European debt crisis assignment

Business

Current European Debt Crisis Since 2010 fears of a sovereign debt crisis also known as the “ Euro Crisis” has developed in Europe having direct impact on countries such as Greece, Portugal, Ireland and more recently European giants Spain, Italy, and France. What is on hand for these countries is a serious economic crisis that could involve widespread defaults and or significant rises in inflation caused by toxic short-term loans. The surreal thought of an entire country defaulting, is becoming more of a certainty surrounding Ireland and Greece specifically.

The European Union and European Central Bank are at a struggle to maintain balance with powers France and Germany attempting to carry the burden of the struggling nations; have now seen an increase in their own accumulated national debt and short-term bank loans that must be repaid in the next 24 months. The current state surrounding this crisis isn’t unmanageable, though without swift action and new policy implementing along with a creation of a new monetary fiscal operation, Europe maybe stretched into abandoning governing members of their Union, and possible abandonment of their currency.

This current debt crisis surrounding Europe was due in part to European Central Bank’s installment of short-term loans and its false impression imposed on investors, those of which who were investors believed short-term loans to be more beneficial opposed to long-term papers. Originally, as noted within Peter Boone and Simon Johnson’s work entitled “ Europe on the Brink” they note that, “ Initially the Bank, treated all nations equally, regardless of their credit ratings, as a result, it became profitable for banks to buy short-term government papers and deposit that paper in the ECB in return for

loans" (Boone and Johnson, pg.). After noting the desire for short-term paper, Boone and Johnson are quick to note three immediate risks surrounding these transactions. Firstly, the European Central Bank created government bonds that were highly liquid, in knowing that the buyer maintained the option to turn to the bank for immediate funds . What results from these highly liquid governmental bonds is a larger market for smaller European nations that would ultimately struggle issuing an inflated amount of national debt. Secondly, Boone and Johnson claim that the ECB and European Union, would never let a sovereign fail, due to the fact that each f the European banks generated a massive increase in short-term sovereign debt, where in return to this matter, sovereign investors themselves issued out more debt. Boone and Johnson however state that, " Sovereign defaults would be catastrophic for the banking system" (Boone and Johnson, pg. 2) and therefore the major governing organizations in Europe would never let this occur which leads into their last claim that high risk is involved surrounding banks who engaged in a high credit expansion. What is to come of this claim results in a system of severe uncertainty, due to the fact that investors were under the false impression.

If a problem were to occur, it was thought governments and shareholders together would leverage reserve capital in order to prevent defaults. Sovereigns believe they are under a blanket of protection from the bank, and believe they obtain the ability to take on high volumes of short-term debt. European nations currently reside under the impression that the Central Bank has the authority to print new cash flow for regular revenues making

their investments more stable. If only however European banks operated under this measure accordingly.

The problem surrounding this current debt crisis revolves around “ Creditors that lent money to banks and the sovereign under an assumption that Europe would all be supported fully during times of need and trouble” (Boone and Johnson, pg. 3). Germany who is currently being asked to bailout many in need nations, is at the forefront of a new regime moving away from what was known as moral hazard or what Boone and Johnson note as a “ No Default” policy that is needed to roll over large amounts of short term bank and sovereign debt.

In doing so with this new policy, the ECB and EU attempt to see improvements surrounding nation spending to a more downscaled margin rather than leaning on the doorstep on insolvency. ECB President Jean-Claude Trichet, has called for “ No defaults, no credit events, no selective defaults within the Eurozone” the debts ensuing within the current European nations however has reached to a point where leaders must act upon with a sense of urgency regarding this issue.

A recent New York Times article titled “ Investors Fret at Costs if Rescues are Needed” written by Landon Thomas Jr. states that in a recent report, that collectively 90 of Europe’s biggest banks hold 4. 7 trillion Euros ($6. 7 trillion) in short-term loans that must be repaid within two years time, which is half of the Gross Domestic Product (GDP) of the 17 nations that make up the Eurozone and utilize the euro currency. The focus of this specific study

proposed by Mr. Thomas notes that banks are suffering and are in obvious need of relief.

However, Thomas' article identifies three of the larger banks in the world Societe Generale of France, Unicredit of Italy and Santander bank of Spain all of which current stock prices have severely dropped this calendar year. These specific banks have been called upon to take on the debt of some of the neighboring smaller banks which has struck a problem that requires action from the European Central Bank. The European Central Bank is providing relief, Thomas notes within his article that the ECB has provided, " 4 billion Euros, or $5. 7 billion dollars in short-term on Wednesday August 10th" (Thomas, np).

Where the problem escalates is the lack of action from the European Financial Stability Facility, that of which will take at least another month to be fully functional and begin providing relief bunds and bailout to the banks in need. According to Thomas' insight however, " Parliaments of euro area countries, must vote of the rescue plans new charter, where an approval is by no means guaranteed" (Thomas, np). The worry has surrounded the bigger countries such as Spain, France, and Italy, but most of the attention surrounding these European Debt crisis centers around Greece, Ireland and Portugal.

In regards to Greece in particular, they are struggling to coup with the massive amounts of rolling debt in their nation, and it can now be said regarding their banks that they have avoid insolvency for some time. The Portugal, Ireland, Italy, Greece, and Spain or PIIGS have been analyzed by

experts regarding their bond leverage and have examined that problems lay ahead in the near future for bond holders. Touching back on Boone and Johnson's recent study, they note the difference that European bonds entail in comparison to that of New York of US bonds. European nations are largely under domestic law, which makes it simple for any nation to restructure debt, but strikes fear bond holders, as their legal recourse in the event of a default is minimal" (Boone and Johnson, pg. 5). There is a certain trap in which European banks seem to fall into in regards to bonds. It doesn't sound out of the ordinary for a person to analyze. Simply put when bond yields rise, the bank tends to buy more in order to maintain the survival of their sovereign. This is one of the steps that begins a turn of capital outflow that severely hurts European banks.

Boone and Johnson state that, " Foreign institutions tend to sell back bonds to the local banks of government that issued them, but corporations and households save money outside their local banks, which results in foreign bank branches to reduce the size of their balance sheets" (Boone and Johnson, pg. 6). What comes of these steps that Boone and Johnson write about involve a lack of national liquidity, in which has result in depleted foreign reserves in nations such as Greece, Ireland, and Portugal, which ultimately could see governmental default.

There are possible solutions that have been provided to bailout a country such as Greece. First, involves a buyback proposition set forth which would see the euro zone administrate a new regime of bailout fund relief efforts, though this proposition would take a long period of time through votes of the members of the union and would certainly face criticism due to the

uncertainties of the operations. The second proposed solution for Greece would see the capital Athens receiving the rights and resources for the creation of an agency that would take 100 percent responsibility for buying back bonds from investors.

Ultimately these new propositions would take serious negotiations with all members of the Union, and possibly would not be ideal solutions. What is certain however is that if the euro zone must strive towards a more stable fiscal union of operations and regulations. If action isn't taken swiftly, the possible result maybe a slow destruction of the euro zone, which could result in possible problems for the United States economy.

Joseph Stiglitz suggests that these problems in the euro zone could stretch into the United States, specifically if the euro zone decides to dampen sales of United States exports to Europe. Corey Flintoff's article titled " Europe's Debt Crisis: What it Means for Americans" points to Greece's most recent political elections, when it was discovered that a new government broke euro zone rules that states, " A member's country's debt most not exceed 3 percent of the gross domestic product, when examined, Greece had a debt of 12. percent of its GDP, and had been covered up by Greek Government ministers" (Flintoff, np). Stiglitz's insight and breakdowns of a potential Greek default do raise concerns for the United States, concerns in which cannot be ignored. Stiglitz is quick to mention that the problem in Greece, " Is putting more pressure on countries all over the world to engage in deficit reduction, which results in lower aggregate demand for goods and services off all kinds, especially those produce in the United States" (Flintoff, np).

The euro has been struggling to maintain its value over the past few months, where there have been dramatic fluctuations of the value of the euro in respect to the dollar. What has to be examined in response to the deflation of the euro remains that if it continues to fluctuate downwards, euro zone countries will be forced to pay more for exports from the United States.

What is eminent for PIIGS and possibly future countries such as France and Germany is austerity which serves as a common theme for many experts covering this debt crisis will continue to increase, and imported and exported goods, will become inflated and therefore less likely to be used. Though the crisis has been occurring for some time now, and cannot be said that this catastrophe was one that occurred out of the blue, experts and researchers fear that this crisis maybe turning into a political crisis on top of an economical and financial battle.

Complicating the relief efforts directed towards Greece, European Central Bank President Jean-Claude Trichet stood firm on his stance that the ECB wouldn't alleviate the burden of an entire nation proclaiming, " The Central Bank will not accept bonds from any defaulting country as collateral which could result in Greek banks without financing if credit agencies saw a restructuring, even a volunteering one such as default" (Saltmarsh, np). The political background to this sovereign debt crisis has identified a direct effect that can impose problems for the United States.

For the first time in the history of this great nation of which is looked on as a nation of political strength and stability has lost its AAA rating standard, which has drawn concerns surrounding our current political regime and

fading economy. Spencer Kimball’s current article circulating surrounding the political crisis titled “ US, EU Debt Crisis Escalates in the Face of Political Gridlock” explains that the EU and United States have lost control of the fiscal house. He explains that, “ In the US, the debt is a product of inopportune tax cuts that wiped out our budget urplus, along with two wars in the defense budget that were not paid by taxes for the first time ever in American history” (Kimball, np). What is common with the two governing bodies is that the people of all nations don’t want to give up their sovereignty, but draws back to the EU issue that 17 nations share the euro currency, but reassure the point needed to be made, that there lacks a higher governing institution that is able to implement policies and maintain and promote proper stability needed for the currency.

Also, we are able to connect that the EU and United States have taken the back seat to nations such as China and India according to Kimball. “ Developing nations such as China and India are making their presence felt in the global market, where the US and EU have failed to adopt sustainable long-term fiscal policies” (Kimball, np). A common reference has remained constant during this current debt crisis signified by many scholars and interest groups studying this matter, Greece simply has to go.

Greece is the clear weak link in this issue, more so than extremely poor Ireland and is causing credit and financial problems of the other members of the euro zone. Europe operates under a fiscal policy one that entails monetary policy implications that denotes a specific working age and retirement options, all of which Greece has neglected.

PBS recently published an article titled “ Europe’s Debt Crisis-How to Fix the Economy” Suzanne Pratt coldly states, “ Greece has to go, they have to let them leave the euro zone, and must let it restructure or in other words letting them default, ideologically Greece is far away from the powers Germany and France” (Pratt, np). Many have acknowledged and solidified this same claim that Greece must be abandoned in order for reform, but it is unclear how the debts remain to be lifted.

German Chancellor Angela Merkel and French President Nicolas Sarkozy are to hold an emergency meeting in the short coming to set forth the possibility of the creation of a euro-bond. Pratt describes this action as, “ Insurance, as these bonds will allow all member states to borrow more affordable rates, and could result in the consolidation required for the European government” (Pratt, np). This solution is bold, seeing that the European Union have in place a monetary union, though without a new improved fiscal union, and the dropping of dead weight debt attached to Greece, the euro zone will continue to struggle and any wonder how long these problems will last and how much more debt maybe accumulated. Our society regarding the United States and European Union have been in this situation before, and we can only hope that within the next decade of operation the political systems set in place or purposed and newly revamped monetary policy will pull all in need out of this rut. What is imminent for the next 10 years will be restructuring in all aspects of government regarding this current debt crisis and struggling stock market.

Private and public sectors respectably must shave off some of the debt together over the years, otherwise a recession that will affect more than

European will loom. Keith Schaefer of Business Insider wrote a piece “ Market to Rebound After Solution to European Debt Crisis” claims that this debt crisis is the “ Driver of the stock market shifts, where as soon as it can be managed, unemployment, high US debt, and the declining dollarwill be begin to level back to a moderate level” (Schaefer, np). However, we cannot expect immediate action surrounding this issue.

International Law entitled within this current crisis will bring forth slow regulations, and paperwork on top of more paperwork, opposed to direct action and authority implications. Works Cited Boone Peter and Johnson Simon. The New York Times. “ Europe on the Brink” August 17th 2011. http://www. iie. com/publications/pb/pb11-13. pdf
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