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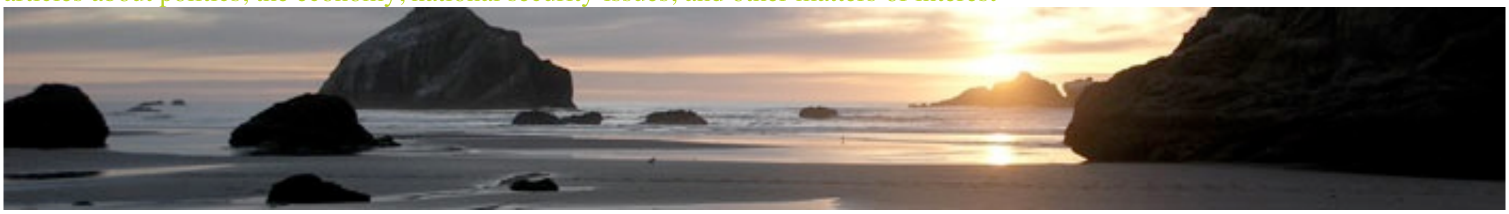

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Will The EU's Collapse Push The World Deeper Into The Great Depression II?

16 05 2010

By Timothy D. Naegele[1]

"For want of a nail . . . the kingdom was lost."[2] Will Greece's debt crisis lead to a Greek debt default and the collapse of the euro and an ensuing collapse of the 27-member European Union (or EU), and trigger the next round of crashes that will be described by economic historians decades from now as "the Great Depression II"?[3] The assassination of Archduke Franz Ferdinand of Austria and his wife in Sarajevo, Serbia brought the tensions between Austria-Hungary and Serbia to a head. In turn, it is said this triggered a chain of international events that embroiled Russia and the major European powers; and World War I broke out in Europe.[4] Will Greece's debt crisis set a series of events in motion that sends the world into a downward economic spiral of unfathomable proportions?

For years, I have wrestled with the question of whether the Europe would collapse economically, politically, socially and militarily. Sounds absurd, you say? The countries are too interwoven and mutually dependent now for that to happen, and at the very least they will muddle along, making the worst of the best situations, and achieving the lowest common denominator? The United States of Europe, they are not and never will be, but they have achieved a degree of cohesiveness that I never thought was likely years ago.

I believed jealousies and rivalries and, yes, the hatreds of the past would linger barely beneath the surface, coming unglued at the most inopportune times when it really mattered the most. When the chips were down, I felt the EU would splinter and fall apart; and that its participants and the world would write it off as a noble experiment that failed, much like the League of Nations. After all, *its* successor—the United Nations—is considered to be a colossal joke by Americans, many of whom would love to see it shipped to Europe, and its building on the East River in Manhattan bulldozed and turned into a park, or made into co-ops or condominiums.

The bitter hatreds of the past seem to have subsided in Europe though, and it has become a cultural melting pot, more and more. Airbus was the first tangible sign of economic integration that I never thought would be possible. To see the Germans and French working together, and genuinely enjoying each other and producing competitive aircraft on a global scale, was something to behold. The economic interdependence and booming economies covered up a myriad of sins, mistakes and weaknesses. It all looked very rosy until the economic tide in Europe and worldwide began to turn. Then, potholes showed up where there had been rose gardens; and recriminations began to occur that had been buried beneath the surface.

Today Greece is teetering, and anger is intensifying over proposed cuts that are to be made as part of the EU deal to save the country's economy. It is the age-old battle between the haves and have-nots, and between those who will bear the burden of the cuts and the wealthy who will escape them. However, anti-American sentiments are growing because the International Monetary Fund (or IMF) is viewed as a tool of the U.S., which is carrying out American policies. Like the U.N., the IMF has taken on more powers and responsibilities than were ever envisioned; and it needs to be curbed, and its U.S. support diminished.[5]

Perhaps a recent editorial by the Wall Street Journal best captured the "contagion" that began with Greece:

> It hasn't been a week since the terms of Athens's . . . bailout were set, and already the reviews of this latest Greek drama are saying it's a flop. Yesterday the euro sank to its lowest level in a year. Stock markets across Europe fell nearly 3%, and the carnage spread to Wall Street and beyond. Greek interest-rate spreads climbed higher again, and market players have turned their attention to the euro zone's other weak sisters as everyone tries to figure out who is most likely to follow Greece down the road to national insolvency.
>
> The bailout, in other words, hasn't stopped the much-feared contagion. If anything, it has spread it.[6]

The Archduke revisited—and hardly encouraging to a world that is in the process of revisiting the Great Depression. And reason enough for panics, with many more to come.[7]

In another editorial, the Journal added:

> The real gamble is being made by politicians who are calculating that, by taking the risk of sovereign default off the table for now, they are giving the global economic recovery time to build and making it easier to address Europe's fiscal woes.
>
> . . .

> In the euro's first serious test, the political class blinked. The resulting moral hazard will haunt the single currency for years and reduce the incentive for governments to keep their fiscal houses in order.[8]

Even more troubling is the prospect that the 16-nation (out of the 27-EU member states) shared euro currency may be headed for disintegration. "The euro is doomed," said one market analyst.

As German Chancellor Angela Merkel observed, Europe is in a "very, very serious situation"; and the U.K.'s new Prime Minister David Cameron and his coalition partner, Nick Clegg, may have major problems keeping the left wing of the Liberal Democrats and the right wing of the Conservatives (or Tories) in line, and a new election may be called before year-end.[9] Also, it is predicted that "China's economy will slow and possibly 'crash' within a year as the nation's property bubble is set to burst"—which may have troubling implications for whether China will continue to buy and hold our government debt.[10] In turn, this is a major economic and national security risk.

The economic tsunami that former Federal Reserve Chairman Alan Greenspan unleashed has produced consequences far beyond those that were ever envisioned—and far beyond American shores—which will last through the end of this decade, and possibly a generation. Giulio Tremonti, Italy's Minister of Economy and Finance, has said: "Greenspan was considered a master. Now we must ask ourselves whether he is not, after [Osama] bin Laden, the man who hurt America the most." These words speak volumes; however, they fall short of describing the global dimensions and consequences of Greenspan's actions and inactions.[11]

The central banks of the world are essentially out of options, and the worst is yet to come. Hold on tight. It will not be pretty—and global citizenry anger may be truly mind-boggling![12]

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[1] Timothy D. Naegele was counsel to the U.S. Senate Banking Committee, and chief of staff to Presidential Medal of Freedom and Congressional Gold Medal recipient and former U.S. Senator Edward W. Brooke (R-Mass), the first black senator since Reconstruction after the U.S. Civil War. He practices law in Washington, D.C. and Los Angeles with his firm, Timothy D. Naegele & Associates (www.naegele.com). He has an undergraduate degree in economics from UCLA, as well as two law degrees from the School of Law (Boalt Hall), University of California, Berkeley, and from Georgetown University. He is a member of the District of Columbia and California bars. He served as a Captain in the U.S. Army, assigned to the Defense Intelligence Agency at the Pentagon, where he received the Joint Service Commendation Medal. Mr. Naegele is an Independent politically; and he is listed in Who's Who in America, Who's Who in American Law, and Who's Who in Finance and Business. He has written extensively over the years. See, e.g., www.naegele.com/whats_new.html#articles

[2] The proverb, "For Want of a Nail," states:

> For want of a nail the shoe was lost.
>
> For want of a shoe the horse was lost.
>
> For want of a horse the rider was lost.

For want of a rider the battle was lost.

For want of a battle the kingdom was lost.

And all for the want of a horseshoe nail.

See http://en.wikipedia.org/wiki/For_Want_of_a_Nail_(proverb)

[3] *See, e.g.*, http://apnews.myway.com/article/20100408/D9EURADO0.html and http://www.bloomberg.com/apps/news?sid=aL3SiaURK8dQ&pid=20601087

[4] *See, e.g.*, http://en.wikipedia.org/wiki/Assassination_of_Archduke_Franz_Ferdinand_of_Austria

[5] As the London Times points out:

> Even greater social unrest is expected as resentment simmers among poorer families at being told to tighten their belts when wealthy Greeks can protect their fortunes by moving their money abroad, some of it into property bargains in London.

See http://www.timesonline.co.uk/tol/news/world/europe/article7113941.ece The Times article adds:

> Mikis Theodorakis, the 84-year-old musician who composed the score for the film Zorba the Greek, calls for revolt against what he sees as an American plot to turn Greece into a "protectorate".

[6] *See* http://www.naegele.com/documents/TheGreekBailoutFlop_000.pdf

[7] On May 6, 2010, the Dow Jones Industrial Average "ended down 347.80, or 3.2 percent, at 10,520.32, after being down as much as 998.50 earlier, the Dow's biggest intraday drop on record."

See http://www.cnbc.com/id/36988229

The CNBC article added:

> "We've seen a crisis start in a country—Greece—become regional, impact the whole of the Euro zone and is on the verge of truly going global," said El-Erian, CEO of the world's biggest bond fund.
>
> . . .
>
> There is simply a growing recognition that Greece has got to default, said Rochdale banking analyst Dick Bove. "The riots in the streets showed the decision to repay the debt was not going to be made by the people in Germany, France and Switzerland, it's going to be made by people in Greece and they're not going to repay it," he said. "Anyone seeing the riots is going to recognize that this government is going to be thrown out and anything replacing this government is going to be far more leftist leaning and they're going to repudiate."

See id. A Wall Street Journal article added:

> The velocity of the plunge in stocks was breath-taking. Investors fled everything from stocks and risky bonds to commodities and poured money into safe assets such as U.S. Treasurys and gold.
>
> . . .
>
> "You worry about the a domino effect, from Greece to Portugal to Ireland and Spain," said Richard Schottenfeld, general partner of Schottenfeld Associates, a New York hedge fund. "Pretty soon those kinds of losses are bigger than housing."
>
> Investors said they were worried about potential contagion from Greece's ongoing problems, and whether eventual losses could even exceed those of the U.S. housing collapse.

See http://online.wsj.com/article/SB10001424052748704370704575227754131412596.html?mod=WSJ_hps_LEADNewsCollection

[8] The Journal's editorial added:

> The real euro crisis, in short, is one of overspending and policies that sabotage economic growth. Sunday's shock and awe campaign has merely postponed that reckoning—and at a fearsome price.

See http://www.naegele.com/documents/TheRealEuroCrisis.pdf

[9] *See* http://www.bloomberg.com/apps/news?pid=20601087&sid=aqquuYOAN_sE ("European policy makers last week unveiled a loan package worth almost $1 trillion and a program of bond purchases in an effort to contain a sovereign-debt crisis that has threatened to shatter confidence in the euro. . . . By resorting to what some economists have called the 'nuclear option,' the [European Central Bank, or] ECB may open itself to the charge it's undermining its independence by helping governments plug budget holes")

[10] *See* http://www.upi.com/Top_News/Analysis/2010/05/07/Commentary-Fiscal-WMD/UPI-69801273233877/

[11] *See* http://www.philstockworld.com/2009/10/11/greenspan's-legacy-more-suffering-to-come/ and http://www.americanbanker.com/issues/173_212/-365185-1.html and http://www.realclearpolitics.com/news/tms/politics/2009/Apr/08/euphoria_or_the_obama_depression_.html

[12] *See also* http://www.naegele.com/documents/MatthewKaminski-EuropesOtherCrisis.pdf ("Germans no longer feel obliged to pay for the sins of their forefathers by bankrolling Europe. . . . 'The EU is falling to pieces'") and http://finance.yahoo.com/news/Spain-debt-downgraded-by-apf-1816859080.html?x=0&.v=27 (Spain) and http://www.ft.com/cms/s/0/6f696c52-456a-11df-9e46-00144feab49a.html ("Soros warns Europe of
disintegration") and
http://online.wsj.com/article/SB10001424052748703525704575061172926967984.html?mod=WSJ_hp_mostpop_read ("Europe is entering unprepared into a serious economic crisis—and the nascent global recovery could easily collapse due to the unsustainable and Ponzi-like buildup of government debt in weaker countries. . . . The issues for troubled euro zone countries are straightforward: Portugal, Ireland, Italy, Greece and Spain (known to the financial markets, and not in a polite way, as the PIIGS) had

varying degrees of foreign- and bank credit-financed rapid expansions over the past decade. In fall 2008, these bubbles collapsed. . . . Since these struggling countries share the euro, run by the European Central Bank in Frankfurt, . . . they are left with the need to massively curtail demand, lower wages and reduce the public sector workforce. The last time we saw this kind of precipitate fiscal austerity—when nations were tied to the gold standard—it contributed directly to the onset of the Great Depression in the 1930s. . . . Ireland's banks are today probably insolvent. Who can afford to repay their mortgages when wages are falling and unemployment rising? Irish house prices continue to speed downward. This is not an example of a 'careful' solution—it is a nation in a financial death spiral")
and http://www.dailymail.co.uk/news/worldnews/article-1250433/Greece-debt-bailout-EU-leaders-split-euro-crisis.html and http://www.nytimes.com/2010/02/14/business/global/14debt.html?hp=&pagewanted=all

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2 responses

17 05 2010

Ian (01:08:32) : edit

This was a good read. For somebody, like me, who trades currency, it's been a difficult few months. I believe the dollar is fundamentally weak but Greece has managed to blow the Euro completely up. They're talking parity or the end of the Euro now.

The problem for the USA is the people are still pretty much asleep at the wheel. Our political elite are polarized and paralyzed and unable to deal with the economic problems at hand.

I happen to believe that when this house of cards comes crashing down, there's going to be blood in the streets and maybe even a political revolution if hyperinflation wipes out the middle class……as some like Peter Schiff suggests could happen.

It's interesting times to say the least.

Reply

17 05 2010

naegeleblog (01:20:17) : edit

Thanks, Ian, for your excellent comments.

With respect to your statement that "[o]ur political elite are polarized and paralyzed and unable to deal with the economic problems at hand," you are so so correct. Most have zero training in economics, and the issues go straight over their heads. Also, they are political "beasts" who only truly care about getting reelected and wielding power while they have it.

Your third paragraph is also very interesting. As you know, there is one school of thought about the coming hyperinflation; and there are others who believe that hyperinflation will be short-lived, and that deflation will rule the day. I tend to agree with the latter scenario; however, it is anyone's guess, and the economic history of this period will be written 20-40 years from now.

Regardless of one's point of view, there will be chaos; and as stated in the last paragraph of my article, "global citizenry anger may be truly mind-boggling!"

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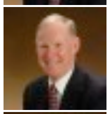
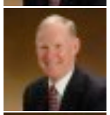
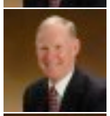
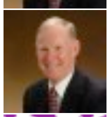
 naegeleblog on The End Of Barack Obama

 naegeleblog on The Great Depression II?

 naegeleblog on The End Of Barack Obama

 naegeleblog on Russia's Putin Is A…

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