Charade of the Debt Crisis

From Buffoonery to Tragedy

in the

Debt Folly and Euro Farce

Steven Kim

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MintKit Press

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Summary

In dealing with knotty issues, a rampant mistake involves a mix-up between the destination and the journey. For instance, the blooper applies to an entrepreneur who spends a heap of effort in refining a product even though the tinkering has scant impact on the quality of the offering. Another sample concerns a politician who believes that rescuing a bunch of crippled banks from their own bungling is a sensible way to shore up the economy.

The confusion over means and ends is showcased by the hullabaloo over the financial crisis of 2008 along with the debt crisis in Europe. Among the rash of goof-ups, one example was the batty policy of the politicos for propping up the market for sovereign bonds in Southern Europe. According to the rhetoric of the ringleaders, an official default by Greece or any other country in the vicinity would shatter the common currency in Europe, which in turn would clobber the regional economy as well as the entire planet.

Needless to say, but worth saying, the whole argument was a gust of hot air. As a result, the mass of international investors were loath to swallow the swill.

Any thoughtful person with a smattering of experience in financial markets would realize at once that the real objective of the meddling was to salvage the pulped banks that were based mostly in France and to a lesser extent in Germany and elsewhere. The rabid bettors had thrown caution to the winds during the run-up to the financial flap and had gobbled up mounds of flaky bonds issued by the profligate countries.

Now the time had come for the gamblers to pay for their sins, and – in line with their customary chutzpah – the bankers

called on the government to pay for their mistakes. Since the French taxpayers were unable to foot the colossal bill, the bulk of the burden would have to fall on their German brethren.

No doubt some of the actors in the public sector were taken in by the specious arguments. If so, the goof-up stemmed from a patchy grasp of financial and economic issues. An example of this sort lay in the proper role of the banking industry in the economy at large. Another sample involved the true purpose and import of a currency union across neighboring countries.

In any field of human enterprise, a solid grasp of means and ends is the first step toward fixing up a worthwhile scheme while cutting down waste and beefing up productivity. The next step is to thrash out a trenchant plan that exploits the opportunities and avoids the pitfalls in the landscape. The third task is to put the resulting plan into action with gumption and dispatch.

In the case of the debt crisis, the proper course would require a cogent agenda to ensure a speedy recovery of the financial forum and the real economy. On the downside, the damage done to date by the banksters and politicos is far too massive to allow for a quick or painless recourse.

On the upside, though, the lack of a pat answer does not mean that there are no useful cures, or that the problems should be left to fester on their own. For there are baneful schemes as well as healthful ways to deal with the ailments.

To this end, it’s high time to consider the big picture and take the high ground. As things stand, the politicians will not on their own initiative take up the gauntlet and tackle the problems in a serious way. In that case, the voting public will have to prod the pols in the right direction.

In other words, the ultimate responsibility lies with the electorate that has to insist on higher levels of integrity and

accountability from their leaders in dealing with the weighty issues of the age. The examples of this stripe are legion, as in the case of public debt in the U.S., currency union in Europe, and economic growth round the world.

The crucial issues are spotlighted by the hoopla over the debt crisis and currency union in Europe. To clean up the mess for real, the first order of business is to pinpoint the causal forces in the financial, economic and political spheres. The second, and related, step is to distinguish the bedrock of reality from the quagmire of illusion. The third task is to build on the hard facts in order to fix up a sturdy solution.

In this way, a sound remedy can serve as an antidote for the usual hash of obfuscation and bumbling that spawns an endless chain of bombshells in the financial forum as well as the real economy.

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Private Gain and Public Mulct

The financial crisis of 2008 exposed a lot of bad habits in the public sector as well as the private sphere. One crummy fallout was the breakdown of sovereign bonds in Southern Europe along with fears of a breakup of the regional currency.

The debacle was led by Greece, whose spendthrift government had been piling up a mountain of debt that it could never expect to repay to any meaningful extent. In the years to follow, scads of heat and noise were whipped up by the actors at center stage as well as the spectators in the wings. The participants in the melee spanned the gamut from international

investors and banking executives to public officials and market analysts.

One remarkable aspect of the debt crisis was the extent of the confusion and distress in the financial forum. The muddle was far more extensive and prolonged than the usual flap in the marketplace.

The fiasco was compounded by the bumbling of the policymakers and debated ad nauseum by the talking heads in the mass media. So many folks were so stumped for so long that the escapade stands out as a model of bungling in real and financial markets.

It was as if the mass of jousters left their common sense at home when they got up and went off to work each day. The muddlement cut a broad swath across the fields of finance, economics and politics.

A case in point was the scrimmage on the financial front. For instance, the battlers in the arena seemed unable to distinguish between the debt racked up by a government and the currency used as a unit of account.

The Currency is Not the Debt

In selling a bond, the issuer takes on a liability regardless of the currency used to gauge the size of the debt. Moreover the commitment, along with the burden of repayment, applies just as much to a debtor in the public sector as the private sphere.

Sad to say, the Greek regime had taken on so much debt that the state would be unable to meet its obligations regardless of the currency employed. It mattered not whether the bonds had been denominated in terms of the euro, the greenback, or any other unit of account that happened to be more or less stable over the course of the years.

For this reason, the government would have to declare a default – in whole or in part – whether or not it chose to take up a brand-new currency. As a direct result, the reckless banks that had lent stupendous amounts of money to Greece would lose some or all of the capital they had put up at the outset.

The forthright move for the nation was to declare a default, leave the eurozone, and take up a newborn currency. On the downside, the local economy would crumple further over the short run.

The takedown would spring in part from the risk of flighty currencies faced by locals as well as foreigners. To wit, all types of actors in both the private and public sectors have to deal with the uncertainty linked to the incessant churn of exchange rates.

A second bugbear lies in the cost entailed in swapping currencies in order to conduct any kind of transaction across national boundaries. The players of this stripe include the exporters of local goods as well as the investors from foreign shores.

As a result, any scrap of value remaining on Greek bonds marked in euros would collapse even further as soon as the plans for a currency switch should come to light. On the upside, though, a newly minted currency would give the Greek economy a fresh start.

To get back to basics, the seeds of the currency flap lay in the berserk binge of borrowing by the Greek government along with mindless spree of lending by foreign banks. As a result, the nation had been living far beyond its means for many years.

The discrepancy between income and spending by the Greek state was reflected in the bloated level of prices for goods and services, including the cost of labor, in the private sector. Over

the long range, the average burden of wages would have to fall to a sustainable level that matched the productivity of the economy at large.

The revamp of the entire system of prices to sustainable levels would turn out to be a long and grinding process if Greece were to retain the euro. The makeover would be disruptive for commercial firms, debilitating for wage earners, and suicidal for the regime in office.

By contrast, the transformation would take place in one fell swoop if a brand-new currency were to be adopted. A short and sharp recession would ensue, thus clearing the stage for a bold new era of renewal and upgrowth.

The real question is not whether Greece can avoid a default and escape the pain of adjustment. The only issue is whether the discomfort is to be fleeting and cathartic or lengthy and ruinous.

Along one path, the misery will likely last only a couple of years at most. The alternative is a protracted malaise that could easily run for a decade or more.

The Currency is Not the Economy

Turning to a slightly different topic, an example of a mix-up across two domains lay in the distinction between a financial instrument and the physical economy. More precisely, the flub involved a confusion between the currency used by the nation and the economy at large.

As it happens, the chains of production and distribution exist independently of the medium of transactions. To bring up an extreme case, an economy based on barter has no currency to speak of.

In that case, there's no good reason to suppose that the economic system will fall apart just because a nation opts to take up a newborn currency. Moreover, claiming that the entire continent will go kaput just because a small country like Greece decides replace its scrip is far-fetched in the extreme.

Admittedly, there may be a transient period of turmoil and hardship after a switchover of the currency. But that is true to a greater or lesser degree for any sort of change in any area of everyday life.

On the upside, the overhaul of the economy after adopting a brand-new currency should lead to a sane system of prices throughout the country. Moreover the exchange rate in a sound marketplace will ensure that the average level of prices within the nation is compatible with its productivity compared to that of other countries.

On the downside, though, a hail of witless programs whipped up by misguided politicos can prevent the economy from reshaping itself in a natural way within a free market. But the threat of derailing the recovery is a constant specter regardless of the state of the economy. More generally, the pols have a habit of churning out perverse schemes in any kind of environment.

For this reason, replacing the currency will not automatically usher in a bright new day. Instead, the changeover will simply result in a huge hike in the prospects for growth and prosperity without undue delay.

Muddle of Economic and Financial Factors

As we noted earlier, the row over the debt crisis was woefully short on insight from the get-go. An example in this vein was the confusion between a debt and the currency in which the liability happens to be denominated.

In this light, the politicos had a perverse habit of pointing to the debt crisis as a showdown for the unified currency. To compound the flimflam, a lot of pols argued that Greek bonds had to be salvaged in order to save the euro.

This is the kind of hyperbole that only a desperate creditor would deign to cook up. The bluffers of this ilk took the form of reckless banks in France, and to a lesser extent Germany as well as other countries.

In the drooly pursuit of juicy yields over the short run, the zealots had gobbled up humongous amounts of Greek debt while brushing aside the glaring risk of default over the long range. And now the time had come to pay the piper for the bacchanal of greed. As the day of reckoning drew near, the shameless speculators wanted to be rescued by the public sector.

As is often the case, the guzzlers had wolfed down gobs of profits for themselves during the run-up to the blowout. But the same gluttons now wanted the entire population of strapped taxpayers – especially the marks located in Germany – to pay for the spree of plunder.

The ditsy argument was that Greek bonds had to be saved in order to ensure the survival of the regional currency. In a barefaced show of sophistry, the banksters and their mouthpieces in public office claimed that a breakup of the euro would shatter the economy throughout the continent, thus setting the stage for a similar catastrophe round the planet.

As we noted earlier, though, the debt is not the currency. The best way to drive home the point is to bring up a couple of simple examples.

To begin with, suppose that Greece had retained its traditional currency, the drachma, and had never bothered to adopt the euro to begin with. In that case, the national government

would still be in hock for all the money it had borrowed from witless lenders.

Moreover the choice of currency has no bearing on the need to service the debt nor to repay the money when the bonds come due. If the government borrows a lot more cash than it can ever pay back, then it has to go into default at some stage.

In this setting, the viability of the euro is a completely separate issue from the question of solvency for Greece, Spain, or any other country. Granted, there are always some connections, however tenuous, between any two objects or events in the world around us. In spite of – or due to – the prevalence of tie-ups, the pointed question is not the existence of some linkage or other, but rather the strength of the connection.

The Greek government was insolvent because it had borrowed massive amounts of money. The intake was then frittered away on wasteful schemes designed to appease the electorate over the short run rather than pursue constructive projects to strengthen the economy over the long haul.

The predicament had nothing to do with the currency of denomination for the debt. The same was true for the waste of resources through profligate programs as part of a populist agenda.

To bring up a second cameo, suppose that the state of California were to become bankrupt. Does that mean that the local government should replace the U.S. dollar with a newfangled currency such as a Californian peso?

In actuality, the prospective or actual declaration of bankruptcy has no connection to the issue of the local scrip. The destitute state could in fact take up a novel currency if it wanted to distance itself from the rest of the country. The switchover would be unhealthy for the nation as a whole and even more harmful for California.

Whatever the path taken, though, the decision has no real bearing on the plight of the bankrupt state. California became insolvent because its expenditures surpassed its revenues. The spendthrift habits drove the state to the poorhouse, and would surely continue to do so regardless of the currency it used.

Suppose that California did in fact choose to ditch the U.S. dollar. In that case, should its neighbors do likewise?

Would it make sense for Nevada to dump the greenback and take up a newly minted currency called the *dinar*? And should Michigan scrap the dollar and create a brand-new scrip called the *ruble*?

In addition to the breakup of the currency, would we expect the entire country to split into a welter of independent and squabbling nations? Why should the United States break down wholesale and turn into into a bunch of disjoint states just because California were to go bankrupt?

And why should any other state shoot itself in the foot just because one oddball did so? The notion that the neighboring governments would ditch the greenback after the forced move by California happens to be ludicrous. Yet this burlesque is precisely the scenario sketched out for the eurozone.

In short, the prophets of doom point to the hypothetical split-up as the reason for bailing out a single state; namely, Greece. The rescue is required, they claim, in order to ensure the survival of the euro along with the preservation of the European Union and the global economy. If nothing else, the charlatans deserve a medal for a lively imagination.

Boons of Currency Union

For the sake of argument, suppose that the regional currency were to collapse and the euro were no more. In that case, the

sensible nations of Europe would do well to band together and set up a brand-new currency as soon as possible.

To pick an example, Germany could join hands with Finland and the Netherlands in order to create a common currency to be called the *marko*. Compared to the prior state of separate scrips, each member of the newborn union would enjoy a surge in productivity. The efficiency of transactions would increase amongst producers and consumers, tourists and investors. A similar benefit would accrue from the rubout of exchange rates along with the death of uncertainty caused by flighty currencies.

Moreover the founding members of the marko ought to invite other responsible countries throughout the continent to join the monetary union as well. It would be in everyone’s interest to remove the artificial barrier to trade and commerce due to a multiplicity of currencies.

But wait a sec. Why would these countries need to print up brand-new bills and stamp out newfangled coins branded as the marko?

The shrewd countries could instead simply use the notes and tokens that already exist. In other words, they could simply use the existing stock of paper and coinage called the *euro* in lieu of the *marko*.

Given this backdrop, the euro was never in danger of dying out completely over the foreseeable future. Granted, one or more countries might quit the currency by necessity or preference.

But the other members of the monetary union would have every reason to stay put. Better yet, the existing members should welcome to the club any other country in the region that could boast a history of fiscal prudence and stable finances.

A unified currency removes the barriers to trade and investment, thereby resulting in gains for every member of the ensemble. The merits of membership is spotlighted by the eagerness of Estonia to join the eurozone in 2011. At the time, the brouhaha over the currency crisis was in full bloom.

A lot of folks in Europe seemed to be puzzled by Estonia’s move. In fact, the business media and financial press based in other countries asked the actors at center stage why the Baltic nation would join a currency union that could break up in short order.

Luckily for the people of Estonia, the leadership had a lot more sense than the mass of public officials and market watchers in other countries. For one thing, the euro was ripe for a breakup but it was never in serious danger of dying out anytime soon regardless of the brouhaha in Greece or anywhere else.

For a second thing, a currency union involving the economic powerhouse of Europe – namely, Germany – is a big plus for producers as well as consumers throughout the unified zone. The same is true of remote parties in dealing with the locals. The foreigners of this breed run the gamut from commercial firms and sovereign funds to transient tourists and solitary investors.

The only real drawback of a unified currency lies in the lack of autonomy in setting the basic rate of interest. Due to the shortfall of control, the monetary policy at any stage could be out of whack with the business cycle in the local economy.

As an example, one region might welcome a low rate of interest in order to perk up the economy. By contrast, a different locale may desire a high level to cool down the pace of commerce in order to dampen the upsurge of inflation.

On the other hand, this type of discrepancy plays a minor role at best when the economies are tightly bound. All across Europe, the geography and population are compact enough that the economies could and should be closely integrated. If a huge expanse such as China or India can fare nicely with a single currency, then there's no good reason why Europe can't do likewise.

To bring up a counterexample, no two regions within the United States will move in lockstep at all times from one round of the business cycle to the next. Does that mean, then, that a state such as Kansas should abandon the U.S. dollar so that it can pursue its own monetary policy? That would be absurd.

The heartland of America is closely tied to its local environs as well as the nation as a whole. As an example, Kansas is most unlikely to flourish if the rest of the country happens to be slumping.

In this milieu, the drawback of a uniform approach to monetary policy is more hypothetical than substantive. In practice, the small nuisance is far outweighed by the big boon to productivity stemming from a unified currency.

To sum up, the prospect of bankruptcy by Greece or any other country has no real bearing on the survival of the euro, and even less on the viability of the European Union. The big picture remains largely unchanged whether or not Greece were to replace the euro with a new-fangled currency of its own.

In recent years, scads of heat and noise have been whipped up on the financial and economic fronts. Yet the gale of bluster over the debt crisis is only a sideshow at best, full of sound and fury but expressing nothing of import. For the source of the crisis is far more narrow and venal than the groundless and grandiose stakes bandied about by the politicos.

Contagion of Debt

Since the financial flap of 2008, the raft of attempts to paper over the debt flap in Europe has failed to fix the problem. On the contrary, the bogey has grown bigger with the passage of time.

By 2011, even solvent countries such as Italy came under fire as the swarm of international investors shied away from local bonds. The contagion of debt was viewed by many commentators as a loss of faith in the ability of the EU to provide the besieged countries with enough backing in the form of credit and liquidity.

According to this argument, the crux of the problem lay in a temporary shortage of money as investors balked at buying new issues when the older ones expired. Put another way, the market suffered from a transient loss of confidence in the ability of the cash-strapped states to roll over their debt.

In that case, the solution was simple enough: Germany and other moneyed countries on the continent had to buttress the market by a firm commitment to make up for any shortfall of cash. This slant was so widespread that even the financial press had a habit of chiming in and spouting the party line of the bankers and politicians.

As an example, the sentiment was expressed with a measure of eloquence by opinion leaders such as *The Economist*. On the whole, the magazine – which bills itself as a newspaper – has a deserved reputation for its incisive analyses of current events. The publication helps to shape the views of decision makers in all walks of life across the globe, ranging from investors and executives to policymakers and academics.

In the muddle of the debt crisis, though, even this savvy sherpa lost its footing. A case in point was an editorial piece with the following message.

> Unless politicians act fast to persuade the world that their desire to preserve the euro is greater than the markets' ability to bet against it, the single currency faces ruin.... It is not just the euro that is at risk, but the future of the European Union and the world economy. (*Economist*, 2011)

The editors of the illustrious magazine opined that disaster would strike unless Germany were to step up to the plate and pour gobs of money into the communal pot. To this end, the German chancellor Angela Merkel would have to convince her countrymen to cough up the dough required to save Greece along with the regional currency. Otherwise the European economy would fall apart, along with the meltdown of political unity across the continent. The crackups in turn would lead to the breakdown of far-flung economies throughout the world.

As things stood, however, Germany had neither the money nor the desire to prop up its profligate neighbors indefinitely. Since the financial flap of 2008, the countries in dire straits had run the gamut from Ireland and Hungary to Greece and Spain.

To put things in proper context, the loss of confidence in financial backing from the European Union was not the cause of the contagion in the first place. For one thing, any sane investor had to be aware from the outset that neither Germany nor anyone else could save a big economy such as Italy if the latter were to go down the drain.

Instead, the main reason for the jitters of the investing public lay in the lack of certainty concerning the bond market. A second, and related, factor stemmed from the swirl of deceit by central banks and elected officials in claiming that they could cure the problems in Greece and neighboring countries.

If the policymakers stooped to blatant lies over obvious truths, who could be sure what else remained hidden behind the closed doors of government agencies? The politicos, along with the European Central Bank, were fooling no one. What they had to do was to face about and come clean by admitting the obvious.

In October 2011, a solid step in this direction was made by requiring a modest sacrifice from the bondholders. The gang of reckless banks that had played a leading role in fomenting the debt crisis were to accept half the losses involved in a contrived program of default.

The cutdown was less severe than the drubbing to be expected in the absence of meddling by the politicos. Even so, a partial acceptance of the need for a clean sweep was an improvement over the vain denial of the reality in the bond market.

To recap, the propaganda dished out by shameless bankers and pliant politicians took center stage in discussions of the financial fiasco and economic pother. Hardly anyone bothered to look at the big picture and point out the mayhem wreaked on the entire nation over the short run as well as the long range.

Granted, certain elements of the ongoing charade met with loud complaints from motley quarters. A notable example lay in a grass-roots campaign known as Occupy Wall Street. The popular movement sprouted in New York then spread like wildfire across the U.S. and throughout the planet.

On the other hand, the common thread among the activists was an urge to cut down the gross inequality in income levels in the population at large. The main target was the financial sector that would have to be torn down and built anew.

On the downside, though, the activists focused only on a small piece of the puzzle. Moreover their common theme dealt with the symptoms rather than the causes of the malady.

More to the point, the dissidents glossed over the larger problem of wealth destruction in the entire economy due to the long-running custom of misguided policies in the public sector. The meddling of the politicians in favor of the worst speculators gave rise to an endless chain of bombshells. The upshot was to wipe out trillions of dollars at a stroke within the financial forum as well as the real economy.

Meanwhile the agitation of the investing public was focused on still other issues. By contrast to the fanciful theories of financial economics, the madding crowd does not approach the market with cool logic and boundless wisdom. In reality, the gamers have a habit of fixating on short-term concerns rather than long-range prospects.

A prime example lies in the jitters in the stock market during a spate of great uncertainty in the external environment. For instance, the dithering prior to the outbreak of a major war is apt to cause more angst than the conflict itself. Once battle is joined, however, the market finds its footing and begins to recover.

In line with this trait, the inept moves of the politicians was far more upsetting for investors than letting the market fend for itself. For instance, the complete breakdown of the bond market in Greece would clear out the detritus in the financial forum. A full cleansing would then pave the way for a robust recovery in the capital markets of Greece as well as other countries round the globe.

A second bogey for international players lay in the dicey prospects for the economy in Europe and the U.S. over the year to come. Given the lack of wholesale reform in the

financial sector, along with the rash of counterproductive schemes adopted by bumbling politicians, the investing public had plenty of reason to fret over the economy over the years to come.

In actuality, the gamers need not have agonized over the course of the economy in the near term or medium range. By taking the big picture into account, the outlook for the global economy was plain enough: it was lousy.

More precisely, the mature countries were destined to bump and grind well into the second half of the 2010s at least. Meanwhile the emerging regions would soldier on at a respectable pace, albeit at a muted level due to the stunted health of the advanced economies.

For this misfortune, the entire planet could thank the short-sighted pols of the industrialized nations. The victims of the mess-up spanned the rainbow from investors and entrepreneurs to consumers and producers.

Political Factors

Since the end of the Second World War, Germany has been asked to pay a huge portion of the tab for forging together the nations of Europe into a unified entity. The price tag faced by the Teutons has been far bigger than their fair share in comparison to their neighbors.

By the eve of the millennium, though, the German populace came down with a mild case of donor fatigue. On one hand, the Teutons were prepared as usual to make amends for the sins of their forebears during the conflagrations of the 20th century.

On the other hand, the demands from their neighbors seemed at times to be insatiable. Even so, the powerhouse of Europe

has continued to bear the brunt of the burden and go out of its way to earn extra dollops of goodwill.

Despite the legacy of the past, however, the folks in Germany have every right – and even duty – to argue stoutly for their own cause if the community as a whole stands to gain as well. A good example is a firm refusal to pay the tab for cleaning up the mess caused by their spendthrift neighbors to the south.

To this end, the German government could and should muster the support of its friends that share the same sentiment. The allies in this camp range from Finland and Slovakia to Britain and the Netherlands.

The European Union has already made a number of grave mistakes in dealing with the financial crisis of 2008. For one thing, each of the sovereign states opted to prop up the bloated banks caught up in the housing bubble. After the orgy of mindless lending during the run-up to the financial flap, the gassy banks were simply falling on their own swords.

A second, and related, muff of the politicos was a rash of measures to shore up the housing market which had ballooned and taken up a hulking share of commercial activity in the economy at large. The property sector had to shrink wholesale in order to restore a semblance of balance within the larger economy.

In a fit of demagoguery, the politicos cooked up a raft of schemes to prevent real estate from shrinking down to a decent size. Far better would it have been for the pols to leave the market alone and let it deflate of its own accord.

The implosion would release a humongous heap of resources, ranging from office space to human capital, which could be put to productive use in other portions of the economy. After a quick and sizable comedown, the property market would then

be in proper shape to grow once more and resume its usual role as an engine of economic growth.

Inflation as a Cure for Political Bungling

Due to the flimsy crutches put in place by the politicians, the distortions in the economy caused by the vast bubble in real estate continued to hobble the chains of production and distribution. Instead of mucking up the system, the government should have let the market alone so that it could repair itself.

Better yet, the government should have accelerated the healing process by taking active steps to cut out the tumors in the financial sector. For example, the politicos should have taken the trillions of dollars that they wasted on the blighted banks and instead used part of the funds for hearty causes.

An example of the latter was to encourage and subsidize a spate of training programs run by operators in the private sector. In this light, a plain sample lay in a workshop catering to the newly jobless workers in the defunct banks in order to train the participants for productive work in other fields.

The subjects of instruction could deal with narrow functions such as graphic design, or broad-based skills as in electronic commerce. Depending on the thrust of the tuition and the bent of the participants, the graduates could seek employment in healthy companies or set up the brand-new ventures from scratch.

By propping up the housing market and the financial sector, the politicos hampered the natural ability of the economy to heal itself. Thanks to the myopic schemes, the rebuild of the economy would have to wait for the halting creep of inflation to reset the forces of demand and supply in the marketplace.

To explain the process, we will consider a house whose price tag stays fixed at a lofty level for a decade or two. From a larger stance, the upward crawl in the average level of prices throughout the economy will whittle down the real value of the property.

Along with the rise in the cost of living, the nominal level of wages will clamber upward even if the purchasing power of the income stream remains unchanged. As a result, the house will come to be cheaper in real terms even if the nominal price stays the same.

The downside of this process stems from the fact that inflation takes many years to have a significant impact on prices that happen to be grossly out of whack. If the mangling of the economy was severe to begin with, then a couple of decades may be required in order to unwind the contortions in the chains of production and distribution. In that case, the economy will have to stagger and flounder for an entire generation.

The maiming of the housing sector was a rampant problem in many countries including the U.S. and Europe. Due to the raft of misguided schemes whipped up by the politicos, the hobbled economies were destined to limp and flail for decades to come.

Private Windfall and Public Largesse

The plight of Greece was merely one aspect of the barrage of bungling. In the run-up to the financial crisis, a bubble of mammoth scale had built up in the housing sector in concert with mortgage-based assets.

The froth in real estate sprang from a flood of loans from witless banks to mindless speculators. The horde of borrowers included many a pauper who had no money to put up as a

deposit for buying a property. Given the scale of the bacchanal, the blowout when it came was bound to be calamitous for the financial forum as well as the real economy.

To ensure a swift process of adjustment and recovery, the bond market should have been allowed to collapse of its own accord. In that case, the reckless banks that had gorged on Greek debt would go belly up. The fallout would be the release of valuable resources such as labor and capital that could now be put to productive uses.

Moreover the wholesale rubout of the worst offenders in the financial sector would usher in a fresh era of sobriety in capital markets. Among the banks left standing, the shareholders would demand higher standards of transparency and accountability from the boards of directors. Due to the change in mindset, each board would require better norms of sobriety and control from the top executives, who in turn would impose saner procedures down the line.

As things turned out, however, the employees and investors were disposed to learn nothing of the kind. On the contrary, what they faced was a confirmation that an orgy of rampant greed was not only acceptable but lucrative.

When the carnival came to an end, the revelers could keep the obscene profits they had racked up prior to the blowout. In addition, the pillagers could count on the government – and thus the taxpayer – to make good the losses to their companies caused by the rampage.

Given this backdrop, there was no reason for the pillagers to change their tune in the future. Instead, the stage was set for additional bombshells over the years and decades to come.

Noxious Impact of Misguided Schemes

To sum up, the continuing efforts by the European Union to prop up the debt market had a host of toxic effects. One baleful outgrowth was to hamstring the natural process of adjustment and recovery in the financial forum as well as the real economy.

Another fallout was to prolong the agony of the hapless denizens of Greece. If the markets had been left alone, the nation would have encountered a short and sharp downturn of the economy followed by a long and hale spell of renewal and upgrowth. Instead the entire population was consigned to an interminable stretch of turmoil, thrashing and grinding.

Given the grim outlook for Greece, the investing public responded by knocking down the markets in neighboring countries ranging from Spain and Portugal to Italy and Turkey. The brouhaha across the region tripped up the investors in the financial forum and the producers in the real economy. As a result, the entire marketplace was doomed to flounder for ages.

Another turnout was to prolong the agony suffered by the actors in the stock market and other domains due to the uncertainty stirred up by the antics of the politicians. The roiling of the markets round the globe was an ordeal for all participants ranging from private investors to public companies.

Moreover the tumult in the market acted as a damper on the smooth flow of capital needed to fuel the growth of the global economy. As a result, the real and financial markets were caught in a feedback loop.

The weakness in the marketplace prompted both consumers and producers to cut back on their expenditures. The takedown sapped the economy and painted drab prospects for growth,

which in turn put off investors and weighed down the markets both real and financial.

German Resolution to a Greek Tragedy

For its part, the Greek government ought to welcome a flat refusal by Germany and its friends to waste any more money on ratty schemes to prop up the bond market. The forthright decision would provide the politicos in Greece with a compelling reason to pursue a healthy course of action.

In that case, the pols could come clean and announce with perfect honesty: “We can’t repay the bonds. We have no choice but to declare bankruptcy and start over with a clean slate.”

In taking this route, the country would first tumble into a severe recession. But the meltdown would ensure a readjustment of prices in the economy at large, which in turn paves the way for a robust recovery. Moreover the government could and should take proper action to ensure a speedy return to health rather than make futile attempts to hold back the tide.

As an additional measure, the state could willingly exit the eurozone as well. Upon the issue of a brand-new currency, the community of international investors will settle on an exchange rate at a suitable level.

A fitting rate will ensure that the average level of prices within Greece turns out to be compatible with the innate levels of productivity and income. The objects in this category include input factors such as the cost of labor as well as output items like the price of food.

As soon as nation moves in the right direction, helpful neighbors such as Germany will rush in to help out in earnest. The purpose of the engagement is to nurse the Greek economy

back to health rather than waste gobs of money or prolong the malady.

For instance, Germany might disburse just half of the money that it had been frittering away by propping up the bond market in Greece. The rest of the moola could be returned to the German treasury and stashed away for other constructive programs down the road.

From a different angle, the earmarked funds should not be handed out in a haphazard way to any supplicant that comes along. To ensure that the money is spent wisely, the cash should be alloted as matching funds for worthy causes initiated by live wires in the private sector.

An example of the latter is a nonprofit group, whether based in Greece or abroad, whose mission is to train job seekers with the latest advances in digital tools. Another sample is a German firm that wants to help a Greek venture in acquiring the skills needed to become a reliable supplier of goods or an able contractor of services.

Hale Approach to the Banking Industry

The efficient allocation of resources is a hallmark of a healthy economy. Moreover just about every resource is associated with a monetary value, ranging from raw materials and office space to human labor and intellectual capital.

For this reason, the deployment of resources comes down to the allotment of capital. Moreover a vital feature of the monetary system lies in the transfer of funds from the savers in the economy to the borrowers in the fields of business and commerce; that is, the banking function.

To an increasing degree, however, a host of outfits have strayed far from their real mission in life. An obvious example cropped up in the ramp-up to the financial crisis.

A horde of sleazy banks coaxed people of limited means into signing up for huge mortgages during a period of abnormally low interest rates. As a result, millions of borrowers lost their homes when the cost of borrowing returned to a moderate level: the strapped clients could no longer afford to keep up with the hike in monthly payments.

Another showcase lies in a hedge fund nestled within a commercial bank. On the whole, the operators of this ilk make their money through sham schemes rather than honest investments. Taken as a group, hedge funds perform the amazing feat of destroying wealth for their investors as well as the real and financial markets at large (Kim, 2011).

The inevitable turnout is a series of bubbles and blowups in the marketplace which grow more destructive over time. All too often, though, the government has not only tolerated but abetted such behavior. An obvious example lies in the repeated ploys to rescue the predators from their self-inflicted wounds.

A standard pretext for propping up the rot is the claim that large banks are required for the efficient allocation of capital. To be fair, there may have been some justification for this viewpoint in the olden days prior to the age of the computer and the Internet.

In days of yore, everything had to be done manually. In that case, there was plenty of opportunity to enjoy the economies of scale in every industry.

A plain example involved a staffer in a large firm who could focus on their own area of expertise rather than work as a jack of all trades within a tiny outfit. Another sample lay in a hefty

discount from suppliers, as in ordering pencils or staples by the gross rather than the dozen.

In a similar vein, a couple of small banks would have to pay more in toto if each of them were to set up a wireless network. By contrast, a single system with ample capacity is apt to cost less than two separate platforms each of which boasts half the bandwidth.

In a broader sense, the same idea applies to the synergism to be gained from the interaction of multiple parties. For instance, a couple of dozen workers in a single firm can learn from each other and pool their knowledge more efficiently than two separate camps of a dozen clerks each.

On the other hand, the economies of scale are negated or even overturned in the age of cyberspace. The examples are legion and the evidence rampant.

To begin with a counterexample, a mindful person will note that a checking account is apt to be more costly to maintain at a large bank than a smallish one. From the converse stance, the story is similar in terms of a savings account which is likely to pay a higher rate of interest at a bantam outfit than a giant one.

The reason, of course, is that smallish banks tend to be more efficient than biggish ones. In other words, the economies of scale are not only canceled but in fact reversed.

In the world of commerce, a large company might have more money to spend on innovation rather than a smaller rival. On the other hand, a behemoth is weighed down by the blubber of bureaucracy.

That’s why, for instance, small firms are the primary engines of innovation in the field of biotechnology as in many other fields. In this niche, the role of the giants is to buy up the small fry along with their intellectual property. Then the gobblers

simply pour boatloads of money into sprucing up the goods and hawking the products to a global marketplace.

To an increasing degree, the story is similar in the banking industry. For instance, the greatest advances of the modern era include the ability to send any amount of cash, including small change, without incurring a hefty fee.

The standard bearer in this neck of the financial woods is none other than PayPal. The company was formed in 2000 by the merger of a couple of sassy ventures. Each of the latter, launched in the late 1990s, focused on the electronic transfer of funds. The newborn platform, along with the payment scheme, has been a boon for millions of users throughout the planet.

By contrast, what passes for innovation by large banks has been constrained mostly to new-fangled ways to take advantage of the general public. A prime example lay in the packaging of risky mortgages into knotty balls of complexity. These contraptions were then trotted out as the next big thing in the circus of finance. A widget with a kitschy name like *collateralized debt obligation* (CDO) might sound fancy and exotic to a gullible investor; but the snazzy label fronted a flaky scheme.

The promoters presented the mishmash of dicey mortgages as a robust product for investment. To add to the whitewash, the rating agencies whose job is to assess the innate levels of risk ignored the warnings of prudent voices in the financial ring. Instead, the service providers rashly declared that the packets made up of junky parts could serve as investment-grade products.

The argument was that a bundle of unreliable parts can join together to form a sturdy structure. But that’s only true if the behavior of each piece happens to be independent. An example

of the latter is a spare tire in a car which is unlikely to blow out at the same time as any of the units placed in direct contact with the road.

On the other hand, a similar argument dealing with risky mortgages is simply bogus. When the overall rate of interest clambers upward – as it will surely do after lingering at unusually low levels – then all the loans at risk will fall apart in unison. That much is obvious to anyone who has a smidgen of knowledge about the housing market or interest rates, business cycles or monetary policy.

A house of sand will not withstand the onslaught of a tidal wave. In the case of a CDO, the agglomeration of frills and trimmings does not change the fact that the whole thing is made up of flimsy pieces that are destined to hold up or break down en masse.

Sure enough, the shell game broke down during the financial crisis of 2008. The meltdown caused a whale of a blowout in the financial forum as well as the housing market and the entire economy.

To round up, the arguments in favor of bloated outfits have not only been neutralized but reversed in the banking industry. The same is true of the reasons for saving the biggest clods from their self-caused wounds.

In the wake of the financial flap, the deadbeats balked at fulfilling their mission of lending money to small and midsize firms. The refusal of the bankers to do their job, when and as required, was bad enough in itself. By contrast, the same banksters have no qualms about making loans in spades when the economy is in full swing.

As a rule, commercial firms need money to grow but rarely to survive in the midst of an expansion in the larger economy. Yet the banks are happy to discharge their duties when the money

is not really needed by the borrowers. On the other hand, the same jokers refuse to provide financing in a pinch, when the lack of credit sends legions of bantam firms to their deaths.

To recap, there is a persistent and growing problem in the financial sector. For one thing, large banks as a whole are less efficient than their smaller rivals. The poor showing is underscored by the difference in the average level of fees charged by motley outfits for similar transactions.

A second factor lies in the upsurge of volatility in the marketplace, along with the cutdown of stability. An exemplar popped up with the unholy tangle of frothy properties in the real economy coupled with mortgage-based assets in the financial bazaar.

A third bogey lies in the dearth of useful innovation by the biggest players in the banking industry. What passes for ingenuity in the mammoth firms is directed largely toward new-fangled ways to take advantage of the general public.

From the opposite stance, the greatest advances in the modern era were spearheaded by bantam banks or external actors. The example in this vein range from mobile banking to online payments.

To begin with, the basic technologies were developed by solitary tinkerers and smallish teams. The then breakouts were converted into practical platforms by independent firebrands and visionary ventures.

Next, the pilot programs were turned into commercial products by bantam outfits. A case in point was the rollout of financial services on mobile phones by midsize banks in Scandinavia.

With the passage of time, the oversize firms had scant choice but to follow suit. A rising chorus of customers called out for similar functionality from service providers of all sizes.

A fourth, and related, issue lies in the surfeit of wrackful schemes cooked up by devious groups ensconced in large outfits. In the financial sector, the gimmicks that pass for innovation have been geared largely toward ways to befuddle and bilk the customers.

A plain example springs from the asymmetry of payouts for the opposing parties to a convoluted deal. The hustler lures the patsy into a setup where the odds are stacked heavily against the victim. The bunco is summed up by the following mantra: "Heads, I win; tails, you lose".

The deception relies on the fact that dicey gimmicks destined to blow up over the long haul can at times turn in a windfall over the short run. In that case, the sharks have something to gain and nothing to lose by taking up as much risk as possible while making use of other people's money.

If the wager hits the jackpot, the bettor takes home a big chunk of the spoils. When the scheme blows up – as it's bound to do sooner or later – only the investors and taxpayers suffer the consequences.

In this sordid setting, the government has taken up the perverse custom of tolerating and even supporting the racket in the financial sector. A proven policy of saving the trouble-makers from their own follies at the expense of the larger community can have no other effect than to encourage such antisocial behavior.

From a larger stance, the banking industry is too important for the economy as a whole for the financial system to be mucked up and knocked about by a bunch of cloddish firms. It's high time for the government to abandon the deadbeats bent on trashing the stability and productivity of the financial forum along with the real economy.

At a minimum, the policymakers should leave the bunglers alone so that they can die a natural and well-deserved death. Better yet, public policy ought to focus on the promotion of leanness and efficiency, along with innovation and progress of the healthy kind. To this end, the government ought to provide a nurturant environment in which bantam banks and sapling ventures can flourish.

Right and Wrong Ways to Boost the Economy

It seems clear that any sort of intervention by the government ought to be constructive rather than worthless, let alone destructive. A plain example involves the buildup of productive ventures rather than the support of brain-dead firms.

The guiding principle is compelling as well as self-evident. All too often, though, the precept is ignored entirely by public officials.

A glaring example popped up with the immediate reaction of the politicos in Europe as well as the U.S. during the financial crisis of 2008. For instance, the lawmakers doled out hundreds of billions of dollars at a stroke to keep alive a bunch of bludgeoned banks.

The bunglers in the financial sector had caused the fiasco to begin with, and were now dying of their self-inflicted wounds. Instead of clearing out the rot, the politicos rushed in to prop up the blight.

The mountain of bailouts could have been spent far better if it had gone toward helping the victims rather than the perpetrators of the financial flap. An example lay in the millions of souls thrown out of work when the blowup flattened the economy at large.

Among the ranks of the unemployed were legions of innocent folks within the financial sector. The hapless workers were laid off by the top brass at the crippled banks in order to pare down the cost of operations in the lower levels of the enterprise.

Amid the carnage, the moola from the taxpayer could have been allotted to the newly jobless rather than finance plump bonuses for the hangers-on in the financial sector.

The luckless folks should have received most or all of the handouts to tide them over as the they looked for work in a faltering economy. The same was true of the go-getters who attended workshops or took classes to upgrade their skills. And likewise for self-starters that chose to fire up brand-new ventures.

As an example, one-fifth of the total budget could have been meted out as matching funds for training programs. For instance, a municipal government might offer to pay half the fees for a jobless person to take a hands-on course on entrepreneurship hosted by a private outfit or a community college. Then the rest of the tab could be picked up by a federal agency.

The type of arrangement is also suited to the buildup of a novel business. For instance, the matching funds could be used to support a modest wage for a fireball in the early stages of launching a venture.

Under a sensible program of sponsorship, each dollar from the public treasury could generate several more in tax receipts in due course. Sadly, though, the opportunity for a slew of gainful initiatives was squandered by the politicians in the U.S., Europe and elsewhere.

On the contrary, the pols managed to compound the problem and prolong the agony through a bunch of misguided schemes to buttress the distortions in the economy. In other words, the

meddlers chose to feed the malignancy that had brought down the financial sector and the economic system in the first place. In this way, the bunglers ensured that the malady gripping the nation would linger on indefinitely.

In these ways, a slew of blunders were made before, during and after the financial blowup of 2008. On the other hand, there's no good reason to keep trudging down the wrackful path.

Forward Gaze

A lucid grasp of the big picture paves the way for a trenchant course of action in any domain. A case in point is the need to recognize the difference between a debt and its currency of denomination.

In this setting, the proper move is clear enough for a nation that wields an independent currency. An example of the latter lies in the U.S. or China. For starters, there's no need for a fully sovereign state to fret over the issue of leaving some kind of currency union.

In the autonomous case, the exchange rates against other currencies will drift toward their natural levels based on economic factors such as the relative levels of productivity and trade. For this reason, the only vital task for the policymaker is to scuttle any hard controls on the natural flows of capital in and out of the country.

As we have seen in this review, there are baneful schemes as well as healthy ways for dealing with a stumbling economy. The proper role of the leadership is to embrace a host of hearty programs to ensure a speedy recovery in the real and financial markets.

In the case of the debt crisis in Europe, the damage done to date is far too extensive to allow for a painless remedy. Even so, the predicament is far from hopeless.

The politicians and voters alike would do well to step back and take stock of the markets in their entirety. The expansive view sets the stage for drumming up a fruitful course of action.

In the final analysis, the electorate has to demand higher levels of sobriety and responsibility from their leaders in dealing with weighty matters that affect the entire society. The issues of this sort include the debt burden in the U.S., credit flap in Europe, and economic growth round the world.

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About the Author

Steven Kim is the founder of MintKit Institute, a think tank on investing for growth in a global marketplace. The research program spans the spectrum from global trends and market dynamics to world-class ventures and investment strategy. The author has counseled and trained self-starters of diverse backgrounds, ranging from budding entrepreneurs and senior executives to international investors and public officials.

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Keywords: Debt, Crisis, Euro, Bonds, Europe, Markets, Financial, Economy, Growth, Global, USA, Europe, Greece, Currencies, Forex, Real Estate, Government, Policy, Stocks, Strategy

Debt crisis is a situation in which a government (nation, state/province, county, or city etc.) loses the ability of paying back its governmental debt. When the expenditures of a government are more than its tax revenues for a prolonged period, the government may enter into a debt crisis. Various forms of governments finance their expenditures primarily by raising money through taxation. When tax revenues are insufficient, the government can make up the difference by issuing debt. The Great Recession. v. t. e. The European debt crisis (often also referred to as the eurozone crisis or the European sovereign debt crisis) is a multi-year debt crisis that has been taking place in the European Union since the end of 2009. Several eurozone member states (Greece, Portugal, Ireland, Spain and Cyprus) were unable to repay or refinance their government debt or to bail out over-indebted banks under their national supervision without the assistance of third parties like other eurozone The â€œglobal debt crisisâ€ was caused by so many different factors, but it ALL boils down to the Federal Reserve, the arbiter of the money supply, and consequently interest rates, in the US, and actions taken by Congress for decades and decades lead...Â The â€œglobal debt crisisâ€ was caused by so many different factors, but it ALL boils down to the Federal Reserve, the arbiter of the money supply, and consequently interest rates, in the US, and actions taken by Congress for decades and decades leading up to the crisis. Many will have you believe the global debt crisis was caused by the actions of a few excessively-leveraged investment banks who made highly, risky investments that failed. Student Debt Crisis is a non-profit corporation (501C-4) dedicated to fundamental reforms...Â About student debt crisis. Who We Are | One Million Supporters Fighting to End StudentDebtCrisis.org is a non-profit organization (501c4) dedicated to fundamentally reforming the