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Should the BRICs bail out Europe?

By Pradumna B Rana

Synopsis

The sovereign debt crisis in Europe is fast becoming a banking crisis which could plunge the world into Great Depression II. Europe needs to take bold actions and make a political case for the survival of the euro. But even after last week's IMF meeting, it is split.

Commentary

THE ECONOMIC and political news from Europe in the past month have been disturbing. The IMF-EU financial support programme for Greece has veered badly off-track. Austerity fatigue is clearly visible in the almost daily protests and disturbances.

The eurozone debt crisis has now spread from Greece, Ireland, and Portugal to Spain and Italy. French banks are also starting to experience funding difficulties. In Germany, there is political resistance to enlarging the European financial stability facility and to the issuance of Eurobonds guaranteed jointly by all members. This bailout fatigue is also visible in Finland, the Netherlands and Austria. The risk that the Eurozone will experience a spate of sovereign defaults within the next few months has heightened considerably. This would certainly lead to a major banking crisis in Europe which could pave the way for the unravelling of the euro.

Two global economic crises in three years?

These developments in Europe would most certainly have serious adverse impacts not only in Europe but the entire world. The IMF's World Economic Outlook released last week has marked down significantly the forecasts for the global economy. It warned: "The chance of a serious slowdown of the world economy, with growth falling below 2 per cent, has doubled from earlier in the year." If this were to happen, it means that within a relatively short period of three years, the world economy would have been ravaged by two serious crises made in the Western world – the global economic crisis round I of 2008-2009, which originated in the United States, and round II which is now unravelling in Europe.

Nouriel Roubini, the person widely credited as the only one who foresaw the 2008-2009 crisis, has argued that the situation could be even worse, and that the only option now for Greece and some other members is to exit the eurozone. As the process will be traumatic, he argues, the risks ahead are not just of a mild double-dip recession but of a severe contraction that could turn into the Great Depression II. (The first Great Depression was in the 1930s when world trade slumped by 50 per cent and US unemployment rate reached 25 per cent).

In 2008-2009, the threat of Great Depression II was averted by the coordinated stimulus packages under the auspices of the G20 and the world experienced a less painful recession. But now, if Roubini is correct, Great

Depression II is still a clear possibility. And there is no sign of the G20 when it is most needed. Has the G20 become a G Zero as Roubini remarked a few months ago?

The euro experiment

When the euro was born in 1999, the eurosceptics, basing themselves on Nobel Laureate Professor Robert Mundell's theory of optimum currency area, had argued that it would not be possible to have a lasting currency union without a political union. The only successful currency union in the world, so far, is the United States of America which is a single country. The europhiles, however, had argued that the economic union would eventually lead to a political one.

Events have proven the eurosceptics correct. It is not because the architects of the euro had failed to see the need for a fiscal rule. They had thought that the Growth and Stability Pact would be enough. Unfortunately, the Pact was breached every now and then -- even by Germany and Italy. Sometimes data were even falsified.

All members of the eurozone benefited from the 12-year experiment with the euro. These benefits were in the form of higher economic growth, low inflation, and low foreign exchange transaction costs. Now that the system is facing difficulties, as the Chinese Premier Wen Jiabao remarked at the recent World Economic Forum in Dalian, the EU (all members, including Germany) should put its house in order. The European countries need to implement the deal reached in July to provide additional resources to the European financial stability facility and to restructure Greek bonds held by the private sector. They must also issue Eurobonds guaranteed by all eurozone members.

While the need for bold actions is clear, Europe's preference so far has been for incrementalism -- doing just enough to avoid an imminent collapse but never enough to restore confidence and change market sentiments. Despite the pressure applied by many countries at last week's IMF annual meeting, Europe is still split on a rescue plan. This has to change if the collapse of the euro is to be averted and the world is to avoid Great Depression II. Now is the time to "shock and awe" -- recall US actions in 2008 - with bold collective actions to help each other, not to find fault with each other.

Appealing to the BRICs

In the above context, the newly-appointed managing director of the IMF, Christine Lagarde, last week called on the BRICs -- Brazil, Russia, India, China, and more recently South Africa -- to use their financial resources to help European and other stricken countries via purchases of bonds and through direct investment. Should the BRICs help?

In a globalised world, the BRICs are fully aware that eurozone stability is in their national interests. They also know that the problem in the eurozone is less about money and more about the political will to help each other. At the recent Singapore Global Dialogue organised by the S. Rajaratnam School of International Studies (RSIS), Lord Mandelson, the former European Commissioner for Trade, aptly emphasised the urgent need for bold actions and for making a political case for the survival of the euro.

European countries need to sacrifice short-term national self-interest and work for the common good. Unless Europe takes these actions, any support from the BRICs can only be notional and symbolic.

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