The eurozone debt crisis research paper examples

[Parts of the World](), [Europe]()

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Location

The Eurozone Debt Crisis

The Eurozone crisis is essentially a problem of over-borrowing by some countries and their inability to pay these debts. These countries are unable to pay the debts because their economies are not performing well enough so government and banks cannot generate enough revenues from internal economic activities. At the same time, the collapse of some US financial institutions severely aggravated the situation. Banks and government completely lost their investments.

The Eurozone crisis began as early as 2005 when some countries began having problems paying their debt from private banks. The problem escalated when some financial institutions in the US—like Lehmann Brothers—collapsed. Many banks suffered as a result as they had substantial investments in these institutions.

The problem was compounded by the poor economic performances of some member countries of the European Economy—Greece, Ireland, Italy, Portugal and Spain. These countries not only lost their sources of debt but also their sources of income like revenues from economic activity and yields from bank investments.

The Culprits: Employment and Wage Protection

Among the things blamed for some Eurozone countries economic failure are the policies related to citizen benefits, welfare, and employment and wage protection. Obviously, these policies had been pursued to maintain a high standard of living for the population of the region. Unfortunately, these policies made some countries uncompetitive in the world economy. So, for some domestic companies to survive, they moved out of the country and set up their operations elsewhere in the world where the cost of production—especially labor—would be much lower.

The impact of this lack of competitiveness is that government cannot raise enough revenue to fund its expenses. There are not enough companies in the industries and corresponding employees. With unemployment going, people rely more on government for assistance. Government thus have to raise funds through borrowing and rely on passive income—like interests from investments in international financial institutions. Thus, when these institutions failed, the government and domestic banks did not have any more source for additional borrowings and worse even lost all their investment. They did not have any more sources of funds. As interests and maturing obligations piled up, the governments with more debt than revenues began to have problems.

The government problems compounded when the countries tried to maintain status quo, that is to maintain people’s standards of living through protected wages, benefits and welfare. The concerned countries’ economies simply could not support these needs.

Employment and wage protection is just part of the problem. The wanton expenditures of some governments are also to blame. Many investments were purely to support living standards rather than investments into industries that would become productive and yield revenue for the government.

Low interest rates and easy credit also being attributed as a problem. Governments could not raise enough revenues as a result.

Among the affected countries, Greece seems to have so far suffered the most and had been the focus of most studies. It practically underwent all of the above mentioned problems. Its government had been described as being profligate in the way it managed the country’s expenditures.

Moreover, the country has practically been accused of lying in its statistics and economic data. Some quarter have suggested that Greece status as a developed country should be evaluated. It has been suggested that it should be reclassified as an emerging market rather than a developed economy. After all, it could not support payments to its borrowings with its own economic activities. This would demand large sacrifices from its population as the country has to learn to support its lifestyle with its own ability to earn income rather than rely on borrowings.

The Germany ‘ Trilemma’

For one reason or another, Germany has prepared for the crisis ahead of every other country in the Eurozone. Its preparation is not the result of financial or monetary policies however. Rather, it was a result of a concerted effort of its people and its government. Early in the 2000s, Germany’s government had negotiated with its people benefits cuts to keep the country competitive with other countries. In short, the country undertook austerity measures before any problems occurred. Apparently, these moves were undertaken not to avert any crisis. After all, there was no crisis to avert at that early time. It was mainly an anticipation of certain competitive issues developing in the world. However, the moves benefited the country in many ways when the Eurozone crisis ensued.

Germany, being one of the few countries thriving in the crisis, will be one of those countries that failing countries would rely on. Understandably, when the European Central Bank issues bonds for instance, no one nor any bank would in the ailing economies would purchase those bonds. Local banks in the failed economies would not be able to offer any loans to its government. These banks simply do not have any money to lend and neither could they trust their government to pay. One of the economies that could provide such loans is Germany.

As there are resistance in the ailing economies in following reforms recommended by the IMF and the EC, there is resistance in Germany to provide aid to other countries. Understandably, the people of Germany agreed to make sacrifices even before there was any crisis. Curiously, the people of other countries—especially Greece and Italy—do not want to make similar cutbacks in benefits, salaries, among others. Germany survived and even thrived in the crisis precisely because it had undertaken austerity or similar programs before the crisis. So why should it be helping other countries that seek aid but are not willing to undergo similar programs? Germany was bound to lose in the process of helping failing economies unwilling to make similar sacrifices.

Curiously, some economists have suggested that the solution is to the Eurozone crisis is for Germany to lower wages in the country. This would allow countries like Greece to remain competitive. This proposition may be valid if the Eurozone is one solid country or economy and closed to the rest of the world. Obviously, this is not the case. Even if Germany lowers the salaries of its laborers, it would not necessarily meant that the Eurozone—especially the ailing countries—would become competitive.

Rescue Operations: the IMF, EC, and ECB

In the effort to help the failing economies, three institutions played very important roles. These are the International Monetary Fund, the European Commission and the European Central Bank. These institutions were relied upon since the afflicted countries are unable to perform their sovereign economic responsibilities.

The International Monetary Fund (IMF). Founded after World War II, the IMF aims to help nations rebuild from destruction or any similar problems. Member countries put their funds together to be lent to countries in need. The IMF lends money to countries at certain interest rates and, more importantly, conditions. It divides the loans into tranches and release each tranche depending on how the countries have met the conditions. These conditions are advisory in nature. Given the situation and needs of the borrowing countries, these conditions are as good as policies. The countries will have to comply or they will not get the succeeding tranches of the loans. However, if the country has successfully recovered, it may just have to pay its loan and not follow the conditions.

The IMF has pledged US$130 billion to help Greece, Portugal and Ireland. It has offered €30 billion (or US$37 billion) to rescue Greece alone in 2010. These loans have worried other IMF member countries. After all, the Eurozone countries are not the only ones affected by the crisis. Countries elsewhere in the world may also need help.

The conditions set were agreed upon by the IMF, the European Commission and the country concerned. In Greece for instance, the country will have to raise taxes on certain goods like cigarettes and alcohol to ensure that the country would have revenue to assist itself in economic recovery and also to pay its loans.

The European Commission (EC). The EC is the body governing the entire European Union. It is not like the government of the US or the UK. Rather, it seems more like a coordinating body with the power to implement policies which it accomplishes by way of sanctions on other countries.

Since many of the failing economies are not in a negotiating position anymore, the EC acts on these countries behalf especially with regard to dealing with the IMF. It provides the guarantees the IMF of its obligations. The EC also coordinates with all the member countries to find support for the problematic ones.

The EC provides policies—including the IMF conditions—for countries to follow. Its chief control measure is the release of the funds. . It is not a sovereign power. Thus, countries like Greece and Italy could reject some of its policies. Yet it is still powerful enough to be able to influence some changes in government again as what happened in Greece and Italy. These countries badly need loans to survive so in the end they would just have to abide by the conditions. The countries' own governing body or people in the end choose to reject their existing leaders and accept the conditions. Otherwise, they would not have any money at all.

The European Central Bank. Like any other central bank, the role of ECB in the crisis is to control the interest rates, to ensure sources and availability of funds and also to ensure inflation rates is low. It has achieved its main objective of keeping inflation in the Eurozone at less than 2% through the years, even during the crisis. This accomplishment is considered as among the best in the world. It is lower than those in most developed countries.

In Greece, the ECB's chief task was essentially the same: Keep inflation and interest rates under control. It has also helped the country by issuing bonds and earn interest from these.

One of the strange thing though that the ECB has accomplished is to keep the euro exchange rate high against foreign currencies . This thrust seem to go against economic recovery efforts. A lower exchange rate would mean lower prices—including slaries—against those in other countries. This could result in more investments into the community. Correspondingly however, a lower exchange rate could mean higher costs of imports and thus higher costs for consumers.

The ECB has continued to pursue low interest rates. It claims that this is a solution to the problem and to keep inflation down. Interest rates have been at about 2% for the past several years and ECB plans to bring this down further. However, some analysts consider these low rates as precisely among the reasons why there was a crisis in the first place.

The Italy Debacle

In early 2013, for the Italian economy to survive, the IMF and the EC imposed similar sanctions on Italy. The IMF understandably has to comply with certain IMF requirements for IMF to release its loans. Unfortunately, the Italian senate rejected all the proposals of the IMF and the EC causing a downfall in confidence in the European market entirely. The case of Italy is a very recent development in March 2013 and is still undergoing resolution.

Conclusion

The Eurozone crisis escalated should have been confined only into certain industries, mainly banking and finance. Unfortunately, the economies in the community were not prepared. Economic precautions had not been set up. The affected economies—like Greece—were not prepared for the crisis. These countries were relying heavily on passive income, mainly interest and similar payments from large financial institutions in the US. Their economies were failing. There was not real productivity to speak of and for the economies to bank on. So, when the banks and financial institutions in the US failed, these economies did not have any other source of income.

The Eurozone debt crisis has become a complete economic problem for entire economies with some members of the European Community. The crisis is not simply one related to debt or the financial sector. It has become a problem that requires—for some countries—a complete overhaul of the concerned countries’ economic policies.

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