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Causes and Enlightenments of European Debt Crisis on China's Participation in East Asia's Monetary Cooperation

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Abstract

Deterioration of European sovereign debt crisis caused the global market slump. Although the European Union has introduced the first round large-scale rescue plan of 750 billion euro to Greece on May 10, 2010, the worsening trend of sovereign debt crisis has not been controlled effectively, and the prospect of crisis is still worrying. The paper firstly introduced the process of European sovereign debt crisis, then analyzed the causes of outbreak on European debt crisis, and finally concluded the enlightenments for China's participation in East Asia's monetary cooperation.

Key words: East Asia; Monetary cooperation; European debt crisis

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INTRODUCTION

Process of the European Sovereign Debt Crisis

Beginning of the Crisis (December 2009). Because ratio of government deficit to GDP for Greece was more than 12% by the end of December 2009, the world's three major rating agencies have downgraded Greece's sovereign rating, Fitch de-rating it from A- to BBB+, and defined outlook negative; Standard & Poor's de-rating from "A-" to "BBB+"; Moody's announced that Greece's sovereign rating lowered to A2 from A1, and its outlook was negative. However the financial sectors generally agreed that the Greek's economy was small, which would not expand the impact of the debt crisis.

Outbreak of the Crisis (January-February 2010). In 2009, for Greece, Ireland, Spain, ratio of government deficit to GDP is more than 10%, and the deficit crisis seems to be spreading to the entire euro zone. In addition, 20 countries of the 27 EU member states, displayed excessive deficits. Other European countries have also started to fall into crisis, and the EU as a whole is plagued by the debt crisis. On February 5, 2010, the Spanish stock market plunged dramatically by 6%, marking the largest decline since the 15 months.

Spreading of the Crisis (February-April 2010). Germany and other euro-zone countries as axis powers were affected by the crisis, which caused the euro short positions as of February 9, 2010, has increased to $ 8 billion, a record high. On February 10, 2010, the risk exposure of U.S. banking industry in Greece, Ireland, Portugal and Spain, reached $ 176 billion.

Escalating of the Crisis (April-May 2010). Greece formally requested assistance from the EU and IMF, however, the euro zone led by Germany expressed, unless the introduction of more stringent fiscal austerity in Greece, would it not be given assistance. And finally on May 10, 2010, the EU and the IMF have spent € 750 billion bailout on the euro area member state.

Presentation of a Growing Crisis Trend (June-December 2010). On June 14, 2010, Moody's downgraded Greece's sovereign credit rating to junk. On November 21, 2010, the Irish government presents a formal request to the European Union and the IMF for relief and became the second fall in the debt crisis of the euro zone member states.

Continued Expanding of Crisis Continued to Expand, Which Impacts the Euro Area Economy as a Whole (Since 2011). On May 5, 2011, Portugal became the third fall of euro zone member states in the debt crisis. On November 9, 2011, the Italian 10-year bond yields rose to 7.48 percent, a record high since 1997. On November 10, 2011, the European Commission released economic forecast report, which said, Europe displayed the stagnation of economic growth. On January 13, 2012, Standard & Poor's announced a reduction in the long-term credit rating of nine euro-zone countries, including France, and the European Central Bank announced its benchmark interest rate unchanged at 1%.

CAUSES OF OUTBREAK ON EUROPEAN DEBT CRISIS

In 2007, in Europe there were signs of sovereign debt crisis, and the outbreak of the financial crisis in the United States had accelerated European countries' exposure to the sovereign debt crisis and outbreak of the process. Only by the data comparison, the United States, the United Kingdom, Japan and the European sovereign debts are all very serious, even Japan's sovereign debt burden is more serious than the Europe, however, the first outbreak of the sovereign debt crisis is in the euro zone, which means that there are special reasons and backgrounds.

Firstly, European debt-crisis countries' industry structure is in disequilibrium which led to real economy hollow and economic development fragile. From the economic fundamentals, the debt-crisis countries is undeveloped relative to other member states, however, better wealth fare and high level of public service made the government in the status of excess spending and fiscal over burden. Their economy is more dependent on exports of labor-intensive manufacturing and tourism. With the deepening of the globalization of trade, the labor cost advantage of the emerging market gradually attracted global manufacturing and shift it to emerging markets, which caused labor advantage of the southern European countries no longer exist. And these countries cannot timely make adjustment of the industrial structure, making the economy extremely vulnerable to crisis.

Secondly, Euro area's unified monetary policy limits the space of the ability for countries using economic policy. Fiscal policy and monetary policy are the two most important policy tools of a sovereign state to regulate economy, with loose fiscal policy often accompanied by tight monetary policy, and tight fiscal policy by loose monetary policy. Due to the different policy points and different adjustment mechanisms for fiscal policy and monetary policy, elastically various combinations of these two macroeconomic policies can be effectively implemented on regulation of the economic operation, and thus achieve the established economic and social development goals. Since euro zone began to implement a unified monetary policy, macroeconomic policies of various countries displayed the phenomenon of the "lame", plus countries no longer creating money, therefore, they can only rely on fiscal policy to develop economy. Due to euro area's own innate deficiencies in the system, and because there were no uniformed and strict fiscal policy framework throughout the region, all countries applied the fiscal policy to the extreme as much as possible. In 2008, with the outbreak of financial crisis in America, in order to get out of the recession quagmire, the European countries mostly took massive expansionary fiscal policy to stimulate the domestic economy, which led to the rapid accumulation of sovereign debt risk, and continue to evolve into the sovereign debt crisis threatening global economic development.

Thirdly, the debt-crisis European countries displayed a far cry from the axis powers of the euro zone. Several countries in Southern Europe displayed obvious gap with Western Europe, in economic system and economic running model. Due to only a unified monetary policy and not adapting fiscal policy, foreign trade policy and labor policy, after joining the euro area, various countries gradually clearly manifested their different strengths and weaknesses. Greece, Portugal, Spain, Italy, Ireland have neither the special geographic advantage, nor obvious advantage in resources, let alone leading innovation advantage, in this case, the euro zone's exports largely been monopolized by Germany and France, which led to increasingly prominent comparison of development advantages of strong countries and development disadvantages of weak countries. Due to powerful countries being not dragging weak countries, and weak delaying the powerful, the euro zone's economic development strengths and market competitive advantage not only failed to be reflected, but instead showing a gradually weakening trend, slowing economic growth in the entire euro zone. In the first quarter of 2010, U.S. GDP year-on-year rate increase by 3.2%, while the euro-zone GDP growth of less than 0.5%, the implementation of a unified monetary system showing a sharp contrast with the single-currency-system country, resulting in intensified euro zone's sovereign debt crisis of no potential for further development.

Fourthly, huge flaws of the euro zone – the new trilemma. In the euro area as a whole, no matter how the deterioration of a country's economic fundamentals, the euro supply cannot make the appropriate adjustments; ECB execute unified, independent monetary policy, that is, monetary policy pegging on the inflation rate, which make the country into financial crisis with neither monetary policy bailout nor fiscal instruments; Short position forces on an open international financial markets exacerbated the panic for the European financial sector liquidity needs, and the formation of a "vicious cycle" state on the Greek problems drag down the euro. As for three elements of the unified regional currency, pegged on the inflation rate of the monetary policy and the laissez-faire market transactions, if one among the three cannot be waived or changed, then the euro area must fall into the trap of the new "trilemma", which caused the problems of Greece and Euro crisis form a vicious circle.

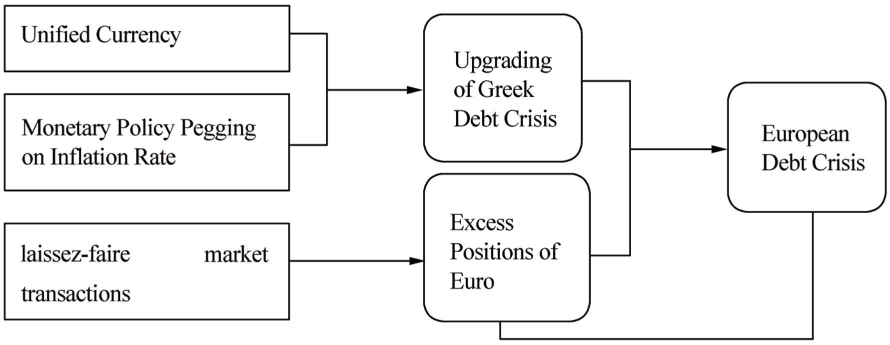

Figure 1
New Trilemma

Fifthly, operating mechanism in the euro area needs to be improved. The delay of the euro zone rescue mechanism made the predicament country difficult to receive rescue within area. Coupled with the decision-making mechanism on the euro area being extremely complex, all relief acts require the unanimous approval of the national parliaments, the major issues decisions need going through all the national referendum and agreed to determined, which makes at the beginning outbreak of a big crisis the euro zone difficult as a whole quickly react and develop appropriate countermeasures, led missing a better opportunity of rescue and worsening of the crisis. And meanwhile, the euro-zone designs have no exit mechanism, leading to high cost of negotiation when problems exist.

ENLIGHTENMENTS FOR CHINA PARTICIPATING IN EAST ASIA'S MONETARY COOPERATION

For China, it is far away from the scene of the debt crisis in Europe, and the sovereign debt crisis in the short term cannot occur, however, the Asia Yuan mode is the apply and practice of Euro mode in East Asia, therefore, the European debt crisis provides a useful reference and inspiration on China's participation in East Asia's currency cooperation.

Firstly, as the big country of East Asian area, China occupies a pivotal position in the East Asian currency cooperation, so its own financial and fiscal accounts should maintain inevitably stable, well-functioning, must not be in status similar to the euro-zone axis countries – France, whose own financial position exists problems, let alone able to help other member states of the region and maintain global confidence in local area.

Second, in promoting monetary cooperation in East Asia of the Asian Yuan's mode, Chinese government should pay more attention on whether the undeveloped countries relative to powerful member states meet the conditions of participating in currency area. Because an area composed of different developing level of member states established the monetary union, when a single member state meet difficulty, the overall area will be affected, country crisis will turn into area crisis, let alone China, therefore, promoting the expansion of the Asia Yuan zone needs to be excessively cautious.

Third, when China participates in the Asia Yuan mode currency cooperation system designs, it should not only think of the benefits side, but also fully estimate the status of economy serious deterioration which cannot be reversed, consider the anti-crisis mechanism in the overall design of the whole system, that is, relief mechanism and exit mechanism should be raised to a special status.

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