

Background Guide Topic Three:
Combating the European Debt Crisis

Introduction

In 2008 the global economy took a turn for the worst. Starting in the United States in the summer the downturn soon spread to Europe in October of 2008 and eventually the entire globe. Although Europe is not unique in experiencing a crisis, the crisis in Europe has several unique factors. Many of the nations on the European continent are members of a collective governmental group known as the European Union. The European Union's trade with the rest of the world is responsible for approximately 20 percent of global trade, import and exports, although it only makes up 7 percent (495 million people) of the world's population. The EU is the world's main exporter and the second largest importer. The United States and China are the EU's largest and most important trading partners respectively.¹ In 2009 exports to and imports from the United States totaled 204.4 billion and 159.8 billions Euros respectively. Total imports and exports in the EU account for well over 5 trillion Euros. The European Union together with the United States account for about half of the world economy², so stagnant growth in either will be detrimental to the rest of the world economically, both in terms of growth and trade.

Compounding with short term economic problems that may arise, the European economic crisis and global economic crisis in general has had a major effect on foreign direct investments. As a result of the crisis foreign direct investment (FDI) by the 27 members of the European union has fallen by 30 percent between 2007 and 2008 from 496 billion Euros to 354 billion Euros. Also intra-EU27 foreign direct investment (between EU members) has fallen by 42 percent between 2007 and 2008. Some major recipients of EU extra-EU27 FDI include the United States, Canada, Russia, Japan, Hong Kong, China, Switzerland, and Brazil.³

Including the economic problems, the European Debt crisis may have a large effect on the disbursement of foreign humanitarian aid from the EU. In the last few years the EU has maintained a

¹ "EUROPA - Key Facts and Figures about Europe and the Europeans - Quality of Life." *EUROPA* "The Official Website of the European Union." Web. 25 Aug. 2010. <http://europa.eu/abc/keyfigures/qualityoflife/index_en.htm>.

² "European Commission : Trade : United States (Bilateral Relations)." *EUROPA - European Commission - Homepage*. Web. 25 Aug. 2010. <<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/united-states/>>.

³ "EUROPA - Press Releases - EU27 Foreign Direct Investment, EU27 Investment in the Rest of the World down by 30% in 2008, Investment in EU27 down by 60%." *EUROPA* "The Official Website of the European Union." Web. 26 Aug. 2010. <<http://europa.eu/rapid/pressReleasesAction.do?reference=STAT/09/68&format=HTML&aged=0&language=EN&guiLanguage=en>>.

budget for foreign aid of around 700 million Euros. In 2007 the major recipients of humanitarian aid included Africa (55 percent), Asia and Latin America (21 percent) and Caucasus, the Middle East and Mediterranean (21 percent). With foreign aid the EU provides emergency cash to purchase and deliver basic essentials, food aid, and shelter for those displaced by conflict.⁴ It is important to try and resolve the European debt crisis as soon as possible in order to restore economic continuity in both the developed and developing world.

Topic History

In the wake of World War Two the balance of the global financial system shifted to a much more interdependent Global Economy. As countries became much more interconnected several regional alliances formed. One of the most well known is the European Union. Germany, France, Italy, the Netherlands, Belgium and Luxembourg signed treaty to cooperate economically in heavy industry, coal and steel, forming the European Union on April 18, 1951. With the initial success of the Coal and Steel Treaty, the founding nations expanded their economic cooperation forming the European Economic Community (EEC) to facilitate the free movement of economic goods across borders. From the initial six member nations the EU has expanded to include the following nations: Austria, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom

Today the European Union has an administrative and political structure very similar to the United Nations. The general bodies of the EU are the European Council, which sets the agenda that the European Union will address, the European Parliament that represents the citizens of the EU by vote and the Council of the European Union, which represents the member nations of the EU. The European Parliament and the Council of the European Union work together to discuss and adopt laws presented to them. The EU also has several specialized committees that address different aspects of the agenda established by the European Council. Some of the agencies that are pertinent to the GA 2nd include the European Investment Bank and the European Central Bank which address the finances for EU investment projects and manage European Monetary policy respectively.⁵ Formed in 1998 the European Central Bank is the sole financial institution responsible for the management of the euro, the

⁴ "Activities of the European Union - Humanitarian Aid." EUROPA "The Official Website of the European Union. Web. 24 Aug. 2010. <http://europa.eu/pol/hum/index_en.htm>.

⁵ "EU Institutions and Other Bodies." EUROPA "The Official Website of the European Union. Web. 25 Aug. 2010. <http://europa.eu/institutions/index_en.htm>.

sole currency for the European Union. The ECB also manages the interest rates for loans throughout the EU. Sixteen of the twenty-seven member nations of the EU have adopted the euro (Eurozone) as standard currency.⁶ With a common currency all member nations that use it for all intensive purposes must be treated as one nation. Any adjustment to percentage rates or to the value of the euro will affect all sixteen Eurozone nations.

In 1997 the EU established the Stability and growth pact to “ensure that Member States maintain budget discipline in order to avoid excessive deficits and coordinate their economic policies at the European level.” An excessive deficit as defined by the pact is 3 percent or more of GDP for a member state.⁷

The EU has four major economic sectors. These are agriculture, fisheries, industrial goods, and services. Agriculture, Fisheries and Industrial goods make up about 25 percent of the EU gross domestic product (GDP), while the service industry accounts for the remaining 75 percent. In addition over 75 percent of all EU jobs are in the service sector.⁸ The European Union boasted a very healthy economy that experienced a GDP growth rate for all 27-member nations of at least 2.0 percent for the 10 years prior to 2008 (except 2002 and 2003). In addition most member states had a credit rating of AAA, the highest possible rating. With these ratings the banks were able to increase their asset holdings without having sufficient capital to back them. Construction and real estate booms assisted in this asset acquisition in several EU nation including Spain and Greece.

The global financial crisis began to take hold of Europe in 2008 when GDP growth fell to just seven percent and then in 2009 collapsed and the GDP contracted by 4.2 percent for the EU as a whole.

Mirroring the tumble in GDP the unemployment rate for the European Union on a whole has exponentially increased from a ten year low of 7.16 percent in March 2008 to a ten year high of just over 10 percent in 2010. The unemployment rate is a key indicator of long-term economic health of a nation.⁹

⁶ http://europa.eu/institutions/financial/ecb/index_en.htm

⁷ "Stability and Growth Pact and Economic Policy Coordination." EUROPA “ The Official Website of the European Union. Web. 25 Sept. 2010.

<http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/index_en.htm>.

⁸ http://ec.europa.eu/trade/creating-opportunities/economic-sectors/index_en.htm

⁹ "Euro Area 16 (fixed Composition) - Standardised Unemployment, Rate, Total (all Ages), Total (male & Female),

This led to a large increase in the government deficit of many EU nations. The nations with the largest deficits include; Ireland at -14.3 percent, Greece -13.6 percent, the United Kingdom -11.5 percent, Spain -11.2 percent, Portugal -9.4 percent, Latvia -9.0 percent. Of the 27 member nations of the EU only 5 (Denmark, Estonia, Finland, Sweden, and Luxembourg) recorded deficits under the EU mandated 3 percent of GDP in 2009. None of the nations recorded a government surplus.

At the onset of the economic crisis in 2008, and in accordance with the Stability and Growth Pact the EU established the European Economic Recovery Plan. The plan constructed a European response to the crisis which included swiftly stimulating demand, helping the most vulnerable people affected by the economic downturn, preparing Europe to be competitive with a view to future growth, and taking advantage of this period of upheaval in order to accelerate the establishment of a cleaner economy with more concern for the environment.¹⁰

In September of 2009 the UN released the Report of the Commission of Experts of the President of the United Nations General assembly on Reforms of the International Monetary and Financial System. This report was one of the first major documents to investigate the causes of the financial crisis. It also established the UN as a major route for facilitation toward a resolution of the crisis. According to the report the crisis has expose fundamental problems in national regulatory systems, competition, and corporate governance, along with international institution s and arrangements created to ensure economic and financial stability. The report established the crisis as a crisis of confidence, which may also be applied the EU debt crisis. The commission came to the conclusion that any reform should have as its goal the improved functions of the worlds economic system in support of the global good.¹¹

Current Situation

The most recent figures released by the European Union indicated that the deficit for the Euro area and the EU27 government are at 6.3 percent and 6.8 percent of GDP and that these two areas are

Eurostat, Seasonally Adjusted, Not Working Day Adjusted, Percentage of Civilian Workforce - Quick View." ECB Statistical Data Warehouse. Web. 26 Aug. 2010. <http://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=132.STS.M.I5.S.UNEH.RTT000.4.000>.

¹⁰ "A European Economic Recovery Plan." EUROPA â€œ The Official Website of the European Union. Web. 25 Aug. 2010. <http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/ec0004_en.htm>.

¹¹ Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System. Rep. 21 Sept. 2009. Web. 26 Aug. 2010. <<http://globalpolicy.org/images/pdfs/SocEcon/2009/reportofexpters.pdf>>.

experiencing government debt of 78.7 percent and 73.6 percent of GDP respectively. This represents roughly 800 billion Euros of debt for the EU 27 as a whole.¹²

One of the nations worse hit by the European debt crisis was Greece. Greece experienced several years of growth prior to this following the Olympics however in 2008 and 2009 the economy contracted by 2 percent annually sending the nations economic stability spiraling downward. Following this contraction and the full impact of the global economy crisis the government debt status of Greece was downgraded to junk status by several credit rating agencies. At this point the debt of Greece was almost 115 percent of its GDP. The unemployment rate for the nation in 2010 hit a high of 10.6 percent with unemployment of 15-24 year olds at 24.6 percent,¹³ which has resulted in strong social unrest with strikes and marches throughout Greece. Since the financial collapse the GDP has continually shrunk. Along with the contraction of GDP by 2.0 percent in 2009 as mentioned above the GDP is projected to contract by 3.0 percent in 2010 and again by .5 percent in 2011 however the actual contractions may be higher or lower.

In order to fight the tumbling economy in Greece the EU and IMF announced a 110 billion Euro bailout of the Greek Government on May 2, 2010. With this loan the Greek government will receive the money that is needed to pay off its creditors. In order for the EU and IMF to agree to the loan Greece has agreed to several major cuts to the public and private sectors. Some cuts that will affect jobs in the private sector include a 15 percent cut in official wages, the capping of bonuses at 1,000 Euros per year, and the freezing of workers salaries until 2014. The Greece government also asked the private sector to institute a new minimum salary for younger workers. The government also plans to amend legislation limiting the number of firings a company may perform in a given month. Other changes that will heavily affect the working class include an increase in sales tax from 21 to 23 percent compounding a previous two percent hike from 19 to 21 percent in March. There will also be a further 10 percent tax increase on alcoholic beverages, tobacco products and fuel. Greece also plans to institute a one-time tax on what they deem "highly profitable" companies. With all of these measures in place Greece plans to lower the government deficit from 14 percent of GDP to about 4 percent of GDP by 2012. These drastic measures have been taken to ensure that Greece does not cause a domino effect on

¹² Provision of Deficit and Debt Data for 2009 - First Notification. Rep. Eurostat, 22 Apr. 2010. Web. 26 Aug. 2010. <http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22042010-BP/EN/2-22042010-BP-EN.PDF>.

¹³ Maltezou, Renee. "UPDATE 1-Greek Unemployment Jumps, Union Vows Strikes | Reuters." 11 Feb. 2010. Web. 26 Aug. 2010. <<http://www.reuters.com/article/idUSLDE61A1AD20100211>>.

other EU nations at risk of default.

Compounding on the debt crisis several European nations have Greek bonds held as collateral for investments. . The 16 Eurozone nations hold about 164 billion of Greece's 300 billion Euros in state debt in the form of bonds. With the deteriorating value of these bonds another type of domino collapse of the countries holding these bonds is feared. Recently a Spanish bank reported a 79 percent fall in quarterly profits due to "shifts in sovereign bond markets".¹⁴

Currently several European nations have bank assets that far exceed the countries GDP. Some of these nations include Ireland whose bank assets total 872 percent of its GDP, France whose assets total 338 percent of GDP, and Greece whose assets total 141 percent of GDP. Due to the interconnectedness of the European economy, problems in nations such as Greece or Ireland, may lead to drop in bank assets, which may cause debt of nations to exponentially increase.¹⁵

In addition to the 110 billion the Eurozone gave to Greece on May 8, 2010 the EU announced the creation of an agency with up to 70 billion euro's at its disposal to ensure the euro remains stable. The euro has suffered a declining value from speculation that several nations like Spain and Portugal may suffer the same debt crisis as Greece.¹⁶ An example of this was the downgrading of Spain's debt status from AA+ to AA. This comes on the heels of an unemployment rate topping 20 percent the highest in over ten years surging up 11.45 percent since January 2008.

Recently the Spanish government has announced numerous cuts to the government spending in order to combat its deficit. These cuts include a 5 percent pay cut for civil servants and a pay freeze in 2011. There will be a 6 billion euro cut in government investment. The termination of a 2,500-euro payment for newborn children in 2011 and a further 6 billion cut in government spending. These measures are being put in place in an attempt to reduce the Spanish government deficit to 6 percent of GDP in 2011.¹⁷

¹⁴ Lantier, Alex. "Europe-IMF Bailout, Social Cuts Announced in Greece." World Socialist Web Site. Web. 28 Aug. 2010. <<http://www.wsws.org/articles/2010/may2010/gree-m03.shtml>>.

¹⁵ "Who Are the Real Winners in Europe's Bailout." Global Policy Forum. Web. 26 Aug. 2010. <<http://globalpolicy.org/component/content/article/229-world-economic-crisis/49099-who-are-the-real-winners-in-europes-bailout.html>>.

¹⁶ "Debt Crisis: EU Leaders Announce a -70bn Plan to Protect Euro | Business | Guardian.co.uk." Web. 27 Aug. 2010. <<http://www.guardian.co.uk/business/2010/may/08/debt-crisis-merkel-sarkozy-euro-protection-plan>>.

¹⁷ Madrid, Tremlett In. "Spanish PM Makes Debt Crisis U-turn with Emergency Cuts | Business | Guardian.co.uk." Web.

The EU has also announced the creation of an economic stabilization mechanism with up to 500 billion Euros at its disposal to stabilize the EU economy. About half of the money is expected to come from the IMF with an arrangement similar to the EU/IMF Greece loan.¹⁸

Government cuts have also taken place in some of the EU's largest economies. Germany, the EU largest economy has announced austerity plans to save 80 billion Euros. This will involve cutting social subsidies, new taxes on the nuclear power industry, and shedding as many as 15,000 government jobs by 2014.¹⁹

In addition to the IMF/EU action the UN has taken a serious role in attempting to combat the debt crisis. Resolution [A/C.2/64/L.9](#) on external debt sustainability and development focuses on the global economic crisis as a whole but includes several ideas and issues that may be applied to the EU debt situations.²⁰ Other resolutions discussed by the GA 2nd include moving towards a new international economic order, resolution [A/C.2/64/L.16](#). This topic has experienced renewed discussion following the global economic crisis. Besides these two topics the UN has taken no action directly concerning the European Debt Crisis.

In July the EU gave the European banks a stress test on their ability to deal with a debt crisis. Seven of the ninety-one banks tested failed and another seventeen barely passed. The banks represented 65 percent of total assets held in EU banks. The objective of the exercise was to provide more information about the resilience of the European financial system.²¹

Even though the IMF/EU bailout has allowed Greece to begin to pay of its debts, the World Bank's Global Economic Prospects summer 2010 report lists several possible problems that are left with the

25 Aug. 2010. <<http://www.guardian.co.uk/business/2010/may/12/spanish-pm-debt-crisis-emergency-cuts>>.

¹⁸ Council of the European Union. Economic and Financial Affairs. Extraordinary Council Meeting. European Union, 10 May 2010. Web. 26 Aug. 2010. <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf>.

¹⁹ Sohn, Michael. "Germany Unveils Cuts to Welfare, Jobs Totaling 80 Billion Euros - USATODAY.com." Web. 28 Aug. 2010. <http://www.usatoday.com/money/world/2010-06-07-germany-austerity_N.htm>.

²⁰ "UN General Assembly - Second Committee - Economic and Financial - List of Draft Proposals." Web. 27 Aug. 2010. <<http://www.un.org/ga/second/64/proposals.shtml>>.

²¹ Aggregate Outcome of the 2010 EU Wide Stress Test Exercise Coordinated by CEBS in Cooperation with the ECB. Rep. Committee Of European Banking Supervisors, 23 July 2010. Web. 26 Aug. 2010. <<http://stress-test.cebs.org/documents/Summaryreport.pdf>>.

economic recovery facing Europe. The major message in the report is that market nervousness dealing with the fiscal standings of several European countries will present new challenges to the world economy. These challenges will result from the change in the style of economic recovery as it transitions from fiscal stimulus (government loans, bailouts) packages and becomes much more dependant on private investments (job creation) and consumer consumption. In addition economic growth may be much more hindered by the tightened fiscal policy of developed European countries. The largest possible effect on economic growth is the loss of confidence in the 5 EU countries (Greece, Spain, Italy, Ireland, Portugal) with large deficits and high government debt that has led to a credit freeze in those countries and may slow GDP growth to a rate of 2.4 percent in 2011, which may cause a recession in high-income (developed) nations.²²

For the large economies in the European Union there are still problems ahead. The international monetary fund (IMF) has estimated that the debt of the G-7, four of which are European nations (Italy, France, Germany, United Kingdom) will reach approximately 113 percent of the G-7's GDP in 2010. This debt reflects growing demands on the government due to pensions and health liabilities from aging populations. The IMF has estimated that high-income nations would have to cut government spending or increase revenues by 8.8 percent of GDP for 20 years in order to bring debt levels down to 60 percent of GDP. If the debt crisis spreads to these economies the EU may be in for a much longer and tougher recovery.

Directive

The third topic that the committee will be discussing is combating the European Debt Crisis. The purpose of this topic is to address the possibility of sovereign default by several prominent European nations. Delegates should research the composition of the European Union (EU), since all major European nations in danger of sovereign default are members of the EU. It is also important to understand economic structure at the global, regional (eg. EU or African Union), and the state level for the nations involved in the crisis and delegates respective member nations. Delegates should treat the EU as one body when doing research and coming up with possible solutions instead of just focusing on possible fixes for nations individually.

²² Global Economic Prospects Fiscal Headwinds and Recovery. Rep. The International Bank for Reconstruction and Development / The World Bank. Web. 27 Aug. 2010.
<<http://siteresources.worldbank.org/INTGEP2010/Resources/GEPSummer2010MainReport.pdf>>

Although the delegates primary focus should be on combating the crisis at hand, they should also try to determine and address the root causes of the European crisis and by extension the global economic crisis. Question that the delegates should consider when researching and debating include:

- 1) Why was the debt crisis allowed to occur?
- 2) What are the financial ramifications from the European Debt Crisis?
- 3) What is the most efficient way to prevent nations at high risk from defaulting while allowing others to grow?
- 4) How can the European Debt Crisis be avoided in the future?
- 5) Who is most responsible for the crisis?

With all of the different facets of the debt crisis delegates face a difficult decision in deciding the best way to solve the problem. One way may be to suggest a loan from the IMF to the EU as a whole if the economy continues to worsen. Another may be to work with international trade to stimulate the global economy by infusing foreign investment from UN member nations to the EU. A third way may be to suggest a restructuring of the EU economic system as a whole. It will be up to the delegates to research their nations economic policy and decide the best solution for the European Union Debt crisis within the ideals and boundaries of the UN. Due to the on going and volatile nature of this topic it is imperative that delegates keep up with any major changes to the global and EU crises leading up to the conference.