Vadyba
Journal of Management
2017, № 1 (30)
ISSN 1648-7974

THE EUROZONE CRISIS AND THE EFFECT OF BREXIT

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Abstract

Eurozone debt crisis continues for more than five years. It is important to understand the causes of the crisis, it is possible for the future development scenarios, and how it will affect individual country companies and individuals finances. Over last five years the euro area shocked two major crisis. Greek decision to leave EU (Grexit) and now UK (Brexit). Greek stayed in the EU after all, but UK looks made the last solution to leave EU. There are important to look what will happen with the EU citizens resident in the United Kingdom, and United Kingdom nationals residing in the EU. If there will be any changes for the immigration and emigration to the UK after Brexit. How the Brexit will impact the foreign direct investments, economy in all European Union after UK withdraw. This situation in Europe is likely to reduce lending and economic growth is not or it would be very slow for a number of years. That is why Europe (and other countries) politicians are ready to do everything to prevent such a scenario. After Brexit, United Kingdom, will not be able to reach for excellent deals with non-EU countries in order to reduce trading costs and that this would encourage foreign direct investment. Although the UK would no longer have to compromise with other EU countries in the negotiations. If the UK were to leave the EU but wanted to remain a member of the European Free Trade Area or the European Economic Area, it may have to accept unrestricted EU immigration.

KEY WORDS: Eurozone, Crisis, Brexit, Immigration, Foreign Direct Investment.

Introduction

Eurozone debt crisis continues for more than five years. Although these are the political and institutional decisions suggest that the worst is behind us, the consequences of the crisis will be felt for many years. European Central Bank's liquidity loans, fiscal discipline, contracts and other agreements lead Europe in the right direction, but a huge debt burdens weigh heavily on the shoulders of many years. It is important to understand the causes of the crisis, it is possible for the future development scenarios, and how it will affect individual country companies and individuals finances.

The euro zone crisis has many aspects, starting for a variety of the crisis in the global economy and the implications of Europe as well as in Sweden and the Baltic countries.

The purpose of this article is to discuss what means a number of euro zone crises of uncertainty, to indicate two biggest crises in Eurozone in past 5 years.

There are two main euro zone crisis objectives. Such as the breakup of the monetary union and the Greek default and exit from the euro zone in 2012. After the Greek crisis became a bit of a stable situation in the euro zone, but then suddenly comes out United Kingdom's Brexit referendum to leave the EU in 2016. It is not clear what the UK's future will look outside the European Union (EU), which allows Brexit leap into the unknown. This report gives an overview of the pros and cons of the most likely possibilities. After Brexit, the EU continues to be the world's largest market and the UK's the largest trading partner. But one of the main question is what will happen with the EU citizens resident in the United Kingdom, and United Kingdom nationals residing in the EU? How the Brexit will impact the foreign direct investments, economy in all European Union after UK withdraw?

In May of 1998 11 European countries met the convergence criteria and were the first to adopt the euro. Those countries are: Germany, Belgium, France, Spain, Italy, Ireland, the Netherlands, Luxembourg, Portugal, Finland and Austria. At that time, the United Kingdom and Denmark have completed the first two stages of readiness to adopt the euro currency, used the so-called "opt-out" reform of the third stage of EMU, meantime at the same time, Sweden and Greece failed to meet the necessary requirements. Sweden has decided not to join the Exchange Rate Mechanism on the outstanding criteria despite the opt-out form. In 2001, Greece adopted the EMU in 2007 - Slovenia, in 2008 - Malta and Cyprus in 2009 – Slovakia, in 2011 - Estonia, in 2014 - Latvia, in 2015 - Lithuania.

The rest of Europe countries are planning to adopt the euro in 2018 - Bulgaria, in 2019 - Romania and in 2020 - Hungary, Poland, Croatia and Czech Republic. Also, there are few EU countries which are not going to adopt the euro are Denmark, Sweden and United Kingdom. (This country actually is leaving EU.)

The beginning of the Euro Zone crisis and recession and the sovereign debt crisis. The euro zone crisis is more than 5-year debt crisis, what have been started in the European Union since 2009.

The euro zone debt crisis is not a direct global financial crisis and the consequent global recession, its direct consequence, but the events have highlighted the structural problems in the euro zone and increased the tension in it. “Falling global demand has forced central banks to cut interest rates and increase liquidity, and the government, in accordance with "good old" Keynesian economic policy of attempting to promote their economies by increasing by spending and budget deficits.” (Nerijus Mačiulis, 2011 [R.1.1]) At the same time, the economy was in recession and tax revenues. Due to just mentioned reasons, the budget deficit of Portugal, Ireland, Greece and Spain in 2009. Exceeded 10 percent’s GDP and gave rise to the contempt acronym "pIGS". These countries together with Italy remain the euro area debt crisis epicentre.

While imbalances in the euro zone (because of cheap credits and uneven competitiveness) formation of the main unit cohesion in the euro area and its "foundations" loss was caused by chronic problems of the Greek economy. Throughout 2009 year, the confidence in the euro zone countries remained high despite retreating euro area economies and frenzied world financial crisis. The difference between Greek and German 10-year government bond yield was 1 percentage point. However, at the end of 2009, investors began to doubt whether that Greece would not be able to give back their debt and EMU countries will want to save it, so one way or another to take over part of Greece debt. During a few months’ time the Greek government bond yields jumped above 10 percent. Borrowing on financial markets as the price lost its meaning.

When the crisis has greatly increased tensions in the banking sector and the weakening of market confidence, it lays deep distrust of governments and their ability to repay a huge debt. In part, this lack of confidence stems from the fact that the individual euro-zone members cannot print money and inflation help to reduce their real debt burden. Sovereign debt crisis in the beginning with no institutions that could help countries solve their liquidity problems.

In 2009 deteriorating economic situation in Greece, the country’s GDP contracted by 3.3 per cent, (2008 - 0.2 percent). Along negatively markets approach to the stability of Greece’s debt - in 2009 Greek debt jumped from a year ago, the former 113 percent by 129.3 per cent. Although the debt level itself is not a very big problem (for example, Japan’s public debt exceeded 200 percent Their GDP), but the retreating Greek economy and the government’s inability and unwillingness to reduce the budget deficit, also the other to initiate much needed reforms showed that the debt is out of control, i.e., Greece it will never be able to repay.

In 2010 other euro area members continued to perform very expansionary fiscal policy - neither one of them (except Finland and Luxembourg) has not fulfilled the Maastricht Treaty’s less than 3 percent GDP budget deficit criterion. In 2010 May the beneficiary Greece was the only country - in the same year to the IMF and the EU turned and Ireland, which received 67.5 billion million loan. In 2011 May of these two institutions in Portugal received 78 billion EUR formal loans. A few months after the granting of the aid, began to decline in capital confidence in the euro zone countries - Spain and Italy. The ECB has updated the Securities Markets Programme (SMP), which he bought government bonds on the secondary market. While official aid has been designed from the SMP update to 2011. The end of the ECB bought more than 130 billion euro Italian and Spanish bonds. Meanwhile, the Italian public debt, which for many years has exceeded 100 percent Of GDP in 2011, was already more than 120 percent GDP. This is the second highest debt level in the EU, which is lower only for the Greek public debt level (160 percent). The main reason for lack of confidence in Italy was too small for its competitiveness, slow growth and government inaction.

Ireland is an exception in the sense that the country their knees at the irresponsible behaviour of public finances - the debt before the crisis was only 24.7 percent GDP - but the government’s decision to guarantee the six Irish banks, reckless financing of the huge real estate bubble commitments. In a sense, the Irish Government, in order to avoid a banking crisis, part of the debt from the private sector moved to the public sector.

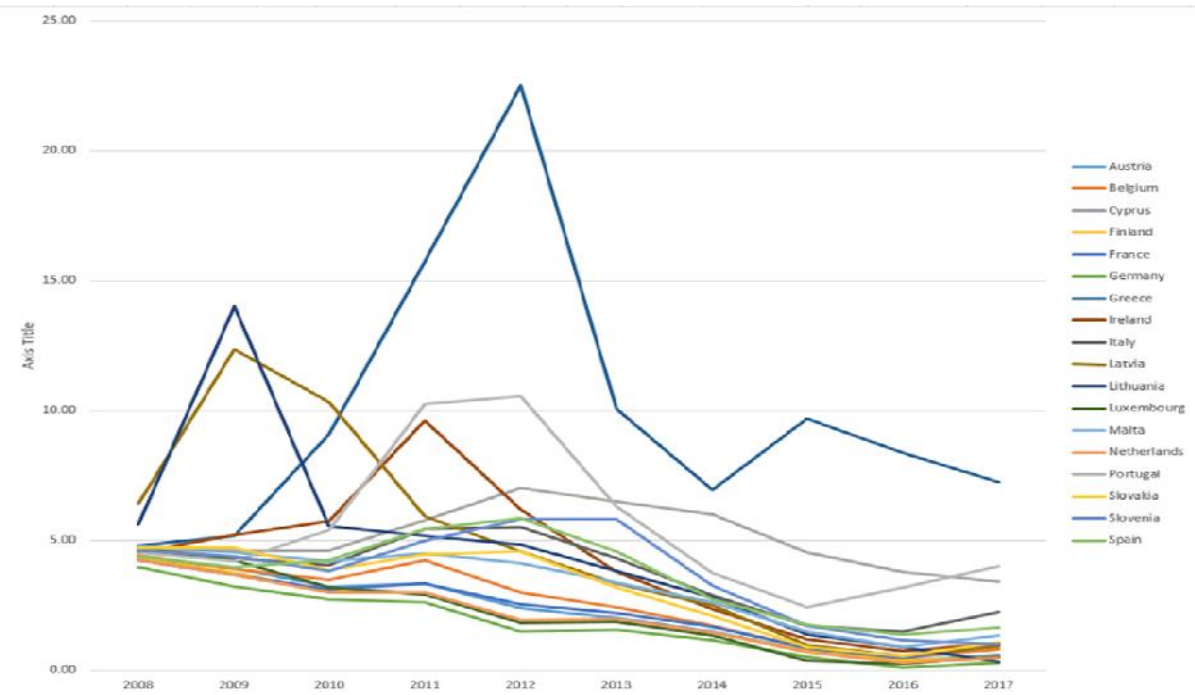

Fig 1. Long-term interest rates
[Statistical Data Warehouse]

Crisis and trust policy are related

Although the U.S. and UK debt and budget deficit figures are worse, these countries can borrow much lower interest rate than most European countries. This indicates that the structure of the euro area is fundamentally flawed, and investors have questioned whether politicians and the ECB will want to avoid the bankruptcy of the country's states. Germany's initial claim that the ESM, which if necessary will be able to lend euro-area Member States should include private sector participation in the elements, prompting investors generally avoided the euro zone sovereign bonds. Only later, this idea was abandoned, and European politicians began to argue that the Greek debt restructuring was a unique event, which will never happen again in any other euro zone state.

Politicians' actions during this crisis can be described as a "foot-dragging" - reluctance (or inability) to take urgent measures to stop the crisis from spreading further. Initial response - the European Financial Stability Facility (EFSF) was an obviously inadequate and only a temporary measure. Most likely, the policy not in a hurry to build a "firewall" to stop contagion and restore confidence about the moral hazard risks - quickly solved the problems of Greece, Italy and other countries have never had to end on a far-reaching reforms, they could be initiated only when the market began to "breathe them in the back of the head."

The situation worsens and sometimes seen in the differences between Member States as to why, when and how they should save each other. Because of the many important decisions had to vote in national parliaments, and the process was not smooth - for example, in Slovakia because of disagreement on this issue the government fell. Almost all the problems in countries with policies cannot explain to the public that fiscal austerity and structural reform path is the least painful way out of the crisis. Upcoming elections that will be held this year in Greece and France, and in the 2013 was - in Italy, creates a lot of uncertainty and further complicates the situation. There is a risk that populist politicians will decide who, although not unpopular among their constituents (for example, refuse to extend a helping hand and to withdraw from the euro zone), but it can have tragic long-term consequences.

The Growth and Stability Pact Compliance

"Strict Maastricht convergence criteria are designed to ensure that all countries in the euro zone, to maintain stable prices and exchange rates, low budget deficits and debt, and that they have confidence in the financial markets. The Stability and Growth Pact (SGP) was to ensure sustainable growth in the euro area members, demanding that their budget deficit below and not exceed 3 percent. GDP and public debt - 60 percent of GDP. Initially, the SGP had set much stricter limits than those provided for in the Maastricht Treaty, for example. Reducing the budget deficit to 1 percent GDP and the use of automatic financial sanctions.“ (Nerijus Mačiulis, 2011 [R.1.1])

However, before signing the pact, the requirements were relaxed, for example, The imposition of sanctions was to accept a two-thirds majority of finance ministers violators automatic financial penalties for violation of the requirements have not been applied in many countries, including France and Germany, they will continue to be violated The pact was violated more than 60 times. Peer pressure was weak, while sinners were allowed to decide whether to punish or not. Because violators there were so many, the system never failed.

In 2012 year March signed a new fiscal agreement which one helped address the root problems. The aim of this agreement is to adjust the structural budget deficit (adjusted, taking into account the economic cycle), and for violations of this requirement is subject to a semi-automatic financial sanctions unless the vast majority of countries (85 percent). Would vote against it. The avoidance of sanctions remains, because of large budget deficits and may occur due to objective reasons, such as natural disasters.

Relevance of these days in the Eurozone

There are signs that the euro area economy is recovering, but it is far from back to normal**.**

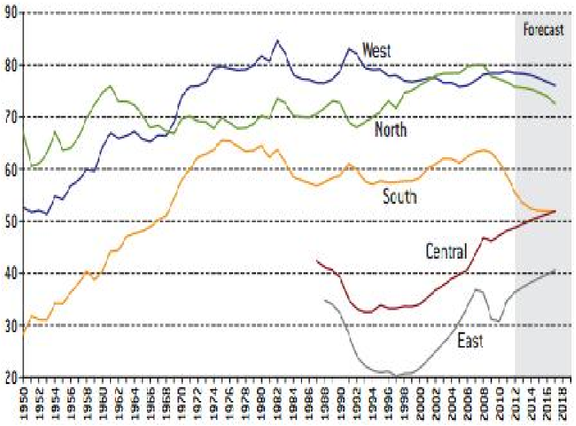

Fig. 2. GDP per capita in major geographical regions of the EU (USA = 100), 1950-2017
[Article: The euro crisis: Ten roots, a fewer solutions, 2017]

When the Eurozone crisis started one Professor of International Economics in Geneva said: "The Eurozone is levitating on the hope that European leaders will find a way to end crisis and take steps to avoid future ones. Unless more is done, however, this levitation magic will wear off and the Eurozone crisis will resume its destructive, unpredictable path." [Charles Wyplosz, 2010]

Right now, after more than five years, this prophecy proved to be accurate. The situation was getting worse and worse until taken determined steps to stabilize the financial markets. However, many shortcomings and imbalances that caused the crisis in the EZ are still without demonstrated arguments:

- non-performing loans
- growing interest rates very fast
- unsuccessful investment

Nowadays, when the all situation about Greece (Grexit) left behind and we can see a bit better times for Eurozone. Suddenly, other very strong country decided to Leave EU, it is United Kingdom. This decision is called Brexit.

What is Brexit?

The United Kingdom European Union membership referendum, also known as the Brexit referendum is the term of United Kingdom‘s planned withdrawal from the European Union.

UK membership of the EU has been a quite big topic of debate in the United Kingdom for a while. In 2015, Conservative Party desired to hold referendum for a leaving the EU membership was established by the UK Parliament through the European Union Referendum Act. This determination was mostly corroborated by the Prime Minister David Cameron and Chancellor George Osborne.

This term means, that UK population had to vote to support for the country either remaining member of, or leaving, the European Union.

The first vote took place on 23 June in UK. And the result was a bit shocking for the remaining EU countries, because 51, 9% of voters voted in favor of leaving the EU. United Kingdom citizens have been voted that they want United Kingdom to leave the European Union, but UK citizens and the rest EU counties population don't know quite yet what this will mean for the future of Britain's economy, its policies, and its relations with other European countries.

The British government has initiated a formal withdrawal from the European Union on March 29 in 2017 and until March 30 in 2019 supposed to leave the EU properly. Basically, UK have two-years period to filled up all the necessary documents, to solve all issues what will become with export/import from foreign countries, emigration problem and others important parts of leaving EU; unless EU parties will not agree with these negotiations, and offer to do otherwise.

There are lots of reasons why such a strong country as United Kingdom decided to leave European Union. All of these problems appear out of all over the world corners. UK government believe that this big change as the Brexit will be useful in the UK. "We are absolutely going to have to provide fiscal security to people, in other words we are going to have to show the country and the world that the country can live within its means." [The chancellor George Osborne, 2016 06 28]

The most important reasons for UK decision to leave EU:

- The EU threatens British sovereignty
- The EU is strangling the UK in burdensome regulations
- The EU entrenches corporate interests and prevents radical reforms
- The EU was a good idea, but the euro is a disaster
- The EU allows too many immigrants
- The UK could have a more rational immigration system outside the EU
- The UK could keep the money it currently sends to the EU

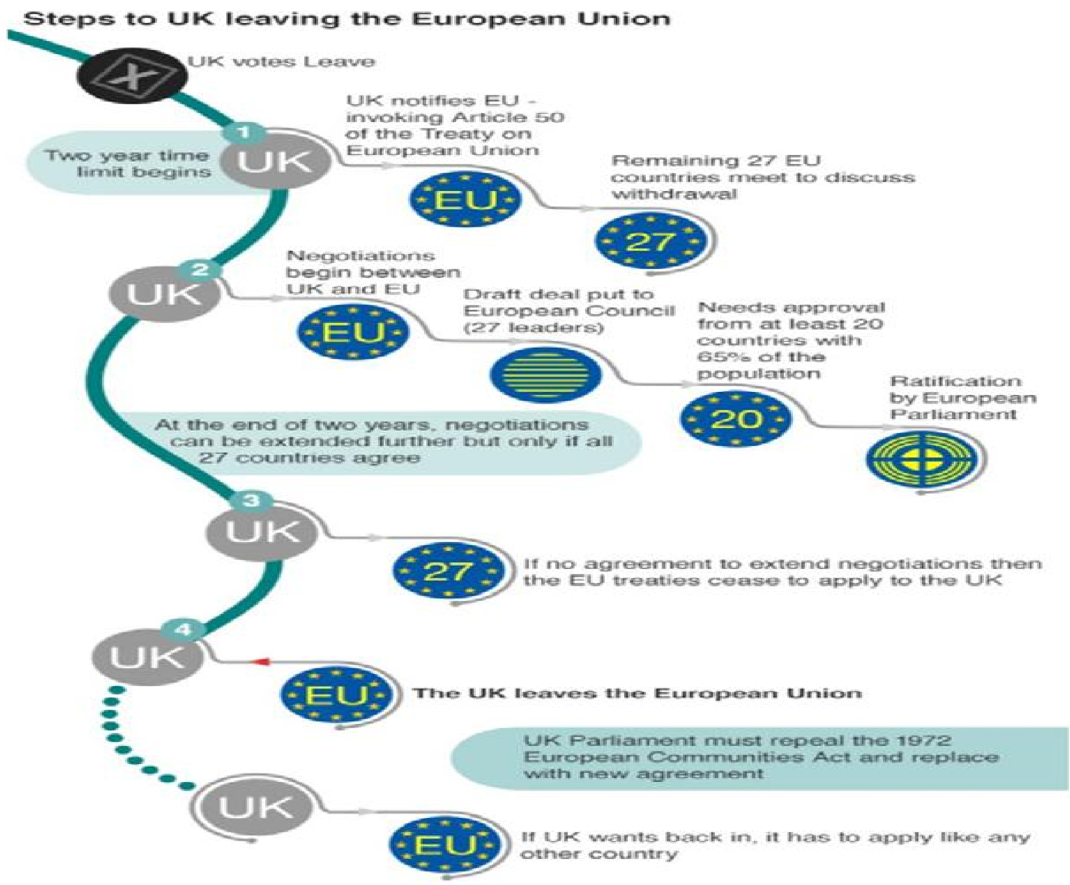

Fig. 3. UK leaving plan

[Article: "Brexit: George Osborne says tax rises and spending cuts needed", 2016]

Brexit effect for the United Kingdom and the world

Much of economists argue that withdrawal from the EU negative repercussions for the UK economy. More recent estimates from different sources, such a decision of the United Kingdom GDP level in the long term could change from -20% to 2% (range 20% decrease to 2% increase compared to the level of GDP, which would be if the UK continues to be an EU member).

The UK solution to leave the EU, a significant increase in uncertainty regarding the economic future.
As a result, a possible depreciation in the UK financial assets (e.g., Shares, bonds, pound sterling) would increase borrowing costs. Pound sterling effective exchange rate since November, 2015 within six months period fell by 9%. While in the last month, offsetting only a small part of its lost value. If the pound sterling devalued even stronger, obtain a presumption of goods and services prices rising in the UK, and the positive impact of export growth is expected to be short-lived.

Due to the resulting uncertainty in the business is expected to reduce the volume of investments could be relieved of the employees. This is a slowdown in the UK economic growth or even lead to recession.

It is estimated that the UK foreign trade and foreign direct investment volumes in the long term is also reduced. This has a negative impact on UK productivity growth prospects.

It is estimated that the UK government's budget also reduced. On the one hand, the UK savings, because not pay direct contributions to the EU budget (currently paid about 1% of the tax collected in the UK). On the other hand, due to the above reasons, the UK economy shrinks, leading to automatic tax collection would fall.

However, a small part of economists predicts that the withdrawal from the EU slightly increase the level of GDP in the United Kingdom. These analysts base their estimates on the assumption that in this case the UK very quickly and successfully carry out negotiations with foreign countries for freer trade and significantly liberalized business environment. But hardly UK talks on freer trade to take place as smoothly as, for example, much greater economic weight with the EU negotiations on the trade agreement with Canada took seven years. In addition, business conditions in the United Kingdom is already one of the most liberal among the developed countries of the world.

Withdrawal from the EU the United Kingdom affected not only economically, but also politically. In particular, the British regain more autonomy in shaping the economic and social environment in their own country. However, how much autonomy to recover from being subject to a new agreement with the EU on trade relations. In addition, there is a chance that the UK's withdrawal from the EU, pro-European Scotland initiate another referendum on secession from the UK to again become part of the EU.

If UK citizens to speak up for a stay in the EU, would disappear uncertainty regarding the future of the UK economy. It is believed that the pound sterling recovered from the end of last year and the loss of value of investments start to grow rapidly. In addition, to avoid the debate on a possible new referendum on the secession of Scotland from the UK. On the other hand, the UK economic and political life and continues to be closely aligned to common EU rules.

Referendum debates about UK membership of the European Union (EU), the main argument for Leave campaign is that Brexit allow more control over the flow of immigrants to Britain from the rest of the EU. Many people are concerned that high levels of immigration could undermine their work, wages and quality of life.

Immigration has increased a lot over the past 20 years and a big part this growth came from other EU countries, especially after the 2004 when eight Eastern European countries joined the EU. Between the 1995 and 2016 immigrants from other EU countries, in the United Kingdom has tripled from 0.9 million to 3.5 million. Increased immigration has increased gross national income (more employees will create more GDP) and has benefited from immigrants who come to the UK, although a small difference, but here they are better than their native country.

Another argument in favor of the Brexit is that the large increase in the minimum wage (national living wage) is planned over the next four years, will attract a large number of EU immigrants. It is not clear how big it will be a draw, because it depends in part on what other countries do, that their own wages and the relative cost of living in each country.

Looking from the world side when the British withdraw from the EU, financial markets around the world there will be more uncertainty and volatility. Their size is difficult to assess, because similar events have not occurred. In addition, there is a chance that will begin enhance considered safer world currencies - the US dollar, Swiss franc, Japanese yen.

The negative impact on the EU economy should be relatively small. Direct effects on exports should not be significant, because the UK is sold only 7% of all EU exported goods. Potentially increased EU financial market volatility increased risk for countries with high debt levels. Investment growth can be slow, but foreign direct investment in the EU - particularly in Ireland - flow could even increase if the company decides to move from the UK to the capital of the EU.

The political consequences of the EU could be more significant than economic. At present, EU enlargement critics rank the UK decision to withdraw from the EU would be an additional challenge for the European integration. Therefore, the European Union's economic and political role in the world will become smaller.

If the British decided to stay in the EU, it will avoid the increased volatility of the world, including the EU's financial markets. EU countries with a high level of debt, to avoid the risks of borrowing cost growth. Increased stability of the EU could have a positive impact on investment growth. In addition, if UK citizens overwhelmingly speak for future membership in the EU, it would be a serious Support strengthening of European integration.

It is very important to have a look how it will affect the Lithuania as well, cause more than 140,000 of Lithuania citizens are emigrated to United Kingdom right now.

Lithuanian economic growth in case of Brexit should not significantly slow down. Lithuania UK sells only 5% of total exports of goods and services. However, goods of Lithuanian origin exports to the UK accounted for slightly higher proportion - 7%. It feels more damage unless the individual sectors, such as leather processing industry: in the UK it sells a fifth of its production is exported.

On the other hand, since the UK is the most popular emigration from Lithuania direction (from 2010. About half of the emigrants reside precisely in the UK), the United Kingdom withdrew from the EU, could alter migration: in the UK schedule the leave Lithuanians or stay live the homeland, or more often choose emigration other countries (Germany, Ireland, Norway, and so on.). This would affect the remittances from abroad to Lithuania: last year the total amounted to 1.1 billion euros, while orders from the UK - the largest share.

Lithuania, and the remaining countries of the EU, the political consequences could be more significant than economic. However, if the unity in the future to further weaken, Lithuania - a small open economy - in the long run could feel and greater economic losses.

Conclusions

Although the euro zone, while at the same time, the euro collapse risk is sufficiently low. The main reason for this low risk - high level of uncertainty associated with the potential costs of such a decomposition. They are mainly related to capital flows and trade decline, the dominant uncertainty in the financial sector and the banks. This situation in Europe is likely to reduce lending and economic growth is not or it would be very slow for a number of years. That is why Europe (and other countries) politicians are ready to do everything to prevent such a scenario.

There's another option - the monetary union may decide to leave and some "hard core" countries (Finland, Germany or the Netherlands). However, and in this case would be the inevitable problems - they are mostly related to giving up the value of the currencies of countries appreciation. Though these countries are richer, they would be much more difficult to compete in the global market, and their growth rates are likely to reduce the unemployment rate - have risen.

In point of fact that the Brexit may have a negative impact on inward foreign direct investment. This analysis shows that leaving the EU will reduce foreign direct investments in UK. Such losses will damage the UK investment and productivity would reduce real incomes. Case studies of finance also suggest that Brexit would reduce EU production-related goods and services, and disrupt the UK's ability to negotiate concessions with the EU regulations on related transactions.

After Brexit, United Kingdom, will not be able to reach for excellent deals with non-EU countries in order to reduce trading costs and that this would encourage foreign direct investment. Although the UK would no longer have to compromise with other EU countries in the negotiations. Moreover, would not get automatic access to new deals struck with the EU, such as currently being negotiated with Japan and the United States of America.

If the UK were to leave the EU but wanted to remain a member of the European Free Trade Area or the European Economic Area, it may have to accept unrestricted EU immigration just as all other countries like Norway or Switzerland do. Only a looser trading agreement with higher trade costs would potentially enable the UK to restrict work-related EU immigration in much the same way as non-EU immigration is restricted.

There is no possibility to be precise about the size of the losses from restricting immigration following a Brexit. But we can confidently say that the empirical evidence shows that EU immigration has not had significantly negative effects on average employment, wages, inequality or public services at the local level for the UK-born. Nor, it should be said, are there large positive effects.

At the national level, immigration falls within the EU may fall in living standards in the UK born. This is partly because immigrants are helping to reduce the deficit: they are more likely to work and pay taxes, and less likely to use public services because they are younger and more educated than the UK born. It is also partly due to the positive impact of EU immigrant's productivity.

The previous report reflects the broad consensus that trade and foreign investment will also fall under Brexit, both of which would reduce the UK revenue. Looking at the point of immigration, the result of this investigation shows that lower immigration will push the UK living standards even lower.

As the euro zone break-up probability is low, used article‘s authors has established results, that there is no reason to reduce savings in euro (who saves money), but investors should be noted in the estate of the issuer (deposit-taking banks, etc.). The quality and potential exchange rate fluctuations.

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RECEIVED: 16 January 2017 **ACCEPTED: 10 May 2017**

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