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Political Science 7: IR

Section: Thursday @ 2:00 PM

Viewing the Crisis in the Eurozone: Looking at Economic Theory

 The trends of global politics are now being transformed by the new notion of globalization. This idea refers to the increasing integration of economies around the world, mainly through the transfer of goods, services, and capital across countries borders. This integration of states has been facilitated by the advancements made in technology and communication and has provided great innovations and benefits to countries all over the world. However, some argue that globalization is a problem, especially in the globalization of international finance, and this is evidenced by the current financial crisis in Europe. In the international political economy there are certain theories that can explain the actions taken by the states. The realist theory states that unitary actors should be in control of their own international economic affairs and that politics drives economics in a zero-sum world; the realist theory is best-defined as mercantilism. Another theory derives from the liberalist perspective; commercial liberalists state focus on the idea of a free market and that absolute gains can be made possible through cooperation and utilizing the comparative advantage. The realist theory proves true when we look at how Greece reacted to the crisis in the Eurozone, while commercial liberalism better explains the behavior of Germany. When the issue is looked at analytically, it could be said that the liberalist viewpoint is the better way of thinking in terms of the economic crisis in Europe because in such a globalized world, cooperation is necessary to solve international problems.

 According to their website, the European Union was created primarily to foster economic cooperation between the states, an idea that stems directly from economic liberalism. The union was created after the end of the Second World War, where the United States came out on top as political and economic leader of the global world. In order to create a European economy that is comparable and able to compete with that of the U.S. the European economy needs to be unified. It was a solution formulated to stop the fighting between the European nations, hoping that the economic interconnectedness would promote more peace and less conflict. The European Coal and Steel Community (ECSC) was established first, uniting the countries of Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Its chief purpose was to unite the two rivaling states of World War II, France and Germany, tying them together through a common industry. Several years a later a treaty was signed transforming the (ECSC) into the European Economic Community (ECC) where the interconnectedness of the states was strengthened economically and politically. In using comparative advantages, this international institution would maximize Europe’s profits. The nations specialize in producing what they do best so they can spend more time and resources on other things, than making goods others can make more productively. Soon the (ECC) adopted a new name, the European Union, and developed an Economic and Monetary Union (EMU) within the organization. The European Central Bank was created in order to keep the Union’s finances under control. A common currency was created, the Euro, not only to ease confidence and interconnectedness as a fixed currency, but also to compete with the very powerful U.S. dollar. Though this international organization seems solid and infallible, and works to provide the best welfare to the states and the citizens, the system is still vulnerable for failure (europa.eu).

 The crisis in the Eurozone can be described as the bulk of the European nations struggling to repay their outrageous debts (Kenny, 2012, 1). The EU is a liberal institution that really takes care of the welfare its citizens in the European states. That means that there is a lot of social spending being done by all of these nations to pay the wages of civil servants, ensure the benefits of the old and the sick, provide for education, and so on. This unrestrained spending along with the cheap and irresponsible lending practices done by these states have greatly contributed to the crisis going on today (CNN, 2012, 1). Soon the debt for some of the EU nations grew to be even greater than what the economies were producing, by using these risky practices and not by implementing a fiscal reform these nations, like Greece, have dug themselves so deep in the debt hole that it is nearly impossible to recover. Bailouts have been initiated by the stronger and richer nations of the EU, but a call for austerity – cuts in national spending – has led to tensions between these nations and heated protest within (Kenny, 2012, 1). There are also countless questions on how to deal with the issue and the consequences that can affect many more countries on the global scale.

 The actions that Greece has taken during and leading up to the European financial crisis can be described using the realist economic theory of mercantilism. As stated earlier, this theory believes that nations should base their economic policies in ways that benefit them and enhance their power in relation to the other nations on the global scale. These polices are selfish, looking only in national interest. Greece is acting in this way now because the nation has to, it’s the least powerful. It is in such economic despair that the status of other nations is none of its concern. Of all the nations suffering in this economic crisis, Greece is suffering the most. Greece’s national debt, is “put at €300 billion ($413.6 billion), [this] is bigger than the country's economy” (CNN, 2012). These are Greece’s options: stay part of the EU, default and stick with austerity, and lose their national sovereignty; or leave the EU and risk using their old currency to compete with the euro. The options are limited and they both detrimental towards Greece. Already there are protests and riots combatting the strict austerity. They are severe, but not following them again shows how they act in a realist perspective – looking out for the interests of its citizens and not the big picture of how it affects other nations. It’s okay to be selfish; the nation has to take itself out of this horrible situation before it can even consider the welfare of other states. Before the crisis struck however, Greece was already acting quite self-interestedly and arguably contributed a great deal to the economic downturn. First of all Greece was not even eligible to join the EU in the very beginning. Though many other nations, such as Italy and France, never abided by the EU debt and deficit limits, Greece manipulated its borrowing statistics to look way better than they actually were (Friedman 2012, 1). Greece’s outstanding debt was only recently revealed and it put all of the nations of the EU in jeopardy. How are they going to pay off the skyrocketing Greek debt? A realist would argue that it would be in the state’s best interest to break off from the EU. “The standard mainstream solution for a country with Greece’s problems is exactly that: if the debt is too much to pay then don’t pay it. Better that some lenders lose their money than an entire population get screwed down into poverty to pay it back.” (Worstall, 2012, 1). Another option would be to devalue the currency, but because Greece is part of the Eurozone it does not have the capabilities to do so. The state must leave the organization. In looking at how economic theories would describe this issue really any decision will be a realist decision because Greece is looking out for its national interest.

 It can be argued that the realist economic theory can also explain some of the actions Germany took during the European crisis. It was discussed earlier that much of the issue can be blamed on Greece, but Germany too did lead to the economic downturn by looking out for its own national interest. Though Greece deceived the EU in calculating their debt and deficit, many argue that Germany was complicit and turned a “blind eye” (Friedman, 2012, 2). Germany has also been practicing irresponsible lending, allowing for many Eurozone states to access credit that did not reflect their economies What Germany cares about is facilitating consumption and demand of its exports, so that it can benefit from the trade. But according to Friedman, “The Germans have used the institutions and practices of the European Union to maintain demand for their exports.” Germany is the world’s second largest exporter, and it benefits greatly from the EU nations, to where many of its exports settle (Friedman, 2012, 2). Germany has also been practicing irresponsible lending; allowing for many Eurozone states to access credit that did not reflect their economies. Germany has as much fault as Greece in allowing these practices to occur over and over, but the ways in how the state uses liberalist policies in trying to fix the situation are commendable.

 Commercial liberal theory best explains Germany’s actions in trying to provide aid and a solution to the economic crisis in the Eurozone. Though Germany has been blamed for many of the problems contributing to the crisis, Germany has taken a huge role in trying to repair the Eurozone. “Led by Germany's Chancellor Angela Merkel, all 16 countries which make up the euro zone have agreed a rescue plan for their ailing neighbor” (CNN, 2012, 3) Being one of the stronger nations, Germany has taken on the lead role in the issue. Mandating austerity in Greece may have been harsh, but necessary. Where else are they to get money for a nation that is suffering from its own problems, at its own fault? The EU and the ECB, with much of the help and resources from Germany, have repeatedly bailed Greece and other countries out providing them with a lot of aid. “According to a joint statement on the EU Web site, a "majority" of the euro zone States would contribute an amount based on their Gross Domestic Product (GDP) and population, ‘in the event that Greece needed support after failing to access funds in the financial markets.’” (CNN, 2012, 3). Germany is acting as the big brother in this situation. If Greece fails then perhaps others will fail as well, the “domino theory.” This is too big of a risk to take. As the liberal theory states, through cooperation absolute and mutual gains are possible. Some analysts argue that it would be more beneficial if Germany left the EU instead of Greece. Though questionable this would fall in line with the liberalist theory. “If Germany were to leave the euro would be the currency that falls in value, relative to Germany’s new national currency and also to the dollar. The weaker European countries would get to keep the euro but still get the devaluation they need, which would reduce their labor costs far less painfully than through wage cuts. In addition, the value of their outstanding debt would decline along with the value of the euro, and they would be more likely to be able to make payments on that debt and avoid defaulting.” (Sivy 2012,1). Not only would this be beneficial economically for the Eurozone, but also morally – taking a stand in the issue and making sacrifices for the greater good.

 The actions taken by Greece and Germany during the financial crisis going in the Eurozone can be explained by looking at the economic realist theory, mercantilism, and the commercial liberalist theory. The financial crisis arose because of states acting irrationally and for their own benefit. The failure of states to follow EU and EMU regulations and the continued use of cheap and risky lending are reasons why this crisis has become such a big issue. If states agreed in cooperating for a goal of mutual benefit, then perhaps this issue may have never occurred. In such a globalized world states need to stop being so self-interested and need to find a ways to work together in order to solve issues like these and live in harmony.

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