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Classes: European Integration
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Lessons for European integration in the face of global crisis

Some questions to think over and suggested answers

This set of questions should help the understanding of the study by Marek Dąbrowski, titled *The Global Financial Crisis: Lessons for European Integration* (published by Case Network, Warsaw etc. 2009), concerning the threats for European integration carried by the present economic crisis.

Abstract, p.5

1. (a) State the following thought without using the word „hybrid". *The European integration can be viewed as a kind of intermediate hybrid between an international organization and a federation, subject to further evolution.* (b) How do you imagine a deeper EU integration?

> (a) The European Union has some features of federal state and some of international organization. Like the latter, e.g. UN, UNESCO, NATO, it consists of sovereign states, but – unlike in such organizations – their sovereignty is limited in favor of EU authorities in respect of legislative, executive and judicial power. A difference between EU and a federal state consists in the degree of limitations, which is significantly lesser than in the case of EU (e.g., defense and foreign policy belong to the governments of member states). Moreover, a part of each member state power is **delegated voluntarily** to supranational UE authorities, while in the case of a federal state the relations between central and local authorities are defined in the constitution imposed by federal legislation. (b) As for a deeper integration to approximate a federal state, it should involve establishing common EU policies in fiscal matters, defence, and foreign affairs.

2. Explain the meanings of the following phrases: (a) „nationalization of a fiscal response", (b) „potentially insolvent country", (c) „financial supervision".

> (a) The term „fiscal response" denotes a set of fiscal measures undertaken by firms or governments to repair losses caused by crisis, e.g. to win credit to prevent bankrupcy. *Nationalization of such a response* means that the government in the nation in question provides a private firm with a necessary capital, e.g. to pay its defaults (i.e. debts which the firm in question is unable to pay). In return for such assistance, the firm gets subjected to the control of government as taking responsibility for the firm's liabilities.
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> (b) „Insolvency" means the lack of financial resources to fulfil financial obligations towards other agents in market. Potentially insolvent country is one is very likely to become insolvent, as can be exemplified with the case of Greece before the crisis (now Greece has become *actuallly* insolvent.
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> (c) *Financial supervision* is the activity exercised by a body called, e.g., Financial Supervision Commision (in Poland Komisja Nadzoru Finansowego). Such a body „subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system. This may be handled by either a government or non-government organization." (wikipedia, title as italicised above).

1. Introduction, p.6

3. What does the subprime mortgage crisis consist in?

> *Mortgage* is a conditional conveyance of property as security for the repayment of a loan.
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> *Subprime mortgage* is „a type of mortgage that is normally made out to borrowers with lower credit ratings. As a result of the borrower's lowered credit rating, a conventional mortgage is not offered because the lender views the

borrower as having a larger-than-average risk of defaulting on the loan. Lending institutions often charge interest on subprime mortgages at a rate that is higher than a conventional mortgage in order to compensate themselves for carrying more risk." (investopedia) NOTE: you can learn from Goggle that there is more than 600.000 statements of definition, and more that milion of other uses of this term, what displays the econommic significance of this concept.

The U.S. *subprime mortgage crisis* was one of the first indicators of the late-2000s financial crisis, characterized by a rise in subprime mortgage delinquencies and foreclosures, and the resulting decline of securities backed by said mortgages. (wikipedia)

Forclosure is „the legal process by which an owner's right to a property is terminated, usually due to default. Typically involves a forced sale of the property at public auction, with the proceeds being applied to the mortgage debt." (see http://www.investorwords.com/2039/foreclosure.html).

Security is a formal declaration that documents a fact of relevance to finance and investment; the holder has a right to receive interest or dividends.

Mortgage-backed securities are securities backed by mortgages. Such securities can be issued by banks. The story of how such procedures triggered the present crisis is fairly complex, hence we have to dispense of a more penetrative investigation. Let it be enough to remember the following. At the start there were defaults of individual debtors applying for mortgage backed credits, while their reliability had been pledged by the money of specialized agencies (established for supporting and safeguarding credit operations). When the debtors massively failed to pay debts, since their possibilities had been much overestimated by banks (for bankers' greedy drive to increase their profits from interest rates). This must have led to crunch of banks refusing to lend to each other, and to collapses of may of them. This in turn resulted in colossal losses of state-backed agencies which supported banks, and thus to the enormous crisis in the US economy. If you like having more details, see „Market Watch": http://www.marketwatch.com/story/us-sues-big-banks-over-mortgage-losses-2011-09-02

4. Is it more for European integration advantageous to increase Europe's fiscal capacity than to rely on IMF assistance? Support your answer with an argument.

3. European integration: its institutional assymetries and limitations, p.13

5. Why does the Rome Treaty require the unanimous agreement, and not voting by majority, in the case of any Treaty revision aiming to delegate new prerogatives to the Union level?

6. What does it mean to be eurosceptical?

7. What does it mean that EU is a hybrid construction?

4. Europe's response to the crisis: potential threats to the Single European market, p.14

8. Describe conditions in which there arises a liquidity squeeze.

A liquidity squeeze occurs when a financial event sparks anxiety in financial institutions, for instance banks, regarding the availability of money because of uncertainty of defaults. This results in a shortage of available credit for businesses and consumers.

9. Why did the Lehman Brothers bankruptcy triggered the process of liquidity squeeze?

10. Why the depreciating of US dollar may result in the appreciation pressure on the euro?

11. Why does the liquidity squezze in the US weaken US demand for EU goods?

12. Why are the processes mentioned in 10 and 11 threatening the European market?

13. Explain the notion of toxic assets, and give an example.

Financial assets the value of which has fallen significantly and may fall further [...] [so that no one will buy them.] longer buy. Many of banks' problems in the financial crisis were due to such toxic assets, such as securitisations of subprime mortgages, where the original creators of the securities failed to take into account the real rate of

mortgage default and the extent to which it would be contagious across securities. Assets that were rated AAA and worth a lot suddenly looked like junk bonds and were worth a fraction of their previous value, if indeed it was possible to find a price at all in a market where no one wanted to buy them. (Financial Times Lexicon) An examplle: after the subprime mortgage crisis in the late 2000s, many of these mortgages became considered toxic assets.

14. Give an example of beggar-thy-neighbor policy.

15. Why such a policy may result in disruption of the single European market?