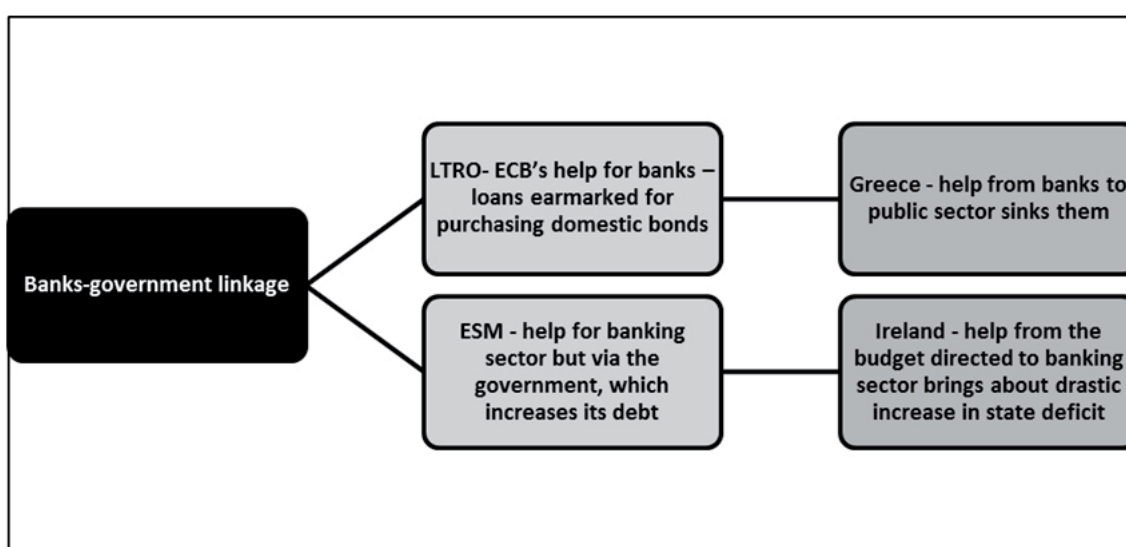


Figure 3: Formation of bank-government linkages and their reinforcement with crisis prevention tools

Source: Gotz, M. (2012). *Crisis and Future of Eurozone*. Warsaw: Publ. Difin, p. 108

which they contain might discipline fiscal policy provided they are consistently implemented. The present situation in which the Eurozone is functioning, i.e. when the ECB mandate is limited, can no longer be maintained. The decision that the ECB should act as a lender of last resort is inevitable. However, such course of action would only enable overcoming the current crisis. If further, undisturbed functioning of the Eurozone is to be ensured, it is absolutely necessary to create new structures such as, for example a bank or fiscal union (Zaleska, 2013, p. 16).

The concept of a bank union would consist in isolating three interlocked components: European bank control, a system of guaranteeing deposits in order to assure the saver that euro in a Spanish or Italian bank is as safe as in a bank in Germany or France and finally a mechanism of closing down banks in an orderly way (resolution fund). Unfortunately, the implementation of the project will take many years as it will have to be approved by the member states, which, judging from the experience of creating the monetary union, may take a few decades.

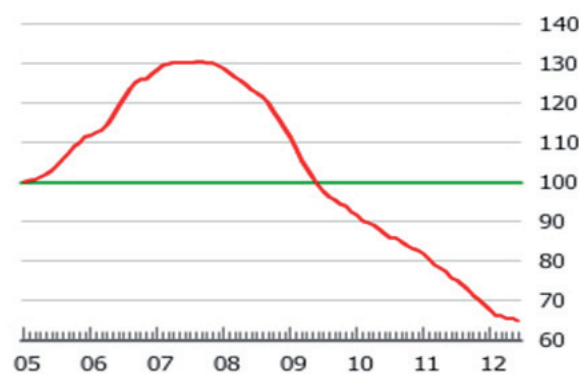


Figure 4: Property price index in Ireland in 2005- 2012 (January 2005=100)

Source: Sources: <http://www.irelandstat.gov.ie>, 12.12.2013

Despite many similarities between actions taken by FRB and ECB there were some differences in their reaction to the economic crises which adversely affected the condition of banks in the EU. Firstly, FRB granted small loans to banks, whereas the ECB gave loans to weak banks which could not get financing in the market. Secondly, FRB purchased almost exclusively risk-free assets (e.g. bonds of the American government) but ECB bought risk assets of much lower value. Commercial banks of the member states applying for help from the ECB had to have obligations of their own countries as security. There was also a possibility of getting support from the ELA (Emergency Liquidity Assistance) or recapitalisation from the European Stability Mechanism. The action taken by the ECB which concerned LTRO was read as an attempt to evade the ECB statute which forbids direct involvement in buying public bonds of the member states. Efforts made by the ECB and FRB concerning the reduction of interest rates were intended to keep up the activity of the real sphere. In fact, it is difficult to observe the effect of monetary policy on the economic situation because the results cannot appear overnight. In 2008, the two central

banks made a significant change in the financial markets which consisted in easing the dependence between changes of official interest rates and short-term interest rates. The financial crisis and particularly solvency problems of big financial institutions and banks resulted in tightening up financial policy. The result was the appearance of a clear disparity between the costs incurred by bank refinancing themselves in the central bank and the costs paid when they use assets from the interbank market. Such a situation makes the policy of slashing interest rates as well as that of refinancing the finance sector by central banks less effective. This is because financial resources pumped into the bank sector require securing its liquidity and due to the high cost of getting capital they are used, to a lesser degree, for financing the real sphere. This causes the phenomenon of accumulation of money in financial channels and because of this it has little chance of reaching the real sphere. The course of action described above was responsible for the impairment of the flow efficiency of market signals activated by interest rate changes. To sum up, it must be said that the policy of low interest

rates has been pursued by both FRB and ECB. However, its effect on the condition of the US banks was definitely more beneficial than that on the EU ones which still have their problems. It is certain that one of the causes of such a situation is the fact that the euro system is composed of states that are at different levels of economic development. Due to this, the efforts made by the ECB had a positive effect on some of them, whereas they adversely affected the others.

CONCLUSION

The above consideration shows explicitly that the origin of the crisis in the whole Eurozone as well as in the particular states is a complex one. The main source of the problems turned out to be the way the fiscal policy was conducted, but the decisions taken by the ECB were also some kind of inducement. In Greece the main problem was the prodigality of the successive governments and their overspending- by a tacit consent from the European authorities, or so-called free riding. In Ireland, however, the main trouble was a lack of supervision for the banking system and state guarantee covering all bank deposits regardless of their size in the name of misinterpreted “union solidarity”. However, the principal cause of the crisis is lack of inner coherence discernible on various planes. The member states differ not only in respect of fiscal policy (its role and the way the automatic economic situation stabilizers operate) but also on monetary policy (differences in the banking system)- there is a problem of so-called “one size fits all”, that is mismatch between interest rates and the economic situation of the member countries. Besides, the differences refer to the general economic development and functioning of the states in respect of the course of economic cycles, structure of the economies, etc. (Schalack, 2012, p. 25).

The Stability and Growth Pact, which was to function as a mechanism coordinating fiscal policy and maintaining fiscal discipline by the member states, turned out to be far from perfect. The states did not obey the regulations and in most cases they got away with it. That meant, as it were, a tacit approval of this kind of conduct. The mechanisms that were implemented in order to discipline the member states proved to be ineffective and did not motivate them to maintain a balanced budget. Another problem which emerged during the crisis was the weaknesses in the institutional design of the monetary

union. As P. Mystadt, a Belgian politician, put it in an interview for *Forsal.pl*- “many of those negotiating the Maastricht treaty suffered from political schizophrenia”. They wanted to achieve two contradictory aims: to create a monetary union, which leads to greater interstate integrity, but also aimed at preserving national independence in the matters of monetary policy and economy. Hence the flaws in the design of the European Union such as: ignoring the divergences in the real economy, lack of procedures for managing cases of insolvency and lack of fluidity, no procedures for leaving the Eurozone and finally no systems of supervising and closing banks.

The problem of crisis in the Eurozone is not due to the member states disobeying the regulations contained in the Stability and Growth Pact or the successive documents, that is in the Six-Pack or Two-Pack, but it ensued from the monetary policy carried out. While analysing the example of Greece or Ireland, it can be noticed that it was neither the amount of national debt nor budget deficit that decided if a particular country would be more or less afflicted. The key factor leading to the crisis was the loose monetary policy pursued by the FRB and ECB that made credit readily available. Unfortunately, banks did not carry out an operation involving increase of reserves at the right time, which would have made banks think twice before granting a loan. Central Banks demanded that commercial banks maintain the minimum level of assets in current accounts, i.e. the so-called obligatory reserve. The interest on assets accumulated in the obligatory reserve account was similar to that of the central bank, hence they were so-called risk free assets. So commercial banks tried to minimize them, thus attempting to obtain a higher return rate than a risk-free rate from their free assets. If, at the right moment, the ECB had put in some effort to make commercial banks maintain higher reserves, they would not most probably have had a possibility of giving loans on such a grand scale.

It might be well to draw conclusions from the above described faulty bank policy and take remedial action in order to prevent this kind of crisis at the right time in the future. One of the suggested courses of action should be ensuring higher bank reserves. It follows from the above analysis that less expansive monetary policy would be the best tool for solving the ensuing problem.

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