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The G20 should say no to the eurozone

By Wolfgang Münchau

For anyone demanding a big bazooka, Friday was a disappointment. The finance ministers of the eurozone settled on one of the lesser proposals for an increase in the firewall. The agreement raises three immediate questions. How big is the firewall really? Will it all be enough? And should the Group of 20 leading economies top up their commitments to the International Monetary Fund?

Ignore the headlines. This is not an increase in the eurozone's rescue fund to €700bn. The reality is that the eurozone's new fund, the European Stability Mechanism, will have €500bn available for future crisis programmes. The €700bn is a meaningful metric only for parliaments of member states because it outlines their risk exposure. It is not a forward-looking measure.

The best aspect of last week's agreement was that it confirmed €500bn will be available, more or less, from day one of the next crisis. But behind that simple statement lies a complex construction where the unused funds from the old mechanism are used to balance a shortfall due to the gradual build-up of capital in the new one.

The essence of the new agreement, however, is refreshingly simple. The €500bn will have to pay for everything. The existing programmes continue but once they expire, or are restructured, any new funds will have to come from below this ceiling. You could say that the ESM was not really raised from €500bn to €700bn but from €300bn to €500bn.

How much will €500bn buy? If one assumes that the IMF will increase its share of the total package proportionately, the total available for new programmes will be €750bn. This would have to pay for second programmes for Portugal and Ireland, a third programme for Greece and probably a first and second programme for Spain (the first being a narrow one focused on the recapitalisation of the banking sector).

The enlarged ESM should be able to handle a subset of those, but will have no headroom left. If Spain were to fall into a deep and prolonged recession, as I expect it will, debt levels will rise and with them the eventual probability of a fully fledged programme. Once Spain is in that position, pressure on Italy and Belgium will rise as well.

The EMS enlargement – if you want to call it that – is big enough to deal with the immediate and the clearly foreseeable problems. But it is not of sufficient size to cope with more distant and unexpected events, which of course is its whole purpose.

Jens Weidmann, president of the Bundesbank, was right when he said you cannot solve the eurozone crisis through a rescue fund. But an enlarged ESM would have given the rest of the world reassurance that the eurozone is serious in its efforts to solve the problem. That is now not the case.

One reason for this exercise was to persuade the G20 to authorise a proportional increase in IMF support for the eurozone. Should the 20 nations agree, as eurozone leaders were quick to demand on Friday? I think not. The US and other member states have asked the eurozone to double the capacity of the ESM and raise its funds from €500bn to €1tn. This would have paved the way for an IMF contribution of €500bn. The combined size of the umbrella would have been €1.5tn, or roughly $2tn. That will now not happen.

Of course, you could always add up numbers that should not be added up. So if you count the €500bn of the ESM, €200bn from existing European Financial Stability Facility programmes, €49bn from another European Union-level programme and €53bn in bilateral support, you do arrive at €800bn, or "more than $1tn", as Friday's official statement helpfully explained. But this number is meaningless.

Last week the leaders of China, India, Russia, Brazil and South Africa expressed their frustration about the eurozone's policy response. This agreement is not going to put their minds at rest. The double-counting also leaves a bad taste. It reminds me of last year's disgraceful attempt to raise the lending ceiling through leveraging – something that surely deserves the title of the daftest idea in the politics of crisis resolution. Friday's agreement was not daft, simply too small. It should and will be understood as just that.

The truth is that eurozone capitals in general, and Berlin in particular, are politically not ready to commit more funds. Any observer of German politics would have known that. Chancellor Angela Merkel simply does not have a majority for a "big bazooka". She may even need a two-thirds majority in the Bundestag to get this agreement passed.

The G20 should tell the eurozone that Friday's deal is unacceptable. The idea of ESM enlargement was to provide a minimally sufficient degree of insurance to preserve the integrity of the eurozone in the most adverse situation. A €500bn ESM cannot do that. It is unreasonable to expect the rest of the world to make up the rest, especially given the negative impact of the eurozone's austerity programmes on the rest of the world. The G20 should instruct the eurozone to return to the negotiating table.

munchau@eurointelligence.com