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Much left undone in E.U. bailout

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INSIDE EUROPE

PARIS Unlike Schubert's "Unfinished Symphony," Europe's incomplete "comprehensive response" to the euro zone debt crisis is unlikely to be rated a masterpiece.

When European Union finance ministers complete a package deal this week to tighten fiscal discipline, improve economic policy coordination and strengthen financial backstops, they leave much unfinished business.

The ministers of the 17 nations that make up the currency bloc are likely to be back in crisis management mode within weeks to bail out Portugal, despite Lisbon's feverish efforts to avert a humiliating international rescue.

"The relative calm now prevailing in euro zone financial markets should not deceive us," said Marco Annunziata, chief economist at General Electric.

"Investors have given them the benefit of the doubt, but if E.U. leaders fail to deliver, tensions will surge anew, jeopardizing the recovery," he wrote in a syndicated column for the economic Web site Eurointelligence.

After a deal reached at a March 11 summit meeting to increase the lending capacity of the euro zone rescue fund and allow it to buy the sovereign bonds of distressed countries in the primary market under strict conditions, the consensus among bank economists was that leaders had done enough to stabilize the euro.

But Portugal is only one of a string of problems that euro zone members left unresolved and that may return to haunt them.

Those issues include the long-term solvency of Greece and Ireland, the solvency and resistance of Europe's banking system, the implementation of tough austerity programs and a widening growth gap between core members of Europe and those on the periphery.

There are also tricky detailed questions of who pays what and how to finance the euro zone's temporary and permanent rescue mechanisms, which could get snagged in domestic politics in Germany, Finland and the Netherlands.

Ireland's new government, elected on a wave of public anger over the bailout last year from the European Union and the International Monetary Fund, will have to make some concessions to Germany and France on bringing the corporate tax base in the euro zone into line with them if it wants the interest rate on its emergency loans reduced. Any agreement could affect Ireland's low 12.5 percent corporate tax rate.

Greece, which has stuck to a draconian austerity program adopted last May, won a reduced interest rate and an extension in the maturities of its euro zone loans by promising to implement a €50 billion, or $71 billion, privatization program.

With a lot of self-help from Madrid, E.U. leaders may have succeeded in erecting a firewall to prevent bond market contagion from spreading beyond Portugal to the far bigger economies of Spain and Italy.

"We are not yet fully in safe waters, but we have made headway," said an E.U. official who is at the heart of the firefighting.

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If the euro zone can also quarantine the three economies in intensive care, it will have bought time to repair its ailing banks and enable them to withstand a possible restructuring of Greek or Irish debt after 2013.

That is the task of Europe-wide stress tests that began last week. But euro zone members are still haggling over how to measure adequate capital reserves in banks, and Germany, suspected of having some of the biggest problems in its regional landesbanks, is resisting pressure to set aside funds to recapitalize them.

While the European Central Bank has repeatedly warned that a default by any euro zone member would have catastrophic consequences for the European financial system, E.U. leaders have stopped short of making a clear commitment to prevent one.

Indeed some German officials, speaking on condition of anonymity, share the view of most market analysts that

THIERRY ROGE/REUTERS

The Irish finance chief, Michael Noonan, left, with Wolfgang Schäuble of Germany.

Greece's debt burden is unsustainable in the long run and will have to be restructured. They just do not want it to happen now, when German lenders are so weak.

This raises at least two major uncertainties — a political one and a financial one.

The political question is how long voters in Greece and Ireland will go on enduring grinding austerity and recession if they come to believe their suffering is being prolonged to spare German, French or British banks from taking losses.

At the same time, there is growing public fury in the euro zone's wealthy northern countries at being asked to put ever more money on the table to back the currency zone's weaklings.

The financial question is who will buy Greek or Irish bonds starting in 2013, when they are due to return to the market and are likely to carry an E.U.-imposed condition opening investors to sharing losses incurred in defaults.

E.U. leaders have kicked those issues down the road by agreeing to a minimalist fix now. Chancellor Angela Merkel of Germany and President Nicolas Sarkozy of France may be calculating that they can avoid more unpalatable solutions until after their next elections.

But their "Unfinished Symphony" ensures that the euro zone debt crisis will continue to fester for years to come.

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