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The Bankruptcy of EU's No-Default Policy

By Boris Kagarlitsky

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The European elite are more afraid of defaults than Russians are of revolutions.

The European Union will avoid a default at any price, even if it means completely destroying a country's economy and impoverishing its people, effectively dismantling the government if necessary and handing companies, territory and natural resources to foreign companies.

It is now apparent that the banking systems and governments in several countries in Southern Europe are basically insolvent, and declaring bankruptcy is the only real option available to solve their problems. Of course, that would lead to the collapse of the euro zone, but that is not as terrible as it might sound. Similar crises have occurred repeatedly in history, and it is definitely not as bad as the fallout from the convulsions and losses caused by a policy of "no default at any cost."

The solvency crisis has become a disaster that has moved from one part of Europe to another.

The moment one country announces that it has "saved itself" through heroic efforts and at great sacrifice, a new crisis crops up somewhere else. The movement of the crisis from country to country is connected with the flow of speculative capital that moves across continents and around the world. Only a comprehensive ban on speculation or the nationalization of those funds is capable of putting a stop to the practice. But the problem is that powerful financial interests that effectively control the governments in most countries of the world do not permit this solution and therefore block the only way out of the crisis.

Moscow was also slow to recognize the scale of the threat and failed to extend assistance when the situation was still under control. The Cyprus default occurred at the very moment that the government was forced to freeze all banking operations.

If the banking freeze had lasted for one or two days, it would have been possible to take some form of corrective action. But it turned out to be impossible to adopt and implement a plan to save the economy in such a short time. The problem was not the amount of money needed for a bailout. The Cypriot crisis clearly showed that time is money. The critical, priceless hours were lost, and no infusion of cash can compensate for them now.

There is nothing left to save in Cyprus. The banking system is in a state of coma, and it is no longer possible to bring it back to normal health. Cypriot banks are scheduled to reopen on Thursday, but it is already clear that simply unfreezing accounts after a two-week banking hiatus will not work. Even without a run on the bank, the size and number of simultaneous withdrawals far outstrips normal activity, thereby automatically triggering yet another banking crisis.

For years, many in the West have criticized Russia for its lack of private property protections, while praising "civilized, law-abiding Europe" for guaranteeing those sacred protections. Now everybody can see that this is not the case.

No matter how painful it is for the reputation of the euro zone and for Russian businesses and depositors, the collapse of the Cypriot economy might serve as a valuable lesson to help improve the international financial system. Governments have long wanted to do something about offshore companies but were powerless to take action. Now the crisis has caused those same offshore interests to self-destruct. The capital that does survive will flee to developed industrial countries where it will be taxed and lead to more economic development.

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