Eurocrisis and monetaryandfiscal policy

Economics

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The government will have to borrow from overseas or International Monetary Funds to pay for the differences between the import spending and export costs. The European Union lend to Greece 109 billion of euros to bailout (Foreleg and Walker, 2011, July 23). This is really a burden for a country and it may bring negative effects to the government policy and function, because the government will have to response the imbalance in both the government spending and policies. It is a real social cost. Meanwhile, the confidences of the foreign will be effect. They may care about the external imbalance in their partner country because it is related to their profits and stability.

The external imbalance may make investors feel risky and then reduce the investment or charge more on the loans, which will make the imbalance worse. And for the country, it is really a risk because the economic imbalance has negative influences on many different factors, such as the value of the currency and the national credit rating. Portugal, Italy, Ireland, Greece and Spain (PASS) face the decreasing of value of their credit rating. Now Greece is C and Portugal is B+ (Hawkers, 2012, January 14). Both of them are not optimistic. When government face recession they will consider increase public expenditure and cutting taxes to stimulate demand and decrease the unemployment rate (Quailing, Eastward and Holmes, 2009).

However, in this case, the crisis countries have so many debts that make their government deficit large enough to do no actions. What they have to do is to austerity their fiscal policy to reduce the deficit. So Greece executes the 5 years plan to get loans. Comparing to other European countries, PASS are relatively falling behind. Their economies are more relied on labor force type of industry such asglobalization, companies are seeking for cheaper labor

forces; their advantages are no longer existed. If these countries do not adjust their industry structure, they will e much fragile than now during the financial crisis. Also, the labor forces among European Union are also not liquid.

Companies from different country have different tax system so their funds become bubbles. The theory of optimum currency area is based on labor mobility, price and wage flexibility as the preconditions. Also the mobility can instead of the floating of exchange rate. Euro zone creates a system that labor can move freely, however, because of theculture, language, welfare and social norms, the labor forces inside European Union cannot achieve completely liquid Robinson, 2008). Monetary Policy The central bank of Europe has set several targets to help to achieve and maintain the macro economic objectives. The main target is to keep the prices stable and achieve the low inflation level in the medium term.

And it also set targets of maintaining financial system stability and improves the payments system. The purpose that the central bank of Europe sets these targets is to achieve the economic objectives, promoting the healthy growth of the whole economy (Paula, 2009). And the most common and effective measure used by it is the monetary policy. The central bank helps to achieve the macroeconomic objectives through meeting its targets, with using the monetary policy. Using the monetary policy, the central bank can change the interest rate to adjust the aggregate demand, and then help to achieve the macroeconomic objectives. When the inflation occurs, the central bank will carry out the cash rate target, bringing up the official interest rate.

And then, the central bank will sell the government securities to commercial banks. The interest rate for cash will be increased, because the decrease of the cash supply. In order to maintain heir profits, financial institutions charges more rates on loans and so does the deposits. Therefore, the households and firms will borrow less and prefer to savemoneyin the banks rather than spend quickly. It means that the aggregate demand is reduced and so does the inflationary pressure. The reduction of demand brings the prices down, so domestic produced goods will have advantage in the prices in the international market. More export earnings will be got and the external balance will be achieved.

In addition, the low prices may attract more foreign investors to invest, which will benefit to the long term economic growth and full employment. It means that although the higher interest rate will reduce the production and make people lose their Jobs in the short term, it could bring chances for the future development. The similar theory is suitable for the opposite condition. When the aggregate demand needs to be pulled up, the central bank will decrease the interest rate and encourage economic activities, stimulating the growth of the economy so European Central Bank decreased interest rate in December 2011 by 0. 25% to increase aggregate demand (European Central Bank, 2012).

Also, European Union has the same monetary policy but without the same fiscal policy (Brittany, Timelier, Bergsten, Exchanging and Meltzer, 2010). Government financial policy serves internal to increase economic growth and decrease the unemployment rate. Indeed, these two on the allocation efficiency, currency policy serves external to keep low inflation rate and the

stable currency exchange rate (Hudson and Quailing, 2009). Currency system and government financial system are not unedited so the coordination is difficult. When European Union was founded, they do not consider the quitting system, so hen there come problems, the costs of negotiations are very high (Repack, 2010). It leads the problems to the Euro crisis.

When one or two membership countries have problems with their economics, they only can discuss inside the meetings to solve the problems. Then the market will face the strong fluctuations, and these fluctuations also make the problems unsolved. The banks among Euro zone have other European Union countries' debts. This makes European banks' credit expansion crazily, and the management risks increase fast. Their ratio of total capital and Tier 1 capital is even Geiger than the banks in supreme crisis in the USA (Beg, 2009). Conclusion Overall, although investors are losing confidence with euros, the monetary policy keeps the Euro price stability at an acceptable range. MIFF also lend huge amount of euros to save the market.