29 March 2012

Leverhulme Centre
for Research on Globalisation and Economic Policy

Wolf warns against eurozone 'nightmare'

Breaking up the eurozone would represent a "nightmare" scenario and lead to another major financial crisis, one of the most influential voices in economics has told an audience at GEP.

Financial Times Chief Economics Commentator Martin Wolf predicted the risk of a break-up would remain "significant" in the coming years but said such a course should be resisted.

Delivering a *Leverhulme Globalisation Lecture*, Wolf – often described as the world's pre-eminent financial journalist – suggested it could take a decade for the eurozone to return to health.

He said: "I've always thought creating the euro was not a very good idea and that including all of Southern Europe, all those incredibly divergent economies, was a mad idea.

"The basic problem was clear, and I wrote about this more than 20 years ago. But the fact that it wasn't a great idea to create it doesn't mean it's a better idea to break it up.

"I think the economic and political costs would be formidable. There's no way of breaking up the eurozone that doesn't risk a devastating financial crisis. It would be a really big mess.

"In the short term it would certainly cause a huge recession. So going in wasn't very bright, and it was managed badly for a variety of reasons – but breaking it up would be a nightmare."

A frequent and popular contributor to the *Leverhulme Globalisation Lecture Series*, Wolf was delivering an address entitled *The Shifts and the Shocks: Prospects for the World Economy*.

The title is derived from a recent National Bureau of Economic Research paper by Professor Douglas Irwin, of Dartmouth College, and Professor Kevin O'Rourke, of the University of Oxford.

Wolf said the growth of emerging economies during the late 20th and early 21st centuries resulted in the "precise inverse" of what most economists might have expected.

With new markets and investment opportunities opening up, it was reasonable to think capital would flow from the developed world to its emerging counterpart – but the opposite happened.

The Asian financial crisis of 1997 was crucial in persuading many developing economies, China chief among them, that they should become capital exporters, said Wolf.

Martin Wolf

Martin Wolf was joint winner of the Wincott Foundation Senior Prize for Excellence in Financial Journalism in 1989 and 1997. He won the RTZ David Watt Memorial Prize in 1994, the Accenture Decade of Excellence award in 2003 and a Newspaper Feature of the Year award in 2003. In December 2005 he was given *First Magazine*'s Special Advocacy Award, and in January 2008 he won the AMEC Lifetime Achievement Award at the Workworld Media Awards.

Wolf was named Commentator of the Year at the 2008 Business Journalist of the Year Awards and was also placed among the world's 100 leading public policy intellectuals by the British magazine *Prospect* and the US magazine *Foreign Policy* in May 2008.

The shocks that followed the shift have left the likes of the UK in a "contained depression", he said, adding: "Between 40 and 50% of the world economy is affected by crisis conditions.

"We now a live in a world where the highest rate of interest offered by any major Central Bank is 1%. This has never happened before. This is a world we've never known before."

The present crisis represents one of the most dramatic in UK fiscal history, with only the Napoleonic War, World War One and World War Two having a greater effect, said Wolf.

He described the UK economy as among those "languishing", adding: "It has effectively not grown since the third quarter of 2010. There's not the slightest sign of growth. It's stagnant."

Wolf blamed the eurozone crisis on the "huge divergences accumulated in the years of excess", pointing to the "enormous deficits" amassed by nations such as Spain, Portugal and Greece.

It was extraordinary, he said, that until the crisis struck in earnest the sovereign credits of such countries were treated exactly like those of a powerful economy such as Germany.

He warned: "If there is a sovereign default there will be a financial catastrophe of the first order. Many of the world's biggest banks will go down. It's an horrendous prospect."

Hopes of a general recovery have suffered a "massive reduction in optimism" during recent months, he said, and economies such as Spain and Italy could shrink by 4% in the next two years.

Wolf predicted the US would prove the most dynamic of the major economies in the years to come but cautioned that growth in high-income countries would generally remain weak.

He also suggested emerging economies would continue to grow quickly but added that these, too, could face the threat of a crisis now that finance is flowing towards them.

He said: "The crisis started in August 2007 and is still with us. This is a very long time for a financial crisis. The only comparable experience in terms of duration is the 1930s."

Asked if economies such as the UK should abandon fiscal austerity, Wolf argued that the government should have been more flexible in its approach from the beginning.

Accusing policymakers of becoming trapped by their own rhetoric, he said: "I tend to think that the trick is to have more flexibility in the short run and credibility in the long run.

"Now the government is stuck, so we just have to hope for something to turn up – and I'm not hopeful. We're living in extraordinary times and don't really know where we're going to end up."

Globalisation and Economic Policy Centre (GEP)

Based at the University of Nottingham in the UK and primarily funded by grants from the Leverhulme Trust, GEP is the major centre in Europe studying the impacts of globalisation and economic policy.

In January 2008 it opened GEP in Malaysia at the University of Nottingham's purpose-built Semenyih campus, 30km from Kuala Lumpur. In November 2008 it launched GEP in China at the University of Nottingham, Ningbo, China.

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