The Eurozone Debt Debacle: A Crisis Foretold?

By Vivekanand Jayakumar, Ph.D.

In the aftermath of the collapse of Lehman Brothers, the synchronized nature of financial contagion and the liquidity and credit constraints posed the greatest threats to the world economy in late 2008 to early 2009. Unemployment and real economic variables contracted some of the most severe downturns experienced by financial markets in the U.S. and elsewhere. While a sustained U.S. recovery since mid-2009 has not matched expectations, the global recovery has been even more robust. Though economists are wary of fiscal stimulus, concerns about the effectiveness of monetary interventions in the aftermath of the collapse of Lehman Brothers have not subsided. The current situation highlights the need for renewed focus on the Eurozone, which is at a critical juncture. The European Central Bank (ECB) is critical. European leaders have also rightly decided to replace the temporary depository insurance program under the aegis of the ECB is critical. European leaders have also rightly decided to replace the temporary depository insurance program under the aegis of the Single Euro Area Financial Stability System, and the need for both continued monetary stimulus and fiscal discipline.

The Euro Was a Monetary Union Without a Union. The Euro was initially launched in January 1999 and became fully operational in January 2002 with the adoption of the single currency, the euro, by 12 of 15 member states of the European Union (EU) at that time (Greece joined in January 2001, and Turkey in January 2008). The adoption of the Euro went ahead even in the absence of common fiscal and monetary policies. While financial integration grew significantly, though all of the criteria suggested by the OCA theory were not met. Despite having high levels of trade openness and economic convergence, fiscal transfers were also culpable as they rather startlingly downplayed or ignored some of the clearly evident warning signs that the Eurozone lacks sufficient levels of intra-

The Eurozone debt crisis: A Crisis Foretold?

The Eurozone debt crisis has been a long and complex story, with roots in the political and economic history of the European Union. The crisis began in 2009, when the Greek government announced it could not meet its debt obligations. This event, known as the Greek debt crisis, was followed by a series of defaults and bailouts in other eurozone countries, including Portugal, Ireland, Italy, Spain, and Greece. The crisis highlighted the weaknesses of the eurozone’s fiscal framework and the need for stronger institutional arrangements to prevent future crises. The crisis also had significant implications for the global economy, as the eurozone is one of the largest economies in the world and a major source of global growth. The eurozone debt crisis continues to be a major topic of discussion and research, with many debates focusing on the causes of the crisis, the effectiveness of various policy responses, and the future of the eurozone.

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THE UNIVERSITY OF TAMPA

THE TAMPA BAY ECONOMY: AUGUST UPDATE

By Jon T. Ardash, Ph.D.

The Tampa Bay economy was the beneficiary of an improvement in the national economy and a reduction in rates of monetary expansion. For the month of July, the seasonally adjusted unemployment rate was 3.6 percent, down from 4.0 percent in June.

The Tampa Bay unemployment rate remains below the national average of 4.3 percent. The seasonally adjusted unemployment rate for the United States was 3.7 percent in July, compared with 3.8 percent in June. The national unemployment rate is seasonally adjusted.

The Tampa Bay unemployment rate for non-agricultural employment was 3.6 percent in July, down from 4.0 percent in June. The seasonally adjusted unemployment rate for the Tampa Bay region was 3.6 percent in July, compared with 3.8 percent in June. The seasonally adjusted unemployment rate for the United States was 3.7 percent in July, compared with 3.8 percent in June.

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The European Debt Debate: A Cross-Sectional Analysis

The periphery countries experienced large increases in both the public and private sector debt during the run-up to the crisis, with the non-financial corporate sector debt rising from 30% of GDP to over 70% of GDP by 2008. The consequences of this rapid growth in debt are reflected in the high interest rates that were required to sustain the debt. By 2010, the interest rate spread between the periphery and the Eurozone core was around 4 percentage points.

The periphery countries were also more vulnerable to shocks due to their large reliance on external financing. The periphery countries were more dependent on foreign capital inflows for investment and consumption spending, while the Eurozone core countries had lower debt-to-GDP ratios and lower interest rate spreads. This dependence on foreign capital inflows increased the risk of a self-fulfilling financial crisis, as the periphery countries faced higher interest rates and reduced access to international capital markets. The stage was thus set for a self-fulfilling financial crisis, with the high interest rates reducing economic activity and increasing the risk of non-performing loans for banks.

The aftermath of the crisis was marked by a deep recession in the periphery countries, with GDP falling by over 20% in some cases. The crisis was exacerbated by the large fiscal drag resulting from the increased tax revenue needed to service the large government debt, as well as the reduced government spending due to the fiscal consolidation measures implemented by the periphery countries.

The periphery countries also faced significant challenges in the labor market, as high unemployment rates persisted even after the recession ended. By 2012, the unemployment rate in the periphery countries was around 20%, compared to less than 10% in the Eurozone core countries.

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Alfred Aldrich BRTF — European Stability and Financial Stability Facility, with a permanent capital base of €500 billion, with access to €30 billion by July 2013.


Hand Out 4B — Price Change by City

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In the aftermath of the collapse of Lehman Brothers in 2008, a generation of macroeconomics and monetary policy went 50 years in the making. The financial crisis and the world economy’s efforts to recover have been accompanied by wrenching balance sheet deleveraging and persistently weak growth. The Eurozone’s travails lie in the mistaken viewpoint that the euro was a natural currency. As we have demonstrated in this series, the Eurozone lineup is a clear case of a failed currency union. Furthermore, the genesis of recent Eurozone travails lies in the mistaken viewpoint that the large eurozone countries are lenders and the small Eurozone countries are borrowers. As such, a eurozone crisis is an unnatural occurrence.

For any country, macroeconomic identities are clear. A country that is saving deficient (current account surplus) would be a net foreign lender while a country that is saving surplus would be a net foreign borrower. In the Eurozone, the mistake was that the large Eurozone countries should have been saving deficient and the small Eurozone countries should have been saving surplus. The Eurozone was principally a tool to further the financial integration (Figure 3.6 shows the absolute number of international bank branches per million residents in the Eurozone). The Euro was fabricated in a period of creating a protected and united Europe — a mistake that, unfortunately, the financial crisis revealed. The euro was a result of the failure to adequately prepare for the adoption of the Euro, proper currency unions require a history of sound economic policies and a generation of positive growth. A decade later, however, Eurozone member countries faced the problem of policy implementation in areas such as the environment, national saving and domestic investment. Thus, Eurozone member countries faced the problem of policy implementation in areas such as financial sector turmoil along with the Eurozone travails lies in the mistaken viewpoint that the large Eurozone countries are lenders and the small Eurozone countries are borrowers. As such, a eurozone crisis is an unnatural occurrence.

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The ECB’s Review of U.S. Trends in Monetary and Fiscal Policy: A Crisis Foretold?

The U.S. Crisis:
- Fiscal: Deficit increased from 2.3% to 13.2% of GDP
- Monetary: Fed surged to 0% interest rates in 2008

The ECB’s Response:
-螺旋式财政扩张 (3.6 trillion €)
-量化宽松 (QE)
-负利率

The Eurozone Debt Debacle: A Crisis Foretold?

1. The Euro was not a fixed rate, but rather a currency in monetary union where sovereign states retained control of fiscal (taxes, spending) and liquidity policies.
2. The adoption of the Euro went ahead even though large imbalances existed within the Eurozone.
3. The rise of internal imbalances and the resultant risk posed to the Eurozone were also culpable as they rather startlingly ignored the principles of the optimal currency
4. The European Central Bank (ECB) was put in place. The European Central Bank
5. The European Stability and Fund (ESF) was introduced as a bailout fund for members of the Eurozone.

The Eurozone Debt Debacle:
- The Eurozone lacks sufficient levels of intra-European production and consumption in terms of trade openness.
- The historically high levels of economic diversification were also culpable as they rather startlingly ignored the principles of the optimal currency
- Tighter fiscal policies were put in place with the institutional restrictions for non-Eurozone members.

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