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Europe's bailout bazooka is proving to be a toy gun

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Welcome back to the crisis. And it's set to get worse once the markets discover that the eurozone is about to fudge the increase in the European rescue umbrella. The argument I am hearing is a wonderful example of circular logic: we don't need a bigger umbrella because market pressure has eased.

Well, the market pressure has gone up again recently. Investors are concerned about Spain. Over the weekend, Angela Merkel was preparing for one of her celebrated U-turns, by letting out a trial balloon in the German press that she would, after all, be ready to accept an increase in the rescue operation.

But the arithmetic is tedious and most statements you get obfuscate the issue through double-counting. The US and other members of the Group of 20 leading economies want the size of the eurozone's contribution of the total umbrella to be doubled from the current €500bn to €1tn. In that case, the International Monetary Fund would put up a further €500bn. To get there, the eurozone would have to do two things. First, it would need to merge the €440bn European Financial Stability Facility, the temporary umbrella, and its permanent successor, the European Stability Mechanism. Second, it will have to make the EFSF's share permanent because the EFSF is due to expire next year. Both of these measures would be necessary to reach a total of close to €1tn. But Ms Merkel is not going to offer that. Not even close.

As I understand it, she is ready to offer only a partial merger and only for a transitional period. Specifically, the Germans are proposing to tack on the existing commitments of the EFSF – the programmes for Greece, Ireland and Portugal – to the ESM. That would get us to a ballpark of €700bn. The trouble is that you cannot just add these numbers. Once the old programmes expire, they are gone. Any new money will have to come from the ESM. Over time, the ceiling will revert to €500bn. This deal would, at most, give a small, temporary increase in the ceiling.

Still, it would raise Germany's maximum risk temporarily from €211bn to about €280bn. This presents a huge political problem for the chancellor because it would require a vote by the Bundestag, which had previously agreed that the total liability of €211bn must not be broken. The €211bn figure has taken on symbolism in the German debate. Ms Merkel and other politicians have pledged many times not to break it. It is not clear she would get the support for such an increase. The CSU, the Bavarian wing of her party, is opposed. After Sunday's election in the Saarland, her coalition is facing an even bigger test in North-Rhine-Westphalia, which holds early elections in May. Remember, elections there messed up the first Greek programme.

A total merger of the EFSF and the ESM would raise Germany's risk temporarily to about €400bn. I find it hard to see how the German parliament would simply accept a near-doubling of the risk, after having been told time and again that this would not be necessary. And even this would not satisfy the rest of the world, since this is only a temporary increase.

The usual European response to such a stand-off is the use of creative accounting. I have heard the suggestion that one could "stretch" the callable capital of the ESM. That would leave the magic number of €211bn untouched. But it would also mean that the total rescue capacity can be no higher than €500bn at any time. The outcome would still look more like a toy pistol than a "big bazooka". It took the markets several weeks to understand the significance of the recent political and economic developments in Spain. It may take some more until Germany's stance on the ESM is understood.

But it is only if you consider the two together that the real significance becomes clear.

The current ESM is big enough to handle small countries, but not Spain. I expect Madrid eventually to apply for a programme, specifically to deal with the debt overhang of the Spanish financial sector. But even a minimally enlarged version of the ESM will not be big enough.

What this stand-off tells us is that we are approaching the political limits of multilateral programmes. If you want to claim funds of such size, you need joint and several liability – ie all eurozone countries need to be jointly liable – not individual liability among member states. Call it a eurobond, call it what you like. If you do not want that either, then you have to accept that there is simply no backstop for Spain. As I said, welcome back to the crisis.