ECONOMIC DIVIDE IN THE EUROPEAN UNION
AN IN-DEPTH ANALYSIS OF EUROPE’S SOUTHERN MEDITERRANEAN ECONOMIES

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ABSTRACT

Our world and the countries and business environments which comprise it continue to become more and more integrated and intertwined each and every day. It is no longer about the American economy or the European economy or even the powerhouse Chinese economy; today, what is of utmost importance is the global economy. The situations, decisions, and business environments of one country and economic area absolutely have impacts and repercussions on the rest of the world. As such, the world waits with bated breath as the European Union with its common currency faces its darkest hour.

As the European debt crisis continues to draw attention, incite speculation, and crush the confidence of the public and its investors, this thesis attempts to answer the perplexing question . . . “Why?” Why the southern Mediterranean countries? Why are the southern European member states the ones which are struggling financially and facing massive national debts and deficits? Is there a common way of life, culture, mentality, or some other entity, which is present in these southern countries that is causing them to perform poorly? Through extensive research and analysis, I have assessed the current state of each of the four PIGS (Portugal, Italy, Greece and Spain) countries. I have attempted to understand which factors, whether cultural, economic, political, or other, have played a role in their current state, and I have then determined whether there are any similar factors among the four countries that can be attributed to a Mediterranean way of life.

What I have concluded is that the common cultural, economic and political factors were significant contributing factors to the European debt crisis. These common factors caused the PIGS countries to (1) fail to effectively use the money given to them to improve their economies, (2) fail to collect the money that was rightfully owed to them, and (3) waste the money given to them to satiate a lifestyle that was beyond their means. All of these failures contributed to the growing obligations of the countries and prevented them from using a period of growth and prosperity to make sure that their countries’ financial positions were in order. All in all, the cultural, structural, and/or governmental
factors in Portugal, Italy, Greece and Spain were an instrumental component of the European debt crisis that is now testing the resilience of the European Union’s common currency.
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Chapter 1:
Overview of the European Sovereign Debt Crisis

The European sovereign debt crisis seems to have acquired a permanent place in world news, much to the chagrin of those at the heart of the crisis. Europe, its countries, its financial markets, its leaders, and most importantly, its currency, have now become an expected daily topic in the media. For the past two years, news stories have claimed that the situation is worsening, the situation is improving, the contagion is reaching new countries, leaders are meeting to decide what needs to be done, if anything can even be done, etcetera. But with all the speculation and commentary it is easy to lose sight of the true issue at hand.

The crisis, in its most simplistic form, is all about money: specifically—who has it and who does not. Certain European countries have massive account deficits and extensive debt obligations that cannot or may not be able to be paid back. Meanwhile, other European countries which are financially stable are desperately trying to find a solution so that Europe and its single market can remain a sustainable world power with a secure currency. There are certain key players in this sovereign debt crisis that must be mentioned. The countries with massive amounts of debt include Portugal, Italy, Greece and Spain. To varying degrees, each one of these PIGS countries (an acronym assigned to these countries) has been thrown in the mix of countries that has too much sovereign debt to be sustainable over the long term. On the other hand, Germany and many other core European countries have strong, thriving economies. As a result, Germany and France have emerged as the two leading European powerhouses working together to come up with a solution for Europe’s debt crisis.

The focus of this thesis is on the southern European countries of Portugal, Italy, Greece, and Spain. All of these neighboring Mediterranean countries are struggling economically and burdened by massive national debts and large fiscal deficits. This thesis attempts to discover the answer to the question: “Is there a reason why the southern European Union countries, located in the Mediterranean region, are the countries at the root of this debt crisis? Is there a common way of life, culture, mentality, etcetera, which
is present in these southern countries that is causing them to perform poorly?” Through extensive research and analysis, I have assessed the current state of each of the four PIGS countries. I have attempted to understand what factors, whether cultural, economic, political, or other, have played a role in their current state, and I have then determined whether there are any similar factors among the four countries that can be attributed a Mediterranean way of life.

Before it can be determined exactly how and why the crisis occurred, and what the implications are for Europe in the future, one must first understand how the European Union came to have a single currency and what it means for each member’s economy.

**The Single Market and the European Union’s Common Currency**

In 1986 there were twelve members of the European Community and four of those spots belonged to the PIGS countries. It was also in this year that the Single European Act was signed with the intent to have a Single Market by the year 1992. The objective of the Single Market was to have the free movement of goods, services, capital and people among the member states. The European Community hoped to achieve this by eliminating tariffs and obstacles of trade between countries, and having countries become more dependent on the success of the European Community as a whole, rather than on the success of twelve independent nations. As early as the inception of the Single Market in 1992, there was talk that a common currency was critical to further integration among member states as well as to advancing the European Union (EU) to be a global player in the international community. However, it would take a decade for that plan to come to fruition.

Despite the many benefits that the Europeans were anticipating with the launch of the common currency, there were also some major sacrifices that each member state would have to make in order for the common currency to be successful. The first consequence of having a common currency was that each country would have to give up its freedom to print more money (Lynn, 2011). This freedom allowed a country to run up a far greater deficit than 3% of GDP (the limit set by the European Community) and still be financially stable. This is because if a country found itself in the position where it was
unable to borrow money from outside investors, institutions, or other countries, it could simply ask its government to print more. This ability to print more money is not a free pass to run up as large a deficit as a country wishes; however, it does give that country more room for a larger national debt than would normally be considered financially stable. As Matthew Lynn notes in his book *Bust: Greece, the Euro, and the Sovereign Debt Crisis*, “this is not the completely cost-free exercise it might appear at first glance . . . but it is still an important freedom” (Lynn, 2011).

The second consequence of adopting a single currency was that “countries weren’t going to be able to devalue their way out of trouble the way they had in the past” (Lynn, 2011). Normally, a country that finds itself with a national debt that is rapidly amassing can quickly and effectively decrease that rising debt by having a positive trade balance. A positive trade balance means that a country is exporting more than it is importing, thus the government is increasing its revenue rather than having a net outflow of cash for goods and services. To quickly attain a positive trade balance, a country can devalue its currency, making its exports cheaper and more in demand in the world market, and thus increasing the revenue to its country.

However, the countries who joined the European common currency gave up their own national currency and thus their ability to freely devalue it. This meant that Greece could no longer increase its exports and competitiveness by controlling the value of its currency because it now shared a currency with sixteen other countries. Countries were essentially losing some of their national sovereignty when it came to their right to control their own money supply. Now, countries would have to fight to stay competitive with the ever efficient and productive Germans, as these countries no longer had a short cut to help boost their exports. Both of these consequences would prove fatal to the economies of many of the PIGS countries many years down the road.

Eventually, the Economic Monetary Union (EMU) was formed within the European Union and a common currency was created. The EMU is the “establishment of a single European currency – the Euro – which eliminates exchange-rate controls to freely trade across borders without paying to convert money from one currency to another” (Staab, 2011). As Staab notes in his book, *The European Union Explained*,
there were four main criteria that each member state had to meet by 1998 in order to join the EMU and adopt the common currency. These four criteria included:

1. Price stability – inflation rate of no more than 1.5% above the three best-performing states
2. Limited public debt – no more than 3% of GDP annually and a total of no more than 60% of GDP
3. Limited exchange rate fluctuation – remain within EMS for two years
4. Reasonably low interest rates – no more than 2% above the three best performers

*Source: Staab, 2011

At the time of the launch of the euro, there were differing views, especially among the European powerhouses of France and Germany, as to what type of currency the countries should adopt. The Germans wanted hard, inflexible limits on how much debt any member of the single currency could run up, specifically allowing a budget deficit of just 3% of GDP (Lynn, 2011). Germans also wanted no bailouts between member states (Lynn, 2011). France, on the other hand, wanted more lax rules among the member states. In the end, it would be France that would win out. “The German demand for stiff, automatic penalties for any country that broke the 3% deficit ceiling was dropped. The worst you would face was an inquiry from the European Commission” (Lynn, 2011). This would prove to be a crucial mistake in the future.

Despite the sacrifices that countries had to make and the differing views about the currency, the euro was launched on January 1, 1999. On this day, the euro became the legal currency of the European Union. However, not all countries within the EU met the requirements for adoption. Greece was one such country. Greece failed to meet every single one of the five criteria prior to the launch. Its budget deficit was 16% of GDP compared to the required 3% (Lynn, 2011). Its outstanding debts were more than 100% of GDP (Lynn, 2011). Its inflation rate was continuously in double digits (Lynn, 2011). However, two years later Greece was re-evaluated, deemed to have met the requirements, and allowed to adopt the euro. Fast-forward twelve years later to present day, and many
individuals and analysts are questioning whether the Greeks really did meet the criteria to join in 2001.

For the next decade, the common currency of the European Union was considered an unequivocal success. One of the most advantageous aspects of the euro was that it lowered the cost of doing business among members of the Single Market. In fact, businesses and consumers saved approximately 2% on transaction costs, and importers and exporters within the EMU no longer faced the risk of currency fluctuations” (Staab, 2011). All Eurozone countries were now on the same page, and business, competition, and efficiency were all stimulated. Another major advantage of euro was that it “[gave] Europeans a concrete remainder of their existence within a community of European states” (Staab, 2011). For ten years, the Eurozone members prospered and everyone was confident that a common currency was absolutely the right choice for their countries. In late 2009, however, that confidence and euphoria was challenged.

The Beginnings of a Crisis

Though the European debt crisis came to a head in late 2009, it was in the works for many, many years before that. In fact, it can be argued that as soon as the euro was launched and certain countries joined the common currency, the seed was planted for a crisis like this to occur. Why? Simply put, countries that previously had weaker, unstable currencies with high interest rates were now included in an elite group of countries with a strong, stable currency (Lynn, 2011). Greece, Spain and Ireland suddenly found themselves in a position to “borrow just as much money as [they] wanted without having to worry too much about paying it back” (Lynn, 2011). They had, in effect, the same financial rating and security as the ever dominant and financially stable Germans and the PIGS countries definitely took advantage of this.

Then, in 2008, the Global Financial Crisis hit. This crisis, originating in the United States, had disastrous effects on many different parts of the world, including Europe. “Stock markets [fell], large financial institutions collapsed . . . and governments in even the wealthiest nations had to come up with rescue packages to bail out their financial systems” (Shah, 2010). In Europe specifically, many major financial
institutions either failed or had to be rescued. The UK and other European countries spent about $2 trillion on bailout packages (Shah, 2010). Many governments, in an attempt to calm the markets and the citizens of their nations, also guaranteed “100% of people’s savings” (Shah, 2010). In addition, the 2008 financial crisis thrust Europe into a very deep recession. Companies were earning less revenue and individuals were either earning less in salaries or losing their jobs altogether. This decrease in earnings for companies and individuals resulted in less tax revenue for the governments despite the fact that they had to increase spending in order to try to keep their economies afloat. So, after years of continuous and reckless spending sprees with an abundance of money, the PIGS countries now found themselves backed into a corner and forced to borrow even more money to help their banks and economies survive this “Great Recession.” The debt just kept adding up.

The Crisis Strikes

Then came trouble for the Greeks. On December 7, 2009, Standard & Poor’s said it was placing Greece’s “A- long-term sovereign credit rating on Credit Watch with negative implications” (Lynn, 2011). The next day, December 8, 2009, Fitch actually cut Greece’s credit rating to BBB+ (Lynn, 2011). Only a few months later, in April of 2010, Fitch downgraded Greece to BBB-, “just one level above what the markets call non-investment junk bond” (Lynn, 2011). The credit rating cuts just kept coming and there was not much Greece could do about it.

Greece was the first country to be targeted with multiple drastic credit rating downgrades by Standard and Poor’s, as well as by every other major credit rating agency. In a matter of weeks, these credit rating agencies completely shattered the public’s confidence in Greece’s ability to uphold its obligations. Figures 1-1 and 1-2 demonstrate why Standard & Poor’s, Moody’s, as well as Fitch, initially targeted Greece in 2009 as the country that would not be able to repay its obligations. Greece had a far greater national deficit and debt compared to its GDP than any other country during 2009.
FIGURE 1-1

Comparison of Countries -
2009 Government Deficit/Surplus

<table>
<thead>
<tr>
<th>Percentage of GDP (%)</th>
<th>Greece</th>
<th>Spain</th>
<th>Portugal</th>
<th>France</th>
<th>Italy</th>
<th>Germany</th>
</tr>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>-15.8</td>
<td>-11.2</td>
<td>-10.1</td>
<td>-7.5</td>
<td>-5.4</td>
<td>-3.2</td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurostat
As the Greek credit rating and budget deficit continued to spin wildly out of control, faith in the country and its ability to pull itself out of this mounting debt obligation was quickly diminishing. It was time for the other countries of the European Union to decide what their roles would be. The Maastricht Treaty that was signed in 1986 in order to establish the European Monetary Union and the single currency specifically stated that a bail out of any country would never be permitted (Lynn, 2011). When it was signed, member states had decided that they did not want the single currency to turn into a charity bank in which the rich members had to continuously pay the price for the bad choices and irresponsible fiscal spending of the poorer nations. The rich nations also did not want the poorer nations to get accustomed to bail outs, because then these poorer nations would have absolutely no incentive to keep their finances and deficits under control. In fact, in March 2010, Angela Merkel “warned against causing further alarm in the international capital markets by raising ‘false expectations’ of a
Eurozone bail-out package for the debt-strapped Greek government” (Peel, 2010). However, time was running out and the EU member states had to make a decision once and for all about which side they were going to take in this crisis.

In May 2010, the rules of the Maastricht Treaty that had been the foundation for the common currency were thrown out the window as Germany, France, and other leading nations of the EU approved a rescue package for debt-ridden Greece. The rescue package included “an unprecedented €110 billion ($146 billion) bailout to save Greece from bankruptcy” (Hope, 2010b). The money would be loaned by both the EU member states, with Germany providing the majority of that money, as well as the International Monetary Fund.

In order for the bailout money to be approved, Greece had to agree to extensive and harsh spending cuts and changes to their economy. Some of these changes included slashing the budget deficit to the required 3% of GDP over the next three years, enacting cuts in public sector salaries and pensions, and raising the value added tax, as well as many other changes (Hope, 2010b).

Though much of the media coverage pointed to Greece as the poster child of the European debt crisis, many other countries were struggling with their budget deficits and public debts as well. As the situations worsened in Portugal, Spain and Italy, worries of a contagion began creeping into the minds of individuals and analysts.

Portugal was the next country to take multiple credit rating hits and find itself amidst the sovereign debt crisis. In 2009, Portugal had a budget deficit of more than 9% of GDP and by 2010 its overall national debt was 90% of GDP (Lynn, 2011). In July of 2010, “Moody's cut [Portugal’s] rating by two notches from Aa2 to A1, saying Portugal’s financial strength would continue to deteriorate over the medium term” (Wise, 2010a). In early 2011, Portugal faced even more cuts as S&P “downgraded Portugal’s long-term credit rating from A- to BBB, bringing Portugal's credit standing closer to junk status” (Wise, 2011a). Portugal had €4.3 billion of bond redemptions due on April 15, 2011 (Oakley, 2011b), and by June of that same year, Portugal had an additional €5 billion of debt due (Oakley, 2011a). Most strategists did not believe that the country would be able to pay it . . . and those strategists were correct.
In the early days of April 2011, despite continued assurances that the country was not intending to seek a bailout, Portugal requested assistance from the European Union over its debt obligations. Not long after, a €78 billion ($115 billion) bailout package was approved, that would be distributed over a 3 year period (Wise, 2011b). This made Portugal the third Eurozone country to ask for a rescue package, behind both Greece and Ireland.

Spain was also facing many of the same challenges as the other PIGS countries. Spain’s deficit for 2010 was 9.3% of GDP (Lynn, 2011). The credit ratings of many of its banks were being downgraded as early as March of 2011. With a budget deficit of 8% of national income in 2011 (Woolls, 2011), Spain implemented various austerity measures to help get the country’s debt obligations under control. Spain imposed income and property tax hikes and €8.9 billion ($11.5 billion) in spending cuts (Woolls, 2011). In May, it was discovered that approximately 5,200 regional and local entities were hiding debt on their books, resulting in an under-representation of €26.4 billion of obligations (Mallet, 2011a). In addition, over the years Spain has struggled with one of the highest unemployment rates in the European Union, especially among the younger generations. The austerity measures and spending cuts imposed as a result of the debt crisis would only exacerbate the number of individuals that were without jobs.

When the crisis first broke, Italy was the country which was garnering the least amount of attention. Its budget deficit was not nearly as bad as the other PIGS countries. Yet, while its deficit was not too high, its national debt was reaching 120% of GDP (The Herald 2011), and as the third largest economy in the Eurozone, the sheer volume of its debt was definitely a reason to watch the health of the country and its economy. Italy was averaging 0% growth annually, was uncompetitive with low productivity growth, and was seeing stagnant exports for the past decade (Lynn, 2011). So while it was not a critical country of the European debt crisis, its economy was severely lagging and its prominence in the Eurozone made it a country that needed to be monitored.

In the early days of the crisis, when no one but Greece was experiencing any major issues, many European countries believed that this issue was an isolated, Greek debt problem which needed to be solved solely by the Mediterranean country. Many
countries, (Germany, for example), were not sympathetic and had no intention of getting involved. However, the situation has gravely changed since the end of 2009. This is not an isolated problem. This is not a Greek problem. This is not even a PIGS country problem. This crisis is a European problem. The sustainability of the euro, the sustainability of the European Monetary Union, and the sustainability of the European Single Market are all wrapped up in how this crisis is handled.

**Why Does This Matter?**

I am sure that the question on many people’s minds is “Why should I care? What does a European debt crisis have to do with me?” As a resident of the United States of America, it may seem like this problem is a world away. One may assume that distance and oceans will keep Europe’s problems across the Atlantic. I assure you, they will not. As much as this is a European problem, it is still of grave concern to our nation and the welfare of our economy. Should the crisis continue to worsen, and should the faith in Europe’s currency and financial system continue to collapse, the United States will undoubtedly feel the effects.

The United States’ banks are “tethered to those in Europe” (Wolf, 2011). Our government, our banks, and our economy are intertwined with the government, banks, and economies of Europe. The United States has exposure in every single one of the PIGS countries, as well as in countries such as Germany, France, and the United Kingdom. If the Eurozone countries are unable or unwilling to resolve this debt crisis, and the PIGS countries can no longer pay their obligations, or the stronger nations refuse to continuously bail them out, then United States’ banks will lose money. The United States will suffer losses and take financial hits. This is something that has the potential to be catastrophic for our already debt-ridden economy.

In addition, Europe is the United States’ most prominent trading partner (Wolf, 2011); we love to export to them, just as they love to export to us. It is a relationship that has benefited both parties for decades. Figures 1-3 and 1-4 show just how important that trade relationship is to the United States.
FIGURE 1-3

United States' Exports To Major Trade Partners

Value of Exports (in millions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Europe</th>
<th>China</th>
<th>Japan</th>
<th>Canada</th>
</tr>
</thead>
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<tr>
<td>2011</td>
<td>$329,014.50</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
</tr>
<tr>
<td>2010</td>
<td>$285,596.20</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
</tr>
<tr>
<td>2009</td>
<td>$258,061.60</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
</tr>
<tr>
<td>2008</td>
<td>$324,997.10</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
</tr>
<tr>
<td>2007</td>
<td>$283,068.00</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
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<tr>
<td>2006</td>
<td>$242,993.60</td>
<td>$50,000.00</td>
<td>$100,000.00</td>
<td>$150,000.00</td>
</tr>
</tbody>
</table>

Source: United States Census Bureau
Figures 1-3 and 1-4 show how crucial trade with Europe is to the United States’ economy. Europe is the nation to which the United States exports the most goods and it is also the nation from which the United States imports the most goods. However, further worsening of the debt crisis could cause this relationship to crumble. "If Europe is weak, if Europe is not growing, as our largest trading partner, that's going to have an impact on our businesses and our ability to create jobs here" (Wolf, 2011).

The United States could also be affected because many companies here in America have investments in Europe that are potentially at stake (Wolf, 2011). Foreign direct investment is an essential and critical component of any business strategy. In the past, Europe has been a key player in United States’ companies gaining a foothold in a foreign market. Europe has single-handedly been the biggest recipient of United States’ foreign direct investment. Figures 1-5 and 1-6 demonstrate just how significant a portion of United States FDI money is invested into European countries.
The Percentage of United States FDI Received by Countries in 2010

45.2% of the United States' 2010 FDI expenditure was distributed to countries in the European Union.

Netherlands, 13.3%
United Kingdom, 13.0%
Canada, 7.6%
Luxembourg, 7.0%
Bermuda, 6.8%
Ireland, 4.9%
Switzerland, 3.7%
Caribbean, 3.8%
Australia, 3.4%
Japan, 2.9%
Germany, 2.7%
Singapore, 2.7%
France, 2.4%
Mexico, 2.3%
Belgium, 1.9%
Other, 21.6%

Source: Barefoot and Ibarra-Caton, “Direct Investment Positions for 2010”
As Figure 1-5 shows, European countries received 45.2% of the United States’ $3,908.2 billion of FDI money for 2010 (Barefoot, 2011). In the same light, as Figure 1-6 demonstrates, Europe has been the region of the world that has historically received the largest amount of foreign direct investment from the United States. The United States has profited significantly over the years from its heavy investment in European countries; likewise, European nations have also benefited significantly from American subsidiaries in their countries. However, now with the crisis engulfing the EU, many European subsidiaries of American companies are feeling the strains of low growth, poor productivity, weakened competition, and so on. These effects may have long-term consequences for the viability of American companies on European soil.

Students at Penn State University must also be aware of the current situation in Europe, and for students in the Smeal College of Business, this knowledge is of utmost importance. It is crucial for business students to stay up-to-date with the global business
world and understand current issues and problems that are plaguing the business environment. It allows one to be a marketable, well-rounded individual who not only achieves good grades and academic success, but also shows an interest in real-world problems and situations. It is critical that when students leave Penn State and enter the working world, they take with them an understanding of exactly what that real-world business environment entails.

In addition, as mentioned above, this financial crisis not only affects European companies and industries, but also companies and industries that are based here in the United States. With Europe being the largest trading partner of the United States, companies need to understand the impact this crisis is having on their businesses and adapt as the current situation changes and evolves. As students leave Penn State and enter the working world with a respectable company here in the United States, it will be crucial for them to be aware of the European debt crisis, as it will undoubtedly have an impact on their industry, their company and perhaps even their job.
Chapter 2:
Greece – Current State

The troubles for Greece seem to be never-ending. Though this crisis has raged on for the past two years, it does not seem to be slowing down or improving in the least, especially when it comes to Greece’s debt woes. In fact, the worsening situation in Greece is making it more and more evident that the rescue efforts are not producing the desired outcomes, and perhaps a different approach is needed. So, where exactly does Greece stand today?

Timeline of the Most Recent Troubles of Greece

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2/7/2012</td>
<td>Greece misses deadline to approve austerity measures required for second bailout (Hope, 2012a).</td>
</tr>
<tr>
<td>2/8/2012</td>
<td>Angela Merkel, German Chancellor, says she has no intention of pushing Greece out of the Eurozone (Wiesmann, 2012).</td>
</tr>
<tr>
<td>2/21/2012</td>
<td>Second Greek bailout of €130 billion approved (Elliot, 2012).</td>
</tr>
<tr>
<td>3/2/2012</td>
<td>Moody’s cuts Greece’s sovereign debt rating to lowest level (Financial Times, 2012).</td>
</tr>
<tr>
<td>3/2/2012</td>
<td>Eurozone members delayed approval of more than half of the €130bn bail-out for Greece (Hope, 2012e).</td>
</tr>
<tr>
<td>3/8/2012</td>
<td>Private investors announced they will participate in Greece’s debt restructuring, allowing the country’s bailout package to proceed (Spiegel, 2012).</td>
</tr>
<tr>
<td>3/20/2012</td>
<td>€14.5 billion of Greek bond repayments became due (Pratley, 2012).</td>
</tr>
</tbody>
</table>

Second Bailout Becomes Inevitable

On March 20, 2012, time once again ran out for the Greeks. The country had yet another debt payment deadline which it could not meet. Greece had €14.5 billion of bond
repayments fall due at the end of March (Pratley, 2012). As a result, Greece was forced, for the second time in less than two years, to turn to its Euro member states for a rescue package or else default on its loans. The €130 billion ($173 billion) loan package was approved and finalized on February 21, 2012.

However, this loan money does not come free. Greece has to approve and carry through with the implementation of even further austerity measures and cuts in government spending in an attempt to get its soaring debt under control. The €3.3 billion of cuts include €300 million in pension cuts, a 22% reduction in minimum wage, and the loss of 150,000 sector jobs over the next few years, among others (Hope, 2012b). In addition, the €130 billion bailout package comes with six main conditions:

1. Greece will have to accept non-Greek inspectors at Athens (Pratley, 2012).
   - A European Commission task force will be "an enhanced and permanent presence on the ground in Greece" in order to improve the workings of the Greek Bureaucracy.

2. The bailout money will be placed into an Escrow Account (Pratley, 2012).
   - Gone are the days of trusting the Greeks. In an attempt to ascertain that the bailout money is being used solely for debt repayment purposes and not for payoff obligations arising for pensions, healthcare, etcetera, the bailout money will be put into a separate escrow account. It will only be allowed to be withdrawn when debt repayments come due.

   - Private holders of Greek bonds must accept even further losses amounting to a 53.5% reduction in the face value of their bonds.
   - With this reduction, Greece’s currently outstanding €206 billion debts to creditors will be cut by €100 billion (Kontogiannis, 2012).
   - 95% of creditors must accept this reduction in order for Greece not to default on its obligations.
   - On March 8, 2012, private investors accepted these further losses.

4. Interest rates on existing bailout loans will be cut (Pratley, 2012).
5. International Monetary Fund will make a sizable contribution to the bailout money (Pratley, 2012).

6. The money will be made available to Greece quickly (Pratley, 2012).

All six of these elements make up Greece’s most current bail-out package. Yet, despite the effort, this rescue package does little to solve the problem at the root of the crisis. It is, at best, a temporary fix. The bailout money helps Greece avoid defaulting on its obligations today. However, it does nothing to allow Greece to attain a position of financial independence and security in the future. It does not improve the country’s competitiveness or productivity. It does not increase the country’s exports or improve the structural flaws in its tax system, government system or pension system. All in all, it does nothing to help Greece find a way to reduce its deficit and national debt on its own through economic prosperity and advancement. Without these changes, the European nations will have to continue to bail out Greece for years to come.

**View of Greeks**

The austerity measures implemented in Greece over the last two years have been extreme to say the least; they seem to keep coming and getting worse. In fact, Greece has been stuck in a recession for the last four years with a cumulative contraction of 14% on its economy (Hope, 2012d). So what do the Greeks think of the current situation in their home country? They are not happy about it and are not afraid to voice their disapproval.

As the second bailout was approved and the details were finalized, Greeks took to the streets in protest of further austerity measures. In no way were the protests, which were mainly centered in Athens, peaceful ones. “45 buildings were set ablaze . . . anti-austerity protests appeared to be an organized arson campaign targeting banks and luxury retail outlets” (Hope, 2012c). In addition, hundreds of youth damaged buildings and wreaked havoc in the streets (Hope, 2012c). It is understandable why the Greeks are so upset. After two years of harsh austerity measures, the thought of €3.3 billion more spending cuts, along with the loss of hundreds of thousands of jobs and increased taxes are more than the residents of this southern Mediterranean country can bear. As one
Greek resident noted, “Two years ago we were demonstrating about [wage and pension] cuts but now they want to take away everything” (Smith, 2012).

It is not only the public faction showing its disagreement with the new bailout plan and further austerity measures. Prominent government officials have also begun voicing their disapproval. In February 2012, as the new bailout deal was being finalized, six cabinet ministers and undersecretaries resigned from their positions in protest of the deal going through (Hope, 2012c). Along with those six individuals, “another 40 backbenches voted against the package,” as they claim that Greece is giving up too much sovereignty to Brussels (Hope, 2012c).

The Greeks have begun to direct their anger and fury at one source, and that is Germany. German flags are being burned in Athens’ streets, and demonstrators are painting the words “Bank of Berlin” onto the façade of Greece’s central bank (Barber, 2012c). While it is easy to simply blame the biggest country in the Eurozone, this Greek/German animosity goes further than that. Tensions between Greece and Germany trace back as far as WWII. Greece is still angered over Germany’s occupation of the country during the 1940s and the national suffering that the Greeks felt at the hands of the Nazis (Barber, 2012c). Understandably, the Greeks do not like the fact that now their country, for which they have unending pride and respect, is essentially being controlled and monitored by the very country that caused them so much distress.

What Lies Ahead for Greece

Greece has a long road ahead of it. It is expected that Greeks will suffer the effects of recession and the most current austerity measures for the next five years (Gow, 2012). The economy is expected to contract by 4.5% in 2012 and remain stagnant in 2013 (Gow, 2012). In addition, Greece’s current debt to GDP ratio is 160% and the goal is that by 2020 that number will be down to 120% (Gow, 2012). In order for that goal to be achieved, Greece will have to make the following changes in the coming years (Münchau, 2012):

- The government must collect taxes
- The government must eradicate corruption
• The labor market must become more flexible
• Trade unions need to be blocked from negotiating wage increases
• Greece needs improved growth and competitiveness

It will be a long, hard, uphill battle for Greece over the next few years. Even after everything the country has been through, and even with perfect implementation of the necessary changes still needed, it is not enough to guarantee that Greece will come out of the crisis on the other side unscathed.

**Economic and Social Indicators**

**TABLE 2-2**

<table>
<thead>
<tr>
<th></th>
<th>Greece – 2010 Quick Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>$305.03 billion</td>
</tr>
<tr>
<td>Real GDP Growth Rate</td>
<td>-4.4%</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>4.7</td>
</tr>
<tr>
<td>Current Account</td>
<td>-$10.6 billion</td>
</tr>
<tr>
<td>Exports</td>
<td>$22.63 billion</td>
</tr>
<tr>
<td>Exports (as a % of GDP)</td>
<td>7.4%</td>
</tr>
<tr>
<td>Imports</td>
<td>$60.17 billion</td>
</tr>
<tr>
<td>Imports (as a % of GDP)</td>
<td>19.7%</td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-$37.54 billion</td>
</tr>
<tr>
<td>Population</td>
<td>11.18 million</td>
</tr>
<tr>
<td>Population Growth</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

*Source: The PRS Group, 2011c*
TABLE 2-3
Unemployment Figures for Greece
As of November 2011

<table>
<thead>
<tr>
<th></th>
<th>Greece</th>
<th>Euro Area Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Unemployment</td>
<td>19.9%</td>
<td>10.5%</td>
</tr>
<tr>
<td>Youth Unemployment</td>
<td>48.1%</td>
<td>21.5%</td>
</tr>
</tbody>
</table>

*Source: Eurostat

FIGURE 2-1

Greece vs. Eurozone Average:
Government Deficit/Surplus

As Figure 2-1 depicts, Greece has had an increasing government deficit for the past several years. The country’s deficit reached its peak in 2009, the same year that Greece’s credit rating began to drastically decline and its economy was caught in the financial crisis. The deficit did decrease from 2009-2010 as a result of austerity measures that the country implemented to bring the country’s debts under control. However, a

*Source: Eurostat*
Greek deficit of -10.6% is still vastly greater than the 3% limit the European Monetary Union imposed as a rule for the Eurozone members. This deficit of 10.6% of GDP equated to a deficit of around $32 billion for Greece in 2010.

**FIGURE 2-2**

Over the past several years Greece has had a much higher national debt as a percentage of its GDP than the Eurozone countries’ average. In 2010, Greece’s debt reached 144.9% of GDP. This equated to roughly $440 billion in government debt for 2010. In 2011, that statistic is as much as 160% of GDP. The country is cutting costs
and increasing revenues every way that it can in an attempt to decrease that number to a more sustainable percentage.

**FIGURE 2-3**

Greece vs. European Union Average Long Term Government Bond Yields (10-Year Bonds)

*Source: Eurostat*

Figure 2-3 depicts the yield Greece must pay on a 10-year government bond. One of the ways that a country raises money is by issuing government bonds to investors and then paying those investors back in the future with interest. The yield on the bond represents the interest that Greece must pay and that the investors will receive. The Eurozone average yield has consistently hovered around 5%, which is a very normal and sustainable rate for a government. Many investors have said that any yield above 7% is unsustainable in the long-run. It is when the yield passes this threshold that investors and analysts become skeptical about whether the country will be able to repay its debt.
obligations. The yield on a 10-year Greek bond has far surpassed the threshold of 7% and today is reaching a value of 25.91%.

Timeline of Greece’s Credit Rating

<table>
<thead>
<tr>
<th>Date</th>
<th>Moody’s Downgrade</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 25, 2009</td>
<td>Greece’s Credit Rating = A1</td>
</tr>
<tr>
<td>December 22, 2009</td>
<td>Greece downgraded from A1 to A2</td>
</tr>
<tr>
<td>April 22, 2010</td>
<td>Greece downgraded from A2 to A3</td>
</tr>
<tr>
<td>June 14, 2010</td>
<td>Greece downgraded from A3 to Ba1</td>
</tr>
<tr>
<td>March 7, 2011</td>
<td>Greece downgraded from Ba1 to B1</td>
</tr>
<tr>
<td>June 1, 2011</td>
<td>Greece downgraded from B1 to Caa1</td>
</tr>
<tr>
<td>July 25, 2011</td>
<td>Greece downgraded from Caa1 to Ca</td>
</tr>
<tr>
<td>March 2, 2012</td>
<td>Greece downgraded from Ca to C</td>
</tr>
</tbody>
</table>

*Source: Moody’s*

Over the past three years, Greece has been downgraded from an original credit rating of A1 with low credit risk, to a current credit rating of C, or “junk bond” status. With a credit rating of C, Moody’s is expecting Greece to default and the investors will not recover their principal and interest. Table 2-5 gives an overview of how Moody’s categorizes these credit ratings and what each one means in terms of a country’s ability to pay back its obligations.
**TABLE 2-5**  
Moody’s Credit Rating System

<table>
<thead>
<tr>
<th>CREDIT RATING</th>
<th>DESCRIPTION</th>
</tr>
</thead>
</table>
| AAA           | Highest quality  
Lowest credit risk |
| Aa1           | High quality  
Low credit risk |
| Aa2           | High quality  
Low credit risk |
| Aa3           | High quality  
Low credit risk |
| A1            | Upper-medium grade  
Low credit risk |
| A2            | Upper-medium grade  
Low credit risk |
| A3            | Upper-medium grade  
Low credit risk |
| Baa1          | Medium grade with speculative elements  
Moderate credit risk |
| Baa2          | Medium grade with speculative elements  
Moderate credit risk |
| Baa3          | Medium grade with speculative elements  
Moderate credit risk |
| Ba1           | Has speculative elements  
Significant credit risk |
| Ba2           | Has speculative elements  
Significant credit risk |
| Ba3           | Has speculative elements  
Significant credit risk |
| B1            | Speculative  
High credit risk |
| B2            | Speculative  
High credit risk |
| B3            | Speculative  
High credit risk |
| Caa1          | Poor quality  
Very high credit risk |
| Caa2          | Poor quality  
Very high credit risk |
| Caa3          | Poor quality  
Very high credit risk |
| Ca            | Highly speculative  
Likelihood of being near or in default  
Some possibility of recovering principal and interest |
| C             | Lowest quality  
Usually in default  
Low likelihood of recovering principal and interest |

*Source: Moody’s*
In April of 2011, Portugal was forced to put aside its pride and ask for bailout money in order to avoid defaulting on its obligations. It was an option that no one in Portugal wanted to take. But eventually time had run out and the need for assistance became inevitable. Ever since the bailout package was approved, Portugal has been struggling to stay afloat. Despite hopes that the extra money would buy the country more time and help it pull itself out of the crisis, Portugal is still engulfed with debt woes and a very weak and struggling economy. This has led many to wonder if the rescue package and austerity measures required are helping the country or plunging its economy into further decline.

**Austerity Measures: Helping or Hurting?**

Before it succumbed to requesting a bailout package, Portugal was putting severe austerity measures in place in order to avoid that fate. The austerity measures implemented in 2010 included a 5% cut in the wage of public sector workers, a 2% increase in its value-added tax, and a freeze on state pensions (Wise, 2010b). Then, Portugal’s €78 billion bailout package was approved, and along with it came even more austerity measures. Hikes in sales, property, and health service taxes were implemented (Steinhauser, 2011). Unemployment benefits were cut to 18 months and there was a further cut to state pensions (Steinhauser, 2011). In January of 2012 even more austerity measures were being discussed in order to ease the debt woes of the struggling country. Among these measures were cuts to holiday entitlement, further cuts to compensation layoffs, cuts to overtime pay, and other cutbacks (Hatton, 2012b).

There can be no question that Portugal is doing everything in its power to reduce its spending and increase its revenues. However, the very measures that were expected to bring the economy out of its downward spiral may very well be plunging it into further despair. Portugal’s economy is struggling. After a severe recession last year, Portugal’s economy is expected to contract another 3.1% in 2012 (Hatton, 2012b). Its
unemployment rate has reached 13.6% of the workforce, and that number is as high as 30% among the youth (Barber, 2012a). Understandably, tens of thousands of graduates are leaving Portugal every year with hopes for better prospects in another country (Barber, 2012a). In light of high unemployment and severe cuts to workers’ wages, the standard of living in Portugal has declined over the past few years and will continue to decline in the future. It is expected that “disposable income will decline 11% between 2011 and 2013” (Hatton, 2012a). This will have a crucial impact on domestic consumption and growth prospects for the country.

At the heart of the austerity measures are Portugal’s banks. As a condition of the bailout package, all banks are required to keep extra cash and funds on reserve in order to more adequately weather the sovereign debt crisis. This process, “called deleveraging, has compelled [the banks] to reduce the number of loans they grant” to people and businesses (Hatton, 2012c). Financing is being cut off. This is having disastrous effects on Portugal’s economy. The lack of credit is hurting export companies which cannot get the cash they need to keep themselves competitive and thriving (Hatton, 2012c). In addition, with a limited supply of money to hand out, banks are finding it harder to come up with money to “help ailing public companies whose low credit rating has shut them out of international financial markets” (Hatton, 2012c). More and more companies are shutting down or scaling back. Productivity is down and exports are hurting. Jobs are being terminated and people are out looking for work that is not there. Unfortunately, this is all a result of the austerity measures that were supposed to rescue a country entangled in the sovereign debt crisis.

**Hometown Opinion**

The Portuguese are the first ones to voice their disapproval over the austerity measures and the after-effects they are causing. As Portugal announced its most recent plans for more cuts and higher taxes, trade unions staged strikes and protests in disapproval (Hatton, 2012a). In November 2011, “planes were grounded, trains halted and public services interrupted as workers across the nation of 11 million people protested against job losses, tax hikes and pay cuts agreed between Portugal and the
troika of lenders—the European Commission, European Central Bank and International Monetary Fund” (Reuters, 2011).

Though the outcry is not as widespread or as violent as that felt in Greece, the Portuguese are clearly not happy with the situation their government has put them in. In a poll taken in February of 2012, 48.4% of Portuguese said that austerity measures are not the best way to solve the sovereign debt crisis (Hatton, 2012a). Despite the resounding voice of disapproval over the bailout package and the steps that have been taken to solve this crisis, the government is standing resolute in its view that there is no other way. It is attempting to assure the public that this is what must be done or the country’s situation will become catastrophic.

Economic and Social Indicators

TABLE 3-1

<table>
<thead>
<tr>
<th>Portugal – 2010 Quick Statistics</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>$228.74 billion</td>
</tr>
<tr>
<td>Real GDP Growth Rate</td>
<td>1.4%</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>1.4%</td>
</tr>
<tr>
<td>Current Account</td>
<td>-$22.61 billion</td>
</tr>
<tr>
<td>Exports</td>
<td>$48.91 billion</td>
</tr>
<tr>
<td>Exports (as a % of GDP)</td>
<td>21.4%</td>
</tr>
<tr>
<td>Imports</td>
<td>$72.67 billion</td>
</tr>
<tr>
<td>Imports (as a % of GDP)</td>
<td>31.8%</td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-$23.76 billion</td>
</tr>
<tr>
<td>Population</td>
<td>10.73 million</td>
</tr>
<tr>
<td>Population Growth</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

*Source: The PRS Group, 2011d
TABLE 3-2
Unemployment Figures for Portugal
As of January 2012

<table>
<thead>
<tr>
<th></th>
<th>Portugal</th>
<th>Euro Area Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Unemployment</td>
<td>14.8%</td>
<td>10.7%</td>
</tr>
<tr>
<td>Youth Unemployment</td>
<td>35.1%</td>
<td>21.6%</td>
</tr>
</tbody>
</table>

*Source: Eurostat

FIGURE 3-1

As mentioned before, the Eurozone set a 3% deficit ceiling. While Portugal was right around that target in 2007 and 2008, the country has since allowed its deficit to increase dramatically. A culture of corruption, rigid labor markets, and severely low productivity are some of the reasons for this extreme increase. These reasons will further be explained in Chapter 7: Portugal – Factors Contributing to its Financial Problems.
Portugal’s -9.8% deficit of GDP equated to roughly $22.4 billion for 2010. The country is now doing everything possible to bring its deficit back to the common currency limit.

**FIGURE 3-2**

**Portugal vs. Eurozone Average:**
**Government Gross Debt**

Portugal’s national debt seems to be staying just above the Eurozone average. However, over the past year Portugal’s national debt has increased, and it is expected that within the next year, Portugal’s debt will have reached 118% of the country’s GDP (Barber, Portugal’s Debt Threatens to Create Fresh Storms for Euro). That large increase, coupled with a massive deficit, high borrowing costs, and a very low credit rating is proving to be quite a challenge for a country that is hoping to pull itself out from the downward spiral it is facing.
FIGURE 3-3

Portugal vs. European Union Average Long Term Government Bond Yields (10 Year Bonds)

Portugal’s yield on its 10-year government bond is well above the sustainable rate of 7%. In fact, in late January 2012, Portugal’s yield reached a record high of 17% (Barber, 2012b). Like Greece, these high yields are completely unsustainable for the Portuguese government and must be brought down if the country has hopes to re-enter the bond market.
Timeline of Portugal’s Credit Rating

<table>
<thead>
<tr>
<th>Date</th>
<th>Moody’s Downgrade</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 29, 2009</td>
<td>Portugal’s Credit Rating = Aa2</td>
</tr>
<tr>
<td>July 13, 2010</td>
<td>Portugal downgraded from Aa2 to A1</td>
</tr>
<tr>
<td>March 15, 2011</td>
<td>Portugal downgraded from A1 to A3</td>
</tr>
<tr>
<td>April 5, 2011</td>
<td>Portugal downgraded from A3 to Baa1</td>
</tr>
<tr>
<td>July 5, 2011</td>
<td>Portugal downgraded from Baa1 to Ba2</td>
</tr>
<tr>
<td>February 13, 2012</td>
<td>Portugal downgraded from Ba2 to Ba3</td>
</tr>
</tbody>
</table>

*Source: Moody’s*

Over the past three years, Portugal’s credit rating has dropped from Aa2 of high quality and low credit risk to Ba3 with speculative elements and a significant credit risk. The multiple downgrades have been a factor in causing Spain’s long-term bond yields to rise dramatically, increasing the country’s cost to borrow money.
Chapter 4:  
Spain – Current State

Spain’s current situation is not as dire as that of some of the other PIGS countries. It is facing troubles such as a high public deficit, need for more austerity measures and an unmatched, soaring unemployment rate. However, that does not mean that the EU or its member states should put Spain on the back burner. As the fourth largest member in the Eurozone, Spain could cause catastrophic consequences to the viability of Europe’s common currency, more so than Portugal or Greece ever could. It is feasible to find the money to bail out the smaller countries of the Eurozone; however, should Spain’s debt obligations increase and their situation worsen to the level of the situation in Greece, the EU would have the near impossible task of coming up with enough money to bail out an economy as massive as Spain’s.

Defying European Union Rules

For the past few years, Spain has been fighting an increasing public deficit. The reasons for this include a national culture of corruption and tax evasion, as well as a massive housing bubble that burst in 2007 and left the economy in shambles. These reasons will be further explained in Chapter 8: Spain – Factors Contributing to its Financial Problems. Spain’s public deficit reached a high of 11.2% of GDP in 2010 (Figure 4-1). Since then, the country has been implementing austerity measures and increasing revenue in the hopes of bringing that number down. Despite its progress in decreasing its deficit, Spain has repeatedly failed to achieve the public deficit target set forth by the European Union. In 2011, the European Union set a target of 6% of GDP for Spain’s deficit. Spain actually recorded a public deficit of around 8.5% of GDP (Agence France-Presse, 2012f). This additional 2.5% of the deficit equated to “the state spending €90 billion ($119 billion) more than it took in last year (Agence France-Presse, 2012f).

Hoping to make up for 2011’s larger-than-desired deficit, the European Union set a 2012 aggressive target of bringing the 8.5% deficit down to 4.4% of GDP (Agence France-Presse, 2012b). Spain accepted that target and said it was an achievable goal.
However, only three months into 2012, Spain has already announced that its deficit for this year will more realistically be 5.8% of GDP (Agence France-Presse, 2012f). The European Union is not pleased with this announcement. Spain may now be forced to pay the price, literally, for its refusal to meet the EU target. Spain “risks a cash fine worth between 0.2% and 0.5% of GDP depending on the severity of the circumstances” (Agence France-Presse, 2012f).

A high public deficit will continue to be a key issue that Spain must tackle in the coming months. It is implementing new measures in order to achieve a deficit of 3% by 2013. In January, Spain banned 17 regional governments from running budget deficits (Agence France-Presse, 2012e). These regional governments, which provide education and health services for the citizens of their regions, accounted for one-third of the Spanish government’s overall spending, thus contributing a large portion to the national debt (Agence France-Presse, 2012e). Spain’s central government is hoping to reign in the actions of the regional governments in an effort to get its deficit back on track with Eurozone requirements. Also in January, Spain “suspended subsidies for all new power plants using renewable energy” (Mallet, 2012a).

Everywhere they can, the central government and the regional governments are cutting spending. However, along with less money being spent comes less projects being completed, less jobs being created, more jobs being terminated, and above all, a shrinking economy. Spain’s economy is predicted to contract by 1.5% in 2012, as the country sits on the brink of a recession (Johnson, 2012b). This does not seem to be a very promising future for the residents of this Mediterranean country.

**Unmatched Unemployment**

One of the most compelling and important issues that the Spanish government must face in the coming months is Spain’s extremely high, and continuously rising, unemployment rate. Spain’s current unemployment numbers are depicted in Table 4-1.
Spain’s unemployment rate of 23.3% is the highest in Europe, significantly unmatched by any other country. In fact, the countries with the next closest unemployment rates are Portugal and Ireland at around 15% (Eurostat). With Spain’s unemployment rate nearing 1 in 4 people, over 5.3 million people are jobless and searching for work in a country without many opportunities (AFP, 2012). While the unemployment rate initially rose as construction workers and other blue collar workers lost their jobs during the burst of the housing bubble, the effects are now being felt more extensively across the nation. Those individuals who are well off and who had previously avoided the effects of the crisis are now losing their jobs and feeling the pain of austerity (Johnson, 2012c).

Yet, among everyone, it is the youth who are affected the most. Spanish youth unemployment, steadily increasing over the past year, reached 50% by the beginning of 2012. One in two younger individuals (age 15-24) is out of work. This is an alarmingly higher rate than the euro-area average of only 21%, and Spanish youth are not happy about it. “Students and unemployed people in their 20s . . . have staged protests in dozens of Spanish cities” (Johnson, 2011). There is an outcry for change and job creation. However, with the austerity measures being set forth and the drastic cuts in government spending, the outlook does not look too bright.

*Source: Eurostat*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>23.3%</td>
<td>10.7%</td>
<td>12.6%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>49.9%</td>
<td>21.6%</td>
<td>28.3%</td>
</tr>
</tbody>
</table>
TABLE 4-2

Spain –
2010 Quick Statistics

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>$1,407.95 billion</td>
</tr>
<tr>
<td>Real GDP Growth Rate</td>
<td>-0.1%</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>1.9%</td>
</tr>
<tr>
<td>Current Account</td>
<td>-$64.34 billion</td>
</tr>
<tr>
<td>Exports</td>
<td>$252.97 billion</td>
</tr>
<tr>
<td>Exports (as a % of GDP)</td>
<td>18%</td>
</tr>
<tr>
<td>Imports</td>
<td>$315.32 billion</td>
</tr>
<tr>
<td>Imports (as a % of GDP)</td>
<td>22.4%</td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-$62.35 billion</td>
</tr>
<tr>
<td>Population</td>
<td>45.32 million</td>
</tr>
<tr>
<td>Population Growth</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

*Source: The PRS Group, 2011b

Unemployment Figures – See TABLE 4-1 on page 36

FIGURE 4-1

Spain vs. Eurozone Average:
Government Deficit/Surplus

The Eurozone set a 3% deficit limit.

Source: Eurostat
Spain’s national debt does not seem so terrible when the numbers are compared to the Eurozone Average; it has a significantly lower national debt than many other countries. However, this data was compiled nearly two years ago. While Spain’s national debt does not seem that bad, its deficit of over 9% of GDP is causing that figure to increase rapidly each year. In fact, analysts put Spain’s actual national debt for the beginning of 2012 at around 87% of GDP (Mallet, 2012b). If Spain does not get its deficit under control, this national debt will continue to increase in the future, putting Spain in a very vulnerable position to pay off its debts.
Spain has thus far managed to keep its 10-year government bond yields within the 7% threshold. This is a positive thing for the country in terms of its ability to raise money and pay off its obligations. However, should the country’s yield begin to increase towards that 7% mark, the country will find itself in a much more dire situation than it is presently in.

*Source: Eurostat*
Timeline of Spain’s Credit Rating

TABLE 4-3
Spain
Moody’s Credit Rating for the Country

<table>
<thead>
<tr>
<th>Date</th>
<th>Moody’s Downgrade</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2010</td>
<td>Spain’s Credit Rating = AAA</td>
</tr>
<tr>
<td>September 30, 2010</td>
<td>Spain downgraded from AAA to Aa1</td>
</tr>
<tr>
<td>March 10, 2011</td>
<td>Spain downgraded from Aa1 to Aa2</td>
</tr>
<tr>
<td>October 18, 2011</td>
<td>Spain downgraded from Aa2 to A1</td>
</tr>
<tr>
<td>February 13, 2012</td>
<td>Spain downgraded from A1 to A3</td>
</tr>
</tbody>
</table>

*Source: Moody’s

In the past two years, Spain’s credit rating has dropped from AAA – the highest quality and lowest credit risk, to A3 – upper medium grade and low credit risk. A3 is not a terrible credit rating status. The country is still ranked as investment grade and is nowhere near defaulting on its obligations. However, the fact that Spain has dropped so many ranks in such a short time is not a positive thing for such a large country, and it is causing investors to worry about the country’s long-term viability.
Chapter 5:
Italy – Current State

It can be argued that the fate of the euro rests with Italy. Italy is the Eurozone’s third largest economy, behind those of Germany and France. “If the Eurozone’s third largest economy cannot chart a credible economic course, the euro does not have a future” (Stephens, 2012). At the epicenter of this very crucial country is Prime Minister Mario Monti, an academic with previous experience as the European Union’s competition chief (Dinmore, 2011d). He has only been in office since November of 2011 and has already instituted a €30 billion austerity package aimed to raise revenue and cut spending (Dinmore, 2011e). He is doing everything in his power to ascertain that Italy does not fall victim to the sovereign debt crisis contagion.

While Italy does not have a staggeringly high public deficit (4% of GDP in 2011) (Agence France-Presse, 2012a) compared to some of the other southern countries, the sheer value of its debt will be more than the European Union and its members can handle, should Italy resort to a bailout package. Both Greek bailouts will have been pocket change compared to the amount of money it will take to prevent Italy from defaulting on its debt obligations. Italy’s current debt burden is €1.9 trillion ($2.5 trillion) which equates to 120% of the country’s GDP (Agence France-Presse, 2012c). In the coming year, Italy must raise €450 billion to meet its debt obligations that are coming due (Leridon, 2011). Though the situation in Italy is not as helpless as those in the other PIGS countries, Italy is not yet in the clear. The country is facing a multitude of problems, only one of which is a rising national debt. Italy is in the midst of a recession, with a high unemployment rate, a crippling labor market, a severe inequality between its developed north and lagging south, and above all, stagnant growth.

Italy’s Chronic Weakness: Lack of Growth

Italy’s most important issue at the present time is its growth, or rather lack thereof. Italy has endured a decade of stagnant growth; its GDP has grown by an average of only 0.2% a year compared to the Eurozone average of 1.1% (Dinmore, 2011a); and its
growth prospects for the future are weak. Monti has already approved an austerity package in order to avoid the spreading of the debt crisis contagion. However, Italy’s Prime Minister is now focusing efforts in the coming months on sparking growth and restoring competitiveness to a country that seems to have forgotten what those two words mean.

In order to combat stagnant growth and low productivity, Monti is looking to create changes and improvements to Italy’s labor market. The reforms that Monti is proposing include:

1. Introducing “more flexible contracts to encourage workers to switch jobs” (Dinmore, 2012)
2. Narrowing the gap between “contracts that effectively give some workers lifelong protection and those that are on vulnerable short term contracts” (Dinmore, 2012)

Italy’s labor market has very strict rules for hiring and firing workers. As one entrepreneur notes, “it is easier to divorce your wife than fire your employee” (Dinmore, 2012). The laws and governing rules have paved the way for a system that guarantees a job for life to some workers while giving little to no benefits to others on short-term contracts (Dinmore, 2011e). Monti hopes to combat these inequalities in order to increase productivity and allow Italy’s economy to grow.

While Monti and several other leaders in the EU agree that promoting growth needs to be a prime focus in order to help pull the struggling economies from their woes, the two EU powerhouses, Germany and France, are not yet sold on the idea. Germany has been a pillar for solving the crisis through fiscal responsibility and austerity measures. Italy might have difficulty convincing Merkel and Sarkozy that spending time, resources, and money in order to stimulate growth and improve productivity are worthwhile investments at a time when a debt crisis is threatening to unravel the euro.

**Italy’s North vs. South: Two Different Economies**

Italy’s economy shares some striking similarities to the Eurozone amid its sovereign debt crisis. Italy’s north is prosperous, industrialized and wealthy, while its southern region is poor, rural and severely lacking in the infrastructure and technology
needed to gain a competitive advantage. This north-south inequality has been an issue for the country for many decades. Countless Prime Ministers and governments have poured money into Italy’s southern regions in hopes of stimulating growth and economic advancement; however, they have seen only minimal success and this is still a problem that Italy must tackle today. In 2011, the “per capita GDP for southern Italy’s 20 million people [was] 40% lower than in the north” (Dinmore, 2011b). Unemployment has historically been much higher in the south as well. In 2011, Italy’s southern regions experienced an unemployment rate that was three times that of the industrialized north (Dinmore, 2011b). The south also experiences much higher rates of organized crime and corruption.

This severe inequality within the country is crippling Italy’s economy and fueling those who are skeptical that Italy can pull itself out of Europe’s sovereign debt crisis. For instance, “GDP in the north may grow by as much as 3% a year, but in the south it shrinks by 2%, pulling the average down (The Economist, 2011). How can Italy expect to cut spending, raise taxes, and still hope for growth when its southern regions continue to undermine the progress and achievements of the north? This is a problem Italy must tackle in the future if it wants to spur growth in the country. However, achieving the necessary reforms and changes while wrapped up in austerity measures and fiscal responsibility will be a definite challenge for the Eurozone’s third largest economy.
Economic and Social Indicators

**TABLE 5-1**

<table>
<thead>
<tr>
<th>Italy – 2010 Quick Statistics</th>
<th>GDP</th>
<th>$2,049.8 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth Rate</td>
<td>1.2%</td>
<td></td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>1.6%</td>
<td></td>
</tr>
<tr>
<td>Current Account</td>
<td>-$67.94 billion</td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>$448.39 billion</td>
<td></td>
</tr>
<tr>
<td>Exports (as a % of GDP)</td>
<td>21.9%</td>
<td></td>
</tr>
<tr>
<td>Imports</td>
<td>$473.13 billion</td>
<td></td>
</tr>
<tr>
<td>Imports (as a % of GDP)</td>
<td>23.1%</td>
<td></td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-$24.74 billion</td>
<td></td>
</tr>
<tr>
<td>Population</td>
<td>60.1 million</td>
<td></td>
</tr>
<tr>
<td>Population Growth</td>
<td>0.4%</td>
<td></td>
</tr>
</tbody>
</table>

*Source: The PRS Group, 2011a

**TABLE 5-2**

<table>
<thead>
<tr>
<th>Unemployment Figures for Italy</th>
<th>As of January 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Italy</td>
</tr>
<tr>
<td>Total Unemployment</td>
<td>9.2%</td>
</tr>
<tr>
<td>Youth Unemployment</td>
<td>31.1%</td>
</tr>
</tbody>
</table>

* Source: Eurostat
When looking at Italy’s deficit as a percentage of GDP, it does not seem as though the country is doing that poorly. After all, it is only slightly higher than the Eurozone limit of 3% and much less than the Euro Area average of 6.2%. However, Italy is the Eurozone’s third largest economy. Therefore, when you consider the size of Italy and its GDP, that 4.6% deficit becomes a huge deficit in nominal terms. In January 2012, Italy’s deficit had reached €4 billion (Agence France-Presse, 2012g). This 4.6% deficit equates to a staggeringly high obligation when compared to the nominal debt obligations of some of the smaller peripheral economies that have higher deficits as a percentage of GDP.
Italy’s national debt was 118.4% of GDP in 2010. In January 2012, that figure reached 120%, amounting to a record high national debt of €1.94 trillion ($2.47 trillion) (Agence France-Presse, 2012g). Again, the worry with Italy stems from its size. Should Italy find itself in a position of near default, the Eurozone and its members would not have the capital and means to bailout a country with this much debt.
Like Spain, Italy’s yield on 10-year government bonds is hovering right around the 7% threshold. It actually surpassed that mark in November 2011 only to decrease a month later. Italy must keep its yield decreasing in order to ensure that its massive debt obligations remain under the country’s control.

*Source: Eurostat*
Timeline of Italy’s Credit Rating

### TABLE 5-3

<table>
<thead>
<tr>
<th>Date</th>
<th>Moody’s Downgrade</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>June 17, 2011</strong></td>
<td>Italy’s Credit Rating = Aa2</td>
</tr>
<tr>
<td><strong>October 4, 2011</strong></td>
<td>Italy downgraded from Aa2 to A2</td>
</tr>
<tr>
<td><strong>February 13, 2012</strong></td>
<td>Italy downgraded from A2 to A3</td>
</tr>
</tbody>
</table>

*Source: Moody’s*

Italy is in the same position as Spain in that its credit rating has not dropped into speculative grade status. However, Italy’s credit rating is currently at A3 which means that the country is rated as upper-medium grade with low credit risk. If Moody’s continues to doubt Italy’s ability to repay its obligations and the agency further downgrades Italy’s rank, the country would become a much greater issue for the European Union and the viability of the common currency.
Chapter 6:  
**Greece – Factors Contributing to its Financial Problems**

**Spendthrift Culture**

Greece is in this financial crisis because it has too much debt on its books. A country does not accumulate this massive national debt without spending much more over the years than it was bringing in. That is exactly what Greece has been doing for the last decade since joining the common currency. They have had a field day with over-consumption. This is, in part, because of the cultural mentality of the Greek people to spend more money than they have; they have “grown accustomed to consuming above [their] means (Gros, 2012).

A spendthrift is an individual, organization or institution that spends money recklessly or wastefully. Greece is one of the world’s leading spendthrifts. The country has a net savings rate of -7% of its GDP (Chancellor, 2010). The government and its leaders are the main players in Greece’s spendthrift ways. For example, in the past, politicians would get elected into office by promising populist policies with increases in government spending. Then the economy would take a turn for the worse, and those politicians would refrain from cutting excessive spending for fear that they would lose the approval of their voters (The Nation, 2012).

In addition, perhaps one of the most prominent examples of Greek extravagance was when Athens hosted the 2004 summer Olympics. In 2004, the Greek government estimated that they would spend $5.9 billion to get the city ready for the games (Lynn, 2011). However, when it was all said and done, the government spent upwards of $15 billion, more than three times its original budget (Lynn, 2011). Much of this money went to constructing brand new stadiums and buildings that would become useless once the games were over. Even today, in a time of debt crisis, the Greek government has done little to curb its excessive spending ways. The government’s spending is still around 50% of GDP in 2012, despite the fact that the country is facing near-certain default (Liao, 2012).

During the past decade, Greece could finance its over-consumption and negative savings rate by raising money in the foreign markets. Whenever the country was in need
of more cash it would issue bonds which it promised to pay back in the future. The
country then was then able to relish in its new-found wealth and satisfy its spendthrift
ways. Some people might question why lenders were so willing to hand over cash to
Greece if it was continuously spending more than it was able to pay back. The simple
answer to that is that many investors felt secure in their investments because they
assumed that the other countries of the Eurozone, namely the rich northern countries,
would pick up the tab if Greece ever got into trouble. They believed that because of the
structure of the common currency, the obligations of one country would have to become
the obligations of every country. As a result, investors continued to lend more and more
money to the spendthrift Greeks.

However, once the obligations began coming due, Greece found it did not have
the means to repay the bonds it issued. Its years of over-consumption had finally caught
up with the country and the Greeks were left to wonder “What do we do now?” The only
option Greece had left was to turn to its thrifty and financially responsible neighbors for
help.

Thrifty Germans

Just as Greece is on one end of the spectrum as one of the world’s leading
spendthrifts, Germany falls on the other end of that spectrum as one of the thriftiest
nations in the world. Where the Greek national savings rate stands at -7% (Gros, 2012),
the average annual savings of a German is 11% of his income (Kulish, 2008). The
mentality of the Germans when it comes to money and savings could not be more polar
opposite from the Greeks. Germans are “always saving, saving, saving; it’s part of the
German mentality” (Daragahi, 2010). As a result, Germans hate credit, invest little in the
stock market, and are less likely to own their own homes (Daragahi, 2010).

The countries’ respective financial positions are a testament to these polar
opposite mentalities. These staggeringly different mentalities can be seen in their
financial positions. TABLE 6-1 compares the deficits and national debts of Germany and
Greece.
TABLE 6-1
Germany vs. Greece
Comparison of the Countries’ Deficits and National Debts

<table>
<thead>
<tr>
<th></th>
<th>Germany</th>
<th>Greece</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010 Government Deficit (as a % of GDP)</td>
<td>-4.3%</td>
<td>-10.6%</td>
</tr>
<tr>
<td>2010 Government Gross Debt (as a % of GDP)</td>
<td>83.2%</td>
<td>144.9%</td>
</tr>
</tbody>
</table>

*Source: Eurostat

While the Germans would normally not care in the least about these stark disparities, the common currency makes Greece’s problems every bit Germany’s problems. The Germans, who have lived fiscally responsibly and thrifty, are now footing the bill for Greece’s, as well as some of the other southern Mediterranean countries’, spendthrift ways. Needless to say, they are not happy about it. In a poll taken in 2010, when Germany and the rest of Europe were first contemplating the idea of a bailout package for Greece, over two-thirds of Germans said that they did not favor financial assistance for the Mediterranean country (Kulish, 2010). In addition, 53% of Germans said that they did favor “expelling Greece from the euro group entirely if its mountain of debt threatened the stability of the currency union” (Kulish, 2010).

**Corruption**

Corruption has been a significant contributing factor to Greece’s economic woes and its inability to pull itself out of this crisis. However, before delving any further into Greece’s disastrous corruption problem and how it is contributing to the country’s current economic state, it is useful to give an overview of corruption in general and why it can be a very serious problem for countries.

*Overview of Corruption*

Corruption is loosely defined as “the abuse of entrusted power for private gain” (Transparency International). This can be achieved through bribes, kickbacks,
embezzlement of money, votes being bought instead of won, etcetera. Government officials, political parties, and institutional leaders are some of the groups of individuals who more commonly get wrapped up in corrupt practices. But what does corruption have to do with an ever-increasing debt problem? Corruption can have many negative effects on a country, some of which include economic as well as social consequences.

In terms of economic consequences, corruption can lead to the financing of “uneconomic high profit projects (such as dams and power plants) at the expense of fundamental infrastructure projects (such as schools and hospitals)” (Transparency International). Projects that will benefit a country and its people may often be overlooked and rejected so that those in power can garner some benefit, either monetary or not. In addition, corruption can also distort competition (Transparency International). Those companies and individuals that engage in corrupt practices will gain a competitive advantage over others who do not. They will be able to conduct transactions quicker and cheaper and with no regard to the rules that have been set forth by the industry. Those companies and individuals who do not engage in corrupt practices may not be able to stay competitive and may be forced to close shop.

In terms of social consequences, corruption can “undermine people’s trust in their [country’s] political system, institutions and leaders” (Transparency International). Trust in its political system is a very crucial thing for any country to have. It is on this system that a country was built and run. It is on this system that decisions for the people are made. If trust is absent, then the government and its leaders may lose their ability to effectively run the government.

So, where do corruption levels stand in the European Union? How do the levels of corruption in the PIGS countries compare to the levels of corruption in the other member countries of the common currency? Transparency International assembled a Corruption Perceptions Index for 2011. The Corruption Perception Index “measures the perceived levels of public sector corruption in 183 countries and territories around the world.” TABLE 6-2 on the next page shows the results for 2011.
TABLE 6-2
2011 Corruption Perceptions Index

<table>
<thead>
<tr>
<th>Country</th>
<th>Score**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>3.4</td>
</tr>
<tr>
<td>Italy</td>
<td>3.9</td>
</tr>
<tr>
<td>Portugal</td>
<td>6.1</td>
</tr>
<tr>
<td>Spain</td>
<td>6.2</td>
</tr>
<tr>
<td>France</td>
<td>7</td>
</tr>
<tr>
<td>United States</td>
<td>7.1</td>
</tr>
<tr>
<td>Germany</td>
<td>8</td>
</tr>
</tbody>
</table>

*Source: Transparency International

**A country’s score indicates the perceived level of public sector corruption on a scale of 1-10, where 0 means that a country is perceived as highly corrupt and 10 means that a country is perceived as very clean (Transparency International).

Table 6-2 above shows the detailed score for the countries on which this paper is focusing. But how do the PIGS countries compare to the rest of the EU and Western Europe? Table 6-3 below shows the countries of Europe ranked in order of their corruptness:
### TABLE 6-3

2011 Corruption Perceptions Index  
Countries Ranked in Order of Decreasing Corruptness  
*Region: EU & Western Europe*

<table>
<thead>
<tr>
<th>European Rank**</th>
<th>Country</th>
<th>Global Rank*** (Out of 183 Countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Greece</td>
<td>102</td>
</tr>
<tr>
<td>2</td>
<td>Romania</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Italy</td>
<td>114</td>
</tr>
<tr>
<td>4</td>
<td>Slovakia</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Latvia</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Czech Republic</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Hungary</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Lithuania</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Poland</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Malta</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Slovenia</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Portugal</td>
<td>151</td>
</tr>
<tr>
<td>13</td>
<td>Spain</td>
<td>153</td>
</tr>
<tr>
<td>14</td>
<td>Cyprus</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Estonia</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>France</td>
<td>159</td>
</tr>
<tr>
<td>17</td>
<td>Ireland</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Belgium</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>UK</td>
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<tr>
<td>20</td>
<td>Austria</td>
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<tr>
<td>21</td>
<td>Germany</td>
<td>170</td>
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<tr>
<td>22</td>
<td>Iceland</td>
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<tr>
<td>23</td>
<td>Luxembourg</td>
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<td>24</td>
<td>Switzerland</td>
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<tr>
<td>25</td>
<td>Netherlands</td>
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<tr>
<td>26</td>
<td>Norway</td>
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<td>27</td>
<td>Sweden</td>
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<tr>
<td>28</td>
<td>Finland</td>
<td></td>
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<tr>
<td>29</td>
<td>Denmark</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Transparency International*

**Rank 1 is most corrupt and rank 29 is least corrupt**  
***Rank 1 is most corrupt and rank 183 is least corrupt*
The Corruption Situation in Greece Today

According to Transparency International, Greece is the #1 country in the European Union with the biggest problem of corruption; in fact, ask any Greek citizen and they will corroborate that perspective. When surveyed, 98% of Greeks said that corruption was a major problem and 88% said that corruption is an everyday part of the Greek business culture (Agence France-Presse, 2012d). Bribes, kickbacks, favorable treatment and misrepresented information have become normal everyday occurrences in the Greek business life, and have been so since Greece joined the common currency in 2001.

In 2010, Greece came under fire because analysts claimed that in 2001 the country “massaged its public finance data to ensure that the country qualified for Eurozone entry” (Barber, 2010). When the EMU was formed, and the five criteria for entry were established, Greece failed miserably in every respect to meet those requirements. However, just two years later, Greece mysteriously seemed to have gotten its finances, public deficits and debt in order. With new information coming to light, many people believe that corrupt practices and misleading information were now behind those improved financial statistics. In addition, over the past few years, Greece has been “condemned by the European Commission for falsifying data about its public finances,” specifically understating its budget deficit and public debt (Barber, 2010).

Greece has even taken its corrupt practices to the extent that it has wasted EU money and subsidies given to the country to help it modernize and gain competitiveness. “Greece has for three decades benefitted from EU subsidies given to the country to help it catch up with richer northern members of the bloc” (Asiaone, 2010). Overall, Greece has received €240 billion euros in European aid (Asiaone, 2010). However, the management of that money “was driven more by a culture of clientelism than by economic efficiency . . . and [the money] ended up going towards consumption and over-consumption” (Asiaone, 2010).

While corruption is a significant problem in every sector of Greek life, nowhere is it more prevalent than in the public sector. One area of the public sector that is riddled with corrupt practices is the national health system and its doctors, surgeons, and hospital employees. “In exchange for bribes of up to €5,000 each, surgeons agree to promote
individual patients to the top of the public hospital surgery waiting list” (Koutsoukis, 2010). In addition, those same doctors and surgeons are claiming that the operations they are performing are for serious medical conditions when, in reality, the patient is receiving cosmetic surgery (Koutsoukis, 2010). This means that the government and its tax payers are coughing up money for surgeries that should not be paid for by the state.

However, the health care system is not alone in corrupt practices. Corruption is rampant throughout every sector of Greece’s economy, and with corruption comes wasted money, resources, and time. It is estimated that corruption costs Greece about €20 billion a year (Koutsoukis, 2010). In 2009 alone, when Greece’s debt troubles were just beginning to raise concern, €790 million bribes were paid. Despite the efforts of the government and reforms that have been instituted to crack down on this problem, Greece is still losing billions of euros every year to corruption (Agence France-Presse, 2011), and the situation does not seem to be improving. This is mainly because corruption has become such an integral part of Greek life and how business is carried out, that it is what people know and expect; after so many years, it has become their way of life. It is nearly impossible to change the mindset of an entire country, one that has been present for decades, in only two years.

Greece’s high level of corruption was absolutely a factor in causing the country’s current debt crisis. First of all, for years money was squandered and stolen and was thrown out the window without a care in the world. It was used to buy cars, and houses, aircraft, etcetera. Now, Greece is finding itself in a position without enough money to cover its debt. It is forced to receive bailouts from other countries because it does not have the money itself. In the same light, the money that was being used by the government over the past decades was not being put into projects that would help improve the Greek economy, its exports, or its competitiveness. At a time when money was plentiful and Greece could have been getting its country and economy on track to be a force among the EU member states, its culture of corruption prevented this from occurring.
Tax Evasion

Just as Greece is riddled with a culture of widespread corruption, the country is also facing a massive endemic of tax evasion. The majority of its citizens are severely underreporting the amount of income they are making or the net worth of the assets that they own. This culture of tax dodging is costing Greece billions of euros every year . . . money that could have been used to pay off the national debt. But before the specifics, it is useful to first give an overview of tax evasion and its role in the PIGS countries.

Overview of Tax Evasion

As mentioned before, this crisis really comes down to the fact that the PIGS countries do not have sufficient funds to pay off their mounting debt obligations. The countries’ governments are in a desperate panic to find money through any means possible: whether that involves cutting costs to save money or increasing their revenue streams with taxes. That is why every single one of the PIGS countries has had to implement austerity measures that are full of cost cuts and tax raises. However, the inability of governments to effectively collect taxes and the prevalent culture of tax evasion among the countries’ citizens over the last several years is precisely a reason why many of the PIGS countries are finding themselves short of cash today.

In 2010, The Wall Street Journal published an article titled Greece Grapples with Tax Evasion. This article contained information about the size of the shadow economies of some of the world’s most prominent countries. A shadow economy is a country’s percentage of GDP that is made up of unreported income (Moffet, 2010). The larger a country’s shadow economy, the more money a country is losing every year to tax evasion and underreporting of taxable income. Figure 6-1 depicts that data from that article:
As the graph highlights, Greece is by far the country with the largest amount of tax evasion. It is essentially losing income equating to one quarter of its GDP each year because of a culture in which tax evasion has become a way of life. What is also striking about these statistics is that the PIGS countries (Portugal, Italy, Greece and Spain) are the four countries that topped the list. They have more widespread tax evasion than any of the other leading world economies. As Jabeen Bhatti points out in her article *Tax Evaders in Greece, Spain, Italy better Beware*, evading taxes “is almost a national pastime in European nations such as Greece, Spain and Italy, and for years their governments largely looked the other way” (Bhatti, 2012). These countries are also the ones that are finding themselves without enough money to pay their bills. Tax evasion is a definite contributing factor to the PIGS countries current financial problems.
The Tax Evasion Situation in Greece Today

Just like corruption, tax evasion has become a facet of Greek culture. It is just what people do and what people expect. People talk freely and openly about it because for years the government has done little to crack down on it. However, with the current situation of Greece and its financial troubles putting a strain on the entire European monetary system, the government is now feeling the consequences of years of being too lax regarding tax collection.

Tax evasion in Greece is predicted to be costing the government around €5bn – €6bn annually (Bryant, 2012). In addition, Greece has accumulated around €60 billion in backlogged taxes (Bryant, 2012). When you consider that the first bailout which Greece accepted in April 2010 was €110 billion, the money that Greece’s government rightfully owned through income taxes but failed to collect would have covered more than half of that loan. Tax evasion has not only contributed to Greece’s financial problems through the loss of incoming revenue, this culture of tax-dodging has resulted in the country’s government having to pour more money, time and resources into the collection of taxes. When looking at percentages of GDP, “Greece spends four times as much collecting income taxes as the United States does” (Surowiecki, 2011). That amounts to a lot of wasted money which the government is shoveling out and which could have a much better use considering Greece’s current economic state.

There are two different methods that Greeks are employing in order to scam the government out of money and keep their own wallets a little thicker. The first way is to simply underreport their income. “Fewer than 5,000 Greeks declare annual income of more than €100,000 although more than 60,000 Greek households have investment in cash and securities exceeding €1 million” (Hope, 2010a). In addition, doctors have routinely reported less income than their receptionists (Hope, 2010a). But doctors are not the only professionals guilty of tax evasion. It is both the wealthy and the working class that have engaged in such practices; taxi drivers and electricians along with engineers, architects, and lawyers are all contributing to Greece’s current tax evasion problem (Daley, 2010).

The second form of tax evasion by the Greeks is to fail to declare certain big ticket assets that they have purchased over the years. For example, in 2009, in one Greek
city alone “only 365 people checked the box on the tax return that they owned a pool” (Daley, 2010). An investigation later revealed that there were upwards of 16,000 pools in that city (Daley, 2010). Other expensive assets that Greeks have not been reporting include yachts, luxury cars, and large properties on the Aegean Islands (Dinmore, 2010c).

So how did the act of tax evasion become an integral part of Greek culture? There are many different reasons. The first is that Greek tax officials are just as corrupt as the citizens who are trying to cheat the system and, as a result, are “notoriously easy to bribe” (Surowiecki, 2011). Greek tax collectors are routinely known for lowering the penalty of an offense and then pocketing some money on the side. It is how the system has worked for decades and citizens became accustomed to just paying off the tax officials and avoiding the larger fine. In addition, Greek citizens have little trust and faith in a government that is riddled with corruption, fraud, and dishonesty (Surowiecki, 2011). Especially with the current economic situation, and the government raising money and enforcing austerity measures, the citizens feel little sense of duty to continue to contribute to such a corrupt system. Finally, probably the most significant reason why tax evasion has become such a ubiquitous aspect of Greece’s system is that the government simply did nothing to enforce the tax law (Surowiecki, 2011). When times were good and money was freely flowing throughout the economy, the Greek government saw no reason to crack down on those not paying their share; they are reeling in the consequences of that decision now. Tax evasion has become a mindset and a normality. It is going to be near impossible to change the views of a nation of 11 million people.

**Low Productivity**

Most of us at one time or another have heard the stereotype that the Greeks are lazy and do not like to work. This notion has become increasingly popular as of late because of Greece’s crumbling financial position and surging debt obligations. However, this notion of the “lazy Greek” is not true. In fact, according to Michelle Caruso-Cabrera in her article *Greeks Work Hard, So Why is There a Debt Crisis?* “Greek workers put in longer hours than any other Europeans or Americans” (Caruso-Cabrera, 2011). As her title suggests, why then are the Greeks so uncompetitive? One of the reasons that she sites is the country has a very low productivity rate. Greece has struggled with this
problem for years. Figure 6-2 depicts the productivity per hour worked in the different European countries.

FIGURE 6-2

<table>
<thead>
<tr>
<th>Country</th>
<th>Productivity Per Hour Worked</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>189.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>132.7</td>
</tr>
<tr>
<td>Belgium</td>
<td>125.6</td>
</tr>
<tr>
<td>Austria</td>
<td>123.7</td>
</tr>
<tr>
<td>Spain</td>
<td>113.5</td>
</tr>
<tr>
<td>Portugal</td>
<td>107.9</td>
</tr>
<tr>
<td>Greece</td>
<td>107.2</td>
</tr>
<tr>
<td>Spain</td>
<td>101.5</td>
</tr>
<tr>
<td>EU</td>
<td>100</td>
</tr>
<tr>
<td>Malta</td>
<td>91.4</td>
</tr>
<tr>
<td>Slovenia</td>
<td>88.1</td>
</tr>
<tr>
<td>Cyprus</td>
<td>82.3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>77.7</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>76.3</td>
</tr>
<tr>
<td>Greece</td>
<td>65.4</td>
</tr>
<tr>
<td>Portugal</td>
<td>41.7</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>26.4</td>
</tr>
</tbody>
</table>

Source: The Guardian, "Who Works the Longest Hours in Europe?"

*Source: Stewart, 2011, "Who Works the Longest Hours in Europe?"

As can be seen above, Greece, along with Portugal, is one of the least productive countries in Europe. It even ranks lower than countries such as Malta and Slovenia.
So why are Greek workers so much less productive than workers in their European neighboring nations? There are many different reasons for this low productivity rate. First, Greece is a country with a very large agriculture sector. Individuals living in Greece are much more likely to work on rural farms than those who live in the northern European nations. Table 6-4 shows the percentage of the Greek population who work in the agriculture, fishing, and forestry sector of the economy compared to the Eurozone average, as well as compared to one of Europe’s most productive nations: Germany. Even Portugal, which also suffers from extremely low productivity, has a much higher percentage of workers in the agriculture sector compared to the Eurozone average.

Table 6-4
Percentage of Population that Works in the Agriculture, Fishing, or Forestry Sector of the Economy

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage of the Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>12%</td>
</tr>
<tr>
<td>Portugal</td>
<td>7%</td>
</tr>
<tr>
<td>Eurozone Average</td>
<td>3%</td>
</tr>
<tr>
<td>Germany</td>
<td>2%</td>
</tr>
</tbody>
</table>

*Source: Dalton, “Greece Has Too Many Farmers”*

Working in the agriculture sector is arduous work with long hours. This type of work also results in very low productivity. As Matthew Dalton notes in his article titled, *Greece Has Too Many Farmers*, “labor productivity improves dramatically when workers live in cities” (Dalton, 2012). However, because of Greece’s staggeringly high unemployment rate and the difficulty that Greeks have in finding a decent job, many individuals find themselves leaving the cities for work in the agriculture industry (Dalton, 2012). As a result, the labor productivity rate of Greece is very low in relation to other European nations.
Michalis Sallas, in his article titled, *The Greek Economy – Measures and Reforms*, also points out several other reasons for the low productivity rate in Greece. These reasons include:

1) The small size of Greek enterprises on average  
2) The lack of capital or technology-intensive companies  
3) The lack of modern forms of organizing production  
4) The limited use of high tech means  

*Source: Sallas, 2010*

What this low productivity means is that Greeks are “working harder and longer than their European peers to support a generally unproductive system” (Caruso-Cabrera, 2011). The country has failed to establish itself as a leading export economy. This low productivity stunts Greece’s growth and therefore, reduces the country’s capacity to raise capital and pay off its debt obligations.

**Pension System**

Extremely generous pensions as well as early retirement have also played a role in adding to Greece’s debt obligations. With more generous pensions given out earlier to its citizens, the Greek government has had to carry a much greater burden of debt over the years in order to cover these extra costs. In some instances, Greeks were getting more money from their pensions than they had been earning at their jobs (Lynn, 2011). In other instances, Greeks were receiving pensions that amounted to 96% of their previous working income (Lynn, 2011). Table 6-5 shows some additional basic statistics about the pension system in Greece.
TABLE 6-5
Greece vs. Germany
The State’s Pension System

<table>
<thead>
<tr>
<th>Pension System Details</th>
<th>Greece</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years of Work to Earn Full Pension</td>
<td>35 years old</td>
<td>45 years old</td>
</tr>
<tr>
<td>Proportion of Wages as Percentage</td>
<td>80%</td>
<td>46%</td>
</tr>
<tr>
<td>2004 Pension Increase</td>
<td>3%</td>
<td>0%</td>
</tr>
<tr>
<td>2005 Pension Increase</td>
<td>4%</td>
<td>0%</td>
</tr>
<tr>
<td>2006 Pension Increase</td>
<td>4%</td>
<td>0%</td>
</tr>
<tr>
<td>Minimum Pension Age for Men</td>
<td>65 years old</td>
<td>67 years old</td>
</tr>
<tr>
<td>Minimum Pension Age for Women</td>
<td>60 years old</td>
<td>65 years old</td>
</tr>
</tbody>
</table>


Table 6-5 depicts some stark differences between the Greek pension system and the German pension system. These differences have added to Greece’s mounting national debt. Greece has a national average retirement age of only 61 years old (Thomas, 2010). However, in certain cases, individuals in Greece can retire much earlier than that: 50 years old for women and 55 years old for men. Greece’s laws state that there are certain occupations which are so ‘dangerous’ that they warrant the individual to retire at a much earlier age than normal (Thomas, 2010). Some of the professionals that are considered ‘dangerous’ include hairdressers and musicians. Because of this law, it is estimated that around 14% of the Greek population will have the opportunity for an early retirement (Thomas, 2010). Paying individuals pension money at an earlier age results in Greece having to shovel out money for more years. This is one reason why the national debt is so high.

In addition, in recent months and over the past year, there has been an occurrence of fraud when it comes to collecting pension benefits. Many individuals do not declare their deceased relative dead right away; this allows them to continue collecting pension benefits long after their relative has passed away (Staffing Industry Analysts, 2012). This
prevalence of fraud is estimated to be costing the Greek government an extra €16 billion dollars in pension benefits (Staffing Industry Analysts, 2012).

Greece has realized that the pension benefits it was providing its citizens were perhaps more generous than they needed to be. When austerity measures were first ordered under conditions of the Greece’s 2010 bailout package, pension benefits were among the first things slashed to save Greece money. Since those first austerity measures, pension benefits have continued to be a source of cuts in government spending.
Chapter 7:

Portugal – Factors Contributing to its Financial Problems

Corruption

Corruption is a problem for the Portuguese, also; however, not nearly to the extent as it is for the Greeks and Italians. Portugal ranks 12th in corruptive activities among the 29 nations in the EU and Western Europe. According to the population, corruption is becoming more and more of a problem. Eighty-three percent of Portuguese believe that the level of corruption in their country has increased in the last three years (The Portugal News Online, 2010). In addition, 75% of its people believe that the government is ineffective at fighting corruptive practices (The Portugal News Online, 2010).

So why is Portugal facing rising levels of corruption? “Complicated laws . . . a judicial system that doesn’t work and poor results in the fight against corruption” are all reasons contributing to the graft in Portugal (Algarve Resident, 2010). If the law is so complicated that people are unable or unwilling to understand all its different facets, then they will just disregard it altogether. In addition, if people are not being punished for the corruptive actions they commit, there is no incentive to stop doing them. In 2010, “more than half the law cases brought for corruption [ended] up being ‘archived’ for lack of proof and of those that [made] it to court, less than 4% [resulted] in convictions” (Pires, 2010).

But of all the types of corruption that exist, nepotism is one of the most prevalent in Portugal, and it is having negative effects on the economy and the workforce. Nepotism is a “form of favoritism based on acquaintances and familiar relationships. Someone in an official position exploits his power and authority to provide a job or favor to a family member or friend” (Transparency International). This favoritism is causing a mass emigration of “young university graduates or skilled technicians” out of the country in search of work elsewhere (Queiroz, 2011). Many young people have spent money and time to acquire a credible education and degree. However, that means little in a country where “it is all about knowing the right people or greasing the right palms” (Queiroz, 2011). With youth unemployment rising to 35% in January 2012 (Eurostat), young
graduates have given up on a homeland that is plagued with corruption and decided to take their chances in other countries.

**Rigid Labor Markets and Low Productivity**

Portugal, like many of Europe’s southern countries, suffers from extremely low productivity, especially when compared to some of Europe’s more powerful nations. Portugal’s average productivity growth rate over the past few years has been -0.18% and it is likely to hover around 0% in the coming year (The Portuguese Economy, 2011). This low productivity rate has been one factor that has aided in Portugal’s stunted ability to compete in Europe’s common market. If companies are unable to produce goods and services as efficiently and cheaply as other nations’ companies, they have little advantage competing in the market. This is the case with Portugal. Without a strong foothold in the market, Portugal must rely more and more on the goods and services produced by other countries, instead of on its own domestic production. As a result, rigid labor markets and low productivity are one contributing factor to Portugal’s current financial troubles.

So where does Portuguese productivity stand in relation to Europe’s other member states? Refer to Figure 6-2 for a depiction of the productivity per hour of an employee in each of the countries of Europe.

As Figure 6-2 shows, Portugal is the least productive country of the PIGS countries and it is also one of the least productive countries in Europe as a whole. Italy and Spain are also drastically less productive than the European powerhouses of France and Germany.

So how did this low productivity come to be? A rigid labor market is partly to blame. In Portugal, the labor market’s inflexibility has resulted in wasted resources and/or resources that are not put to their most efficient use. In Serguey Braguinski’s article, *The Incredible Shrinking of Portugal’s Firms*, he lists some of the regulations that have caused Portugal to have such a strict labor market:

1. It is very difficult to fire workers.
2. It is impossible to reduce employee wages.
3. Mandated severance pays are very high, further discouraging layoffs.

*Source: Braguinski, 2011*
All three of these regulations are factors that have become very problematic for Portuguese companies, especially during times of a struggling economy. A company must be able to adapt and react to the current economic situation. This means that in times of low demand and slow growth, a company should try to cut costs and become more efficient to remain competitive. However, Portugal’s labor market regulations severely dissuade its companies from doing just that. Money, time and resources are often wasted because the companies are stuck continuing to pay all their workers their high salaries as production is forced to decline with shrinking demand.

To sum up, a strict labor market, such as in Portugal, leads to the misallocation and inefficient use of resources. This misallocation and inefficient use of resources lends itself to a lower productivity rate for the country, which in turn hampers its competitiveness. Portugal’s economy cannot hope to pull out of this financial crisis without growth and a strong position in the European and global market.
Chapter 8:
Spain – Factors Contributing to its Financial Problems

Corruption

Spain’s level of corruption is ranked just one spot better than Portugal’s level by Transparency International. Despite that, corruption is still a large problem for the country. Especially in recent years, Spain has seen a rapid increase in the number of corruption cases brought about by prominent and high-profile individuals. Even the royal family has been plagued with accusations of corruptive practices. But this is not a problem that has developed overnight. Over the past seven years, Transparency International has downgraded Spain’s ranking from 22nd to 31st place, a drop of seven spots (Matlack, 2012).

One of the catalysts for this increase in corruption was Spain’s growing real-estate boom (Matlack, 2012). The sector of the economy that is riddled with the most opportunity for corruption and therefore, the most corrosive activities, is the real-estate, construction and development sector. The re-classification of land is a large component of this. An individual buys “rustic land cheap with the promise that it will be re-classified for urbanization/construction. Bribes are paid to the relevant officials and the buyers make lots of money by selling the land once it has been re-classified or by developing it and selling the properties” (Tenison, 2009). A bribe for the re-classification of land can reach upwards of €10 million (Tenison, 2009). These actions and activities were all well and good while the real-estate market continued to boom.

As the corruption level increased over the years, no one or no institution felt the need to stop it. As a result, it became the norm, commonplace and an expected practice among the people. “Neither the EU nor the Spanish government showed much interest in controlling [corruption]. A culture was created, [Spain] had all this economic growth and people sort of thought, ‘who cares?’” (Matlack, 2012).

Today, Spain is bombarded more than ever with new cases of corruption. Inaki Urdangarin, the son-in-law of King Juan Carlos, has been charged with “skimming millions of dollars from padded government contracts” (Matlack, 2012). Valencia’s former premier is on trial for “allegedly accepting expensive suits in exchange for
contracts” (Mallet, 2011b). The Ex-President of the Balearic Islands went on trial in January 2012 “on charges that he spent $1.2 million of public money for personal items” (Matlack, 2012). One of Spain’s most prominent and respected judges was convicted of illegally wiretapping lawyers’ conversations (Johnson, 2012a). It seems every day a new case or allegation regarding corruption is being brought forth. For too long, prominent officials have been allowed to furnish their own needs above the needs of a nation.

The public has finally chosen to speak out. Thousands gather in protest of the country’s current economic condition, new austerity measures enacted, and the high level of corruption. The government “is asking its citizens to swallow more than $19 billion in tax increases and spending cuts while promising a crackdown on tax evasion” (Matlack, 2012). Meanwhile, politicians are taking advantage of the public’s money. And so the country is speaking out and wants an end to the abuses that have become a regular facet of the Spanish economy.

**Tax Evasion**

Spain is another southern European country that is trying to tackle its tax evasion problem in order to find a way out of its economic crisis. The problem is not nearly as widespread as the situations in both Greece and Italy. However, Spain does have an underground economy that is nearly 25% of its GDP (Dawn.com, 2012). In 2010, in an effort to prevent a worsening financial situation, Spain recovered €10 billion from tax evaders (Minder, 2011). This was an increase of 23% from the previous year, but it still only amounted to around 1% of Spain’s GDP (Minder, 2011).

In 2011, some very prominent Spaniards found themselves the target of a tax fraud investigation. Francisco Correa, who was already involved in corruption scandals, was “suspected of accumulating a secret fortune worth at least €50 million ($70 million); he [had] not declared any income to the tax office since 1999” (Kern, 2011). In addition, Judge Baltasar Garzon, the judge who brought Correa to trial, also found himself the subject of a tax fraud investigation for failing to report income (Kern, 2011).

However, it is not just Spain’s elite who are engaging in tax evasion. As a result of the country wide problem, Spain’s new Prime Minister, Mariano Rajoy, has vowed to combat tax evasion in his economically struggling country. Prime Minister Mariano
Rajoy officially took office in late December 2011. By January he had already announced new laws and measures in order to fight the country’s many tax evaders. It is his hope that his government will be able to raise an extra €8.17 billion ($10.5 billion) of tax revenue each year with the harsher regulations (Dawn.com, 2012). Some of the measures that he is proposing to implement include an increase in the number of tax inspectors and a more rigorous tax inspection, as well as a limit to the value of a transaction that will be able to be carried out with cash (Dawn.com, 2012).

One of the stark differences between the tax evasion environment in Spain and those of Greece and Italy is that while tax evasion is a problem in Spain, it does not seem to be so much of a cultural phenomenon here. In Greece and Italy it is a way of life. Everyone has been doing it for so long that it has, in essence, become a mentality of the way the system works. However, the situation in Spain does not seem to have reached that magnitude. It is a problem that must be rectified, but it is not a cultural mindset.

**Burst of Spain’s Housing Bubble**

For ten years Spain experienced a housing bubble that stimulated the economy, ignited widespread demand in the construction sector, allowed millions of citizens to own their own homes, and boosted personal consumption of the country’s people. But when the bubble burst in 2007, a shock was sent through the economy and all the benefits that the housing market had brought instantly unraveled. Spain was now left to pick up the pieces of a shattered economy. This was one contributing factor to Spain’s current economic state and the massive levels of debt the country is facing.

In 2006, at the peak of the real estate boom, Spain built more homes than France, Germany and the UK combined (Zimmerman, 2007). For years, demand in the construction and housing sector had been increasing. Homes were being built, unemployment was down, and people were drawn to the idea of owning their own home. From 1995-2007, “Spanish real estate prices rose over 200%” (Shaheen, 2011). People believed that by buying a home, they would be making a smart investment for their future. So more people bought houses, and more houses were built.

The rising value in their homes also caused people to believe that they had more money and security; this in turn allowed them to increase their consumption (Baker,
In 2000, the savings rate in Spain was 6%, while just seven years later, that rate had dropped to 3% (Baker, 2010). People were relishing in the increasing value of their homes by pouring their extra money into the economy.

By 2007, all of this construction and building eventually led to a severely over-supplied housing market without enough demand to sustain it. Once this occurred, the bubble burst and housing prices began to fall. With prices falling and demand lacking, construction projects were deserted and jobs were lost. Those individuals that had once found great success from the housing boom were suddenly closing up shop. Homeowners suddenly found themselves in severe debt. In the article *Spanish Property Crisis Traps Million in Debt*, Enrique Quemada is quoted as saying, “there is an entire generation of young Spaniards . . . that will have to work their whole life to pay for houses now worth half what they bought them for” (Hetz, 2011). So the country’s citizens were in debt, and as a result, consumption decreased. They no longer were pouring their wealth into the Spanish economy.

It was not just the citizens that were reeling in the negative effects of the housing burst. Banks were also experiencing losses and mounting debts. Banks were heavily exposed to the real estate sector since it was with their mortgages and their loans that people were buying houses (Mallet, 2008). When the bubble burst, banks saw one-third of their loans go bad (Mallet, 2008). Debt had begun creeping up all around the country.

The burst of its housing bubble put the Spanish economy in a very vulnerable position. Add to that the Global Financial Crisis a year later and Spain stood facing a wall of national debt and an increasing budget deficit.
Chapter 9:
Italy – Factors Contributing to its Financial Problems

Corruption

Transparency International places Italy as the third most corrupt country among the EU members and other Western European countries. It is a serious problem that the country must face. During the 1990’s, Italy saw one of the worst corruption scandals to hit a country with “hundreds of people, including politicians and business men, jailed” for corrupt actions and illegal activities (The Economist, 2010). However, 86% of Italians still believe that the current corruption problem is just as bad as it was 20 years ago (The Economist, 2010).

Over the last 20 years, corruption in Italy has continued to worsen and infiltrate other parts of the country’s economy. “Graft, once used to finance political parties, now permeates society for private gain, with bribes routine” (Parodi, 2012). Corruption is still prevalent in the public sector, but it can also be found in the private sector, in the business environment, and even in the sports world with football matches being fixed (Jones, 2010). The number of cases of corruption increased by 229% from 2008 to 2009 (Jones, 2010). It is estimated that corruptive activities cost Italy about €60 billion a year, “around the size of Italy’s budget deficit” (Parodi, 2012). In addition, Italy’s shadow economy is said to make up about 16% of GDP (Squires, 2011).

While corruption is prevalent throughout many areas of the country, Italy has been hit with some very high-profile political cases in the past few years. Italy’s former Prime Minister, Silvio Berlusconi, has been the defendant in multiple trials relating to corruptive practices. He has been accused of trying to pay off a lawyer to lie during his trials and he has also faced allegations of attempting to cover up crimes (The Lowell Sun, 2012). In addition, Giulio Tremonti, Italy’s former Finance Minister under Berlusconi, was under suspicion for having “ties to a former aide and a group of businessmen under investigation for suspected corruption” (Dinmore, 2011c). Despite his continuous claims of innocence, investors grew fearful, and during this time “yields on Italy’s benchmark 10 year bonds were close to euro-era highs” (Dinmore, 2011c). The prevalence of corruption in politics and the consequently splattered throughout the media and news are
the foundation for a culture of corruption that has become commonplace in Italy, specifically its southern regions.

Italy’s problem of corruption is definitely a factor in the country’s mounting debt problem. For decades, its political leaders have sought out their own self-interests rather than the interests of the nation. Money, time and resources are wasted so that the objectives of the elite can be achieved while a nation faces stagnant growth, low productivity, and minimal competitiveness. As mentioned before, Italy is losing €60 billion to corruption each year. With a high deficit and national debt, this extra money every year could allow the Italian economy to get its obligations under control. In addition, the prevalence and familiarity of corruptive activities has created a culture in which these actions are accepted and expected. Italy’s citizens often feel helpless when it comes to the system and become resentful and angry at the government, causing many other problems for the country.

**Tax Evasion**

Just as Italy narrowly trails Greece for the level of corruption seen in its country, Italy also narrowly trails Greece for the prevalence of tax evasion. Like Greece, it has become a huge problem for the Eurozone’s third largest economy and is one of the reasons that Italy is facing such a massive national debt of €1.9 trillion ($2.5 trillion), amounting to 120% of GDP. As Nick Squires notes in his article titled *Italian Ski Resort Lays Bear Tax Evasion*, had Italy “collected taxes as rigorously as Britain and the United States in the last 40 years, the country’s national debt would now be 80% of GDP rather than 120%” (Squires, 2012).

It is estimated that tax evasion causes Italy to lose about $150 billion a year (Donadio, 2011). In addition, Italy’s shadow economy, which results in the evasion of income tax as well as the Value-Added Tax, has a value of around €275 billion (Squires, 2012). Italian citizens have made tax evasion just another part of everyday life.

So just how bad is tax evasion in Italy? Figure 9-1 depicts the percentage of Italy’s population that reported income in certain ranges.
Based on the data provided by this graph, over 65% of Italy’s population reported 2010 annual income of less than $27,000. In addition, only 1% of Italy’s 41 million individuals reported annual income over $135,500. These are preposterous results for the Eurozone’s third largest and third richest country.

As can be determined from the data found in Figure 9-1, Italy’s richest individuals make up a significant portion of the population that is engaging in tax evasion. They are living in expensive homes and driving luxury vehicles all while declaring just a few tens of thousands of euros in annual income. Prime Minister Mario Monti is taking action against them. He has begun to enact new laws and austerity measures in an attempt to
crack down on tax evaders and recover some of the billions of euros that the Italian government failed to collect over the years. In the past few months there have been numerous raids on ski resorts, restaurants, hotels, boutiques, etcetera, all in an attempt to make this country’s endemic of tax evasion a thing of the past and to free up some extra cash to help with the country’s financial troubles (Squires, 2012).

One of the reasons that tax evasion is much more prevalent in Italy and many of the other southern European countries as opposed to their neighbors in the north is that the southern European countries have a much larger population of self-employed individuals and individuals who own their own businesses. For example, Table 9-1 shows the number of individuals who are self-employed in Italy versus those who are self-employed in France and Germany.

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Self-Employed Individuals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>5 million</td>
</tr>
<tr>
<td>Germany</td>
<td>3.9 million</td>
</tr>
<tr>
<td>France</td>
<td>2.7 million</td>
</tr>
</tbody>
</table>

*Source: Donadio, 2011, “Italy Tries Raising the Social Stigma on Tax Evaders”

Individuals who are self-employed or own their own business are much more likely to under-report their income or commit tax fraud since there is no one monitoring their actions and there are no company controls in place to prevent the under-reporting from occurring. The environment of a family business just lends itself to a greater opportunity for tax fraud to occur. With Italy and some of other southern countries having many more individuals who are self-employed or running their own business, it makes sense that those countries would also experience a larger amount of tax evasion as well as a greater shadow economy.
**Spendthrift Government**

Unlike Greece, Italy as a whole does not necessarily have a spendthrift culture. The country’s citizens are not pulling out credit cards and spending money that they technically do not have. However, the Italian government is a very different story. Italy’s government has had a very easy time borrowing money over the years and, as a result, would just borrow its way out of cash shortages. This reliance on excessive borrowing allowed Italy to live the “sweet life” for many, many years (Sanati, 2011). When things got tight, Italy just “kept requesting larger and larger credit line increases” to finance its lifestyle (Sanati, 2011).

It was not just the country’s central government that was exercising its spendthrift ways. Italy is comprised of many regional governments as well. These regional governments are responsible for providing many services and privileges to the citizens of their areas, one of those services being healthcare (Dinmore, 2010a). These regional governments, especially those in the southern regions, have been accumulating massive deficits by over-spending (Dinmore, 2010a). These deficits and debts then make up a large portion of Italy’s national deficit and debt. “20 regions account for 80% of [Italy’s] total state consumption purposes” (Dinmore, 2010a). As a result, the central government is trying to exert more pressure and control over these spendthrift regional governments in an effort to reduce Italy’s overall debt obligations.

**Pension System**

Like the Greeks, the Italians were privileged to have a pension system that afforded them some of the most generous payments and earliest retirements in Europe. Italy has one of the lowest average retirement ages in the European Union at 61 years old (Dinmore, 2010b). There are also instances where individuals can retire as early as 58 years of age (Segreti, 2011).

This generous pension system that is allowing Italians to collect pension payments at a much earlier age than many other European countries does not come without its costs, literally. The government is spending billions of euros of their budget every year to cover these pension payments. In 2007, pension payments cost the Italian government 14% of its GDP, one of the highest rates in the EU (Segreti, 2011).
excess costs are a definite contributing factor to the country’s current increasing debt obligations.

Since pension payments were soaking up so much of the government’s annual budget, when austerity measures were put into effect in response to the current financial crisis, the pension system was one of the first institutions to see reforms. Among those reforms is the increase in women’s retirement age to 65 years old (Dinmore, 2010b). It is estimated that all of the reforms to the pension system will save the Italian government about €9 billion by 2014 (Segreti, 2011).
Chapter 10:
Can Europe’s Financial Crisis Be Attributed to a Mediterranean Way of Life?

Can Europe’s financial crisis be attributed to a Mediterranean way of life? Are the countries of Portugal, Italy, Greece and Spain, trapped with unsustainable national debts and deficits because of common cultural, structural, and/or governmental elements? This is the vital question . . . the question around which this entire thesis and all the research that has gone into it is based.

At the most fundamental level, the answer is yes. Though there are several other factors that could have contributed or did contribute to Europe’s debt crisis, this thesis focused solely on the cultural factors of the PIGS nations. The evidence and information attained undoubtedly supports the claim that cultural factors and mentalities in Portugal, Italy, Greece, and Spain were significant contributing factors to the countries’ excessively high deficits and national debts. The fact that many of the southern countries suffer from extensive corruption, tax evasion, and low productivity, have absolutely contributed to the catastrophic situation presently found in Europe, where the viability of the common currency of 17 member states is being questioned.

How did Cultural Factors in the Mediterranean Countries Contribute to the European Debt Crisis?

As proven in this thesis, many of the PIGS countries suffer from common cultural, structural, and/or governmental problems that have hindered growth, reduced competitiveness, and undermined the success of each country’s economy. But how do these common problems become a Eurozone-wide, continent-wide, and even world-wide debt crisis that has far-reaching and long-lasting consequences for an innumerable number of individuals, businesses, institutions, and nations?

Before understanding how these common factors resulted in a European debt crisis, it is useful to first look back at exactly what factors contributed to each country’s current indebted state. Table 10-1 provides an overview of the cultural, structural, and/or governmental factors mentioned in this thesis which played a role in the debt crisis for each of the four PIGS countries.
<table>
<thead>
<tr>
<th>Greece</th>
<th>Portugal</th>
<th>Spain</th>
<th>Italy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corruption</td>
<td>Corruption</td>
<td>Corruption</td>
<td>Corruption</td>
</tr>
<tr>
<td>Tax Evasion</td>
<td>Rigid Labor Markets</td>
<td>Tax Evasion</td>
<td>Tax Evasion</td>
</tr>
<tr>
<td>Spendthrift Culture</td>
<td>Low Productivity</td>
<td>Burst of Housing Bubble</td>
<td>Spendthrift Government</td>
</tr>
<tr>
<td>Overly-Generous Pension System</td>
<td>Low Productivity</td>
<td></td>
<td>Overly-Generous Pension System</td>
</tr>
<tr>
<td>Low Productivity</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

It is clear that each of the PIGS countries are facing many of the same issues, whether those issues are cultural, such as excessive corruption among the public and wide-spread tax evasion; structural, such as flaws in the country’s pension system; or governmental, such as a corrupt political system or a government that lives beyond its means. These problems contributed significantly to the European debt crisis, causing it to become much more catastrophic and wide-spread than anyone could have ever imagined.

It was inevitable that the southern Mediterranean countries would have access to a plethora of money during the beginning years of the common currency because they were now on the same level as the German powerhouse with a strong currency with low interest rates. However, the PIGS countries, their governments, their leaders, and their people did not use this plethora of money to each country’s advantage. They failed to reign in their rising deficits and debts. Their common problems contributed to the growing obligations of the countries and prevented them from using a period of growth and prosperity to make sure that their countries’ financial positions were in order. To put it simply, the PIGS countries, because of their cultural, structural, and governmental issues, failed in three main respects during the decade of the euro:
1) The PIGS countries failed to use the easy money they received during this time to reinvest in worth-while sectors of the economy, spur growth, increase productivity and promote exports.

2) The PIGS countries failed to collect the money that they were owed and eradicate cultural mentalities such as the pervasiveness of corrupt practices and tax evasion.

3) The PIGS countries wasted the money they received in order to satiate a lifestyle beyond their means.

The first failure of the PIGS countries is that they did not use the easy money they were given to make themselves more competitive or to get their economies in a better position for the future. There was no shortage of cash during the decade of the euro; the PIGS countries were borrowing money as fast as they could. However, they did not utilize this easy access to money to invest in useful and worth-while sectors of their economies which would provide long-term growth and benefits for their countries and their people. A main reason for this is the pervasiveness of the corruptive culture of all of the southern Mediterranean countries. All of the southern countries, some to a worse degree than others, have cultures, politicians, and governments riddled with corruption. As a result, the money that the governments and their leaders were amassing was not going to the projects and investments that would benefit the countries as a whole, but instead to those projects and investments that would benefit those making the decisions. This led to ten years of wasted money during which the countries could have accelerated growth, increased productivity, and promoted exports. Had this been done, the PIGS countries would not have become so dependent on borrowed money and would have been able to decrease their rising national debts and deficits before this crisis became the catastrophe that it is today.

The second failure of the PIGS countries is that their governments did not collect the money they were owed by citizens, companies, and institutions. Again, due to the culture of corruptive practices, as well as the acceptance of tax evasion, many of the governments of the southern Mediterranean countries failed to collect billions of euros over the years. Corruption and tax evasion have been problems for many of these countries for years, and their governments have never done anything to stop it. The results are enormous amounts of lost tax revenue and huge black economies from which
the governments are losing money. This extra income could have lowered the national
debts and deficits of the countries, contained the debt crisis to fewer nations, and/or even
allowed for a much swifter, less painful solution to the crisis, as the situation in each
country might not have become as dire as it is.

Finally, the last failure of the PIGS countries was that they simply wasted the
money that they had because they had become so accustomed to having it. Many
countries developed a spendthrift mentality and culture. They lived beyond their means
for years without worrying about the long-term consequences or repercussions. In
addition, through structural problems such as flaws in the pension systems, some of the
PIGS countries were granting their citizens much more generous terms and excessive
compensation than all of the other nations in the European Union. These perks resulted
in the governments of the PIGS countries spending much more money than they ever
needed to. All of this was well and fine during the decade of easy money; however, once
the countries became strapped for cash, the generous terms and excessive compensation
of the pensions systems were the first things cut for austerity measures. Without the
spendthrift culture and flaws in the pension system, the PIGS countries could have used
that extra money to reduce their national debts and lower their deficits to acceptable
levels.

**Conclusion**

In summary, the cultural, structural, and governmental problems that are prevalent
across Portugal, Italy, Greece and Spain were a significant contributing factor to the
European debt crisis. These common problems focused the crisis on the southern
Mediterranean countries and allowed it to become far more disastrous than anyone could
have every imagined.

The PIGS countries took no proactive measures during their years of prosperity to
ensure that their governments were acting in a fiscally responsible way. They took no
proactive measures to make their economies more competitive against Europe’s stronger
nations. They also took no proactive measures to eradicate cultural mentalities and
lifestyles that were undermining the growth and advancement of their nations. These
proactive measures were not taken because of the common factors of corruption, tax evasion, low productivity, rigid labor markets, spendthrift mentalities, and overly-generous pension systems that are found in many of the PIGS countries. Without some of these common elements, many of the national debts and deficits of the PIGS countries could have been severely reduced, the debt crisis might never have become so catastrophic, and Europe might never have had to question the viability of one of its most significant achievements—the euro.


82. Oakley, David and Peter Wise. “Portugal Gains Time with €1.64bn Debt Auction.” Financial Times 1 April 2011b.


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Thesis Supervisor: Terrence Guay

Work Experience:

January 2011 – March 2011
Audit Intern
KPMG, Harrisburg Office
David Bawel, Supervisor
I worked as a winter intern in KPMG’s audit department at its Harrisburg Office. My clients included Donegal Group Insurance, Pennsylvania State Education Association, and Susquehanna Area Regional Airport Authority. I performed tasks such as “tying out” financial statements and consolidated worksheets, searching for unrecorded liabilities, and testing realized gains and losses.

Summer 2010 and 2011
Employee
Partnership Safety Consultants, Mechanicsburg, PA
Michael Niznik, Supervisor
I assisted my father with his company, Partnership Safety Consultants, over the past two summers. I was primarily involved with office work, including developing and formatting PowerPoint presentations and extensively using Microsoft Excel to create data sets, charts, tables and graphs, etcetera.
Professional Memberships:
  Beta Gamma Sigma International Honor Society
  Golden Key International Honor Society

Grants Received:
  2010 Schreyer Ambassador Travel Grant

International Education:
  Summer 2010
  The Institute at Palazzo Rucellai
  Florence, Italy
  Courses: Land Under the Tuscan Sun (Real Estate of Florence) and The History of Florence
I spent six weeks in Florence, Italy during the summer of 2010. I obtained six educational credits that were necessary for my minor in International Business. In addition, I was able to travel extensively throughout Italy and France.

Community Service Involvement:
  Penn State Arboretum
  Shaver’s Creek Environmental Center
  Alpha Phi Omega Service Organization
  Penn State THON
As a student in the Masters of Accounting program and a member of MPSA (MAcc Program Student Association), I have been involved with several community service activities over the past few years. Our organization spends a day each semester assisting the Penn State Arboretum staff by clearing debris, pulling weeds, or working at their recycling center. With MPSA, I have also volunteered at Shaver’s Creek Environmental Center. We assisted the staff with projects such as constructing trails and paths, laying mulch, or cleaning up the grounds.

In addition, for two years I was a member of Alpha Phi Omega service fraternity. Through this organization, I participated in numerous community service activities such as working with the Boy Scouts of America, volunteering at the local Humane Society, and assisting Penn State University with its Friday Night Lights Out initiative.

For two years I was involved with Penn State’s Dance Marathon: first, as a member of the Finance Committee, and then as a member of the Rules and Regulations Committee. As a member of the Finance Committee, I primarily tallied and registered donated funds; as a member of the Rules and Regulations Committee, I helped to comprise and enforce rules for the event. In addition to these year-long duties, both committees also participated in actual fund-raising and on the weekend of THON, were instrumental in ensuring its success.