"The bail-out [by BRICs] could have an indirect negative impact on the Eurozone"

- Andreas Rasche

Dukascopy continues to interview experts on the topic of European sovereign debt crisis. Andreas Rasche, Assistant Professor of Business in Society at Warwick Business School, Visiting Professor at European Business School in Germany and a former Consultant to the United Nations Global Compact Office, has granted us the possibility to observe the issue from a different perspective.

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1) What do you consider to be the main reasons for current Eurozone economic problems?

Reflecting on the matter, I would point out that there are three causes of the crisis.

The first cause is a quite obvious one – it is the debt that the governments have accumulated over the years. However, we need to differentiate between different economies. For instance, Greece's and Portugal's main troubles are high government expenditures, which limited the competitiveness of the private sector and inhibited economic growth. At the same time in Spain and Ireland there have been private sector asset bubbles, basically being a result of largely unregulated financial markets. Therefore, looking at these different causes there are also different solutions: Spain and Ireland require reforms of their banking sector, whereas Greece and Portugal are in need of reforms of the government and also require tax reforms.

The second cause of the crisis is a single currency which is managed in a very centralized way by the ECB, at the same time having a lot of multiple fiscal policies that do not match very well and make it increasingly difficult to implement bail-outs. For instance, the Eurozone is heavily dependent on German exports, so if exports plummet in Germany due to missing demands in economies like China, which we have seen to some extent in the last years, the entire Eurozone slows down because it depends on such strong economic players as Germany and France.

And then the third cause, which is not very well recognized, is the missing cultural integration and feeling of solidarity in the Eurozone. Other monetary unions, for instance, the U.S. with its Fed system, has a larger common identity compared to the Eurozone where the Germans complain all the time “We need to bail-out Greece” and perceive such actions as a burden, while implementing the bail-out only to rescue themselves. European cultural integration, undoubtedly, is a long-term process. I believe that the euro was designed to achieve a stronger cultural integration; on the other hand, I do not think that in the nearest future the Eurozone can become culturally integrated. Europeans speak various languages; have different values, and economic and political policies. I do not consider that you can simply work out a common monetary strategy by neglecting these differences.

2) How would you assess the statement that by bailing-out Western Europe the BRIC countries are saving their own economies?

I would agree to the statement, because the BRIC countries have significant reserves to carry out Europe’s rescue plan. I would say that China is the leading country being able to offer a wider scale of help. China has more than US$ 3 trillion in foreign exchange reserves. It can bail-out Europe, but the question is “does it want to do that and is this politically feasible?” I am sure that in this case China would turn to G20 for coordination of the bail-out and political backing.

This kind of intervention is very tempting in the short-run since Europeans are not willing to buy their own treasuries, thus the Eurozone is looking for alternative sources of funding.

As I see it, the BRIC would help their own economies if they become involved in a bail-out. Firstly, they currently hold huge reserves in U.S. Dollars, therefore, if a bail-out takes place, their reserves would be diversified.

The second reason is that purchase of European bonds would push the euro to higher levels so that China can maintain a favourable exchange rate for its own currency pushing its own exports.

The third reason is the fear of the crisis spreading further. The BRICs would not want the crisis to spread to Italy and Spain because this might create an uncontrollable chain reaction. This would hurt the BRIC too, because, for instance, China depends on Eurozone FDIs.

The BRICs also wish to make a public impression and become more recognized on the political world stage. If they get the recognition of global institutions, it could significantly strengthen their political position and also send a signal to major economies about the political power shifting eastwards, in the case of China and India, obviously.

The bail-out could have an indirect negative impact on the Eurozone. If large bail-outs by BRIC countries take place, this could potentially cut the European trade surplus. If China starts to sell U.S. Dollars to buy euros, the price of the euro, obviously, increases. In other words, exports would become more expensive making exporters, particularly from Germany, less competitive. In other words, Europe would actually add economic problems by being bailed-out by the BRIC countries.

3) What do you think might be the conditions for the bail-out if it takes place? Will the BRIC countries manage to use the situation for their benefit in terms of trade conditions, access to technologies?

It would help all BRIC countries to buy the goodwill of the policymakers around the world. A potential intervention would increase trust and one might speculate that it would allow the BRIC states to purchase quite sensitive assets such as technologies from the Eurozone later on. For instance, consider that the EU officially still has an embargo on China regarding arms trade, which was established after what happened on Tiananmen Square in 1989.

Furthermore, the Chinese, principally, seek a change of perception. They desire to be perceived as a major force in the global economy which is able to provide stability of global markets.