Eurozone Crisis - What next?

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Understanding the Eurozone Crisis on one level is relatively easy. Put simply, many households are facing a similar situation. Households facing credit card bills and rising interest rates, and not earning enough to pay their bills, are essentially in a debt and deficit situation, like Eurozone states. Just as some households may be looking bankruptcy in the eye, so have Greece, Ireland, Italy and Portugal. Member states overspending have not been collecting sufficient taxes to pay for state expenditure.

Meanwhile, the cost of borrowing on foreign exchange markets to cover the deficit and sustain public expenditure is increasing, adding to debt. The level of foreign debt to GDP in Greece is 252%; in Ireland, 1,093%; in Italy 163% and Portugal 251%. In the UK it is high, at 484%, explained by its active financial sector but it is seen as a low risk country because it holds high-value assets. Government debt to GDP in the UK is relatively low at 81%; in Greece it is 166%; Ireland 109% and Italy 121%. Ireland's problems lie in the housing boom which collapsed as interest rates rose and credit restrictions were imposed. Greece, meanwhile, is notorious for its failure to collect taxes, in addition to its generous social security provisions. Italy's problems are down to low growth, due to poor regulation, vested business interests, and weak investment - all of which limit production.

The origins of the crisis must however be tracked back to the financial crisis and 'credit crunch' of 2008, in which valuation and liquidity problems in the US banking system was caused by credit being extended to those in the housing market who could not afford to pay back loans. The crisis led to the collapse of banks, necessitating bailouts to sustain capital assets and to stave off the threat to the banking system and financial markets. Although Greece, Ireland and Italy have been given billions of euros in bailouts to stop them going bankrupt, there are serious concerns over the impact on other Eurozone countries should they default. Were Greece to leave the Eurozone it would result in the devaluation of assets, its imports would be expensive, interest rates and inflation would rise; contagion could ensue into a meltdown in Europe. Bailouts are at the price of the introduction of austerity measures: cutbacks in public expenditure have resulted in job losses in the public sector and increases in taxation, with resultant social unrest, as well as changes in leadership, with Papandreou stepping down in Greece and Berlusconi in Italy.

The crisis however has raised wider issues about the single currency, the Eurozone and the EU itself. A single market might imply a single currency, to ease trade, but the introduction of the Euro has meant that countries cannot make that time honoured adjustment when faced with such crisis: devaluation, which would make their goods more competitive.

What next for Europe?

Solving the crisis has proved difficult. In the Eurozone there has been little appetite for contributing to a bailout fund through Eurobonds; foreign investors such as the Chinese are reluctant to even add to the proposed €2trillion European Financial Stability Fund (EFSF) currently standing at nearly €500bn. The ECB has not been prepared to take the role of lender of last resort. The route to solution has been the proposal, by the German Chancellor Angela Merkel and President Sarkozy of France, in a debate added to by Jacques Delors, past president of the European Commission, for a deepening of the European Union through greater fiscal integration, with tax and spending of member states regulated by the EU, and a Tobin Tax, and for this to be enshrined in a new treaty.

As breaking news in the early hours of the 9th December revealed, British Prime Minister David Cameron vetoed the proposal for the new Treaty, saying it was not in UK's interests, given he could not get agreement to exemption from EU financial regulation, for the City of London. The 17 Eurozone countries plus 9 others are instead to sign up to a 'European Accord', very much leaving the UK out in the cold. The Accord will take time to put into place and the question is whether the provisions are enough to bring stability to global financial markets, boost business confidence, and so increase investment and even forestall Standard and Poor's planned downgrading of the credit rating of most of the Europe Union, which will add to the debt problem.

What might also be needed is a more proactive approach to secure much needed economic growth. This is recognised by the EU as being an important issue, by the fact that it held a conference on an Industrial Policy for Europe in Brussels in late November 2011. It could be difficult to implement, given austerity measures, as most definitely it would take the route of increased public expenditure to support business development to put people in work to boost demand and who could be taxed and so help clear the deficit. It might well be necessary since private sector led growth is faltering, given uncertainty in the market and demand deficiency. This is the same as for households, as like the EU, they can cut back on expenditure to reduce their deficit but they could also find additional work to boost income to pay off their debts.

As Birmingham Business School students, however, realised, in discussing 'Should we go or should we stay', (after listening to the Clash), it is well to remember that were the EU to go as far as breaking up, one of the mechanisms for preventing war among between European countries will have gone.

It can be said, we live in interesting times.

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