



Europe vs. the Rest of the World

Edwin M. Truman explains why the proposal for an IMF bailout fund for Europe has pitted a dithering European leadership against the United States and the rest of the world.

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Steve Weisman: Can the International Monetary Fund come to the rescue of Europe and should it come to the rescue of Europe? Ted Truman of the Peterson Institute for International Economics is here with me, Steve Weisman, to answer that and other questions. There have been reports this week that the IMF is readying a package for Europe. How would that work and will it happen?

Ted Truman: On the first question, what is being proposed is that the International Monetary Fund will go out and try to raise up to \$600 billion of financing. However, we don't know any of the details of this proposal because the Fund has not yet released the paper that the IMF Executive Board discussed. All we know are the broad numbers. From various leaked reports, the idea seems to be that the Europeans would contribute half the money and the rest of the world would contribute the rest of the money, \$300 billion each. To your second question, will it happen? My short answer is no, because A) I'm not sure the Europeans could come up with another \$100 billion -- they've essentially committed to \$200 billion -- that the Europeans, meaning the eurozone countries, will come up with another \$100 billion. I'm not sure that the rest of the world will want to come up with more themselves because the rest of the world, I think, wants Europe to do more on its own -- without using the International Monetary Fund -- to help themselves. I think it's nearly unanimous in official circles outside of Europe that Europe has not done enough on its own.

Steve Weisman: Why would the Europeans need the IMF? If they raise money themselves, why do they need to funnel it through the IMF?

Ted Truman: The advantage to the Europeans is that they actually don't lend directly to Greece, or Italy, or Spain, but they lend to the International Monetary Fund and therefore, they share with other members of the International Monetary Fund the credit risk associated with lending to Italy or Spain, which is really the issue at this point. From the standpoint of the other members of the Fund, they say: "Why should we take on some of your credit risk when you should be helping yourselves?"

The other part of it is that Europe is imposing huge economic and financial costs already on the rest of the world. We're facing the risk of a global recession. The IMF forecast will be marked down substantially when it's released next week, and that's largely because of what Europe has been doing to the world. And the rest of the world is quite unhappy with that posture. So a part of the money is actually to protect the rest of the world from the spillovers from the mishandling of the euro debt crisis.

Steve Weisman: You keep referring to "the rest of the world." What's the US posture on this IMF proposal?

Ted Truman: The Treasury Department has announced—though again, they didn't put it on their website so you only can read it in the newspapers—that they will not contribute to this

effort by the Fund. That's traditional. We have historically not contributed to special ad hoc efforts to lend to the Fund because that requires Congressional approval. But my understanding is that the United States is quite skeptical about the whole project and spoke against it in the discussions in the executive board. It is deemed inappropriate.

Steve Weisman: Is that because the US also feels that Europeans are not doing enough for themselves?

Ted Truman: Precisely. I think they think it's not doing enough for themselves and until and unless Europe does more to help themselves, the United States should not be supportive of an effort to help Europe. Whether that is wise, given that you're also helping the IMF to help non-Europe, is an important question. I think the case for helping the rest of the world is much stronger than the case for helping Europe.

Steve Weisman: If European dithering is endangering the global economy, isn't the US opposition to an IMF role here cutting off our nose to spite our face?

Ted Truman: I think that is a big risk. If I understand the US position correctly -- that we are at best skeptical, if not opposed, to this effort -- then I think that there is a risk that we will be playing chicken with the Europeans and saying, "We won't help Europe until Europe does more to help themselves." We may be adversely affecting the rest of the world, including ourselves. And as economic activity weakens in China and Korea and India and Brazil, it affects the US economy. The spillover effects from Europe on to the rest of the world impact adversely the United States both directly and indirectly. It's not so clear that some form of support mechanism for the rest of the world is not appropriate.

Steve Weisman: A few years ago, when this recession began, the whole world was ganging up on the United States and blaming it for its mistakes. Now, you say everybody is upset with Europe. Who's upset? The Chinese? The Koreans? The Japanese? The oil producers? All of the above?

Ted Truman: I think it's pretty much all of the above. The people I've talked to, officials, whether executive directors of the Fund or deputies or Central Bank officials or finance officials in various meetings I've been at over the last couple of months -- to a person they say they were unhappy with what Europe is doing to us. I think the Europeans don't completely understand that issue and indeed some of them weirdly say, "Well, it's actually the United States' fault, because if the United States hadn't caused the global financial crisis, then we wouldn't be in this mess." There's a lot of finger pointing across the Atlantic. There's a chill in terms of European-US relations, and maybe, as usual when chills take place, there's probably some blame on both parts. But I think the Europeans haven't absorbed the extent to which they have lost standing and credibility in their handling of this crisis, which is now entering its third year.

Steve Weisman: Our director and colleague, C. Fred Bergsten, maintains that the world should watch what the Europeans do, not what they say. The Europeans can't be seen as stepping up to the plate because that would reduce the incentive for the troubled countries to do the right thing. What do you make of that argument?

Ted Truman: It may well be the case that, as Fred Bergsten argues, in the end this will cause Europe to bind itself together in a more coherent way. In fact, that's the positive. But the fact is that the world is paying a very high price in terms of reduced economic activity to solve an intra-European problem. Moreover, the argument of watching what we do and not what we say, I think,

is politically very dangerous in a democracy. The central point is communication with the people. If the communication with the people is saying one thing and you actually do another thing, I think you have a political problem within Europe as well as with the rest of the world.

I think that's a very dangerous political strategy, if indeed they're going to promise not to do X and then do X. If they promise not to bail out Italy, but in the end, if they have to, they will bail out Italy. That seems to me an invitation for the people of Europe to say, "You promised one thing and flip-flopped," as we say here in American politics. I think there's some considerable risk in terms of that strategy. I have no doubt that in the end, the Europeans will do whatever it takes. [But] maybe they wait too long and things get even worse and worse. The truth of the matter is they've been trying to do whatever it takes for two years and things have gotten progressively worse for two years. So far, what they say and what they've done have not produced any positive results, other than avoiding a complete and total catastrophe.

Steve Weisman: But it sounds like you think that the US has been passive and perhaps should be more proactive. On the other hand, every time the US tries to exercise a more forceful role, the US gets beaten up on by the Europeans asking them to butt out.

Ted Truman: I think that's right. The administration has been very active in trying to coax and cajole, if not threaten the Europeans to do the right thing or do more of the right thing. Many of the Europeans have taken umbrage at being lectured at by the United States. But broadly, I think, the rest of the world -- the non-European part of the world -- has thanked the United States for trying to convince the Europeans to do the right thing. The question is at what point do you say, "Well, even though you won't do the right thing, we're going to help the rest of the world protect itself from the damage that you're inflicting on them?"

Steve Weisman: How could we protect the rest of the world?

Ted Truman: By being a little more supportive of this effort to raise money. We could go to Japan and China and the oil producers and explain, "We can't participate in this special financing for the International Monetary Fund. This is an election year and we have to go to Congress. Normally in the past, we have not participated in this manner. We have been doing other things -- like the Federal Reserve lending money to European banks -- but we think it's important for the world that the IMF play an increased role in this case and, therefore, we support your lending to the fund."

Steve Weisman: You would like to see the US do that?

Ted Truman: I think at this point, we have really no choice. And probably just like the Europeans, if things get bad enough, no doubt, we will change our position and we will endorse the funds coming to the rescue. But again, it'll be only after there'll be a lot more damage to the global economic and financial system.

Steve Weisman: Once again, exhausting all alternatives before we do the right thing.

Ted Truman: Precisely.

Steve Weisman: Thanks, Ted.

Ted Truman: My pleasure.

