RESEARCH PAPER | Commerce | Volume : 6 | Issue : 4 | April 2016 | ISSN - 2249-555X | IF : 3.919 | IC Value : 74.50

European Sovereing Debt Crisis And its Implication For india

KEYWORDS

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ABSTRACT *The European sovereign debt crisis began at the starting of 2008 with collapse of Iceland's banking system and then intensifies with Greece, Ireland and Portugal financial crisis's during 2009. My research proposal with follow the origin and evaluation of European sovereign debt crisis and what are its implications on India.*

OBJECTIVES

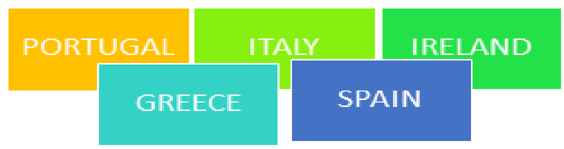
1. Explaining the European sovereign debt crisis.
2. To study its reasons.
3. To study Control measures incorporated by EU.
4. To study its implication on India.

INTRODUCTION

European Union can be defined as a political union between European countries which makes its own policies concerning the members' economics, societies, law and to some extent security. EU was not created overnight but it is the result of gradual integration. It was Maastricht treaty by which EU came into existence on November 1993. It also laid the foundation for a single currency system. Euro was first introduced as an electronic currency. It was on Jan 2002 that euro became a cash currency. Initially 11 state adopted the electronic euro currency and today Eurozone consist of 19 states with Lithuania the latest member. Denmark and U.K opted out of the single currency system whereas Sweden has not yet qualified to be the part of Eurozone. The global economic crisis of 2008-09 exposed the major problems in the foundation of European monetary system. States like Greece, Ireland, Portugal and Cyprus experienced high national deficits that marked the starting of European sovereign debt crisis. Financial crisis are generally preceded by credit booms that turn into bursts with various negative consequences.

Due to the adoption of euro PIIGS countries were able to borrow as cheaply as Germany which was the best economically managed country of EU. Before adopting euro they were at a rate much higher and now when they got to borrow at a cheaper rate they starting borrowing And borrowing. As inflation rate in most of these countries were higher than the interest rate so in a sense they were paid to borrow. Countries like Greece spent huge amounts on pensions and salary of government employees resulting in huge financial deficit financed by borrowings. Countries like Spain had the biggest housing bubble in the world mostly financed by capital from abroad now it has as many unsold houses as USA even when USA is six times bigger than Spain. Even after so much borrowings countries did not make any default due to ECB bailouts. There are various countries that contribute towards recue funds of ECB such as Germany which makes situation more complicated. If any of these PIIGS country default all countries of EU will be affected. A question may arise that if euro is so troublesome why countries don't exit from it. The answer is it will incur them a huge cost (printing of new currency, its circulation etc.) .changing from one currency to the other is very tiresome process.

THE PIIGS COUNTRIES



REASONS FOR THE CRISIS

1. There are several reasons for EU debt crisis such as trade imbalances, impact of global financial crisis from 2007 to 2012, failure of bailout approach, lack of firm decision making on part of EU that are responsible for this crisis.
2. Many EU countries had pre crisis fiscal imbalances and current account deficit. For example 16% of total GDP in 2009 was the amount of deficit.
3. The risky financing of budget deficit also increased vulnerability in Europe. Bank and government became heavily dependent on cross border financing.
4. Common currency that was the strength of EU Became its weakness and it's constrain. PIIGS countries individual credit rating were not good but due to a single currency they were able to take loan at cheaper rates and market could not compute the real risk of financing these countries.

REASONS FOR CRISIS

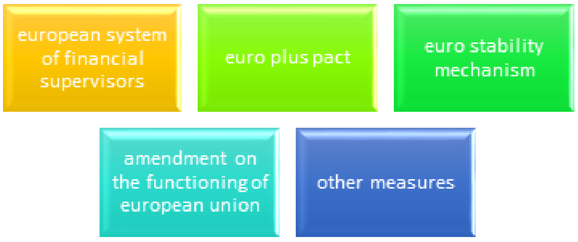
When a country goes into depression its currency depreciates which promotes exports and discourage imports but the self-adjusting benefit of floating exchange rate system was not enjoyed by the PIIGS countries due to having a common currency.

Volume : 6 | Issue : 4 | April 2016 | ISSN - 2249-555X | IF : 3.919 | IC Value : 74.50

4. Implicit government guarantees of financial institution, excessive reliance on banks who were themselves having week balance sheet, fragmented legal structure of euro area, lack of proper crisis management and recue mechanisms contributed to the crisis.
5. The global financial crisis proved to be the external shock that put the last nail in coffin.
6. Gap in the strength of and structure of GIIPS and other member countries because of which monetary policies made by ECB didn't suited these weak countries.

CONTROLMEASURES INCORPORATED BY EUROPEAN UNION

Measure implemented by EU



1. European system of financial supervisors It was created in 2010. It gathers entities exercising financial supervision at national and international levels.It includes the following:

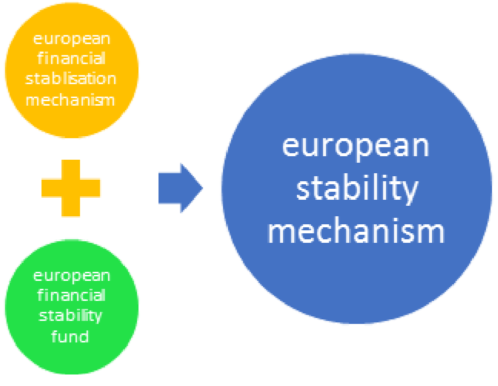
- The European systemic risk board
- The European banking authority
- The European insurance and occupational pensions authority
- The European securities and market authority

2.The euro pact

In 2010 only EU adopted the euro pact. Its aim is to achieve a new quality of economic policy coordination with the objective of improving competitiveness thus leading to a higher degree of convergence.

3.European stability mechanism

European stability mechanism



The European financial stabilisation mechanism and European financial stability fund merged to form European stability mechanism. The "treaty establishing the European stability mechanism" was signed on second February 2012 by Eurozone countries creating ESM. It will provide necessary tools to deal with situations threatening the financial stability of Eurozone as a whole as experienced in 2010.it has the authority to approve bailout deals.

4. Treaty on the functioning of European union This treaty was amended and member states of euro land were given authority to establish stability mechanism if there is a threat to the financial stability of Eurozone.

5. Sovereign risk have declined following the announcement of the ECB's Outright Monetary Transactions (OMT) programme, the Single Supervisory Mechanism (SSM) has taken over from national supervisors and a Single Resolution Mechanism is being phased in. In addition, the Eurozone banking system has survived a comprehensive assessment and a stress test with only minor scratches. Finally, the ECB is embarking on a sizeable and open ended quantitative easing programme. However a lot needed to be done to solve this crisis. Eurozone is incomplete without fiscal union which can become a very important weapon against this crisis as well as will further strengthen the Eurozone .however it is very difficult to get the members in support of that as it means losing their fiscal freedom.

IMPLICATION FOR INDIA

The European crisis is hurting Indian exports and imports. EU constituted 20% of Indian exports and 13% of its imports .so a euro crisis is going to hurt Indian trade. It will also adversely affect capital flows. Rupee depreciation to an extent can also be contributed to this crisis. The value of rupee devaluated from 44.5 in 2011 to 54 Rs in 2015. the slowdown in GDP growth rate from 6.2 % in 2011 -12 to 5% in 2012-13 is partly due to Eurozone crisis.

CONCLUSION

The European sovereign debt crisis has revealed the weaknesses of EU's monetary system. Lack of fiscal union, lack of preparedness and difference in strength of member countries are some of the reasons of this crisis. This crisis is affect other countries of worlds also such as India. To India EU is a very important trade and business partner and it going in crisis is going to affect Indian growth, capital flows and trade.

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