Europe finds its clout receding as debt crisis menaces the globe

WASHINGTON

BY ANNIE LOWREY AND JACK EWING

Europeans may discover this week that the debt crisis is not only threatening the euro zone economy and the integrity of the common currency, but also diminishing Europe's influence in world affairs.

For the second year in a row, Europe's problems are the major preoccupation as government officials and monetary policy makers gather in Washington for the spring meetings of the International Monetary Fund and World Bank, which begin Friday and last through Sunday.

Europe is the "epicenter" of the crisis, said Christine Lagarde, the managing director of the I.M.F. and a former French finance minister, calling for European leaders to encourage growth, strengthen their bailout fund and recapitalize banks.

The failure of European leaders to convince the rest of the world that they have a grip on the crisis is more than just embarrassing. It may also give them less weight in debates on other issues, and hasten the shift of power away from developed countries and toward

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FUND STRUGGLES WITH COHESION

The I.M.F. may emerge from its meeting with more firepower but less force, James Saft writes. *PAGE 18*

Europe facing scorn and loss of influence

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cash-rich and fast-growing emerging countries, like China, India and Brazil.

"Certainly the crisis in Europe has unveiled a structural shift of power from advanced countries to emerging markets," said Thomas Mirow, a German who is president of the European Bank for Reconstruction and Development, which lends to countries in the former East Bloc as well as newly democratic Arab countries. "This is one of the big themes of the 21st century."

Outside Europe, there remains concern that the Continent's problems are undercutting world growth, and distress about the perceived shortcomings of the European policy response.

In a measure of how widespread that concern is, one question at an I.M.F. briefing this week came from a journalist from Jamaica who asked whether Europe's problems could spread to the Caribbean, where Spanish companies own many of the hotels.

In a session with reporters, Zafer Caglayan, the Turkish economy minister, chalked up his country's slowing growth to failed leadership from Paris and Berlin. "Europe is obviously in deep trouble economically," he said, speaking through an interpreter. President Nicolas Sarkozy of France and Chancellor Angela Merkel of Germany "unfortunately did not show adequate resistance" to the crisis, he said.

The I.M.F. and World Bank themselves have repeatedly chastised European leaders for acting too slowly to quiet markets and for cutting budgets too quickly, weakening economic growth around the world and contributing to an unemployment crisis across the Continent.

Elected European officials do not seem to enjoy the attention that is being directed at them, along with the advice that comes with it. For example, Olivier Blanchard, the I.M.F.'s chief economist, said this week that euro zone members should consider issuing bonds backed by all members, a proposal that is profoundly unpopular among Germans who do not want to underwrite borrowing by countries like Italy.

Ms. Lagarde is pressuring Europe to make changes to its bailout fund so that it can lend to financial institutions, not just countries, as I.M.F. economists warn that rapid deleveraging by European banks might destabilize financial markets in the next 18 months. The bailout fund, as currently constructed, "could actually help in terms of recapitalization anywhere in the euro zone," Ms. Lagarde said Thursday. "What we are advocating is that this be done without channeling through the sovereigns."

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Christine Lagarde, managing director of the International Monetary Fund and a former French finance minister, has called on European leaders to revive growth, strengthen their bailout fund and recapitalize banks. Europe is the "epicenter" of the crisis, she said.

German representatives, in particular, are likely to get an earful in Washington. They will be told they should moderate their insistence that euro zone countries like Spain or Greece adhere to strict austerity programs.

Traditional stimulus programs are probably out of the question because most governments simply do not have the money, many economists and officials say. But during an interview, Robert B. Zoellick, the departing president of the World Bank, said there were other alternatives to spur growth in troubled countries. For example, the European Union could make it easier for workers in countries with high unemployment, like Spain, to move to places like Germany, where there are skills shortages. Germany and other countries could also ease regulations that make it difficult for small businesses to offer services across borders, he said.

"I'm saying, 'Take your own integration seriously,'" Mr. Zoellick said by telephone.

There were signs of annoyance in Berlin this week about prescriptions from outside Europe.

"We don't believe the euro zone and the European growth outlook should constantly and exclusively be in focus," a senior Finance Ministry official said Tuesday at a briefing for journalists in Berlin. "That's an important point, but other regions of this world also require our attention."

The official, who spoke on the condition of anonymity in keeping with ministry policy, also dismissed the notion that Europe needed stimulus. "We don't see the need that perhaps other countries see, to stimulate growth through further spending increases," he said.

In what could be seen as a sort of counterthrust, German officials plan to point out what they believe are policy failings by the United States and other powers. For example, the senior official said, Germany would urge other countries to stay the course on regulation of banks and financial markets.

But Europe may have less moral authority to press its views on such issues given that it is also asking the I.M.F. for more money to ensure against a deepening of the euro zone crisis. This winter, the I.M.F. agreed to raise new lending resources — but only if European leaders bolstered the euro zone bailout fund comparably. In March, European leaders agreed to increase the lending capacity of their mechanism to €800 billion, or about $1 trillion, from €500 billion.

That opened the door for other countries to contribute new resources to the I.M.F. Countries in the euro zone had already pledged about $200 billion. This week, other I.M.F. members joined them. Japan pledged $60 billion. Norway, Sweden and Denmark, none of which are members of the euro zone, promised an additional $26 billion. Poland and Switzerland have also agreed to pitch in.

Big emerging economies, like India, are expected to make contributions as well. That is a sharp break from past practice, when emerging countries were usually borrowers from the I.M.F. and richer countries were the lenders.

It will inevitably sharpen the debate about the role of emerging nations in running the I.M.F. and World Bank, both of which have traditionally been dominated by the United States and Europe.

"It will be impossible to have this discussion without thinking about broader governance," said Jacob Funk Kirkegaard, a research fellow at the Peterson Institute for International Economics in Washington.

Cash-rich emerging economies like China and Brazil have withheld making new contributions thus far, believing that larger contributions should bring them increased voting power within the fund.

Europe has made progress since the I.M.F. and World Bank meetings a year ago. Then, some top officials spoke of the euro zone being on the brink of dissolution. There was fear of a chaotic Greek default on its debt or the collapse of a major euro zone bank. Greece has since agreed on a debt-reduction plan with creditors, and the European Central Bank has eased concern about banks by lending them €1 trillion for three years on easy terms.

But other problems have gotten worse, like the unemployment rate, which is at a record high of 10.8 percent in the euro zone.

"Compared with autumn last year there has certainly been a gradual improvement," said Mr. Mirow of the European Bank for Reconstruction and Development. Since early 2011, he said, "things have not improved and maybe have even darkened." The crisis has spread further into Eastern Europe, he said, because most banks there are owned by hard-pressed West European institutions.

The unemployment problem can be fixed only by increasing the potential for countries like Spain and Italy to grow and compete in world export markets. Europe's allies understand that remaking an economy takes time, Mr. Kirkegaard of the Peterson Institute said, but can be expected to push the Continent to pick up the pace of change.

"There is an increasing realization that the kinds of issues the Europeans are dealing with are not something you can fix in a couple of months," he said. "That doesn't mean the Europeans won't be told they need to do a lot more to improve the short-term growth outlook."

Jack Ewing reported from Frankfurt. Nicholas Kulish contributed reporting from Berlin.