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Another crisis, another country!

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In a 1984 Hollywood comedy, *Blame it on Rio,* Michael Caine (playing the role of Matthew with enough of his past marital problems) has an affair during his vacation in Rio De Janeiro with the teenaged daughter of his best friend, Joseph Bologna and lays the blame for all his misfortunes on the vacation resort, where the two families got together.

Since the world recession in late 2007, which was triggered by the American financial crisis, it has become fashionable for countries, small or big, to take the *"Blame- it- on- Rio"* route for conveniently hiding their economic failures.

Iceland

In late 2008, Iceland (population: 318,000 and per capita income: US$ 38,000), a country outside the Euro zone, got into financial difficulties, which had nothing to do with the US financial crisis. Iceland economy was once propelled by fishing activities. However, its financial institutions wanted to spread their wings. They began to offer high interest rates to lure depositors from the overseas. They could not manage the funds. Investments, mostly of the wild-goose-chase variety failed and the news spread. The result was an unprecedented run on Iceland banks. As the bank failures were imminent and Iceland government could not come to their rescue, Britain had to issue a stern warning, short of military intervention, to Iceland to shape up!

Prime Minister Gordon Brown's anger was understandable. Senior citizens, UK civil service unions, and notably the London Police Credit Union, who had put their funds in Iceland banks, were left high and dry by the banks.

An investigating commission looked into the crisis and concluded that the central bank and the government did not exert enough pressure on the banks to shrink their balance sheets. The banks had accumulated liabilities equivalent to 10 times Iceland's output, a development the commission said was the key in fuelling the financial collapse.

It was obvious Iceland's troubles had nothing to do with American crisis: It was their own making.

Greek tragedy

In early 2010, Greece (population: 11 million; per capita income: US$ 30,000), turned out to be a major embarrassment for the Euro zone. The future of the single currency came under severe scrutiny. It became clear that while a common central bank for 15 nations could control money supply and keep a single interest rate, it cannot control each member country's fiscal policy and public sector.

Joining the Euro zone in 2001, Greece took the membership as a credit card for access to international markets, borrowing freely and added to its external debt. No doubt, the Greek economy boomed. Public sector expanded; corruption set in with increasing salaries.

As the global recession hit the world, Greece was ill-prepared to cope. It has come to light that Greece's budget deficit was 12.7% of GDP, more than four times higher than eurozone rules. Its debt in April 2010 was 300 billion euros (US$419 billion) and 125% of GDP.

Germany, the powerhouse of the Euro zone, was upset.

Did Greece really earn the euro membership? Or did Greece gate crash into the elite club?

When the single currency was born on January 1, 1999 with 11 countries (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain), as members of a currency union, Greece was left out. It had to wait for two years as there were some pre-requirements to fulfill.

The minimum qualifications for the exclusive club are:

- Inflation: No more than 1.5 percentage points higher than the average of the three best performing (lowest inflation) member states of the EU.
- Annual budget deficit: ratio of the annual budget deficit to gross domestic product must not exceed 3%; and
- Debt: ratio of government debt to GDP must not exceed 60%.

Greece was admitted to the club in 2001. There were allegations that Greece suppressed its debt figures and fudged its statistics right from the days when it was trying to join the elite club. Oversized public sector and tax evasion caused the problems. They were nothing to do with the American financial crisis, which only compounded its difficulties.

One of the amusing limericks compiled by *Wall Street Journal*'s bloggers is already a big hit.

There are two indisputable facts
That toppled the Greeks on their backs:
Every third Greek today
Works for government pay,
And the rest are evading their tax.

Now to Ireland

Ireland (Population: 6 million; per capita income: US$ 41,000), once one of the world's biggest economic success stories, is now the new headache of Euro zone.

Ireland, a founding member of the Euro zone since 1999, which was long known for high unemployment, high taxes and high rates of emigration, emerged as the fourth most affluent country in Europe. With public sector and tax reforms since the 1990s, (its corporate tax was one of the lowest in the world), shiny towers rose over dusty old Dublin. Business and government leaders justifiably boasted of the strength of the Celtic Tiger.

Then, came the bust brought in by banking excesses.

Last week, Ireland had to bail out its famous bank, the Anglo Irish bank, whose real estate loans landed it into a national crisis. The total cost to the government to fix the banking system is expected to be close to 30 percent of overall economic output.

The banking problems were not new. Years of property speculation, fuelled by loose lending have left the countryside with half-finished houses and incomplete condos, which nobody now wants and nobody can afford to pay for.

Low interest rate, set by European central bank, actually meant for the needs of the bigger economies including Germany, was the culprit. Ireland, being a euro country, had to fall in line. Low rates of interest gave rise to a boom in the property market, which has since collapsed.

Ireland has experienced a full-fledged banking crisis, leading the government to guarantee the liabilities of the major banks, besides Anglo-Irish bank. Bad real estate debts would result in country’s debt of about 110 percent of national income.

Thus, Iceland, Greece and Ireland had their own crises. All were home grown, although their difficulties were compounded later by the ongoing world recession.

Every crisis has a lesson.

During good times, banks lend generously to all, including those who should not have been borrowing on the scale they did. So, the lesson is that prudent lending is the need of the hour.

In the USA and elsewhere, including the case of National Bank of Fiji, banks were reckless, lending to individuals on demand. They sanctioned mortgages to a multiple of several times applicants' income, and to a value greater than that of the home they sought to buy.

There are new pressures on banks building up.

Banks are now required to lend more to small businesses and first-time businessmen. If lending is restricted to credit worthy people, we have learnt a lesson.

If it exposes borrowers to unsustainable levels of debt, it would only mean we have forgotten what we learnt.

Instead of ending on a dreary note, here is a limerick contributed by Dr. Goose to the *Wall Street Journal.*

The credit crunch left deadly traces
On banks found in high and low places;
The research clearly shows,
As many suppose,
Loans on homes were to blame in most cases.

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