

GLOBAL INSIGHT

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# Merkel's intransigence is a way of playing for time over a question of survival

139

By Quentin Peel in Berlin

For the umpteenth time in the two-year-old eurozone financial crisis, Germany seems to be stubbornly resisting a plan that most of the rest of the world seems to think is a no-brainer.

Angela Merkel, Germany's chancellor, has always rejected the need to create a "bazooka" to impress the financial markets, in spite of urgent appeals from the likes of Tim Geithner, US Treasury secretary, and David Cameron, UK prime minister.

But now she is up against more than an Anglo-American conspiracy. She faces pressure from Christine Lagarde, managing director of the International Monetary Fund, the Bric countries in the G20 and most if not all her 16 partners in the eurozone. Others may hint at flexibility, but Ms Merkel refuses to budge.

Is she playing for time to persuade a hostile domestic constituency, or adopting tough tactics to put pressure on her partners? Are there internal divisions in Berlin, or is this a position of principle? Close inspection suggests it could be a bit of all those things.

The proposal is to increase the eurozone "firewall" against contagion by combining the resources of the two rescue funds set up to provide emergency assistance to partners in the common currency.

Ms Lagarde has talked of Europe having to impress the markets. Europe could come up with €1tn by adding the €250bn left in the temporary European Financial Stability Facility (after the programmes agreed for Greece, Ireland and Portugal) to the €500bn in the permanent European Stability Mechanism due to come into existence this year. If the eurozone acts, the IMF might come up with an extra \$500bn, taking its firepower to \$1tn.

Officially, at least, Berlin begs to differ. Any increase above €500bn in the overall ceiling on both "firewall" funds is simply "not necessary", say senior officials.

Wolfgang Schäuble, Germany's finance minister, repeated that line in Mexico at the weekend. He also warned his fellow G20 finance ministers that the move might create "disincentives" for countries such as Italy and Spain to put their own houses in order.

Yet Germany has agreed to discuss the size of the firewall in March – although not necessarily in time for a decision at this week's European Union summit in Brussels. And Mr Schäuble has publicly admitted that combining the resources of the two funds would be “one possible solution to the question”. Legally, it looks manageable, even under German law.

Berlin's position is a matter of both politics and tactics, combined with a deeper-seated suspicion of any solution that might result in throwing more billions of taxpayers' money into the financial markets.

There is certainly a political price to pay. Ms Merkel faces a revolt by some of her own supporters in the German Bundestag. Public opinion is also hostile. Bild, the country's largest-selling newspaper, screamed “Stop” across its front page on Monday, urging the parliament to reject the latest Greek rescue programme.

There is a very real risk that Ms Merkel would lose her 20-seat majority, and endanger her government, if she were to propose topping up the rescue funds at the same time as backing the latest Greek bail-out.

Tough tactics are also in play. Mr Schäuble insists the EFSF and ESM were never intended to be big enough to rescue Italy or Spain: the whole point was to force those countries to put their budgets on a sustainable basis themselves.

There are differences, between those in the finance ministry who say the money will never be needed, so why not agree, and those who believe it is a fundamentally bad idea to provide such vast guarantees. They worry about the long-term inflationary risks.

But tactics seem paramount and the real question may be timing.

Berlin is waiting to see if the Greek debt rescheduling attracts enough backing from private bondholders. It is analysing the bond markets to decide if Italian and Spanish borrowing costs remain under control. And it is waiting to see if the European Central Bank's bank liquidity measures continue to calm the markets.

Until she has assessed all the evidence, Ms Merkel will wait to decide if the political price is worth paying. She wants room for manoeuvre. She will not be rushed.

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