The European Financial Crisis

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As the world's recession continues to expand and the United States' plight becomes more evident, in some circles the conventional wisdom holds that as America stumbles financially, a united Europe—with Germany at its head—will quickly arise to take America's place as the dominant economy, and thus the dominant power. While this view may be propped up with cherry-picked anecdotes, it overlooks a number of key factors.

Even though America has been the focus of most financial headlines of late, Europe is experiencing its own versions of a "sub-prime mortgage" and unemployment crisis. For starters, major European financial institutions have suffered almost as much in write-downs and losses ($138-200 billion) as U. S. financial institutions ($145-246 billion). Similarly, the eurozone's unemployment rate is slightly higher than the U.S. rate (8.0% vs. 7.2%).

More than this, the eurozone allowed its smaller countries to grow abnormally by setting interest rates much lower than they would have been able to sustain on their own—and now the bubble is bursting. The epitome of this has been Spain: By adopting the euro, this once credit-starved nation suddenly had cheap credit, leading to a real-estate boom in which more houses were built in one year than in Germany, France, and Britain *combined*. This fueled phenomenal growth in the banking and construction industries. However, lending policies that were as liberal as America's were allowed, and credit checks were often waived. At one point, 98% of new mortgages in Spain had variable rates—meaning that within a few years, their rates will rise dramatically, forcing many into foreclosure. This comes at a time when Spain has a 14.4% unemployment rate. On top of this, most European housing markets have been overheated even more than the U.S. housing market—and many have yet to go through a price correction.

Banks in Europe play a much more central role to the overall economy than in the United States. In Europe, links between banks and businesses are encouraged, whereas the U.S. is continually trying to keep the government, industry, and banks separate. This means that what affects the banking industry affects essentially *all* business in Europe, while in the U.S. problems in the housing or banking sectors are more contained (since the preferred method of financing is through the stock market). The direct links between European banks and businesses are quite helpful in protecting against minor shocks to the system, but when European banks write-down hundreds of billions of dollars, it means that funds needed to keep businesses running will dry up quickly.

How well equipped is the eurozone or the EU to deal effectively with the present crisis? Its peculiar structure greatly hinders its ability to forge a common solution. The EU has 27 very different economies (15 of which make up the eurozone), and 27 bureaucracies, all of which have to agree to accomplish anything. The European Central Bank (ECB) does not set European financial policy—it essentially only has power to fend off inflation through raising or lowering the interest rate. Because the various economies are so divergent, every time the ECB raises or lowers the rate, some nations are helped, while others are hurt.

As reported in the last issue ("The Rise (Again) of Nations," *Forerunner*, September-October 2008), when the eurozone nations met on October 12, nationalism was on display rather than solidarity or sacrifice for the common good. No Europe-wide solutions were presented—only guidelines for member states as they pursue their own solutions. It is essentially each nation for itself, even though there is an overarching policy that sometimes helps and sometimes hinders. The ECB (and the Brussels bureaucracy in general) was designed for times of growth and prosperity. In times of crisis, it has little—if any—real power, and is forced to defer to Berlin, Paris, Rome, *et al.* The EU is far from being a federalized state that can act cohesively; it cannot even gather enough consent to forge a founding document (see "The State of the Union," *Forerunner*, May-June 2008).

Many prophecy enthusiasts are watching for Germany to rise to head the EU. It is worth noting that Germany effectively had this opportunity but declined it. On October 21, French President Nicolas Sarkozy suggested that the eurozone needs an "economic government" that could provide political direction and leadership to the eurozone—something the ECB cannot do. German Economic Minister Michael Glos immediately and firmly rejected this idea, showing that Germany is not ready to subjugate its national sovereignty, nor are many other eurozone members.

An "economic government" would be one that would arbitrate in areas such as eurozone taxation—and, by extension, financial relief. Under such a system, Germany would be a primary financial contributor, while many of the smaller (or economically sicker) states would be primary beneficiaries. When Germany was given the chance to be the head—which it would be, as Europe's largest and healthiest economy—it rejected it because such a role would essentially hobble Germany (by forcing it to prop up the rest of the eurozone) rather than benefit it.

When we add to this dismal picture the fact that Europe lies at the mercy of a resurgent Russia—which has demonstrated that it is not afraid to use its natural gas exports as a weapon, forcing EU members to strike individual energy deals with Moscow—it becomes evident that Europe is neither united, nor immune to the same market forces and inherent weaknesses of the fractional reserve economy that it and the U.S. have adopted. Europe at present is not poised to rise, nor is Germany in a position to assume effective leadership while it is lashed to a mired eurozone economy.