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Influence of the Currency Unification on the Sovereign Debt Crisis in Europe

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ABSTRACT

For the entire economics, the sovereign debt crisis in Europe which has already been the great research value on the history. There are three big reasons that will cause the sovereign debt crisis. There are three channels which caused the sovereign debt crisis: Currency unification has eliminated exchanges rates among EU countries; fiscal policies are decentralized on Europe for each country; imbalance development among the countries of European Union. And this paper will focus on the impact of the currency unification on the sovereign debt crisis. The reason is that monetary related to the development of nation. The research method of this paper is literature analysis and case study, which took Greece as an example. According to the research results, due to the specialty economics condition of different countries, it is difficult to change nation's currency policy situations. Hence, the sovereign debt crisis is possible not to solve or continuously happening, if there are many countries are being on the European Union.

Keywords: *sovereign debt crisis, Europe, literature analysis, case study, the impact of the currency unification*

1. INTRODUCTION

Nowadays, the sovereign debt crisis in Europe which is still as a very important question in economics even that the crisis has already over with a period. But its effect remains and the roots of crisis still not to solve. The sovereign debt crisis in Europe which has an impact on the entire macroeconomics by effecting countries' GDP, currency, economics operating, etc. The sovereign debt crisis in Europe is often said to have been the consequence of defects of Euro and the accumulation of private and public debt. Thus, based on some assumptions, there are three big reasons that will cause the sovereign debt crisis which are currency unification has eliminated exchanges rates among European Union countries; fiscal policies are decentralized on Europe for each country; imbalance development among the countries of European Union. This research paper will analyze in detail that how the reason causes the debt crisis. On this paper, there will be largely researching some papers and reviews by some scholars, and using some graphs to analyze between Greece and Eurozone so that this paper will have the obviously finding. Lastly, the author intended to give more reasons to check if the currency unification is the main reason and how this reason is largely impossible to solve specially based on the European Union. This research is important that helping European Union analyze the reason and adjust the policy so that European Union can try to avoid new sovereign debt crisis. Besides, each EU country may rediscover its own economics problem and change the policy.

2. THE IMPORTANCE OF CURRENCY UNIFICATION

When the sovereign debt crisis broke out in Europe, the European Union connected each country to explore how to solve about that. The effective way which they find is to reform the Eurozone.

2.1. Maintaining of Financial stability

Currency unification can maintain financial stability as much as possible. However, there is not complete unified so that it brought the long issues on the future. "On the background of the recent financial turmoil, this function has gained major importance, financial stability becoming a priority for many central banks, at least in the short run." [1]

2.2. Inflation

The others important factors which is inflation issues. As someone recording from the beginning of the event, the main goal of exchange rate stability that presided over the European Monetary System assumed the convergence of the economies of the contracting countries, in particular the effort to combat inflation, which was a fundamental priority for the German government. Germany also worked hard to avoid the negative impact of international currency fluctuations, especially when upgrading the Deutsche Mark to a reserve currency. France and Italy believed that participating in the system was a good means to implement their domestic anti-inflation policies [2]. Germany is the benefited from the stable exchange rate provided by the main European monetary system. However, the currency unification means a loss for the Eurozone. Besides, the economic systems of different countries may bring about collapse and conflict. Although many countries believe that the EU is a good way to achieve their goals, they still want to use their own methods to control inflation. Thus, the issue of fiscal sovereignty has become an important factor in the currency issue.

The implementation of the European Monetary System helped to build a zone of monetary steadiness among its contracting States for a decade or more, with stabilization of exchange rates and inflation [2]. However, the system went through a period of instability and crisis due to currency deflations of the French franc in the early ages of the Mitterrand presidency at the beginning [3]. As mention before, the establishment of European Union could be solved the inflation problems, but this amelioration could not exist with a long time. If these conflicts are allowed to be continuously accumulated, the greater crisis will break out.

2.3. Strong currencies and weaker currencies

Another significant key part is the crash of strong currencies and weaker currencies. Apparently, looking at the strategic of EU as a whole, thus ideological purpose of European integration brought the huge benefit for the European Union. But it is worth noticing that monetary policy remained by that time an exclusive national competence, and that the main concerns of the different Member States regarding this area tended to diverge. In fact, the main purpose of Germany is to prevent the gradual appreciation of the Deutsch mark, which maintained the competitiveness of its exports as a powerful currency in the international system. Isotropy apprehensions leaded the direction of other countries with a strong currency—which had surpluses in its trade balance—such as the Netherlands [4]. Without thinking the political reason, if only focusing on the economic, different countries have the trades and battles on the currency. But obviously the European Union try to eliminate these differences, this behavior is? just like cutting the economic control of a country. It seems benefit for the reach a balance for the country, but people need to notice that the European Union liked an organization, country still have their fiscal policy, trade policy and organization policy, etc.

Due to the European Union coalesced the currency as a signal currency, there are not exchange rate between the different countries under the European Union, it is a huge loss for a country. Thus, many countries start to consider exists because they want to get more benefit for themselves. That is also as a reason that one European Union country may use two currencies. However, it will break the law and cause the crash for the economic.

Table 1-Sovereign risk ratios and indicators (Romania, Greece, Bulgaria, Hungary) Source: World Bank, 2011

		2001	2002	2003	2004	2005	2006	2007	2008	2009
Romania	GDP/Capita Th. USD	3,81	4,12	4,35	4,73	4,95	5,34	5,69	6,12	5,70
	GDP growth	5,7	5,1	5,2	8,4	4,2	7,9	6	9,4	-8,5
	Inflation r. %	34,45	22,48	15,37	11,85	8,99	6,59	4,83	4,84	5,58
	TED/GDP	**0,23**	**0,20**	**0,25**	**0,28**	**0,31**	**0,37**	**0,40**	**0,52**	**0,69**
	TED/Exports	0,94	1,04	1,09	1,09	1,19	1,48	1,61	1,65	2,34
	Ext. Db. Ser. Bil USD	2,56	3,18	3,56	4,71	6,91	8,64	11,56	18,03	16,33
	Tot. Reserves monhs of imports	2	4	4	5	5	6	6	5	8
	FDI Bil US	1,15	1,14	1,84	6,44	6,48	11,39	9,92	13,88	6,31
Greece	GDP/Capita Th. USD	12,93	13,35	14,11	14,70	15,01	15,75	16,39	16,52	16,15
	GDP growth	4,2	3,4	5,9	4,6	2,2	4,5	4,5	2	-2
	Inflation r.%	3,65	3,91	3,43	3,02	3,48	3,31	2,99	4,23	1,35
	TED/GDP			**0,97**	**0,98**	**0,99**	**1,12**	**1,21**	**1,41**	**1,62**
	TED/Exports			1,71	1,34	1,30	1,29	4,5	1,08	8,53
	Ext. Db. Ser.									
	TRMI	2	3	1	0	0	0	0	0	1
	FDI Bil USD	1,58	0,63	1,33	2,10	0,65	5,4	1,95	5,30	2,41
Bulgaria	GDP/Capita Th. USD	3,61	3,80	4,03	4,33	4,63	4,96	5,30	5,66	5,38
	GDP growth	4,2	4,7	5,5	6,7	6,4	6,5	6,4	6,2	-4,9
	Inflation r. %	7,36	5,80	2,34	6,14	6,04	7,41	7,57	11,95	2.47
	TED/GDP			**0,53**	**0,61**	**0,71**	**0,82**	**0,95**	**1,03**	**1,07**
	TED/Exports	1,55	1,51	1,33	1,19	1,34	1,03	1,31	1,31	1,74
	Ext. Db. Ser. Bil USD	1,37	1,39	1,11	2,34	3,96	2,73	4,19	5,37	5,21
	TRMI	5	6	6	6	5	5	5	5	4
	FDI Bil USD	0,81	0,90	2,09	2,66	4,31	7,75	13,21	9,92	7,02
Hungary	GDP/Capita Th. USD	1,36	1,41	1,48	1,55	1,50	1,66	1,68	1,69	1,58
	GDP growth	4,1	4,4	4,3	4,7	4,7	4	1	0,6	-6,3
	Inflation r. %	9,14	5,53	4,38	6,78	3,55	3,87	7,93	6,06	4,2
	TED/GDP	**0,60**	**0,59**	**0,70**	**0,68**	**0,62**	**0,59**	**0,60**	**0,73**	**0,75**
	TED/Exports			0,60	0,64	0,76	0,75	0,96	0,98	1,81
	Ext. Db. Ser.									
	TRMI	3	3	3	2	3	2	2	3	5
	FDI Bil USD	3,94	3,01	2,17	4,28	7,62	19,52	70,84	66,89	2,78

As the table showing, the change of currency will not cause a positive for development of nation. For example, these nations' GDP growth show largely decreasing. By contrast, the debt demonstrates stable raising each year. And there is an interesting view that the inflation also averagely displays an annual decline. Thus, these finding can provide that many countries of European Union want to use currency to control the inflation, however this action bring the more negative effect for country development.

2.4. Result

Overall, this crisis can be concluded the Euro zone of European Union's institutional flaws. Because they only published the unified monetary policy, rather than using the detail unified fiscal policy to control and steady it. Hence, the lack of unified arrangement and supervision will lead the serious accumulation economic problem. Due to the relevant of monetary and fiscal policy, when the economic issues came out, the nation lose the approach which that using the currency regulation.

3. A CASE STUDY OF GREECE

It is worth noticing that Greece is a good research object to analyze how currency effect the sovereign debt crisis in Europe. This part will analyze the situation of Greece at the period of sovereign debt crisis, current situation and if there is still a debt crisis. First, at that time of sovereign debt crisis, much research demonstrated that the sovereign debt crisis of main reason was related to the structure of the Greek own economy, the prolonged macroeconomic imbalances that the Greece economy faces and the credibility problem of macroeconomic policy [5].

The Greece economics itself is not particularly strong and its economic scale is so small. Besides, the GDP of Greece only take 2% of the Euro zone's GDP. If consider this situation, the cost of borrowing debt should be relatively high. Fortunately, after joining the Euro zone, Greece has the right to use the debt policy of European Union so that Greece can decrease the cost of debt by using the credit reputation of strong currency countries. As the graph showing below, in the long run, Greece borrowed more money from other countries so that they

raised up huge debt. Hence, when the debt crisis broke on the Europe, the Greece not only as an origin, but also as a bad result.

And if Greece voluntarily leaves EMU, quits Euro, and establishes a national currency, there will be certain economic costs to meet. Firstly, it will have to consider the larger debt payments issue due to devaluation of the national currency. Secondly, international capital markets for new borrowing will be ended for Greece for several years [6]. Thirdly, Greece will be violently forced to balance its budget since it will be locked out international markets and it will impossible to borrow money to help on finance budget and trade deficits [5].

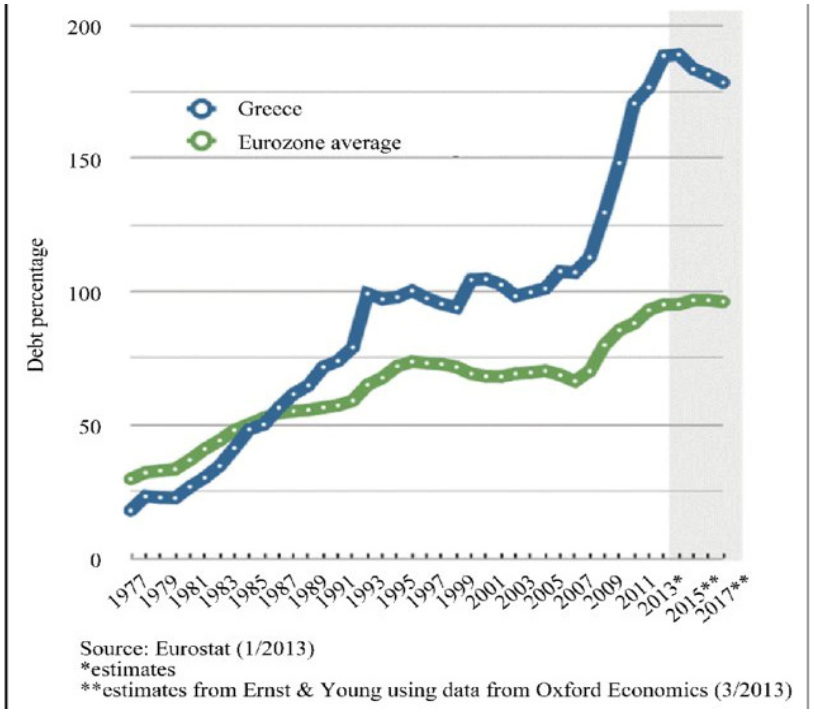

Figure 1. Greek debt compared to Eurozone Average [8]

As shown in fig. 1, Greek debt was so closed compared to Eurozone average until the 2008, this period of time was also happened when the European Union forces the introduction of the Euro. When the sovereign debt crisis broke on the European, France and Germany were also in an overspending situation at the time. However, the seriously situation is Greece. They would be insincere if they did not implement austerity policy for themselves first. Therefore, the sanctions on Greece is uncertain. If they expel Greece, there will be a negative impact on the euro. The EU hope to reinforce the power and influence of the euro in international currency markets. But many countries still want to use their own currency to maintain their monetary sovereignty and some countries confuse to do that. Hence, a strong euro would convince other EU countries, like the United Kingdom, Denmark, and Sweden, to adopt the euro. Because of the differences and disunity have not been resolved. As a result, Greek debt continued to growth until the crisis broke out in 2008 [7].

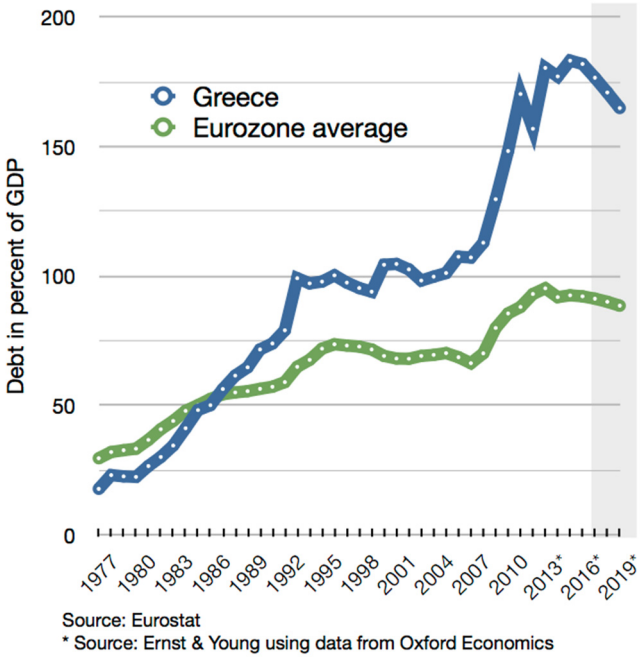

Figure 2. Greece debt compared to European Average after 2017 [9]

Comparing these two figures, there are not big differences. But fig.2 added the changes in the last two years of 2017. And this change of two years is significantly which show Greek still showing a decrease tendency. These is still huge debt for Greece so that the debe crisis will still possibly happened on the future. Hence, if there is effective adjustment coming out for the European Union, Greece, other countries of European Union.

Greece could have abandoned the euro and reinstated the drachma. Without the austerity measures, the Greek government could have hired new workers. It would have lowered the 25% unemployment rate and enhanced economic growth. Greece could have transformed its euro-based debt to drachmas, printed more currency and lowered its euro exchange rate. That would have abridged its debt, dropped the cost of exports, and concerned tourists to their countries so that they had the development of tourism industry.

At first, that would seem perfect for the plan of Greece, but foreign owners of Greek debt would have suffered devastating losses when the drachma slumped. That would reduce the value of debt repayments in their own currency. It also caused some banks to go bankrupt. On the other hand, European governments owned most of the debt, and the taxpayers would pay for the bill. As the increase of cost of imports, plummeting drachma values would have caused hyperinflation [7].

Under this unstable situation, the country could not attract new foreign direct investment. There are only Russia and China have lent to Greece. In the long run, Greece would find itself back to where it started: undertook the unpayable debts. Interest rates on other indebted countries would have risen. Rating agencies would also consider if they would leave the eurozone. The value of the euro itself would fall as currency traders use this crisis as a reason to bet against it [7]. So, euro also as a breakthrough in the European debt crisis. It is apparent that inflation and currency power are two important parts for the regard of Greece. Specifically, all eurozone countries are subject to a unified monetary policy set by the European Central Bank. Supposes that, instead of using the Euro, Greece continues to use its own currency, and when the crisis of default happened, Greece can choose to reduce its debt y common ways, such as devaluation. However, Greece has not to consider its inflation and benefits of other European Union members.

4. DISCUSSION

Overall, even though many people have already analyzed and predicted the European debt crisis brought about by currency unification. However, currency unification also promoted the formation of the European Union and economies development. In fact, currency unification eliminates the exchanges rate among the EU countries, which promotes more trade between countries. And it is a good changing for helping weak currency countries developing themselves. For the strong currency countries, currency unified perhaps cut the more incomes for them by change rate and credit work. But it still brings the currency circulation for the strong currency countries.

5. CONCLUSION

In summary, the harm of the currency unified is far outweigh its benefits and the currency unification indeed is as the important factor for the sovereign debt crisis in Europe. However, that will not be the main roof for lead the debt because consider a fact that the currency unification is as a combine way to help the finance operation under a normal way, unfortunately. This crisis could be attributed to defect of the EU system in the Eurozone. They only announced a unified monetary policy, instead of using more unified fiscal detail to control and stabilize. Therefore, the lack of unified arrangements and supervision will accumulate more Economics issues. For the citizen of European Union, the EU has not eliminated disputes of welfare so that government become difficult to make policy before the crisis and adjust the policy after the crisis. Some allies of the European Union with poor financial development are still carrying huge debts, which will affect the currency. Ensuring financial stability and currency stability is the purpose of the EU after the crisis. Because of Europe wanted to quickly combine European countries to compete with the United States, however, EU ignored these factors due to the short-term reward will conflict with long-tern damage.

The inflation also explains the negative impact after the currency unified. Germany try to use the currency unified to reply the inflation, however, some other countries do not want to do that so that the currency cannot process the whole unified. On the other side, the collapse of strong and weak currencies broke the currency integration due to the conflict with different currency policies under the EU countries.

Meanwhile, Greece is a good research example of how the currency affects the European sovereign debt on the paper. Greece as the first victim of Europe debt crisis, the unification of currencies forcibly caused them to have problems in the economics structure. Hence, national currency depreciation and forced to balance the budget become the main reasons after the currency unified and debt crisis. The good update is that the Greece has already show the decrease tendency of huge debt.

And the limitation of this paper is only showing the analytics of Greece and whole Europe, the limitation is that it is better for comparing the situation of the Greece with other European countries. Because the comparison between countries will be better reflect the problems of the European crisis. The other limitation is that considering some COVID-19 information may be an innovation for the sovereign debt crisis in Europe. Because base on the two graphs which the paper showing before, the time period of the debt just showed to the 2019, there is not any updates after the 2019. And this paper also finds that there would be still decrease after 2019, however, that will be a significant topic for research if the COVID-19 will cause any change for the European debt crisis.

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