

THE ANALYSIS OF THE ORIGINS AND CAUSES OF THE EUROPEAN DEBT CRISIS

АНАЛІЗ ДЖЕРЕЛ ТА ПРИЧИН ЄВРОПЕЙСЬКОЇ БОРГОВОЇ КРИЗИ

The research study gives an insight into the origins and causes of the European debt crisis. The recent and current tendencies of the world economy are reviewed. The non-core countries of the European Monetary Union (EMU) poorly absorb negative shocks generated by low-interest rate policies promoted by the European Central Bank. The single monetary system the EMU is built on is proven to be inflexible, hence disadvantageous to the peripheral economies of the union. A stricter fiscal discipline should be established to avoid another Greek scenario of fiscal data falsifying.

Key words: European debt crisis, a single monetary system, financial discipline, debt burden, indebtedness.

У статті розглянуто джерела та причини європейської боргової кризи. Нещодавні та поточні тенденції розвитку світової економіки були проаналізовані. Встановлено, що периферійні країни Європейського монетарного союзу неадекватно поглинають негативні шоки генеровані політикою низьких процентних ставок Європейського центрального банку. Єдина монетарна система ЄЦБ є негнучкою, а відтак неефективною для периферійних країн союзу. Крім цього, необхідно впрова-

джувати жорсткішу фінансову дисципліну для того, щоб у майбутньому уникнути грецького сценарію фальшування фінансової інформації.

Ключові слова: Європейська боргова криза, єдина монетарна система, фінансова дисципліна, борговий тягар, заборгованість.

В статье рассмотрены источники и причины европейского долгового кризиса. Последние и текущие тенденции развития мировой экономики были проанализированы. Установлено, что периферийные страны Европейского монетарного союза неадекватно поглощают отрицательные шоки генерируемые политикой низких процентных ставок Европейского центрального банка. Единственная монетарная система ЕЦБ является негибкой, а затем неэффективной для периферийных стран союза. Кроме этого, необходимо внедрять более жесткую финансовую дисциплину для того, чтобы в будущем избежать греческого сценария фальсификации финансовой информации.

Ключевые слова: Европейский долговой кризис, единственная монетарная система, финансовая дисциплина, долговое бремя, задолженность.

UDC 336.3:339.7

Pin A.M.

Postgraduate Student at Department of International Economics, Ternopil National Economic University

Introduction. Financial integration across the world is a prerequisite for the intensification of international capital flows, the distinctive feature of globalization. Global economic activity demonstrates a pronounced tendency to pick up in growth, edging up from 3.1 percent in 2016 to 3.5 percent in 2017 [1, p. 1]. The up-to-date economic forecasts for the year of 2018 show merely 0.1 percent of world economic growth in relation to the current year. Commodity prices have pulled out of stormy course due to internationally agreed restrictions upon oil supply and firms' expectations of more healthy global demand. Commodity exporters have breathed a great sign of relief as commodity prices edged up. Moreover, higher commodity prices have alleviated deflationary pressures and lifted global headline inflation [1, p. 1]. Financial markets remains buoyant, but demand from China to stick to the status quo policy support and United States to maintain the course of deregulation and financial expansion. In general, short-term growth is totally dependent of market sentiment. The world developed economies caught a wave in the second half of 2016, accounting for momentum the world economy gain during the period. The U.S. economy picked up due to the increased confidence among companies about future demands. Solidity features the pace of economic growth in the United Kingdom even in spite of the referendum favoring the adherents of euro-skepticism. Solid net exports turned out to be beneficial to the Japanese economy,

meanwhile strong domestic demand gave Spain and Germany incentive to intensify economically [1, p. 1].

Apart from the economic trends of developed economies, emerging markets and developing economies varied widely in economic performance. Chinese economy shows firm economic growth, meanwhile India experienced minor slowdown in economic performance deriving from the currency exchange initiative. Brazil continues to suffer from a deep recession, whereas changeable geopolitical environment slows down Turkey and Middle East.

When it comes to the EU economies, the last three years of improvements and changes in crisis management, fiscal and monetary policies resulted in the members of EU finding solid ground. The GDP edged up from 1.5 percent in 2014 to 1.8 in 2016 [2, p. 3]. The 2017 economic projections suggest 2-percent economic acceleration for the upcoming year. The rate of inflation is likely to fetch up a trough by 2017, displaying a 1-percent edge-up [2, p. 3]. A forecast of a modest decline in the EU economy is made for unemployment. However, the key challenge the EU economies are facing is high private indebtedness, which hampers investment and consumption [2, p. 3]. Debt burdens the private sector of many European countries originated from austerity measures applied to save banking systems of those countries after the breakdown of the 2008 world financial crisis [2, p. 3]. That sharp economic decline was gave birth to the sovereign debt crisis the EU has been suffering since

then. To add insult to injury, Great Britain's euro-skeptical tendency leading to the European Union membership referendum, which resulted in 52 percent of voters ticking off the "Leave" option, makes a case for the hypothesis that the European sovereign debt crisis is highly likely to deepen, probably having negative effects on the economies of EU.

Literature review. This research relies on both the findings of the research studies on the European debt crisis and statistics data retrieved from international financial institutions such as International Monetary Fund and World Bank. The reports prepared by the IMF and the World Bank gives an insight into the recent and current trends in the world economy. The world economy is currently experiencing a mild intensification in economic growth, increase in commodity prices and buoyancy of financial markets [1; 2].

Of particular importance to the researches engaging in studying the matter of the European debt crisis was defining origins and causes of the crisis. All the researches this paper refers to provide strong evidence that poor fiscal discipline combined with the inherently disadvantageous features of a single monetary approach is to blame for the occurrence of the debt crisis. Ruscakova and Semancikova questions the adequacy of the 1992 Maastricht treaty, putting forward an argument that a lot of the countries, which met the criteria at the moment of membership acquisition, currently fall far behind in doing so [3, p. 400]. Furthermore, post-boom recession in the peripheral countries of the EMU would have been less devastating had stricter rules of fiscal discipline been applied [3; 10] Asymmetric shocks the non-core countries of the European Monetary Union (EMU) suffer hamper the progress of full financial integration [4]. Apart from poor fiscal discipline, the researchers put emphasis on the flawed genetics of the single monetary approach. Low-interest rates implemented by the European central bank led to overheating of the non-core economies [4; 5, 6]. The rescue packages assigned to deal with the situation led up to self-perpetuating panic in the financial markets.

Purpose and goals. The purpose of this research study is to give an insight into the origins and causes of the European debt crisis. There are specific goals set to make the purpose attainable:

1. To give an account of the recent and current tendencies of the world economy.
2. To look into the recent research studies on the subject and synthesize findings on European debt crisis
3. To make recommendations for prevention of debt crises in future

Methodology. The research studies dedicated to the matter of debt crisis, particularly focused on the European sovereign debt crisis, constitutes the starting point of this research paper. Prime information for analysis consists of statistic data and analytic reports

gathered and composed by official non-governmental financial institutions, state agencies and research institutions. The methodological approaches applied in the research paper for the attaining the purpose and achieving accompanying goals include customary methods of obtaining knowledge such as observation, analysis, synthesis, comparison, deduction and induction.

Results. The snap of the U.S. mortgage bubble in 2008 led to financial distress across the EU's economies. The ravages of the financial crisis of 2008 firstly plowed the economy of Iceland, bringing down its banking system and spreading to Portugal, Greece and Ireland [7, p. 50]. Shortly after, the crisis avalanche straddled Spain and Cyprus. The repayment and refinance abilities of those countries shrunk infinitesimally close to zero, with Greek debt being moved to junk status at one point of time. Being impotent to fulfill their financial liabilities, those countries became completely dependent of third parties financial assistance. To insulate their economies from the contagion of insolvency, the seventeen Eurozone economies approved by vote the establishment of the European Financial Stability Facility (EFSF), a financial organization designed to raise finance by issuing debt in order to bail out problematic Eurozone countries, whose lending abilities were severely impaired. The European debt crisis became a real concern in late 2009, when an already elected Greek government unveiled the fact of previous governments misrepresented budget data. As a consequence, deficit levels came as a shock to the EU's market players, giving birth to market sentiments and causing slump of confidence among investors. Literally unsustainable increase in bond spreads featured the magnitude of the riskiness of that economic environment. Fears virally hit the entire Eurozone, implanting apprehension about little sustainability of debt levels and fiscal positions. As the expectations that intra-Eurozone sovereign debt levels were growing in 2010, lenders stipulated for interest rates advance from Eurozone countries suffering from deficit levels and high debt [7, p. 51]. Such demand added insult to injury, since economic slowdown incapacitated affected economies from financing their budget deficits. To mitigate the disaster, the impaired countries axed expenditures and put on tax strain, condemning their citizens to social insecurity. Greece in particular set the worst example of a crisis of confidence in a country's leadership among other Eurozone countries.

Having been heavily contaminated by the sovereign debt crisis, the EU admitted that there was great likelihood that the crisis was highly likely to be prolonged and enduring. To minimize negative effects, the EU established a jumping-off place to deal with the crisis in the long-run. For that reason, in 2013 the EFSF was replaced by the European Financial Stabilization Mechanism (EFSM), a permanent financial

fund designated by the European Union to provide emergency financial assistance to the intra-union countries. Financial markets are the source of fund raising [5, p. 339]. The EFSM is given the highest AAA investment grade by Standard & Poor's, Moody's and Fitch, meaning that investments are highly credible. A factor investors consider to be deciding is the legal financial guarantees provided by the European Commission. To put it differently, the latter assumes full financial liability for borrowings under the terms of the EFSM. Unfortunately, ensuring prosperity in Europe, one of the key goals the European Commission is obligated to pursue, seems to stumble along. Ruscakova & Semancikova make a case for the efficiency of the 1992 Maastricht treaty, arguing that the purpose of the latter, which is to ensure symmetric financial integration through incorporating a single currency (Euro), does not show a cause-effect rela-

tionship with the economic status quo of the recent years [3, p. 400]. Inflationary policies promoted in the EU are beneficiary for economies with positive current account of the balance of payment, fiscal transfers and labor mobility are not adequate and diversification of countries in the Economic and Monetary Union (EMU) turns up weak [8]. The empirical research study based on the pre-euro data carried out by Ferreira, Dionisio & Zebende comes to conclusion that asymmetric shocks the EMU's peripheral countries chronically suffer from hinder them from arriving at the state of full financial integration [4]. The fact is that the absence of national currency, an unchangeable tool for fulfilling flexible and efficient fiscal and monetary policy aimed at absorbing imbalances, shackle counteraction to those imbalances. The current status quo, which has little changed for the last decade, proves insufficient functionality of the euro-currency

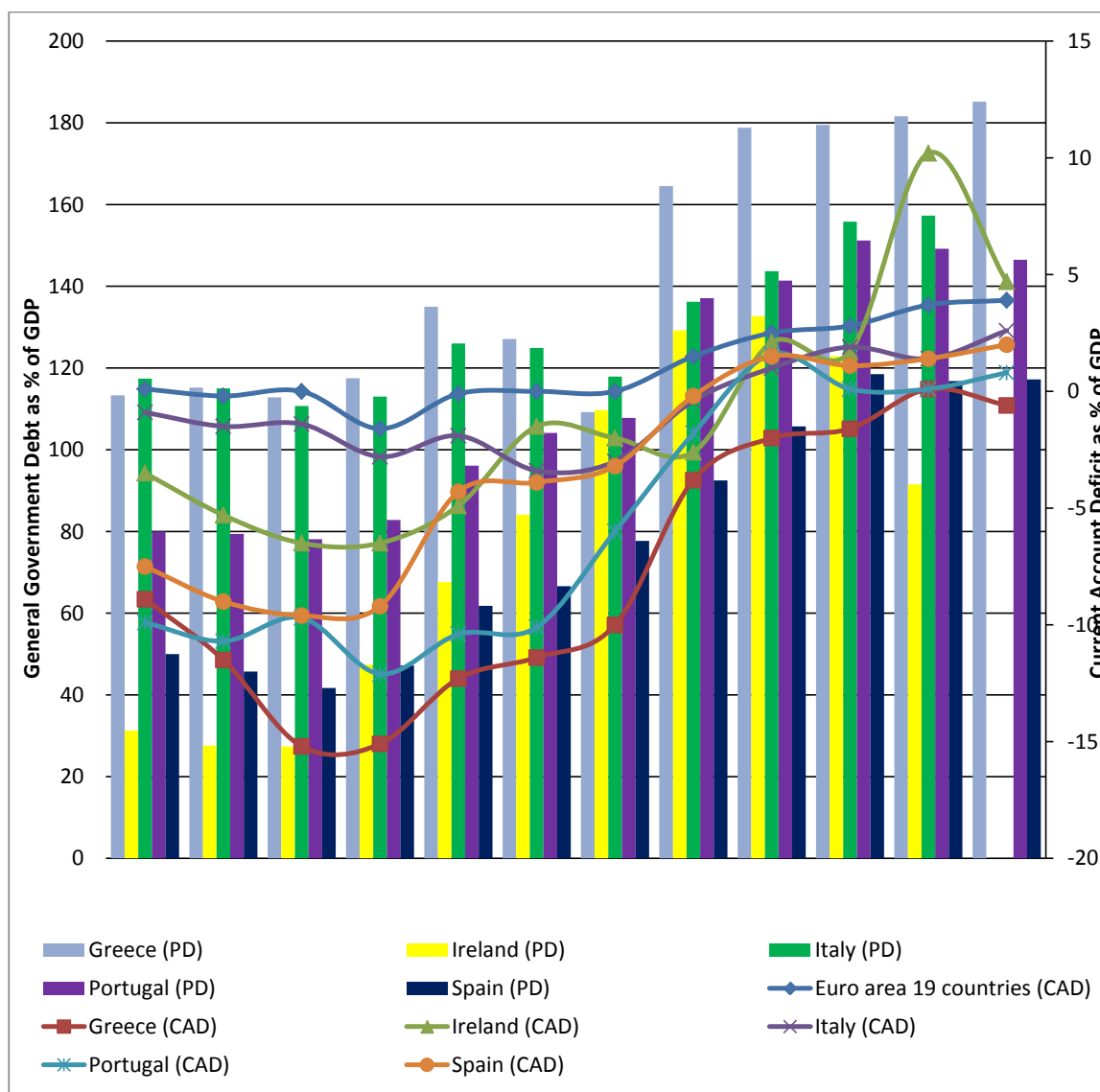


Fig. 1. General Government Debt and Current Account Deficit as % of GDP (2005-2016).

Source: [1; 9]

area. Developmental asymmetry across the Eurozone stems from inappropriate macroeconomic policy benefiting surplus countries, but counting out the well-being of the periphery.

To give a better understanding of asymmetric shocks resulted from external imbalances, it is worthwhile illustrating the dynamics of public debt and current account deficit of the most economically troubled euro-zone countries. The Fig. 1 clearly demonstrates that highly indebted countries chronically suffer from current account deficit. Out of the five countries, Ireland has managed to outstandingly improve the current account position, reaching the surplus of 10.2 percent of GDP [2, p. 45]. Such considerable amelioration boosted international reserves, allowing the country to alleviate debt burden. Hence there was a noticeable slump in general government debt during the period of 2014-2015. Although Italy managed to muscle into the above-zero current account position, its results are far from being as impressive as those Ireland demonstrated. Greece stands out as a by far undisputed champion by indebtedness among the EU's countries. Such a high level of public debt is regarded to stem from public sector, meanwhile the countries such as Ireland and Spain are considered to have exorbitant asset prices in the private sector [3, p. 400-401].

The profound research into the origins and contributing factors of the European sovereign debt crisis Martin & Philippon conducted indicates the fact of GIIPS countries overlooking the opportunity to alleviate post-boom economic consequences [10, p. 34]. The authors assume that there would have been less severe post-boom recession should the countries above have implemented stronger fiscal discipline. This is especially the case for Greece, whose fiscal irresponsibility measured by the extent of tax evasion, revenue-spending gap and cash flow problems led to expensive bailouts. Cost management turned out to be an outright failure by which the Greek government painstakingly headed for economic slump. In spite of Latvia, Estonia and Lithuania, which managed to succeed in crisis struggle by implementing severe austerity measures, Greece failed to follow this strategy. Although its current account deficit has significantly improved over the last decade and is likely to emerge from deficit pit in a handful of the upcoming years, the debt/GDP ratio, though not intensively, edges up in resolute steps.

The lack of fiscal discipline which apparently sheds the light on the origins of the European debt crisis stems not only from oversights regarding fiscal strategizing, but from the very genetics of the EMU. The establishment of the EMU consisted in the acceptance of the commitment to obey fiscal discipline though the introduction of common currency. Eurozone countries expected a single currency to serve as a feasible and efficient tool to achieve eco-

nomical integrity. A unified monetary policy carried out by a supranational central bank naturally discounted variety in levels of economic development and competitiveness of the Eurozone countries. The introduction of a single monetary system brought the GIIPS's interest rates down so that they reached the level of interest rates in Germany. Long-term low-interest rates led to a slump in borrowing costs in public and private sectors in the majority of the Eurozone countries. Those events produced the cumulative effect, leading to occurrence of bubbles in the public sector of Greece and in the real estate market of Ireland and Spain [5, p. 360-361]. Massive speculations and the moral hazard the Eurozone countries and the European Central Bank (ECB) engaged in deepened the economic recession in those countries. Thus, an attempt to boost economies though bringing their individual monetary policies under a single economic strategy designed for the EMU fetched up at self-fulfilling all-pervasive national debt crisis. External shocks and self-perpetuating market sentiment towards deepening of crisis aggravated the already strained situation.

Associated with the arguments aforementioned is a claim that every economy is a unique system, requiring a customized economic strategy. The single monetary policy for the EMU countries case is itself a compelling evidence to support the claim aforementioned. The single monetary policy designed for EMU failed to satisfy the individual needs of each one of Eurozone economies. The "cheap money" policy suited the core economies to the fullest, meanwhile the less advanced economies such as the GIIPS countries found the single monetary policy financially unbearable [6, p. 206].

Empirical studies on the causes of the European debt crisis provide compelling evidence supporting the claim that anti-crisis measures undertaken by the IMF or EU financial institutions turned out to be detrimental, inducing an increase in the level of indebtedness. The most devastating effects those financial injections had on the non-core Eurozone economies. Ureche-Rangau and Buritez conducted research on the effects rescue packages had on the level of indebtedness. The findings revealed a cause-effect relationship between an increase in capital injections and weighting of debt burden [11, p. 30]. The capital injections implemented to mitigate the debt crisis turned out to have poor persuasiveness. As a result speculators took advantage of the financial inflow, which led to a further increase in the level of public's debt. Admittedly, the rescue measures did have positive economic effect in the short-term. However, an anti-crisis policy is nothing but a long-term engagement. Apart from increasing market volatility in the long-run perspective, the anti-crisis rescue packaged discernibly increased the likelihood of contagion to other countries [12].

The design of the EMU was supposed to boost the economic development of the countries constituting the union, especially the less powerful economies abbreviated as GIIPS. Both private and institutional investors surged the GIIPS countries in the expectation of an economic terra-nova. Low-interest rates catalyzed the favorable conditions for overheating, when expected return on investments falls far behind real figures.

Conclusions. The world economy is currently experiencing slight buoyancy in economic growth, a modest increase in commodity prices and increment in yields in financial markets. Prospects for intensification of economic growth suggest a modest increase in the upcoming year of 2018. Expectations of more sustainable global demand in combination with an increase in and following stabilization of commodity prices signify that economic storm the world economy has been undergoing for the recent years has started to die down. The world developed economies managed to gain momentum in the second half of 2016. Equally important, the world's economic leader, the United States, also succeeded in an attempt to intensify its economic growth as there were positive expectations of an increase in future demand among the U.S.-based companies.

The origins of the European debt crisis are in the very genetics of the European Monetary Union. The core countries of the Eurozone benefit from a single monetary system, since their financial markets are advanced enough to process substantial capital inflows. In the meantime, low-interest rate policy led to the overheating of peripheral economies such as Ital, Spain, Greece, Portugal and Ireland. Inflexibility of the single monetary approached in combination with weak fiscal discipline led to a surge in indebtedness. Since debt burdens become onerous, the less advanced economies faced high market volatility caused by panic in the financial markets. Moreover, the probability of contagion to other countries of EMU was dangerously high. The causes and origins of the European debt crisis reveal the dire necessity to reconsider the Stability and Growth Pact. It is reasonable to modify the single monetary system in such a way that the particularities and of each country of

the EMU are counted. To put it differently, well-being of each country should be a priority for the ECB while implementing the monetary policy. On top of that, a stricter fiscal control is required in order to avoid another Greek scenario of data falsifications.

REFERENCES:

1. World Economic Outlook, April 2017: Gaining Momentum? – Washington, DC: Joint Bank-Fund Library, 2017. – 258 c. – (Intentional Monetary Fund).
2. Global Economic Prospects. A Fragile Recovery – Washington, DC: World Bank Group, 2017. – 138 c. – (International Bank for Reconstruction and Development/ The World Bank).
3. Ruscakova A. The European debt crisis: a brief discussion of its causes and possible solutions / A. Ruscakova, J. Semancikova. // *Procedia – Social and Behavioral Sciences*. – 2016. – №220. – С. 399–406.
4. Ferrira P. Why does the Euro fail? The DCCA approach / P. Ferrira, A. Dionisio, G. ZebendeE. // *Évora: CEFAGE-UE, CEFAGE-UE*. – 2014.
5. Cohen D. Endogenous debt crises / D. Cohen, S. Villemot. // *Journal of International Money and Finance*. – 2015. – № 51. – С. 337–369.
6. Lothian J. Monetary policy and the twin crises / Lothian. // *Journal of international Money and Finance*. – 2014. – № 49. – С. 197–210.
7. Eberhardt M. Public debt and growth: Heterogeneity and non-linearity / M. Eberhardt, A. Presbitero. // *Journal of International Economics*. – 2015. – № 97. – С. 45–58.
8. Detlef A. Causes of the Sovereign Debt Crisis [Електронний ресурс] / Detlef. – 2012. – Режим доступу до ресурсу: <http://www.e-ir.info/2012/04/16/causes-of-the-sovereign-debt-crisis/>.
9. General government debt [Електронний ресурс] // Organisation for Economic Co-operation and Development. – 2017. – Режим доступу до ресурсу: <https://data.oecd.org/gga/general-government-debt.htm>.
10. Martin P. Inspecting the Mechanism Leverage and the Great Recession in the Eurozone / P. Martin, T. Philippon. – Cambridge, MA, 2014. – 56 c. – (National Bureau of Economic Research).
11. Ureche-Rangau L. One crisis, two crises... the subprime crisis and the European sovereign debt problems / L. Ureche-Rangau, A. Burietz. // *Economic Modelling*. – 2013. – № 3. – С. 25–44.
12. De Santis R. The Euro area sovereign debt crisis: safe haven, credit rating agencies and the spread of the fever / De Santis. – Frankfurt am Main: ECB, 2015.