

# Financial Crisis

Class 4: From Financial Crisis to Debt Crisis

Pop Economics

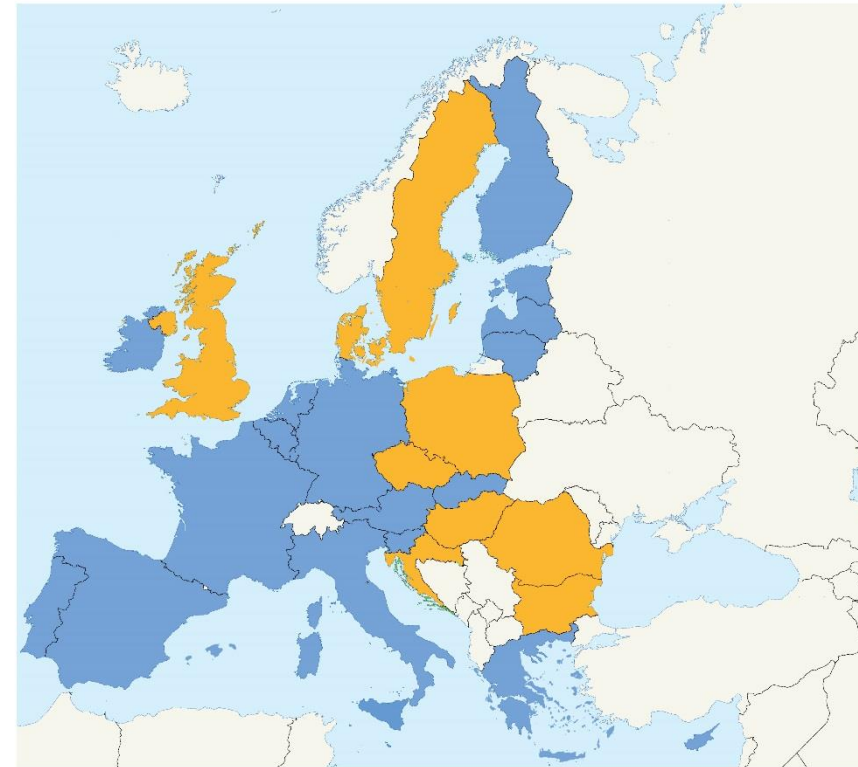


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**MŠMT**  
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# Causes of European Vulnerability

- Euro introduction
- Debt



■ EU countries using the euro

■ EU countries not using the euro

Source: <https://europa.eu/european-union/>

# Debt

- *Government debt*: debt of central government
- *Public debt (also national debt)*: government debt and debt of national, municipal and other levels and other parts of the public sector, such as public corporations
- Some economists do not differ among public and government debt.

# Why Single Currency Does Not Work in EU

- Language and Culture Difference stemming from history
- Regulatory Aspects: EU is not ready for single currency, which leads to massive redistribution of wealth by ECB
  - European bonds missing
  - Banking, fiscal and political union missing

# Hidden unvoluntary solidarity mechanism

- low interest rates:
  - + cheaper mortgages and debts
  - less profitable savings

ECB sets low interest rates:

- +South of EU enjoys cheaper debts
- Germans have less profitable savings



Source: Pixabay

# Andrew K. Rose: Rose Effect

- single currency → increase in intra-union trade
- 1999: main argument for monetary union in EU
- 2015: Andrew K. Rose & Reuven Glick: "Currency Unions and Trade: A Post-EMU Mea Culpa": „We conclude that it is currently beyond our ability to estimate the effect of currency unions on aggregate trade with much confidence.“





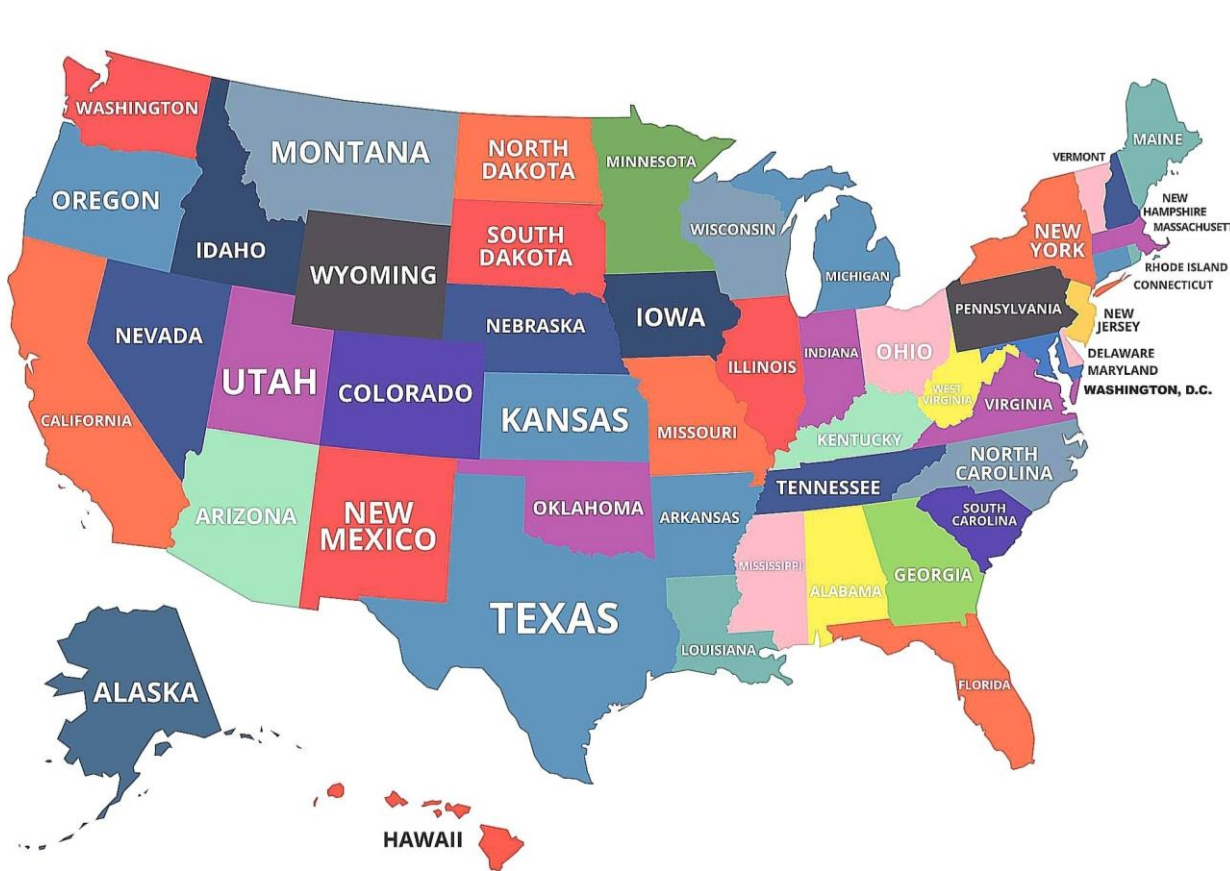
# Theory of Optimum Currency Areas



Source: Wikipedia

- Robert Mundell, 1961
- Criteria for a successful currency union:
  - Labor mobility across the region
  - Openness with capital mobility and price and wage flexibility across the region
  - A risk sharing system such as an automatic fiscal transfer mechanism to redistribute money to areas/sectors
  - Participant countries have similar business cycles

# Labor mobility across the region



Source: [www.studyroom.co](http://www.studyroom.co)



Source: [www.conceptdraw.com](http://www.conceptdraw.com)



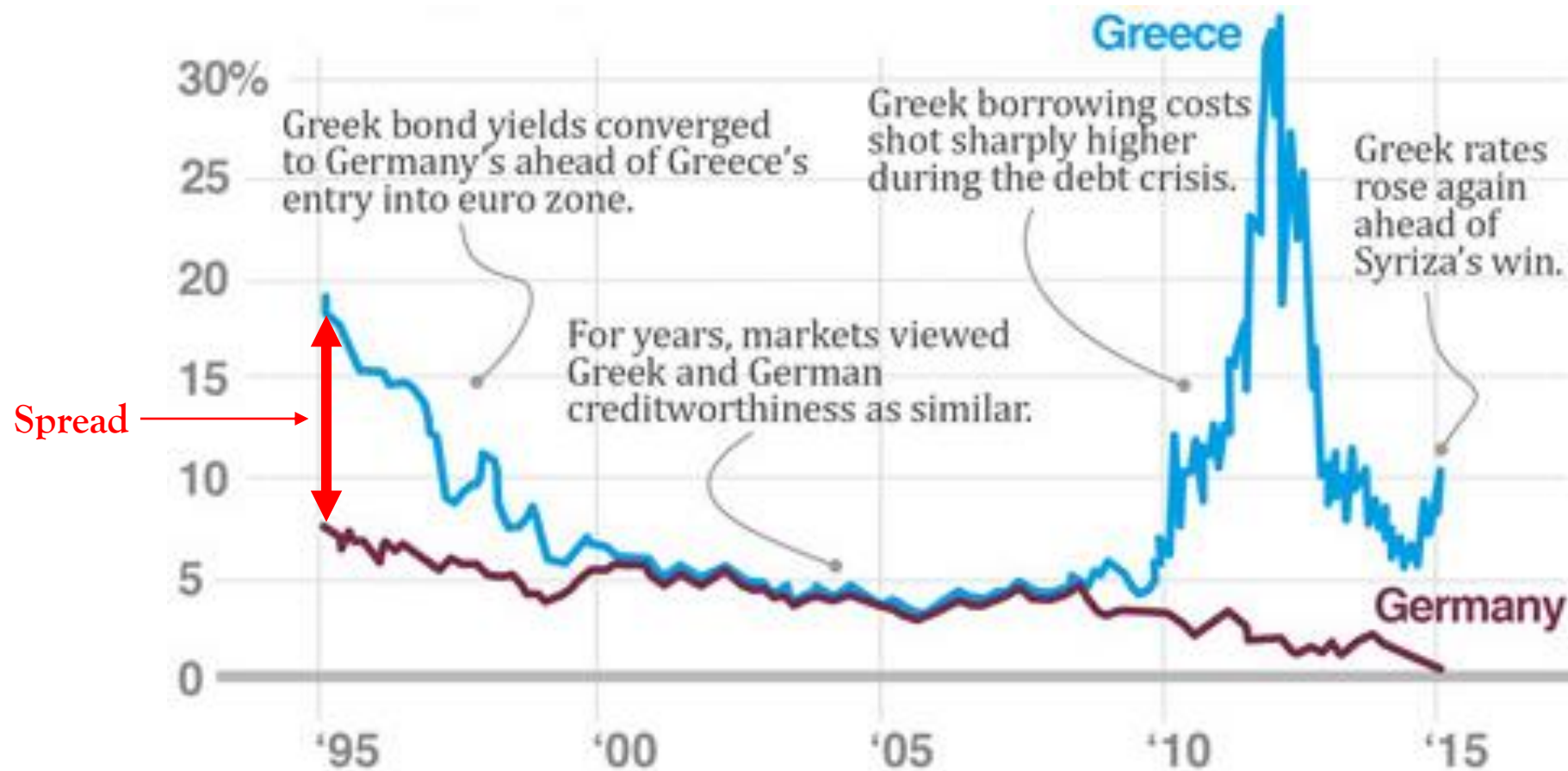
# Greece

- 1970s: socialist governments which increased government spendings in order to reduce power of junta
- 1981: EU accession
- 1985: Politics of blackmailing during accession of Spain and Portugal resulting in agricultural subsidies to Greece amounted to 1 bil USD
- 2001: EMU accession, euro adoption: data falsification in order to fulfill Maastricht criteria

# Maastricht criteria

What is measured:	Price stability	Sound public finances	Sustainable public finances	Durability of convergence	Exchange rate stability
How it is measured:	Consumer price inflation rate	Government deficit as % of GDP	Government debt as % of GDP	Long-term interest rate	Deviation from a central rate
Convergence criteria:	Not more than 1.5 percentage points above the rate of the three best performing Member States	Reference value: not more than 3%	Reference value: not more than 60%	Not more than 2 percentage points above the rate of the three best performing Member States in terms of price stability	Participation in ERM II for at least 2 years without severe tensions

# Yield on 10-year government bonds in Greece and Germany



Source: Factsheet, Tradeweb, July 2015

# Financial crisis in U.S. spreads to China and Europe

- 2008, 2009: Fall of Lehmann Brothers and financial crisis in U.S. decreased consumption of Americans
- American consumer influences the whole world:
  - China: loss of main market
  - Impact on transport companies, mainly international maritime transport which was leading industry
- British banks collapsed:
  - British tourists spend less in Greece
- Greek government faces lower budget revenues. Lower consumption and production, lower budget revenues.

# What to remember

- Government debt
- Public debt
- Unvoluntary solidarity mechanism of Euro
- Rose Effect
- Spread
- Optimum Currency Areas
- Maastricht criteria
- Labor mobility



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