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## Europe is distracted by endless firewall talk

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By Robert Zoellick

Now that the eurozone finance ministers have exhausted themselves with a multilayered package of hundreds of billions of euros, the debate will go global at this week's spring meetings of the International Monetary Fund and the World Bank. The next preoccupation will be how many more hundreds of billions of euros should be pledged to the IMF. It will be Firewall II: the Sequel.

Policy makers under pressure can get preoccupied with the fixation of the moment. For the eurozone, that *idée fixe* has been "the firewall". How big is big enough? Who contributes and how?

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I beg to differ. Not with firewalls exactly, but with the preoccupation.

The survival of the eurozone now depends on Italy and Spain. They are the countries that are too big to fail – or to rescue. Extraordinary action by the European Central Bank has lowered the interest rates that Italy and Spain pay on their debt, but not solved their problems.

In one sense, the much-badgered Germans are right. The fates of Italy and Spain depend on the steps their governments take to cut spending, reduce debt, strengthen banks and make structural reforms. Firewalls offer reassurance to markets, but the governments' action, their political support and the ECB's liquidity will be decisive.

The firewall preoccupation distracts from the fundamental issue: what should the EU do to help Italy and Spain retain political support for reforms? Structural steps are painful for any government. They are devilishly difficult without growth. Reforms can disrupt an economy for a time as investment, business and workers adjust.

In Italy, Mario Monti, prime minister, has begun an exemplary combination of fiscal consolidation and reforms of pensions and labour markets. But unemployment is rising. Will Italy sustain the politics of reform without supportive EU policies? Mariano Rajoy, Spain's prime minister, has set a similar course, but even modest concessions on the path to reduce the

deficit, combined with 23 per cent unemployment and challenges in elections and on the street, have prompted a rise in Spain's borrowing cost. The economics of adjustment and the politics of reform would be easier if Italy and Spain could be boosted by European growth.

Yet as one European told me, economics is a branch of moral philosophy in Germany, so do not expect expansionary demand policies to trump rectitude, discipline and belt-tightening. There is, however, a supply-side growth alternative: strengthening investment, the single market, and the EU itself.

Instead of quarrelling over firewalls, Europeans should add just a fraction – say €10bn – to the capital of the European Investment Bank. Under current conditions, the EIB may actually have to reduce lending. Instead, the EIB could use more capital to borrow and then invest to support structural reforms, showing Spaniards and Italians that their sacrifices will draw productive investments. The EIB is now even led by a talented German, Werner Hoyer, from the governing coalition. President José Manuel Barroso of the European Commission should also demand disbursement of the billions of euros of structural and cohesion funds that sit on its books while poorer parts of Europe go wanting; find the logjam and break it.

The single market – the very fibre of EU integration – could also come to the rescue. Although goods move freely in the EU, the service sector in many countries – including Germany – could open up more. Labour movement is also far more limited than in a true single market. Whether the cause is language, habits, matching jobs with workers, or cost of relocation, now is the moment to overcome the hurdles and advance the true unification of the EU. Show people who want to work that the EU wants them, too.

The combination of fiscal and structural reforms, EIB and EC investments, the opening of service markets, and easing the movement of workers will pay dividends. Mr Monti has travelled to Beijing to show China's sovereign investment fund that Italy is becoming a good place to invest. That makes more sense than lobbying the Chinese to add to firewalls, especially if the EU itself invests and makes the single market more attractive.

Firewalls have their purpose. But this debate risks becoming a distraction. Europeans and their partners need to keep their eye on the strategic *Schwerpunkt*: helping Italy and Spain with growth and the politics of fiscal consolidation and structural reforms that will boost business, competition and jobs. The ECB has done its work. The other institutions of the EU need a burst of activism on investment and strengthening the single market to preserve and secure their union.

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