

No BRICS Rescue for the Eurozone

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SEP 27, 2011

Brazil's ambitious attempt to forge an internal consensus within the so-called 'BRICS' grouping for a timely financial intervention to save Europe's diseased southern economies has gone nowhere.

The finance ministers of the BRICS nations – Brazil, Russia, India, China and South Africa -- just met in Washington D.C. to discuss this idea, but Beijing, New Delhi, Moscow and Pretoria have poured cold water on Brasilia's proposal for coordinated bond-buying from the Eurozone's fiscally weakest governments, Greece, Spain and Italy.

That outcome reflects the varied economic structures, conditions and models that prevail in individual BRICS nations. Brazil holds nearly 80 percent of its US\$352 billion foreign exchange reserves in US dollars and is nervous about the growing levels of public debt in the American economy. It seeks diversification of its reserves away from the dollar and is hence calling for the BRICS to pool their capital and announce a big bond-buying spree for the Eurozone's weak links.

Brazil's calculus dovetails with that of China, which has been making similar noises about the unreliability of the US dollar. With US\$3.2 trillion in reserves, only 25 percent of which are held in euro-denominated assets, China has room aplenty to acquire bonds of European countries like Italy.

When Chinese premier Wen Jiabao expressed willingness to lend "a helping hand and increase our investment in the European economy" at the recent World Economic Forum annual meeting in Dalian, he clearly had diversification of reserves in mind along with concerns about falling European consumption of Chinese exports.

Yet, one sees a rare divergence of views within the Chinese establishment on the wisdom of buying bonds from European economies that resemble sinking ships. The lack of foreseeable growth prospects in the Eurozone's southern economies make them risky bets. Chinese citizen bloggers have been posting angry messages on management of foreign reserves, railing against investing in the Eurozone that is "influenced by political factors, and not on market fundamentals.

Serious weighing of pros and cons of buying Italian Euro bonds is underway in China, attesting to the genuine fear that there is, as yet, no well-developed alternative to the US dollar for safekeeping of one's reserves.

India falls in this same band of uncertainty. Its official comments on Brazil's Euro bond-buying idea have been lukewarm. With only 20 percent of its US\$320 billion foreign reserves in Euro-denominated assets, India has room to buy bonds of cash-strapped European countries. However, The Economic Times quoted an Indian finance ministry official as saying that "we will maintain the 20 percent ratio."

India's economic growth forecast has been marked down in the last few months to less than 8 percent by many analysts, showing that the renewed global downturn has not left it untouched. Yet, as is the reflex reaction in a period of anxiety, Indian authorities are sticking to the safety of the dollar. In any case, like South Africa, which has only US\$50 billion in foreign reserves, India is a relatively small player to execute systemically sizeable bond purchasing of Eurozone countries' debts.

Russia too has rebuffed the Brazilian proposal for concerted BRICS action to buy Euro-denominated debt. Some 45 percent of Russia's foreign reserves of US\$543 billion are already held in euros and its European strategy is less centered on the continent's southern economies and more on Germany, which is the nodal recipient of Russian gas through the newly launched Nord Stream pipeline. If at all Russia were to buy more bonds from a European country, it would be German euros, not those of Italy, Spain or Greece.

Should the 17 member states of the Eurozone overcome objections within their domestic political arenas and issue 'Eurobonds' guaranteed by the whole group, BRICS countries would find them more attractive vehicles to invest their reserves.

Ironically, Brazilian President Dilma Rousseff has been alert to dangers of "excess liquidity" and inflow of hot money from rich nations. Private wealth, including that from the Euro zone, is flowing in the reverse direction, i.e. away from the OECD centres and towards BRICS. To wish for public wealth to go in the opposite way (towards Europe) is to vainly hope that governments are less savvy than private investors when it comes to return-on-investment calculations.

Unlike private investors, governments do have one additional variable to consider when deciding where to place their reserves— political influence and image as 'responsible' actors who come to the aid of the ailing. A private pension fund's moral compass is distinct from that of a sovereign wealth fund. The latter is motivated by competition for security and prestige with other states, geopolitical spaces that need to be filled, leverage and quid pro quos that can be extracted in other spheres for investing one's reserves. It is because of these factors that we hear China and Brazil talking up the possibilities of buying more European bonds.

Misalignment between private capital and public capital is a structural problem that is skewing the global economy. Can advanced economies restrict the outflow of private capital seeking higher interest rates in emerging economies? If money can stay at home and be channeled into buying public debt, it would be beneficial for calming choppy macroeconomic seas in the EU and the US.

Western corporations sitting on trillions of dollars of cash are not doing their bit at all in boosting employment or bailing out governments of advanced economies that are in hock. If giant Western companies share the burden of debt restructurings in the countries where they are headquartered, money from BRICS sovereign funds would not even be needed.

Restrictions on capital movements saved Malaysia in the late 1990s and could do the same in the US and the Eurozone. But it takes political will to force big businesses to buy local public debt in the interests of overall macroeconomic stability of the OECD countries. Private capital does not have nationalism, but it must be controlled to prevent disasters in the making such as a possible collapse of the euro. Capital which is several times the combined weight of the BRICS' foreign exchange reserves can be brought to revive the Eurozone if only highly profitable transatlantic corporations can be induced to buy European bonds.

In November 2010, the billionaire private investor Warren Buffett authored an article to profusely thank 'Uncle Sam' for the expensive bailouts which prevented corporate America from caving in during the financial meltdown. It is now apt for the US and European governments to demand a payback in the form of their corporations buying local public debt.

The Japanese model of locally headquartered companies buying their own government's bonds is more viable for the Eurozone than to expect the parachute to materialize from the BRICS. Unless risks and losses are privatized, the "lesser depression" (as the current global slump has been described by economist Bradford DeLong) will keep extending the pain.

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