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Eurozone Fall & Great Depression

The premise for introducing Eurozone was well thought of The New York Times, one of the reputable and leading newspapers in the United States, in an article titled "*European Union*" observed that among its key mandates was to help participating nations to bring to an end any national conflicts. The first ten years of the existence of the Eurozone recorded tremendous success rising to be world's second reserve currency. However, the success of the Euro and the Eurozone resulted in serious negative consequences for the banking sector and was a major factor in bringing on a sovereign debt crisis of a scale never witnessed before in Europe. Antonia Oprita, the Managing Editor of Emerging Markets and Professor Michael Smith of the EU International Relations and Diplomacy Studies have written extensively on Eurozone. In the articles titled "Eurozone fall akin to Great Depression: economist" and "International Financial Regulation: A Role for Eurozone" both writers agree that the fall of Eurozone resulted to a deepest financial crisis to strike the global economy since the Great Depression (3). As a result, several economic pundits began associating the Eurozone Fall to the Great Depression of 1930s that had the most severe consequence to nations' economies. This report sought to find comparisons between the two and understand the underlying facts in order to make informed opinion in determining whether a relationship between the two exists. Despite the conjectures of some pundits who argue that Eurozone Fall and Great Depression is one and the same thing, the fact of the matter is that both are totally different.

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Roger Bootle, an expert in financial markets and currently the Managing Director of Capital Economic and a weekly columnist for the Daily Telegraph in his article "Spooky parallels between Great Depression and Euro Crisis" asserts that both the Great Depression and Eurozone Fall were occasioned by a rigid exchange system. According to Bootle, the Gold Standard in use during the 1930s and current Euro is rigid making it extremely difficult to alter the exchange market to suit prevailing market conditions. A rigid exchange system is a situation where governments decides the worth of its currency in terms of either fixed amount of gold or fixed amount of another currency. Although this system is known to stabilize economies, it is more prone to economic volatility as compared to a more flexible system that allow nations to adjust much faster to external shocks such as recession.

However, this argument is faulty and does not represent the actual scenario. As much as gold was used as a medium of exchange during the Great Depression, the exchange market then and now was flexible enough to respond to monetary interventions that were implemented. Charles Wyposz, an expert in international monetary system with expansive experience in currency crises in an article "The Eurozone in the current crisis" clearly demonstrates the flexibility of the exchange market during the Great Depression and Eurozone Fall. The Federal Reserve indeed implemented necessary monetary policies in a bid to stabilize the exchange system during the Great Depression and helped in mitigating the otherwise more adverse consequences (9). In Eurozone, European Central Bank as the Federal Reserve institution of the Eurozone raised interest rates making borrowing of money very expensive. This helped in reducing inflation and increased market liquidity. Market liquidity is simply the ability of assets to maintain their value when sold as their prices exhibit negligible movement in their prices.

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PAGE 3 REMOVED

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economy of the EU, and this in turn led to adverse effects on loan books, assets valuations and credit supply" (24).

These arguments are valid to a small extent. It is true that the collapse of share prices during the 1930s depression led to a serious international banking crisis following the collapse of the Austrian Bank, Creditanstalt. It is a fact that the effects of the Eurozone Fall has significantly weakened banks to an extent that remedial policies aimed at stimulating activity in this sector failed. Wyplosz correctly asserts that the weak banking sector necessitated a fall in lending resulting to reduced demand in terms of investment and consumption, a factor that led to further decline of asset prices (3).

However, what these analysts are not considering is the stringent regulations that modern banks have implemented. Modern banks are far more proactive in reducing their default rates and have adopted prohibitive policies that have discouraged risky or unnecessary customer borrowing. Through this method, the borrowing process for customers has been made more difficult consequently leading to reduced demand for investment and consumption that is seen today. Professor Fabio Panetta, the Managing Director of the Bank of Italy and an expert in monetary economics and a member of the Management Committee of the International Journal of Central Banking has researched extensively on the role that banks played in Eurozone crisis. In chapter titled "Life in the Eurozone with or without Sovereign Default?" in the paper "Life in the Eurozone with or without Sovereign Default" edited by Franklin Allen, Elena Carletti and Giancarlo Corsetti, Professor Panetta argues that banks tightened their lending standards and enhanced their demand for liquidity and long term funding thus impairing the money markets in return (Panetta 9). According to him, these bank practices forced the ECB to "*increase the frequency of its long-term operations and extended their durations up to six-months*". In addition,

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Professor Panetta asserts that the move by ECB to change the intra-monthly pattern of refinancing operations was occasioned by the banks preference for front-loading as a means of fulfilling the reserve requirements. Front-loading is basically a strategy that banks prefer to concentrate costs or benefits of a financial obligation in an early period. Therefore, it is utterly misleading to compare the Eurozone Fall and the Great Depression based on the current low investments without proper scrutiny of the banks' actions.

Award winning authors Carmen Reinhert and Kenneth Rogoff in a publication "This Time is different: Eight Centuries of Financial Folly" critically evaluates pronounced differences characterizing the two phenomena. Rogoff, the Recipient of 2011 Deutche Bank Prize in Financial Economics and Reinhert authoritatively agree that the modern crisis of the world should be considered in a different way than is currently perceived (Reinhart and Rogoff 72). As a basic, it is important to note that these economic phenomena occurred at contrasting times characterized by diverse prevailing economic conditions. The Great depression affected the stock market prices in North America, Europe and other industrialized economies then. It was occasioned by the stock market crash, drought, bank failures and American economic policy with Europe. On the contrary, the Eurozone Fall affected real estate prices making it difficult for European nations to finance their government debts without support from other countries. Stephanie Schmitt- Grohe and Martin Uribe, Professors of Economics at Columbia University in an article titled "The Case for Temporary Inflation in the Eurozone" argue the conditions at the Eurozone deteriorated to an extent that affected nations "*increased their external debt position by more than 50 percent of GDP*" (1). According to them, the enhanced external borrowing resulted to increases in nominal wages by about 50 percent and enhanced investment levels (Schmitt-Grohe & Uribe 1).

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Parejo and Carles Sudrià analysed impacts of leadership on sound management of economies. In their article titled "The Great Depression' *versus* 'The Great Recession': Financial crashes and industrial slumps", they argue that the modern day leadership is more vibrant as compared to 19302 and learned lessons from the serious mistakes that were made then (Parejo & Sudrià 44).

The diverse comments on the Great Depression and Eurozone Fall have made huge contribution towards studies on assets and stock markets. These studies have clearly demonstrated the importance of stabilizing stock markets and on the need of safe assets (BBC). However, it is inappropriate and misleading to make comparisons on the Great Depression and the Eurozone Fall. Such comparison will make nations to radically change their economic policies, a move that can further destabilize these nations. As much as both phenomena led to popular unrest, frugality and high unemployment levels does not make them the same.

In conclusion, it is important to undertake intensive and all inclusive research before commenting on a specific issue especially that concerns economics. Countries' economics are influenced by various dynamics and any discussions on the same necessitate consideration of all parameters. Analysts who suggest that the occurrence of Eurozone Fall is suggestive that history is repeating itself should be advised that for economic occurrence to be said to re-occur, then the principle of *ceteris paribus* must be observed. Conditions for both occurrences should be parallel to allow any such comparison.

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PAGE 9 REMOVED

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