The Eurozone Crisis: Overview and Issues for Congress

Rebecca M. Nelson, Coordinator
Analyst in International Trade and Finance

Paul Belkin
Analyst in European Affairs

Derek E. Mix
Analyst in European Affairs

Martin A. Weiss
Specialist in International Trade and Finance

May 31, 2012

Congressional Research Service
7-5700
www.crs.gov
R42377

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Crisis Overview

What started as a debt crisis in Greece in late 2009 has evolved into a broader economic and political crisis in the Eurozone. The Eurozone faces four major, and related, economic challenges: (1) high debt levels and public deficits in some Eurozone countries; (2) weaknesses in the European banking system; (3) economic recession and high unemployment in some Eurozone countries; and (4) persistent trade imbalances within the Eurozone. Additionally, the Eurozone is facing a political crisis. Disagreements among Germany, France, and the European Central Bank (ECB) over the appropriate crisis response, and complex European Union (EU) policy-making processes, are seen as having exacerbated anxiety in markets. Governments in several European countries have also fallen as a direct or indirect result of the crisis.

Recent Developments

Markets were optimistic about the Eurozone crisis in the first quarter of 2012, bolstered by a major write down of Greek debt; a second European-International Monetary Fund (IMF) financial assistance package for Greece; an infusion of more than €1 trillion (about $1.3 trillion) by the ECB into Eurozone banks; agreement on a European "fiscal compact" to, among other things, introduce balanced budget amendments in many national constitutions; and commitments to increase the size of the European rescue fund.

However, market pressure against several Eurozone countries has increased in the second quarter of 2012. Despite the policy responses, many of the fundamental challenges in the Eurozone remain, including lack of growth, high unemployment, and trade imbalances within the Eurozone. Renewed concerns about the Spanish banking sector have also undermined market confidence.

Political backlash against the heart of the crisis response—austerity measures—is also growing. Elections in Greece and France in May 2012 empowered political leaders who have criticized the focus on austerity. In Greece, no coalition government could be formed and new elections are scheduled for June 17, 2012. In France, the incumbent, Nicolas Sarkozy, was defeated by François Hollande, who has been critical of some crisis response measures, particularly the focus on austerity.

Recent market pressure has raised questions about the Eurozone's future. More economists and policymakers are openly questioning whether Greece will remain in the Eurozone, and if Greece exits, what other countries may follow. Others are optimistic that ultimately European leaders and institutions will do whatever is necessary to keep the Eurozone from collapsing, and that the Eurozone could emerge from the crisis stronger and more integrated.

Issues for Congress

Impact on the U.S. Economy: The United States has strong economic ties to Europe, and many analysts view the Eurozone crisis as the biggest potential threat to the U.S. economic recovery. Treasury officials have emphasized that U.S. exposure to the Eurozone countries under the most market pressure is small but that U.S. exposure to Europe as a whole is significant. Recently, the euro has fallen against the dollar; a weaker euro against the U.S. dollar could cause U.S. exports to the Eurozone to decrease and U.S. imports from the Eurozone to increase. Uncertainty in the

Eurozone is creating a "flight to safety," causing U.S. Treasury yields to fall, and volatility in the U.S. stock market.

IMF Involvement: In response to the crisis, some countries have pledged additional funds to the IMF. The United States has not pledged any new funds to the IMF as part of this initiative. Members of Congress may want to consider how to balance, on the one hand, guaranteeing that the IMF has the resources it needs to ensure stability in the international economy with, on the other hand, exercising oversight over the exposure of the IMF to the Eurozone.

U.S.-European Cooperation: The United States looks to Europe for partnership in addressing a wide range of global challenges. Some analysts and policymakers have expressed concern that the crisis could turn the EU's focus more inward and exacerbate a long-standing downward trend in European defense spending.

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Introduction

Since 2009, the Eurozone has grappled with a sovereign debt crisis that threatens economic stability in Europe and beyond.[1] Analysts and investors are concerned that some Eurozone governments could default on their debt in a disorderly fashion;[2] vulnerabilities in the European banking sector could trigger broad financial turmoil; the Eurozone could enter a protracted economic recession; and one or more countries could leave the Eurozone.

The crisis has tested the solidarity of European Union (EU) member states and strained the capacity of EU leadership and institutional structures. Key European leaders have repeatedly vowed to take all necessary measures to protect the euro, which they view as the cornerstone of the European integration project.[3] They have established unprecedented financial assistance mechanisms and have increased European oversight of member state fiscal policy. However, analysts have routinely criticized these measures as insufficient, and questions about economic, financial, and political stability in the Eurozone persist. The Obama Administration has repeatedly called for swift and robust European responses—specifically advocating more substantial financial assistance be made available to struggling economies. It has found, however, that it has limited ability or resources to affect European policy decisions.

Many analysts consider the Eurozone crisis to be the biggest threat to the global economy,[4] and some Members of Congress have expressed concern about the possible effects on the U.S. economy. Some Members have also raised questions about the appropriate role of the International Monetary Fund (IMF) in the crisis, particularly in light of the fact that the United States is the Fund's largest shareholder. Implications for future U.S.-EU cooperation on foreign policy issues more broadly are also a concern. Committees in both the House and the Senate have held hearings on the crisis and issues relating to its impact on the U.S. economy and exercised congressional oversight of U.S. policy responses.[5]

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[1] A total of 17 states of the 27-member European Union (EU) use the euro as the single currency. The 17 countries are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Spain, and Slovenia.

[2] An orderly default typically refers to a government working out a plan to restructure its debt with private creditors before missing or suspending payments, in contrast with a disorderly default, which typically refers to governments missing or suspending payments without previously working out a plan for repaying at least part of the remaining debt with creditors.

[3] German Chancellor Angela Merkel has reportedly stated, "if the Euro fails, Europe fails." Quoted in Howard Schneider and Michael Birnbaum, "Europe reaches bailout deal," *Washington Post*, October 27, 2011.

[4] For example, see "The World Should Heed the IMF's Call," *Financial Times*, January 19, 2012.

[5] Recent congressional hearings include:

1. Senate Banking, Security and International Trade and Finance Subcommittee, September 22, 2011;
2. House Financial Services, International Monetary Policy and Trade Subcommittee, October 25, 2011;
3. Foreign Affairs, Europe and Eurasia Subcommittee, October 27, 2011;
4. Senate Foreign Relations, European Affairs Subcommittee, November 2, 2011;
5. House Oversight, Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs, December 15, 2011 (Part 1) and December 16, 2011 (Part 2);
6. Senate Budget, February 1, 2012;
7. Senate Banking, February 16, 2012;
8. House Financial Services, Full Committee, March 20, 2012;
9. House Oversight, March 21, 201; and

(continued...)

This report provides a brief analysis of the Eurozone crisis and issues of particular congressional interest. For broader analysis of the origins of the Eurozone and its future prospects, see CRS Report R41411, *The Future of the Eurozone and U.S. Interests*, coordinated by Raymond J. Ahearn. For discussion about sovereign debt in advanced economies, including a comparison of the Eurozone and the United States, see CRS Report R41838, *Sovereign Debt in Advanced Economies: Overview and Issues for Congress*, by Rebecca M. Nelson.

Economic Problems in the Eurozone

The current Eurozone crisis has been unfolding since late 2009, when a new Greek government revealed that previous Greek governments had been underreporting the budget deficit. The crisis subsequently spread to Ireland and Portugal, while raising concerns about Italy, Spain, the European banking system, and more fundamental imbalances within the Eurozone. Currently, the Eurozone is facing at least four major, and related, economic challenges:

First, concerns persist about high levels of public debt in some Eurozone countries, often referred to as the "periphery," and whether these countries will default on their debt.[6] Debt levels in some countries in the Eurozone periphery rose after they joined the Eurozone over a decade ago,[7] and the global financial crisis of 2008-2009 further strained public finances (see **Figure 1** and **Figure 2**). Three Eurozone governments—Greece, followed by Ireland and subsequently Portugal—have had to borrow money from other Eurozone governments and the IMF in order to avoid defaulting on their debt. Even with this assistance, the Greek government still had to restructure its debt with private creditors, including a more than 50% reduction in the face value of bonds. There has also been speculation that Portugal will have to restructure its debt.[8]

Investors have become increasingly nervous about high debt levels in Italy and rising debt levels in Spain, much larger economies, and they have started demanding higher interest rates for buying and holding Italian and Spanish bonds. As the Spanish and Italian governments have rolled over their debt at these higher interest rates, their debt levels have risen further, and questions have emerged about the sustainability of public debt in these countries. A disorderly default by a Eurozone country could trigger a broader financial crisis. Possible contagion of the

(...continued)

10. House Financial Services, Domestic Monetary Policy and Technology, March 27, 2012.

[6] During the crisis, it has become convention among some policymakers and analysts on both sides of the Atlantic to refer to a group of mostly southern European countries—Greece, Ireland, Italy, Portugal, and Spain—as the Eurozone "periphery," in contrast to a group of mostly northern European countries, including Austria, Belgium, Germany, Finland, France, Luxembourg, and the Netherlands, as the Eurozone "core." In this context, periphery countries refer to the countries that have been under the most market pressure due to some combination of high public debt levels, large public deficits, and persistent trade imbalances, in contrast with the generally stronger economies in the core countries, which tend to have some combination of lower public debt levels, smaller fiscal deficits or surpluses, and trade surpluses. These terms have limitations and mask important differences among countries in the periphery and the core. Additionally, in EU parlance, the terms "periphery" and "core" can be controversial because they may also be used to distinguish between EU member states that support further EU integration and those that do not. Despite such difficulties, this report uses the terms "core" and "periphery" but only to distinguish between these Eurozone countries under considerable market pressures and those in stronger fiscal and economic positions.

[7] In some countries, such as Greece, borrowing was primarily undertaken by the government. In others, such as Spain and Ireland, private sector debt rose.

[8] For example, see "Portugal's Problems: The Next Special Case?," *Economist*, February 4, 2012.

crisis to Spain and Italy is a particular concern; Italian government debt is forecasted to be €1.9 trillion (about $2.4 billion)[9] in 2012, greater than that of Spain, Portugal, Greece, and Ireland combined.[10]

Second, weaknesses in the Eurozone's banking system are compounding concerns about public debt levels. Most urgently, ongoing concerns about the crisis have triggered capital flight from banks in some Eurozone countries, and some banks are reportedly finding it difficult to borrow in private capital markets.[11] More broadly, European banks are believed to be the largest holders of Eurozone government bonds, but many analysts argue that European banks do not have sufficient capital to absorb losses on their holdings of sovereign bonds should one or more Eurozone governments default. In December 2011, the European Banking Authority (EBA) estimated that European banks need €114.5 billion (about $144 billion) in additional capital in order to withstand a range of shocks and still maintain adequate capital.[12] The EBA is currently reviewing plans from European financial institutions to restore their capital positions by the end of June 2012,[13] and some analysts fear that banks will improve their capital positions by reducing lending, exacerbating the credit crunch in Europe and, in turn, contributing to an economic recession. Concerns about the Spanish banking system also have surfaced in the second quarter of 2012.

Third, there are concerns about the lack of growth and high unemployment in the Eurozone, particularly among the Eurozone periphery. In April 2012, the IMF forecasted that the Eurozone's economy will contract by 0.3% in 2012, before resuming to growth of 0.9% in 2013.[14] The outlook for the periphery is much worse, with Greece's economy forecasted to contract by nearly 20% between 2007 and 2012. The economies of Ireland, Italy, Portugal, and Spain are also forecast to contract during this time period, but to a lesser degree. Unemployment is particularly high in the Eurozone periphery, forecast to be 19.3% in Greece and 24.2% in Spain in 2012 (see **Figure 4**).[15] Youth unemployment is significantly higher, approaching 50% in Greece and Spain at the end of 2011.[16] Slow growth or recession makes it hard for countries to grow out of their debt, and exacerbates debt-to-GDP ratios. The crisis is also adversely impacting growth in traditionally stronger Eurozone economies, with the IMF forecasting that growth in Germany will drop from 3.1% of GDP in 2011 to 0.6% in 2012, and that growth in France will drop from 1.7% in 2011 to 0.5% in 2012.

[9] Throughout the report, values denominated in euros are converted to U.S. dollars using the exchange rate on May 24, 2012: €1 = $1.2557. (Source: ECB). However, the exchange rate has fluctuated over the course of the crisis, and dollar conversions should be used as approximations.

[10] International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

[11] For example, see Tyler Cowen, "Euro vs. Invasion of the Zombie Banks," *New York Times*, April 16, 2011; Megan McArdle, "Is the Other Shoe Dropping in Europe?", *The Atlantic*, August 4, 2011.

[12] European Banking Authority, "The EBA Publishes Recommendation and Final Results of Bank Recapitalization Plan as Part of Co-ordinated Measures to Restore Confidence in the Banking Sector," December 8, 2011, http://eba.europa.eu/News--Communications/Year/2011/The-EBA-publishes-Recommendation-and-final-results.aspx.

[13] Huw Jones and Steve Slater, "EU Watchdog to Assess Bank Recapitalization Plans," *Reuters*, February 7, 2012.

[14] Adjusted for inflation. International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

[15] Ibid.

[16] Youth unemployment is defined as the proportion of the youth labor force that is unemployed. Young people are defied as persons aged between 15 and 24. See Eurostat unemployment statistics, March 2012, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics.

Fourth, persistent trade imbalances have developed within the Eurozone over the past decade, and some argue that these imbalances make the Eurozone more vulnerable to financial crises. Core countries in the Eurozone, including Germany, have actively pursued policies, such as wage restraint, aimed at increasing economic competitiveness by keeping production costs low and bolstering exports. Although it appears that Germany is changing course on wage restraints, with German Finance Minister Wolfgang Schäuble backing wage increases for German workers in May 2012,[17] production costs in the Eurozone periphery have tended to be higher, due to a number of structural issues such as rigid labor markets, generous pension programs, and barriers to economic competition. As a result, Eurozone core countries tend to run trade surpluses with the Eurozone periphery, and, by the same token, the periphery countries tend to run trade deficits with the core countries. These trade imbalances have been associated with a corresponding trend of the Eurozone's stronger economies lending to weaker economies, with the governments or private sectors in the Eurozone periphery building up sizeable debts. Eurozone countries have found it difficult to correct these trade imbalances, because membership in the Eurozone takes away a key adjustment mechanism—the exchange rate. Many economists believe that the buildup of high levels of debt and persistent trade imbalances can be unstable, and increase vulnerability to confidence shocks in financial markets.

More broadly, the crisis has exposed problems in the structure of the Eurozone, which many economists have long debated. The Eurozone has a common monetary policy and currency, without creating a fiscal union, and therefore it does not have a centralized budget authority or system of fiscal transfers across member states. Possibly, under a tight fiscal union, a central budget authority could control spending in different Eurozone member states, and use fiscal transfers to smooth out asymmetric shocks within the Eurozone.

Major European Policy Responses

Policy Measures

Over the past two years, European leaders and institutions have implemented a number of unprecedented policy measures to try to stop, or at least contain, the crisis. Nonetheless, the policy response in Europe has been consistently criticized as delivering too little, too late. Some of the key response measures taken to date include:

Financial Assistance from other Eurozone governments and the IMF. The cornerstone of the European response has been to create new crisis lending facilities that can provide financial support to governments and financial institutions in the Eurozone that are under market pressure. Details of these funds have evolved over time, but the main rescue fund currently in operation is the European Financial Stability Facility (EFSF). It has a lending capacity of €440 billion (about $553 billion) and its resources can currently be used to provide assistance to governments, finance bank recapitalization, or purchase government bonds on secondary markets. The EFSF is a temporary, three-year facility, expected to be replaced in 2013 by a permanent rescue fund, the European Stabilization Mechanism (ESM), which has a lending capacity of €500 billion (about $628 billion). The EFSF and ESM will overlap from July 2012 to July 2013, during which time the total ceiling on EFSF/ESM lending will be raised to €700 billion (about $879 billion).

[17] Chris Bryant, "Schäuble Backs Wage Rises for Germans," *Financial Times*, May 6, 2012.

Currently, the EFSF is providing financial assistance, in conjunction with the IMF, to Ireland and Portugal. It is also being used to fund Greece's second financial assistance package.[18] For more details about these packages, see **Table 1**.

Austerity Programs and Structural Reforms. European and IMF financial assistance comes with strings attached: deep spending cuts, tax increases, and structural reforms. Assistance to Greece, Ireland, and Portugal has been disbursed to the countries in phases, only after a committee with representatives from the IMF, the European Commission, and the ECB (the "troika") determined that sufficient progress on austerity and structural reforms had been made. In both Greece and Portugal, for example, far-reaching spending cuts and targeted tax increases have reduced government budget deficits significantly over the past two years. However, both economies continue to contract, making it increasingly difficult to meet agreed-upon debt-reduction targets. Both countries have also begun to reform their pension systems and bring more flexibility to what remain rigid labor markets, but observers note that progress has at times been slow. Of the three countries receiving financial assistance, Ireland is considered to have made the most progress.

Governments in Italy and Spain have also undertaken far-reaching austerity measures and reforms in an effort to re-gain market confidence and build competitiveness. The Spanish government, which passed a balanced budget amendment in 2011, is seeking to bring its budget deficit to 3% of GDP by 2013, and has proposed a series of labor-market reforms that would result in a decline in real wages. The Italian government has announced similar initiatives, pledging, among other things, to balance its budget by 2013. Such reforms have been politically difficult to implement, provoked public protests, and likely contributed to changes in government in some Eurozone countries.

Losses on Greek Bonds. In March 2012, the Greek government implemented what is being called the largest debt restructuring in history. About 97% of privately held Greek bonds (about €197 billion, or $244 billion) took a 53.5% cut to the face value (principal) of the bond, and the net present value of the bonds was reduced by approximately 75%.[19] The restructuring triggered payment on credit default swap (CDS) contracts, a type of insurance against default. However, with the debt restructuring, Greece's public debt is expected to fall to 116.5% of GDP by 2020,[20] which some economists fear is still too high to be sustainable. European leaders have publicly ruled out debt restructuring (often called "private sector involvement") for other Eurozone countries, although some have speculated that Portugal will eventually restructure its debt as well.

ECB Support. The ECB significantly increased its role in the crisis response in December 2011 and February 2012, when it introduced long-term refinancing operations (LTRO). The LTRO resulted in loans to more than 800 Eurozone banks, totaling more than €1 trillion (about $1.3 trillion), and is the biggest infusion of cash into the banking system since the euro was

[18] Greece's first program predated the creation of the EFSF. Funds from other Eurozone governments to Greece takes the form of bilateral loans.

[19] Landon Thomas Jr., "97% of Investors Agree to Greek Debt Swap," *New York Times*, April 5, 2012.

[20] International Monetary Fund (IMF), "Greece: Request for Extended Arrangement Under the Extended Fund Facility—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Greece," March 2012, http://www.imf.org/external/pubs/ft/scr/2012/cr1257.pdf.

introduced. The LTRO aimed to address the liquidity crunch in the Eurozone banking system and to encourage banks to continue buying Spanish and Italian government bonds.[21]

Previously, in May 2010, the ECB began buying government bonds on secondary markets for the first time in an attempt to stabilize bond yields, and the ECB is now believed to be the biggest holder of Greek bonds.[22] The ECB has also provided unusual flexibility in its short-term refinancing operations throughout the crisis, in particular by agreeing to accept securities, including government bonds, with lower credit ratings on collateral in its refinancing operations than it would have under normal circumstances.

European Governance Reforms. Over the course of the crisis, European leaders have agreed to a series of measures aimed at better coordinating and increasing oversight of member state fiscal policies. In December 2011, EU leaders announced the creation of a new fiscal compact. The primary focus of the fiscal compact is an agreement that government budgets should be balanced or in surplus, and that constitutions should be amended to reflect this rule. The compact would also strengthen the enforcement of EU rules related to debt levels and budget deficits, including by allowing European authorities to launch infringement proceedings at the EU Court of Justice against governments in breach of the rules. In January 2012, leaders of 25 of the EU's 27 member states concluded a draft text on the agreement, but it will still need to be adopted at the national level by the signatory countries, and will take effect once 12 countries have ratified it.[23]

In late 2011, the EU also adopted legislation containing additional reforms to economic governance, including greater surveillance of national budgets by the European Commission, closer coordination of economic and budgetary policies at the EU level, and an early warning mechanism that would prevent or correct macroeconomic imbalances within and between member states.

Proposals to Increase Funding for the IMF. Some officials and analysts fear that the IMF's current lending capacity, about $381 billion as of May 17, 2012,[24] would not be sufficient to respond to a crisis in a major European economy, such as Italy or Spain. In April 2012, some IMF member countries pledged $430 billion in additional funding for the IMF.[25] About $200 billion of the pledges come from countries in the Eurozone, but countries outside the Eurozone have pledged funds as well, such as Japan, South Korea, and Saudi Arabia, among others. Several large emerging economies, including China, expressed willingness to contribute but have not made any commitments to date. The United States has not pledged any new funds to the IMF as part of this effort.

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[21] *Economist*, "The Euro Crisis: Checking In on Europe," January 20, 2012.

[22] For example, see Ralph Atkins, "The ECB and its Greek Bonds," *Financial Times*, January 23, 2012.

[23] The UK has announced it would not participate after it was unable to secure safeguards regarding financial supervision and regulation, and the Czech Republic did likewise because it did not have the necessary mandate from its parliament.

[24] International Monetary Fund, "IMF Financial Activities – Update May 17, 2012," http://www.imf.org/external/np/tre/activity/2012/051712.htm.

[25] International Monetary Fund, "IMF to Double Lending Power as Pledges Top $430 Billion," http://www.imf.org/external/np/sec/pr/2012/pr12147.htm.

Political Dynamics of the Crisis Response

Governments across Europe are facing increasing public opposition to the crisis response. A combination of deep cuts in public spending, rising unemployment, and negative economic growth in several Eurozone member states has provoked sustained, large-scale protests. Governments in 7 of the Eurozone's 17 member states, including Greece, Ireland, Italy, the Netherlands, Portugal, Slovenia, and Slovakia, have collapsed as a result of public dissatisfaction with the crisis response. The election of new governments in France and Spain was also viewed in large part as a repudiation of the economic policies of previous governments. Leaders in some of the Eurozone's strongest economies, such as Germany and the Netherlands, have faced considerable political resistance to providing financial support to weaker economies, with critics opposed to the idea of rescuing countries that, in their view, did not exercise adequate budget discipline.

In recent months, a growing number of policymakers and observers have called for a renewed focus on spurring economic growth throughout the Eurozone. Led by Germany, the policy response thus far has emphasized fiscal consolidation and structural reforms as the platform for future growth. Skeptics of this strategy argue that rather than creating growth, austerity has fueled recession and rising unemployment. The new President of France, François Hollande, elected on May 6, 2012, has joined Italian Prime Minister Mario Monti and Spanish Prime Minister Mariano Rajoy in calling for policy measures focused on growth, through the creation of a European "Growth Pact." Proposals are expected to be discussed at a European summit on June 28-29, 2012.

The Role of Germany and France

The governments of the Eurozone's two largest economies—Germany and France—have been at the forefront of the EU's crisis response. Since the beginning of the crisis, German Chancellor Angela Merkel has, with French backing, advocated a response predicated primarily on spending cuts, tax increases, and structural reform in exchange for financial support. The election on May 6, 2012, of a new French president, François Hollande of the Socialist Party, who had been sharply critical of the Franco-German-led response, has increased pressure on Germany to consider new approaches to promoting economic growth and has heightened tension within the Eurozone on the appropriate crisis response.

EU leaders continue to disagree on the extent to which Europe's more prosperous member states, like Germany, should provide financial support to lesser performing economies. Merkel, in particular, has faced criticism for failing to demonstrate clearer German support for other Eurozone member states. German officials have emphasized that Germany is, in fact, the largest national contributor to the Eurozone rescue fund. They add, however, that the prospect of guaranteed "bailouts" would create dangerous moral hazard, removing leverage and leaving little incentive for governments of poorly performing economies to enact politically unpopular reforms. French President Hollande has joined his Italian, Spanish, and Greek counterparts in calling for a relative easing of austerity and increased economic stimulus to create jobs and growth. He has also at various times advocated measures to pool the national debt of Eurozone member states by issuing so-called Eurobonds. Advocates of Eurobonds argue that such a mutualization of European debt would send a clear signal of Europe's commitment to support its common currency, relieving market pressure and providing the space and time necessary for national economic reforms to bear fruit.

The Merkel government has firmly opposed proposals to guarantee the debt of other Eurozone member states through Eurobonds or other similar schemes. Although Germany has agreed to consider new proposals to spur economic growth, Berlin continues to emphasize the need for national governments to reduce budget deficits and debt levels, largely through far-reaching fiscal austerity measures. In the German view, economic growth and economic convergence will not come without significant fiscal consolidation and economic reform. Accordingly, Germany and EU institutions have ensured that financial assistance to the Eurozone's struggling economies is contingent on the implementation of rigorous economic reform programs. Berlin has also advocated the adoption of balanced budget amendments in all Eurozone countries.

On the institutional level, one key point of contention between Germany and France remains the role of the ECB. German policymakers and ECB executives consistently highlight the importance of upholding the bank's foundational principles: political independence and a narrow mandate to maintain price stability. French leaders, on the other hand, have long envisioned a more activist ECB that would play the role of a "lender of last resort," akin to the U.S. Federal Reserve. As the crisis has unfolded, French and other officials have at times argued that the ECB should broaden its mandate and provide more financial support to the Eurozone's struggling economies. German and ECB officials, among others, have been reluctant to endorse such a policy shift, arguing, for example, that "central banks should not be called upon to finance states."[26]

Some economists have questioned what they consider Germany and others' narrow focus on austerity. They argue, for example, that severe budget cuts further impede economic growth and that policymakers should focus more on restoring economic competitiveness, particularly in the Eurozone periphery.[27] Critics allege that the fiscal compact announced in December 2011 will do little to address growth and competitiveness issues in the short term. Some analysts explain the fiscal compact by noting that strong re-assurance of an enhanced economic governance framework is the necessary pre-condition for maintaining political support in Germany for crisis response measures.

Current Developments and Outstanding Questions

Recent Developments in 2012

The Eurozone crisis has cycled through periods of intense market pressure and relative calm. Market sentiment about the prospects for the Eurozone was relatively positive in the first quarter of 2012, driven by a number of factors including

- measures to address the crisis in Greece, including finalization of a second European-IMF financial assistance package and a successful restructuring of Greek debt;
- an unprecedented injection of more than €1 trillion (about $1.3 trillion) by the ECB into the Eurozone banking system;
- agreement on a "fiscal compact" to, among other things, introduce balanced budget constitutional amendments and strengthen the enforcement of deficit and debt rules; and
- agreement to increase the European and IMF financial "firewall," or resources that could be used to stem contagion from Greece to the much larger economies of Spain and Italy.

Despite improved market sentiment in the first quarter of 2012, many economists remain concerned that the fundamental challenges facing the Eurozone have not been adequately addressed. For example, they fear that Greece's debt is still not on a sustainable path; the focus on austerity is choking growth and creating social unrest in the Eurozone; even the enlarged European rescue fund ("firewall") is still not big enough to backstop Italy or Spain; banks in the Eurozone remain undercapitalized; and persistent trade imbalances within the Eurozone remain uncorrected.

Market concerns about the crisis have surfaced again in the second quarter of 2012, driven in a large part by recent political developments. After Greek parliamentary elections on May 6, 2012,

[26] German finance minister Wolfgang Schaeuble, as quoted in Marcus Walker and Charles Forelle, "Europe's Options: Few, and Shrinking," *Wall Street Journal*, October 22-23, 2011.

[27] See, for example, Martin Wolf, "First Aid is not a Cure," *Financial Times*, October 11, 2011.

did not produce a clear governing majority, a second election has been planned for June 17, 2012. The May 6 election emboldened parties on the extremes of the political spectrum that have been sharply critical of the conditions agreed by previous governments in exchange for European and IMF financial assistance. The two frontrunners in the June 17 election are a center-right political grouping led by the New Democracy party, and the far-left Syriza party, or Coalition of the Radical Left. Both parties say they are committed to keeping Greece in the Eurozone, but Syriza leaders say they will refuse to abide by the conditions for financial assistance negotiated by previous governments. According to economists, without European and IMF assistance, Greece would be unable to fund its government and make required debt payments by as soon as the end of June. Unless other Eurozone members and the IMF agree to renegotiate the terms of the financial assistance package, this could lead to a Greek default. New Democracy leaders appear committed to upholding the current agreements, but, given public opposition, could also face public pressure to renegotiate with Brussels and Berlin.

Events in Spain have also bred pessimism. Adding to the country's negative 2012 growth outlook and soaring unemployment, a solvency crisis is emerging in the Spanish banking sector, and one major Spanish bank has already required large-scale public support. Both Spain and Italy have recently indicated they will miss their 2012 deficit targets. With added fuel from fears of a Greek exit, borrowing costs for both countries have again risen substantially, leading Spanish Prime Minister Mariano Rajoy to press for further ECB action.

News reports indicate that investors with deposits in Greek banks are pulling their money out of the country, and some analysts fear that a full bank run in Greece could develop. Analysts are now discussing more seriously the implications of a Greek exit from the Eurozone, which some analysts have started calling a "Grexit." Exiting the Eurozone, and issuing a new national currency, could help Greece regain competiveness against the stronger Eurozone economies, and promote export-led growth. Exiting the Eurozone could potentially involve huge costs, however. Greece's debt is denominated in euros, and leaving the Eurozone in favor of a depreciated national currency could significantly raise the value of their debt in terms of national currency. The technical and legal obstacles to exiting the euro are also significant, and would likely trigger capital flight.

By itself, Greece accounts for just 2% of the overall Eurozone economy. However, many fear that a Greek exit from the Eurozone would trigger contagion to Italy and Spain, which could have much more substantial implications for international financial markets. Observers also speculate that a Greek exit could effectively force other vulnerable economies out of the Eurozone and lead to at least a partial fracturing of the currency bloc. Should Greece decide to leave the Eurozone, tremendous market pressure could be quickly directed at countries such as Portugal, Spain, and Italy.

Despite the many challenges, some economists are ultimately optimistic about the crisis.[28] They note that many crises have threatened the project of European integration over the past 50 years, but that European leaders have overcome these challenges, with Europe emerging stronger and more tightly integrated than before. They believe that in this crisis too, European leaders and institutions, particularly in Germany and the ECB, will ultimately do (or pay) whatever is

[28] For example, see C. Fred Bergsten and Jacob Funk Kirkegaard, "The Coming Resolution of the European Crisis," *Peterson Institute for International Economics*, Policy Brief Number PB12-1, January 2012, http://piie.com/publications/pb/pb12-1.pdf.

necessary to keep the Eurozone from collapsing. But, in the meantime, they argue that it is important for these leaders to be tough in negotiations, in order to compel governments under market pressure to take difficult policy measures and to prevent moral hazard and a "bailout" precedent from taking root in Europe.

Key Upcoming Dates

June 10 and 17, 2012: Parliamentary elections in France

June 11, 2012: Spanish banks present government with recovery plans

June 17, 2012: Greek parliamentary elections

June 18-19, 2012: G-20 summit in Los Cabos, Mexico

June 28-29, 2012: European Council (EU leaders) meeting (summit) to discuss "growth pact"

July 1, 2012: The permanent European rescue fund (ESM) starts to operate alongside the temporary European rescue fund (EFSF)

July 5, 2012: ECB Council meeting and press conference

Outstanding Questions and Issues

Significant questions about the crisis that may remain include:

- **How can growth be restored in the Eurozone?** Many economists believe that, at the end of the day, economic growth will be the key driver to resolving the crisis. They fear that the focus of the policy response on austerity comes at the expense of growth. To address growth concerns, austerity measures have been paired with structural reforms aimed at improving competitiveness and boosting exports, but the benefits of these structural reforms may pay off only in the long term. Until the benefits of structural reforms set in, observers have asked how governments will "grow out" of their debts while imposing tough fiscal reforms. Recent political developments appear to be shifting the debate more toward measures that stimulate growth. What form might a Eurozone "growth pact" take and how likely is it to be effective? If the EU fiscal compact is adopted, will countries have the flexibility they need to respond to economic downturns in the future?
- **Can European leaders maintain public support for the crisis response?** Although a majority of Eurozone voters still appear to view membership in the European Union favorably, enthusiasm for economic integration and the euro appears to be waning.[29] While publics appear to have mixed views of their leaders' handling of the crisis, opposition to ongoing austerity measures has become more pronounced in some countries. Discontent with the crisis response was the main factor in the result of Greece's May 2012 election, and was also reflected in the result of the French election. Italy, which is currently led by an unelected government of technocrats, must hold national elections by 2013. What effect will the elections in Greece, France, and Italy have on the implementation of previously agreed crisis response measures? How long can European leaders implement response measures that may be opposed by a majority of their publics?
- **Can Greece remain in the Eurozone?** There are increasing fears that Greece may decide to exit the Eurozone. News reports indicate that, in May 2012, economists at Citigroup revised

[29] See Pew Global Attitudes Project, *European Unity on the Rocks*, May 29, 2012, http://www.pewglobal.org/2012/05/29/european-unity-on-the-rocks/.

their estimate of Greece leaving the Eurozone in the next year or two upwards from 50% to between 50% and 75%, and assume that Greece will exit at the start of next year (January 1, 2013).[30] News reports also indicate that policymakers in Europe are discussing how a Greek exit from the Eurozone could be managed. If there is a disorderly Greek default or a Greek exit from the Eurozone, how can contagion to other Eurozone countries be prevented? Is the European-IMF financial "firewall" or "bazooka" large enough to provide financial resources to adequately defend Italy and Spain from contagion effects?

- **What is the ECB's capacity to calm markets?** Markets responded favorably to the ECB's long-term refinancing operations, but some question whether the expansion of the ECB's holdings of periphery government bonds, both through the collateral posted by banks in refinancing operations and the sovereign bonds that the ECB has purchased on secondary markets, weakens the ECB's financial position.[31] How will the ECB weigh concerns about financial stability with its holdings of securities of possibly questionable quality? Will the ECB be willing to intervene in the future, if market pressure against the Eurozone increases again?
- **What other policy options are available to European leaders for resolving the crisis?** As market pressure intensifies, new proposals for responding to the crisis have resurfaced or emerged. In addition to a "Growth Pact," there are proposals for creating bonds issued jointly by all 17 Eurozone countries ("Eurobonds"), and shifting oversight of Eurozone banks from national authorities to EU-wide authorities. How effective would these policies be in reducing market pressure on the Eurozone? How strong is the political support for these proposals, and what are the potential costs and benefits of such an approach? Are there other policy options?
- **How can trade imbalances within the Eurozone be corrected?** Some economists believe that the crisis, and the build-up of public debt in the periphery, is the result of fundamental, underlying trade imbalances within the Eurozone, but that the policy responses taken have failed to correct these imbalances. In particular, the focus has been on improving the competitiveness of the periphery countries, in order to lower their costs of production and bolster exports. Germany appears to be changing course, and letting wages rise, which could help correct imbalances. Are there other policy measures that the Eurozone core countries could pursue to become less reliant on exports for growth, and reduce their trade surpluses?
- **What are the implications for European integration?** On one hand, the crisis has prompted EU member states to move ahead with new and unprecedented agreements that serve to tighten economic integration, including the creation of the EFSF and ESM, legislation for more central surveillance of economic governance, and the proposed fiscal compact for greater economic coordination. The ECB has also expanded its role in significant new ways, and some argue that the solution to the crisis lies in moving ahead with a fiscal union, in which member states relinquish control over their national budgets. On the other hand, the crisis has also increased tensions among EU member states. The initial crisis debates centered on the legality and moral hazard of "bailouts," and many people in the Eurozone core remain opposed to using taxpayer money to rescue what they consider profligate governments. At the same time, while many people in the countries receiving assistance may recognize the necessity of reform, many also resent the adoption of austerity programs they perceive as

[30] For example, see Eva Szalay, "UPDATE: Citigroup Sees Greek Exit on Jan. 1, 2013," *Dow Jones Newswires*, May 24, 2012.

[31] For example, see Javier E. David, "Swelling ECB Balance Sheet Brings Relief, Poses Risk for Euro," *Dow Jones*, January 12, 2012.

imposed on them by Brussels and Berlin. The tensions caused by the crisis have led some observers and officials into discussions on the desirability of expelling poor performers from the Eurozone; of withdrawing from the Eurozone in order to re-gain an independent monetary policy; or of creating a multi-speed EU in which a group of countries would proceed with deeper economic and fiscal integration.

Issues for Congress

Impact on the U.S. Economy

The Eurozone crisis poses risks to the U.S. economy. The United States and EU have the largest and most deeply integrated bilateral trade and investment relationship in the world. In 2010, the United States and the EU combined accounted for almost 50% of world GDP, and more than 40% of the world's trade in goods and services.[32]

Exposure of the U.S. Financial System

The Eurozone crisis could impact the U.S. economy through a number of different channels. One possible channel is through the financial system and, in particular, the exposure of U.S. financial institutions to the Eurozone. One U.S. financial institution, MF Global Inc., filed for bankruptcy in October 2011 as a result of its exposure to the Eurozone, and developments in the Eurozone impact the U.S. stock market.[33] Modeling and quantifying the impact of a banking crisis in Europe on the U.S. financial system is difficult. When asked about the exposure of U.S. financial institutions to Europe in a Senate Budget Committee hearing, one witness responded, "I think the honest answer is I don't know, and I don't know anyone else who knows."[34]

One source of data on U.S. bank exposure is the Bank for International Settlements (BIS), which reports that direct and other potential U.S. bank exposure in December 2011 to Greece, Ireland, Italy, Portugal, and Spain totaled $765 billion, or 7.5% of U.S. direct and other potential exposures overseas.[35] However, these data do not reflect hedges or collateral that U.S. banks may have in place to lower their exposures; do not capture the exposure of non-bank financial institutions (such as money market, pension, or insurance funds); and do not include how the crisis could be transmitted through the financial system, such as to U.S. banks that are exposed to French banks, that are in turn exposed to Greek banks.

According to the *New York Times* in January 2012, five large U.S. banks, including JPMorgan Chase and Goldman Sachs, have more than $80 billion of exposure to Italy, Spain, Portugal,

[32] World Bank, *World Development Indicators*, 2010. For more on U.S.-EU economic relations, see CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by William H. Cooper.

[33] For more on MF Global, Inc. see CRS Report R42091, *The MF Global Bankruptcy and Missing Customer Funds*, by Rena S. Miller.

[34] Simon Johnson, Senate Budget Committee hearing, February 1, 2012. Simon Johnson is a professor at MIT and was formerly Chief Economist at the IMF.

[35] Exposure to public and private sectors. "Other potential exposures" includes derivative contracts, guarantees extended, and credit commitments. Bank for International Settlements (BIS), *Consolidated Banking Statistics,* "Table 9E: Foreign Exposures on Selected Individual Countries, Ultimate Risk Basis," April 24, 2012 (Preliminary Report for December 2011), http://www.bis.org/statistics/consstats.htm.

Ireland, and Greece, but use credit default swaps (CDS) to offset any potential losses by $30 billion, putting their net exposure at $50 billion.[36] An analysis by the Investment Company Institute, the national association of U.S. investment companies, finds that U.S. money market funds cut their exposure to the Eurozone by about 50% between April 2011 and April 2012, from 30.1% to 15.7%.[37] An analysis by Fitch, a major credit rating agency, in November 2011 argues that large U.S. banks have been reducing direct exposure to stressed markets over the past year and that net exposures are manageable, but warns that U.S. banks could be "greatly affected" if contagion continues to spread to other Eurozone countries.[38]

During a congressional hearing in October 2011, Treasury Secretary Geithner emphasized that direct exposure of U.S. institutions to the Eurozone countries and institutions under the most market pressure is small, but that exposure to Europe, as a whole, could be "a big deal."[39] Secretary Geithner also stressed that the U.S. financial system is better capitalized than in 2009, putting it in a better position to weather potential shocks. In January 2012, the Securities and Exchange Commission (SEC) requested that banks provide a fuller and more consistent presentation of their European positions.[40] Additionally, in March 2012, the U.S. Federal Reserve (the Fed) released the results of a bank stress test for large U.S. banks that gauged, among other things, a hypothetical shock related to turmoil in Europe.[41]

Other Impacts on the U.S. Economy

Another channel through which the Eurozone could impact the United States is through trade and investment. There has been concern that austerity measures would slow growth in Europe, depressing demand for U.S. exports, and that the crisis would erode confidence in the euro, leading to a depreciation of the euro relative to the U.S. dollar. Although the euro has retained its value throughout most of the crisis, growing concerns about the future of the Eurozone have caused the euro to depreciate recently, from 1.41 €/$ on October 28, 2011, to 1.24 €/$ on May 31, 2012 (see **Figure 6**). Depreciation of the euro against the U.S. dollar makes U.S. exports to the Eurozone more expensive, and U.S. imports from the Eurozone cheaper.[42] Although it is not clear how the crisis has affected overall U.S.-EU trade (**Figure 5**), a weaker euro relative to the U.S. dollar could widen the U.S. trade deficit with the Eurozone.

Slower growth rates in Europe could also cause U.S. investors to look increasingly towards emerging markets for investment opportunities. On the other hand, a weaker euro could make

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[36] Peter Eavis, "U.S. Banks Tally Their Exposure to Europe's Debt Maelstrom," *New York Times*, January 29, 2012.

[37] Emily Gallagher and Chris Plantier, "Prime Money Market Funds' Eurozone Holdings Down 50 Percent Over the Last Year," *Investment Company Institute*, May 21, 2012.

[38] Joseph Scott, Christopher D. Wolfe, Thomas Abruzzo, "U.S. Banks – European Exposure," *Fitch*, November 16, 2011.

[39] Congressional Quarterly, "Senate Banking, Housing, and Urban Affairs Committee Holds Hearing on the Financial Stability Oversight Council Annual Report as well as Votes on a Few Pending Nominations," October 6, 2011, http://www.cq.com/doc/congressionaltranscripts-3957612.

[40] Andrew Ackerman and Liz Moyer, "SEC Asks for Debt Disclosure," *Wall Street Journal*, January 10, 2012.

[41] Federal Reserve Press Release, March 13, 2012, http://www.federalreserve.gov/newsevents/press/bcreg/20120313a.htm.

[42] For more on the exchange rate, see CRS Report RL34582, *The Depreciating Dollar: Economic Effects and Policy Response*, by Craig K. Elwell. For more on U.S.-EU trade, see CRS Report R41652, *U.S.-EU Trade and Economic Relations: Key Policy Issues for the 112th Congress*, by Raymond J. Ahearn.

European stocks and assets look cheaper and more attractive, attracting U.S. capital to the Eurozone. It is not clear to date how the crisis will shape long-term U.S.-EU investment flows.

In addition, uncertainty in the Eurozone is creating a "flight to safety," causing U.S. Treasury yields to fall, and volatility in the U.S. stock market. Longer-term, a break-up of the Eurozone could have substantial implications for U.S.-European cooperation on economic issues.

U.S. Government Involvement

Since the early stages of the crisis, the Obama Administration has repeatedly called for a swift and robust response from Eurozone leaders, and has been in contact with European leaders regularly throughout the crisis. Most recently, the Eurozone crisis was a central topic of discussion during the G-8 summit at Camp David in May 2012. At the close of the summit, President Obama warned that the crisis poses a threat to the global economy and welcomed the emerging consensus that more needs to be done in Europe to promote growth and job creation.[43] President Obama has also held follow up discussions with German, French, and Italian leaders, to help lay the groundwork for action before the G-20 leaders meet in June in Mexico.[44]

As the lead on international financial issues within the Administration, Treasury Secretary Geithner has also been in frequent contact with his European counterparts, even, unusually, attending a meeting of Eurozone finance ministers in September 2011, during which he urged stronger policy responses. Other Treasury officials have also been actively engaged in the Eurozone crisis. For example, in May 2012, Treasury Under Secretary for International Affairs Lael Brainard traveled to Greece, Germany, Spain, and France to discuss the crisis.

European reactions to the U.S. appeals have been mixed. Some Europeans have pushed back against perceived U.S. criticism while pointing out the United States' own economic problems. They note, for example, that the IMF is forecasting the total U.S. government debt (including federal, state, and local) to be 107% of GDP in 2012, compared to 90% for the Eurozone area as a whole.[45] While the United States wields an influential voice on the issue, it ultimately has limited ability to affect policy decisions made by and among the EU member countries and institutions.

The Federal Reserve

In May 2010, the U.S. Federal Reserve (Fed) announced the re-establishment of temporary reciprocal currency agreements, known as swap lines, with several central banks. These swap lines had been previously used during the global financial crisis and aim to increase dollar liquidity in the global economy. They are designed in a way which minimizes exchange rate and credit risk to the Fed. The swap lines re-established in May 2010 were set to expire in January 2011, but have been extended a number of times due to continuing concerns about the crisis. In November 2011, the Fed also reduced the borrowing rate for the swap lines, in order to further ease strains in financial markets. As of May 23, 2012, $26 billion was outstanding on these swap

[43] White House, "Statement by President Obama at Closing of G8 Summit," Camp David, Maryland, Office of the Press Secretary, May 19, 2012, http://www.whitehouse.gov/the-press-office/2012/05/19/statement-president-obama-closing-g8-summit.

[44] David Jolly, "U.S. Steps Up Pressure on Europe to Resolve Euro Crisis," *New York Times*, May 31, 2012.

[45] International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

lines, compared to a high of $583 billion during the global financial crisis in December 2008 (see **Figure 7**).[46] Additionally, as mentioned above, the Fed is currently conducting stress tests related to U.S. bank exposure to turmoil in Europe.[47]

One source of concern about the swap lines is the impact that dollar swap agreements could have on the rate of U.S. inflation. Through the Federal Reserve, the United States has provided the ECB and other central banks with dollars to maintain stability in short-term money markets that European banks have used to fund much of their ongoing operations. In a swap transaction, dollars are exchanged for a foreign currency, say the euro, at a certain price for a specified period of time. As these swap arrangements are implemented and the foreign currency is exchanged for dollars, the supply of dollars increases, which in theory may boost the rate of inflation. The Federal Reserve has indicated, however, that it has a number of options to sterilize, or to offset, any increase in the money supply in order to suppress any inflationary pressures.

Role of the International Monetary Fund (IMF)

Of the 187 members of the IMF, the United States is the largest financial contributor to the institution, and the United States has a leading role in shaping the IMF's lending programs.[48] IMF programs in Greece, Ireland, and Portugal have been supported by the Obama Administration, but some Members of Congress are concerned about whether these programs are an appropriate use of IMF resources. Concerns have generally focused on the unusual nature of the programs, particularly that the IMF has not generally lent to developed countries in recent decades, and that the programs provide a large amount of financing relative to the size of the economies. There are also concerns about whether the IMF will be repaid in full and on time. Proponents of the IMF programs in the Eurozone point out that the programs are consistent with the IMF’s mandate of maintaining international monetary stability; the IMF has lent to developed countries in the past, if not recently; and that as members of the IMF, Greece, Ireland, and Portugal are entitled to draw on IMF resources. They also argue that the IMF has several safeguards in place to protect IMF resources, including making the disbursement of funds conditional upon economic reforms, and that the IMF has a strong historical record of countries meeting their repayment obligations.

In addition to the support to Greece, Ireland, and Portugal, pledges have been made to bolster the lending capacity of the IMF. Current pledges total more than $430 billion.[49] The United States has not pledged any new funds to the IMF as part of this effort. As the biggest shareholder in the institution, the United States may want to consider how to balance, on the one hand, making sure that the IMF has the resources it needs to ensure stability in the international economy with, on the other hand, exercising oversight over the exposure of the IMF to Europe and the concessions that countries are looking for in exchange for providing financial assistance.

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[46] Federal Reserve, http://www.federalreserve.gov/releases/h41/hist/h41hist13.htm.

[47] For more on financial stability in the United States, see CRS Report R42083, *Financial Stability Oversight Council: A Framework to Mitigate Systemic Risk*, by Edward V. Murphy.

[48] For more on the IMF, see CRS Report R42019, *International Monetary Fund: Background and Issues for Congress*, by Martin A. Weiss.

[49] International Monetary Fund (IMF), “IMF Managing Director Chirstine Lagarde Welcomes Pledges by Members to Increase Fund Resources by Over US$430 Billion,” April 20, 2012, http://www.imf.org/external/np/sec/pr/2012/pr12147.htm.

The Eurozone Crisis, the IMF, and Legislation in the 111th and 112th Congress

Member concerns about IMF resources being used to "bailout" Eurozone governments led to the passage of legislation in the 111th Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010 (P.L. 111-203). Section 1501 of the law requires U.S. representatives at the IMF to oppose loans to high- and middle-income countries with large public debt levels (greater than 100% of GDP) if it is "not likely" that they will repay the IMF. Prospective IMF loans to low-income countries are exempted from this requirement. If the IMF does approve a loan to a high- or middle-income country despite U.S. opposition, the law requires the Treasury Department to report regularly to Congress about various economic conditions in that country.

In the 112th Congress, continuing concerns about use of IMF resources in the Eurozone debt crisis likely contributed to the introduction of legislation in the House (H.R. 2313) and Senate (S.Amdt. 501; S. 1276). The legislation calls for rescinding the U.S. financial commitments to the IMF approved by Congress in 2009. The Senate voted against the amendment on June 29, 2011. This language was also included in a House draft of the FY2012 State and Foreign Operations Appropriations bill,[50] but the language was not included in the final FY2012 appropriations legislation.[51]

On December 15, 2010, the IMF Board of Governors agreed in principle to a package of reforms, including a doubling of IMF quotas, the IMF's core source of funds, to about $747 billion.[52] To be implemented, the reform package needs to be approved by member countries, including three-fifths of the members having 85% of the total voting power. IMF Managing Director Christine Lagarde has reportedly urged member countries to implement the reform package by October 2012.[53] However, the Obama Administration did not request any funds for meeting the U.S. commitment for the quota increase in the FY2013 budget request.

Implications for Broader U.S.-European Cooperation

The United States looks to Europe for partnership in addressing a wide range of global challenges, and some analysts and U.S. and European officials have expressed concern about the potential effects of the Eurozone crisis on U.S.-European political and security cooperation. Successive U.S. administrations have been proponents of a more united, outward-focused EU, capable of playing a larger role in addressing global challenges. Over the last two decades, some analysts and policymakers have viewed the EU's focus as largely introspective, with EU leaders preoccupied with EU treaty reforms, institutional arrangements, and EU enlargement. The Eurozone crisis appears to have again turned the main focus of the EU inward.

In addition, the crisis raises questions about future constraints on Europe's ability to use economic policies in pursuit of foreign policy objectives. The EU is the world's largest aid donor (counting common funds managed by the European Commission plus bilateral member state contributions), accounting for roughly half of official global humanitarian and development assistance.[54] Some observers question whether the crisis could in the long-term limit Europe's ability to continue providing such levels of foreign assistance or economic incentives aimed at boosting stability and prosperity in developing countries. Some commentators suggest, for example, that the Eurozone crisis has hindered the EU's ability to respond more robustly, both politically and economically, to the recent transformations in the Middle East and North Africa.

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[50] http://appropriations.house.gov/UploadedFiles/FY12-SFOPS-07-25_xml.pdf.

[51] P.L. 112-74.

[52] "Factsheet: IMF Quotas," *International Monetary Fund*, September 13, 2011.

[53] Lesley Wroughton, "IMF Urges Members to Boost Funding Under 2010 Plan," *Reuters*, December 22, 2011.

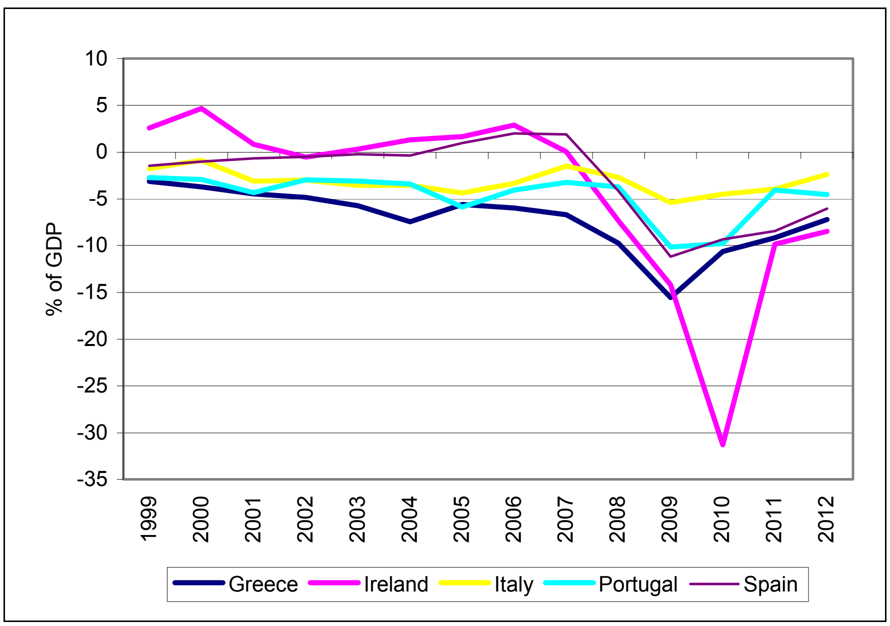
[54] European Commission DG ECHO, *Operational Strategy 2011*, November 16, 2010, p. 4, http://ec.europa.eu/echo/files/policies/strategy/strategy_2011_en.pdf, and European Commission, EuropeAid, *Annual Report 2010*, p. 5, http://ec.europa.eu/europeaid/multimedia/publications/documents/annual-reports/europeaid_annual_report_2010_en.pdf.

The crisis could also exacerbate a long-standing downward trend in European defense spending and cast further doubt on Europe's willingness and capability to be an effective global security actor in the years ahead.

Despite Europe's own internal financial problems and preoccupations, others contend that the European countries and the EU have a proven track record of close cooperation with the United States on a multitude of common international concerns. The United States and Europe are working closely together to manage Iran's nuclear ambitions, have significantly strengthened their law enforcement and counterterrorism cooperation over the last decade, have recently concluded a successful NATO mission in Libya, and together continue to promote peace and stability in the Balkans and Afghanistan. As such, those of this view remain more optimistic that the Eurozone crisis will not significantly alter the EU's willingness or commitment to transatlantic cooperation.

Supplemental Figures and Charts

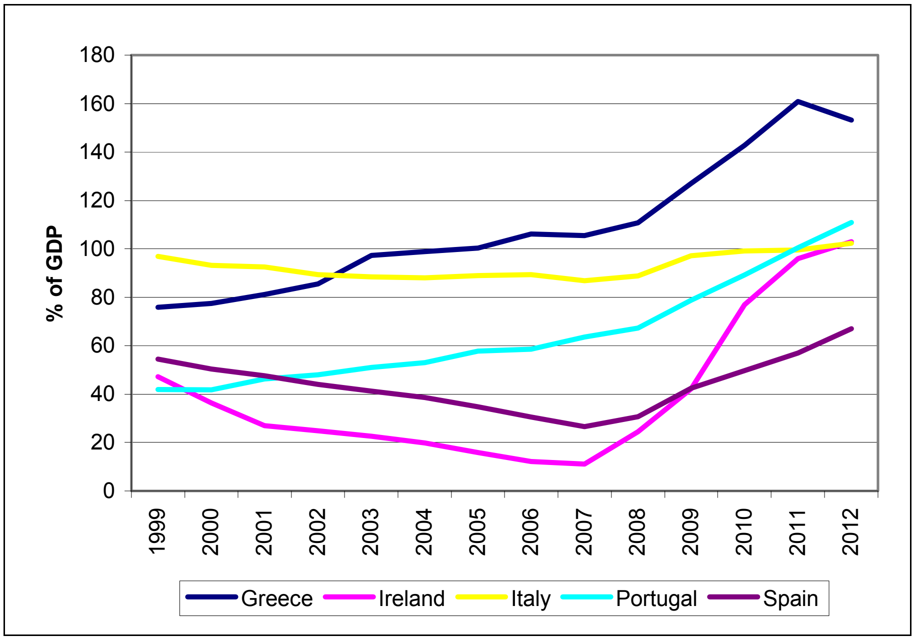
Figure 1. Fiscal Balance in Selected Eurozone Countries since 1999



Source: International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

Note: Forecasted data starting in 2010 or 2011, depending on the country.

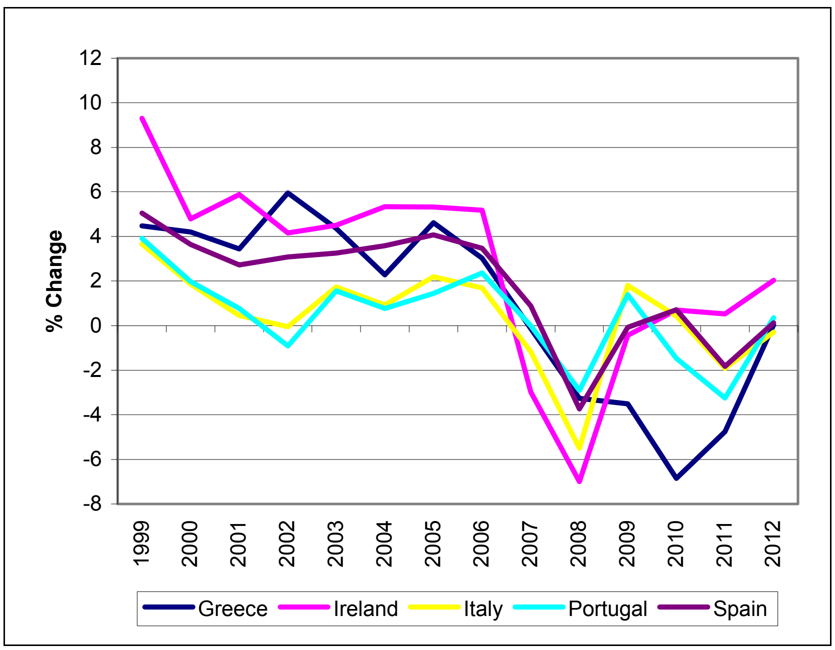
Figure 2. Public Debt in Selected Eurozone Countries since 1999



Source: International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

Note: Forecasted data starting in 2010 or 2011, depending on the country.

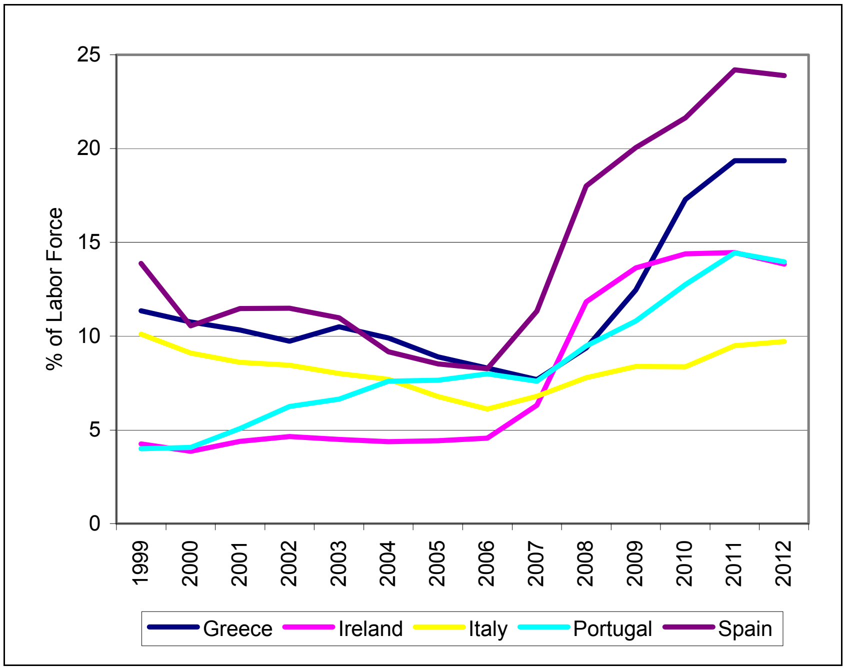
Figure 3. Economic Growth in Selected Eurozone Countries since 1999



Source: International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

Note: Forecasted data starting in 2010 or 2011, depending on the country.

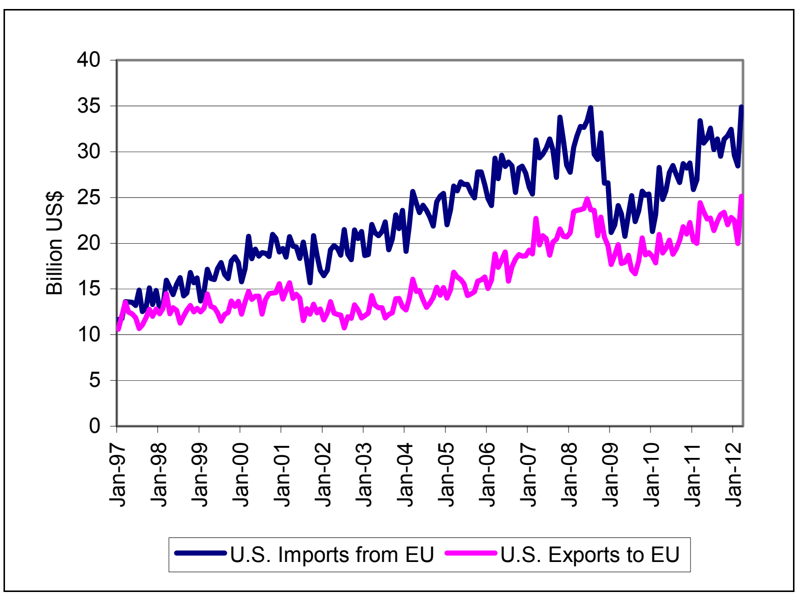
Figure 4. Unemployment in Selected Eurozone Countries since 1999



Source: International Monetary Fund (IMF), *World Economic Outlook*, April 2012.

Note: Forecasted data starting in 2010 or 2011, depending on the country.

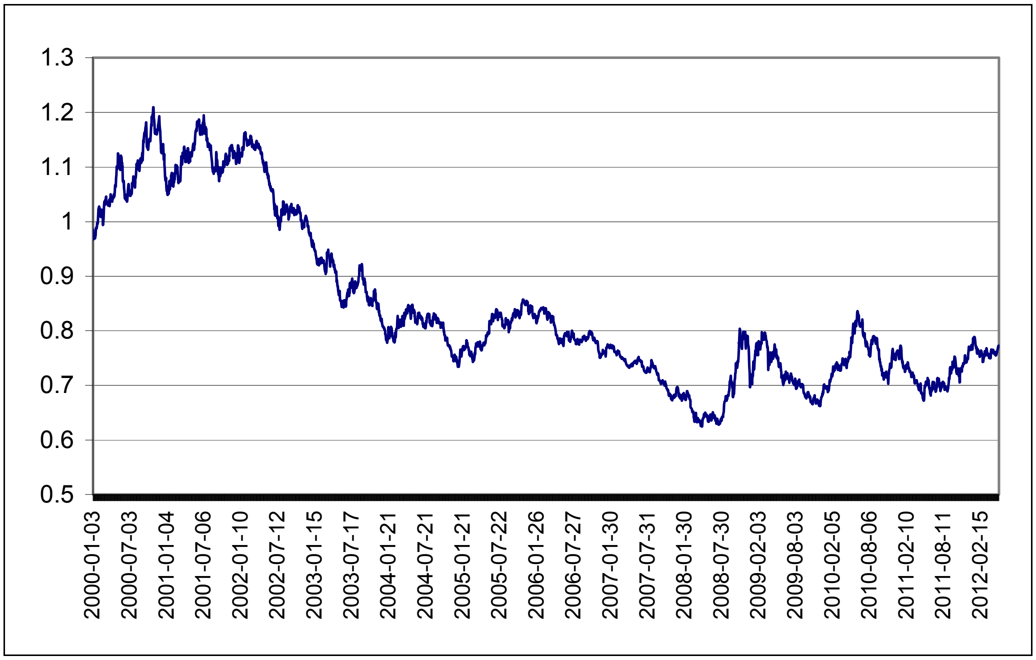
Figure 5. U.S.-EU Trade in Goods since 1997



Source: Census Bureau, "Trade in Goods with European Union," http://www.census.gov/foreign-trade/balance/c0003.html.

Notes: Does not include trade in services.

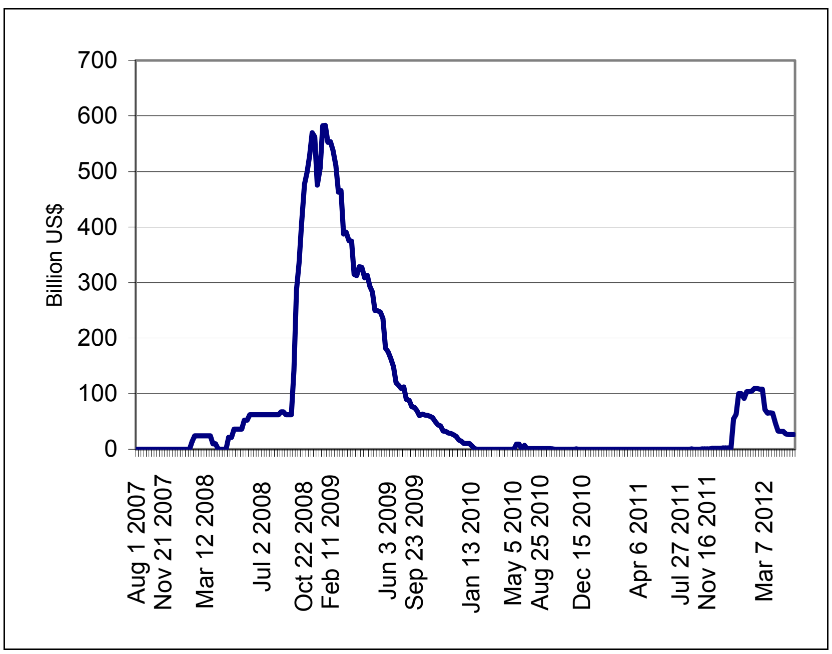
Figure 6. Euro/US$ Exchange Rate since 2000



Source: Federal Reserve.

Notes: An increase in the €/$ exchange rate represents a stronger dollar relative to the euro; a decrease in the €/$ exchange rate represents a weaker dollar relative to the euro.

Figure 7. Fed Swap Lines, Amount Outstanding



Source: Federal Reserve, http://www.federalreserve.gov/releases/h41/hist/h41hist13.htm.

Table 1. European-IMF Financial Assistance Packages for Eurozone Governments

	Date Agreed	European Financial Assistance	IMF Financial Assistance	Total Financial Assistance	IMF Share
Greece	May 2010	€80 billion (about $100 billion)	€30 billion (about $38 billion)	€110 billion (about $138 billion)	27%
	February / March 2012[a]	€120 billion[b] (about $151 billion)	€18 billion[c] (about $23 billion)	€138 billion (about $173 billion)	13%
Ireland	December 2010	€45 billion (about $57 billion)	€22.5 billion (about $28 billion)	€67.5 billion[d] (about $85 billion)	33%
Portugal	May 2011	€52 billion (about $65 billion)	€26 billion (about $33 billion)	€78 billion (about $98 billion)	33%
Total		**€297 billion (about $373 billion)**	**€97 billion (about $121 billion)**	**€394 billion (about $494 billion)**	**25%**

Source: International Monetary Fund; European Union.

Notes: Figures denominated in euros converted to dollars using exchange rate on May 24, 2012: €1 = $1.2557 (source: ECB). However, it should be noted that currency swings have been underway during the crisis and the dollar conversions have also fluctuated accordingly. Figures may not add due to rounding. Funds are disbursed in phases conditional on economic reforms; not all funds have been disbursed to date.

a. A second rescue package for Greece was originally announced in July 2011, and was to provide €109 billion in official sector financing to Greece. However, the package was pending negotiations, and a revised package was announced in February 2012. The IMF approved its portion of the program in March 2012. When the second program for Greece was announced, about €34 billion from Greece's first program had not yet been disbursed (€24 billion by the Europeans and €10 billion by the IMF). This 2012 figures show additional financial commitments beyond what was previously pledged.

b. Includes providing up to €30 billion to private holders of Greek bonds participating in a write-down of Greek debt; up to €5.5 billion to pay accrued interest on Greek bonds; and €48 billion for bank recapitalization.

c. The first IMF program for Greece was canceled in March 2012, with €10 billion in undisbursed funds. At the same time, a second IMF program for Greece was announced for €28 billion, resulting in a net increase of €18 billion beyond what had been previously pledged.

d. The headline number for Ireland's financial assistance package in news reports is often €85 billion. This includes €17.5 billion from Ireland's cash reserves and other liquid assets. Resources used by national authorities in the crisis response are not included in the table.

Author Contact Information

Rebecca M. Nelson, Coordinator
Analyst in International Trade and Finance
rnelson@crs.loc.gov, 7-6819

Paul Belkin
Analyst in European Affairs
pbelkin@crs.loc.gov, 7-0220

Derek E. Mix
Analyst in European Affairs
dmix@crs.loc.gov, 7-9116

Martin A. Weiss
Specialist in International Trade and Finance
mweiss@crs.loc.gov, 7-5407