Analysis on the Economic Crisis of Sovereign Nations: Consequences, Reasons and Inspiration

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Abstract The global financial crisis, which derived from the U.S. subprime crisis, has seriously affected the development of economy, politics and society of many sovereign nations. Based on the influences and consequences caused by the economic crisis in Iceland and Greece, the internal and external reasons were investigated and discussed. Moreover, some policy suggestions were summarized and proposed to cope with the future economic crisis, such as the implement of prudent macroeconomic policies, the establishment of reasonable industrial structure as well as the enhancement of financial supervision and expansion of international cooperation.
Key words Financial crisis; Iceland crisis; Greece crisis; Industrial structure; Financial supervision

1 Introduction

With the strike and "infection" of the global financial crisis, during the year of 2008 to 2009, there successively appeared the economic crisis or "bankruptcy" in some sovereign nations, namely in Iceland and Greece. A number of experts and organization continuously focused on the progress and effects of this economic and financial crisis [1, 2]. As we know, from the viewpoint of individual crisis in Iceland or Greece, some of reasons and consequences of the crisis has been investigated; meanwhile, the evolutionary process, structural characteristics and crisis-shaping mechanism of the crisis were also analyzed [3]. This paper is the first one of investigating the reasons and consequence of the economic crisis of two sovereign nations with the method of comparative analysis, and furthermore based on the experiences and inspiration, proposing the reasonable suggestions and measurements to instruct other sovereign nations.

2 Impacts and Consequences of the Crisis

2.1 Impacts and consequences on economy

The economic crisis in sovereign nations have greatly affected the development of economy, such as the recession of the national economy, currency devaluation, rise of inflation, decline of import and export in volume. The presence of economic crisis has serious destroyed the integrated structure and system of Icelandic economy. Firstly, due to the impact of crisis, the exchange rate of Iceland Króna sharply declined 63.9% against the dollar and 284% against the Euro in October of 2008. At the same time, the market capitalization of the Icelandic stock exchange had decreased by more than 90%. In addition, all trading on the exchange was frozen for two days. The decrease of capital mobility resulted in failing to finance from international market and be unable to meet maturing obligations. Finally, this country has undergone a severe economic recession, and some economists predicted that the nation's GDP will decrease by 10% and the rate of inflation will rise to 75%.

2.2 Impacts and consequences on society

As the result of the impactive consequence of the economic crisis in sovereign nations, every industry, such as the financial, banking, securities, investment, service and real estate industries, suffered from negative influence. The three major banks in Iceland have to carry on the nationalization gradually during September to October in 2008. With the radical restructuring of the organizations, the private Sterling Airlines declared bankruptcy, the newspaper 24 Stundir Corporation ceased publication subsequently and one of major bank in Iceland, Landsbanki fired more than 300 employees. By late November of 2008, there were over 7000 registered unemployed in contrast with just 2136 at the end of August in 2008. A similar picture also occurred in Greece: various enterprises were bankruptcy or running-down of business which was attributed to the decline of export and tourism income resulting from the worse economic condition. The organization for Economic Co-operation and Development (OECD) predicted that the unemployment rate in Greece may be over 10% and will last until 2011.

2.3 Impacts and consequences on politics

The economic crisis in sovereign nations induced the constant shrinking of many enterprises in profit and resulted in the sharp decrease of workers' welfare, which aroused the turbulence and instability in society. In late January of 2009, many Icelanders demonstrated and called for to take an early election. In Greece, the strikes, riots and demonstrations also emerged in an endless stream. Meanwhile, people have lost faith to the governments and the political system of EU because they cannot agree on the economic assistance to Greece. Finally, the credibility of governments was doubted when they failed to take the proper measures to cope with the economic recession and the high unemployment.

2.4 Impacts and consequences on international affairs

The British citizens have about £4,000 million deposits in Icelandic banks. Besides, over £10,000 million in cash from more than 100 UK organizations, such as the local authorities, police services, hospitals and schools were invested in Icelandic banks [4]. Due to the presence of economic crisis, Icelandic banks were unable to return these deposits. Therefore, in order to protect the interests of depositors, the British government took measures to freeze the assets of branches of Icelandic banks [5], which was imitated by German government. The British and German governments refused to provide aid, which resulted in the further recession and the international tensions or conflict.

3 Reasons of the Economic Crisis

3.1 External reasons of the economic crisis

The development of globalization connects all the countries as an entire economic community. In the whole economic system, any instability or turmoil in economy of one country will cause to the economic fluctuation of whole world. The external reasons of the economic crisis in Iceland and Greece were mainly attributed to the U.S. subprime crisis. When there appeared the global financial crisis derived from U.S. subprime crisis, Iceland cannot finance from foreign countries because of the high interest rate and low capital mobility, which triggered the explosion of the economic crisis. At the same time, the emergence of global financial crisis caused the recession of tourism and shipping business, which inevitably hit the Greece economy.

3.2 Internal reasons of the economic crisis

External factors are a necessary condition, but the internal factors are the root reasons that determine the development of matter. External causes become operative with internal causes. When discussing the reasons of the economic crisis of the sovereign nations, internal causes are particularly important. Through a comparative analysis on the reasons of the economic crisis in Iceland and Greece (as shown on Table 1), the novel phenomena and viewpoints can be recognized and proposed.

Table 1 Comparison of the Reasons of Economic Crisis

Sovereign nations	Differences		Similarities	
	Internal reasons	External reasons	Internal reasons	External reasons
Icelandic economic crisis	1. Unbalance of industrial structure (excessive proportion of financial industry); 2. Lack of supervision; 3. Vulnerable monetary system.	Broke out at the beginning of the global financial crisis; Developed together with the global financial crisis.	1. Lack of natural resources in domestic and slow development of pillar industries; 2. Inappropriate macro economic policies; 3. Ineffectiveness supervision of relevant departments.	Global financial crisis
Greek economic crisis	1. Inappropriate macroscopic economic policies and huge amount of public debts; 2. Immoderate dependence on external funds; 3. Serious tax evasion and imperfect social welfare system.	Broke out in the late stage of the global financial crisis; Developed after the global financial crisis.		

As for the economic crisis in Iceland, the industrial structure of Iceland was out of balance and the financial industry occupied considerable proportion in the national economy. The proportion of the agriculture and fisheries reduced from 11.6% to 5.9%, contrarily the financial and real estate industries rose from 17.6% to 26.6% during 1996-2006 years [6].The ineffectiveness of financial supervision resulted in the rapid development of financial industry, especially the banking. The assets and liabilities of the Icelandic banking sector (denominated in foreign currency) amounted to ten times the Icelandic GDP within six years of privatization [7]. Also, the scale of financial industry was distinctly deviated from real economy. In the mean time, the vulnerable monetary system of Iceland led to the currency devaluation. On the other hand, the country's foreign exchange reserves were not enough to pay for the foreign debts, which resulted in the sharp collapse of the Icelandic financial system when the economic crisis broke out. Figure 1 shows the process of Iceland "bankruptcy" induced by the vulnerable monetary system.

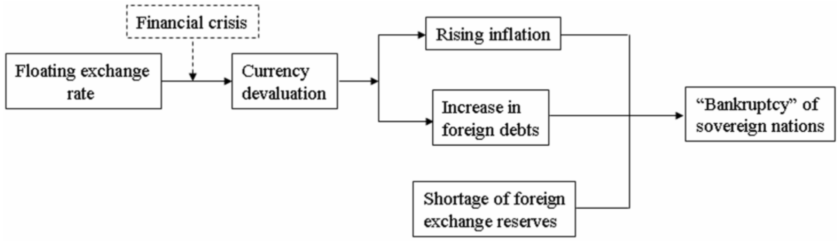

Figure 1 Process of Iceland "Bankruptcy" Induced by the Vulnerable Monetary System

The high fiscal deficit, huge amount of public debts and government's careless measures were the root of the economic crisis of Greece. Being lack of natural resources, tourism and shipping businesses were the traditional pillar industries of this country, so the national economy depended seriously on external funds. There was a serious slump in the global economy when the global financial crisis occurred. Inevitably, the number of tourists and the volume of import and export of goods were decline, the Greece economy sank into recession ultimately.

Through the above analysis of the internal and external reasons of the economic crisis in Iceland and Greece, the inspiration of responding to the economic crisis of the sovereign states will be summarized.

4 Inspiration of the Economic Crisis

4.1 Implement of prudent macroeconomic policies

The national unity, ethnic solidarity and social stability determined by the appropriate macroscopic economic policies of the country. Large-scale haphazard investment and imprudent policies are dangerous for the government. It is important to balance the interactions between economic stimulus and macro economic stability. Exorbitant economic stimulus or imprudent macroeconomic policies will cause the high fiscal deficit and huge amount of public debts, such as the crisis in Greece. In view of the economic crisis in Iceland and Greece, the sovereign nations should adopt loose monetary and fiscal policy to stimulate consumption, expand inner demand and promote economic recovery during the depression. In addition, the governments also should pay more attention to the fiscal deficit and the amount of foreign debts to prevent the crisis. The structure of fiscal expenditure should be optimized and the efficiency should be promoted gradually.

4.2 Establishment of reasonable industrial structure

It will be unsustainable for any sovereign nation if the industrial structure is unreasonable. To develop the national economy, based on their natural resources, any government should fully develop their own advantages and encourage the diversified industries, especially focus on the rationalization of industrial structure. The fisheries industry has made a significant contribution to the economic development of Iceland. However, the export of fisheries relied too much on the international demands and the condition of weather, so it is necessary to develop the diversification of industries. But the government of Iceland did not put in force the reasonable industrial structure policy. They overdeveloped the financial industry, which led to the fictitious economy hastens and broke away from the real economy. Ultimately, fictitious economy seriously damaged the real economy and stimulated the explosion of economic crisis in Iceland.

4.3 Enhancement of financial supervision

The government of Iceland was lack of the financial supervision during the continual process of financial liberalization, which led to the systematic risks of financial market. The financial system almost collapsed when the risks was not minimize and avoid effectively through the supervision. Every sovereign nation should draw a lesson from the experience of Iceland and Greece. It is urgent that nations should establish an effective financial supervision system to adapt to the developments and changes of financial markets [8]. The function of market is not universal and the over-marketization is harm to financial security, so the government should strengthen the supervision on financial institutions and avoid the risk when invest capital into financial market [9].

4.4 Expansion of international cooperation

With the globalization wave springing up, the development of every country's economy is strongly interrelated and capitals, technologies and talents become more mobile. The national economy will be affected once the international economic environment changes, such as Iceland and Greece sunk in economic crisis in the global financial crisis. The country's economic strength and ability to withstand risks are limited, so the international cooperation is required essentially to cope with the economic crisis. For example, Iceland got financial aid from the IMF and others sovereign nations, and Greece got loans from EU, which actively alleviated financial pressure in their difficult times. Every sovereign nation should strengthen their international cooperation to face and solve the crisis together.

5 Conclusions

The global financial crisis, which derived from the U.S. subprime crisis, seriously affected the development of economy, politics and society of many sovereign nations. There were various internal problems in these governments, such as the inappropriate macroscopic economic policies, irrational industrial structure and shortage of financial supervision. All the other sovereign nations should get lessons from the economic crisis in Iceland and Greece so as to avoid falling into the same trap again. In the future, it is necessary to implement prudent macroeconomic policies, to establish rational industrial structure, and especially to focus on the proportion of virtual economy and real economy. At the same time, the government should establish a fair, open, unified and highly efficient financial supervision system to guarantee a sustained and healthy development of the financial industry. Finally, it is urgent and essential to enhance and expand international communication and cooperation.

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