E.C.B. chief critical of euro zone's leadership

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'Dispel this fog,' declares Draghi, calling structure of bloc 'unsustainable'

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BY JACK EWING

The president of the European Central Bank, Mario Draghi, warned Thursday that the structure of the euro currency union had become "unsustainable" and criticized political leaders who he said had been slow to respond to a regional debt crisis now well into its third year.

On the desperation scale, the plea by Mario Draghi to European lawmakers

NEWS ANALYSIS

Thursday was not on the same level as the genuflection to congressional leaders in 2008 by the U.S. Treasury secretary at the time, Henry M. Paulson Jr., who was begging them to approve a huge bank bailout.

But the note of frustration and urgency in Mr. Draghi's voice made clear that he was aware of the problems in the euro zone that he said only the member nations' politicians could now solve.

There have been many spikes in the euro zone's crisis fever in the past, of course, with a bailout here or a stopgap measure there seeming to calm things for a while. But this time, Europe may have reached a moment when the currency union's survival depends on a powerful, convincing response.

Greece, progenitor of the debt debacle, is in political turmoil once again, and this time it is in danger of dropping out of the euro zone altogether. Spain, with one of the region's largest economies, is in the grip of a banking crisis, and there is a growing sense that the danger to Spanish banks is of an entirely different order of magnitude from that in suffering but small Greece.

The clearest danger signal may be the euro currency itself. It is at a two-year low against the dollar, as investors who can do so are pulling money out of the euro region.

U.S. officials are also displaying increasing concern. President Barack Obama spoke with European leaders by video conference this week and the U.S. Treasury Department dispatched a senior official, the under secretary for international affairs, Lael Brainard, to Berlin and other European capitals to get the message across.

Mr. Draghi, in what may have been his bluntest criticism of political leaders since he took office in November, said Thursday that half-measures and delays had made the euro zone crisis worse. He said the leaders needed to decide what kind of euro zone they wanted, and fast.

"Dispel this fog," he said.

Mr. Draghi, a dignified Italian and economist by training, is not the type to go down on bended knee. But even if he were, whom would he beseech for action? At least Mr. Paulson, as head of a national treasury within a single government, knew whom to convince. The euro zone has 17 heads of government and 17 parliaments, not to mention the relative-

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ly powerless European Union executive branch and the E.U. Parliament that was Mr. Draghi's audience Thursday.

Mr. Draghi, in other words, was underscoring the differences between the European and U.S. financial systems that might explain why the United States was able to recover, however feebly, from its crisis by the end of 2009, while Europe's has no end in sight.

In some ways, in fact, Mr. Draghi may be the single most powerful figure in the euro zone drama, as head of the only institution with both huge financial resources and an ability to make decisions without a laborious political process. Government leaders, wary of the political cost, have looked time and again to the E.C.B. to deliver relief.

But Mr. Draghi said Thursday that the crisis now demanded solutions that could only come from political leaders — like creation of a Europe-wide bank deposit insurance program. Such a system, like the deposit insurance in the United States, would reassure bank customers that their money was equally safe in any euro zone country, and that might very well prevent the sort of money flight that is now sapping Spain. He also backed calls by European Commission leaders on Wednesday for a more unified banking system. But only the lawmakers of the euro zone countries could together create such a deposit insurance system.

"From the E.C.B.'s perspective, the next iteration of crisis management largely falls on the shoulders of member states," said Mujtaba Rahman, a euro zone analyst at the Eurasia Group. "Arguably all the incremental plays have been exhausted."

The E.C.B. has tools to spur governments to action but must use them carefully. Mr. Draghi can use rhetoric as he did Thursday. He also can use the E.C.B.'s role as lender of last resort to banks, which effectively gives the bank power of life and death over financial institutions.

That power was inadvertently on display Thursday. Mr. Draghi disclosed that the E.C.B. had resumed normal lending to Greece's four largest banks after they received a fresh infusion of European bailout money. That should at least temporarily ease fears of bank failures in that country before its election on June 17.

In May, the E.C.B. cut Greek banks off from credit because they had exhausted their capital reserves — their financial safety cushions — and were no longer eligible to receive the credit under the central bank's rules. The Greek banks continued to receive money from the European system of national central banks, but through a separate program known as emergency liquidity assistance.

As deposits continue to flow out of Greece and Spain and fears of a bank run rise, Mr. Draghi underscored the E.C.B.'s determination to make sure that solvent banks not fail because they are temporarily short of funds.

"The E.C.B. will continue lending to solvent banks," Mr. Draghi told a committee of the European Parliament. "We will avoid bank runs by solvent banks."

Still, the situation illustrated how dependent Greece is on the E.C.B. If the E.C.B. cut off funding, Greece's banking system would collapse, and the country would probably have to leave the euro.

European leaders say they agree with Mr. Draghi on the need for a more centralized euro zone.

"I have always said we need more Europe," Chancellor Angela Merkel of Germany told reporters in the German coastal city of Stralsund on Thursday, hours after Mr. Draghi spoke.

But she did not sound as if she would be able to deliver major changes soon.

"There are integration steps that require treaty changes, and we are not there yet today," Ms. Merkel said.

Mr. Draghi's powers are also limited, by the E.C.B.'s charter and conservative members of the bank's 23-member governing council. Unlike his counterpart Ben S. Bernanke, the chairman of the U.S. Federal Reserve, for example, Mr. Draghi cannot buy government bonds on a vast scale.

The structure of the euro currency union has become "unsustainable unless further steps are undertaken."

While the E.C.B. can make sure that banks have enough money to operate from day to day, Mr. Draghi said, it cannot replenish depleted capital reserves. Nor can it solve the problem of excessive government debt or the inability of countries like Greece to compete in international export markets, he said.

Underlying the euro zone crisis are underperforming economies that lack the basic requirements to create jobs or foster innovation, like modern universities or functioning government institutions. Just getting an electricity connection takes an average of 77 days in Greece, according to the World Bank.

"Can the E.C.B. fill the vacuum left by lack of euro area governance?" Mr. Draghi asked. "The answer is no."

Almost daily, new data illustrate that time is running out for political leaders to act.

On Thursday, the Bank of Spain revealed that investors had withdrawn €66 billion, or $81.7 billion, from the country in March, almost double the previous record monthly withdrawal of €34 billion last December. The statistics, however, do not reflect the most pressing problems faced by Spain, led by the cost of nationalizing Bankia, a giant mortgage lender.

With the Madrid government struggling to impose fiscal discipline on Spain's regions, Fitch, the credit ratings agency, downgraded eight of the 17 regions on Thursday. Fitch said that the rating cuts reflected the fact that these regional deficits "will require considerable additional efforts to be reduced, and also the difficulties in accessing long-term funding."

In unusually detailed criticism of Spanish leaders, Mr. Draghi cited Bankia as an example of how indecision by political leaders has made the crisis worse. It took too long for Spanish authorities to deal with the problems at Bankia, he said.

"Everybody winds up doing the right thing at the highest possible cost and price," Mr. Draghi said.

Nicholas Kulish contributed reporting from Berlin, Raphael Minder from Madrid, Paul Geitner from Brussels and Liz Alderman from Athens.

I.M.F. denies Spain talks

The International Monetary Fund said Thursday that it was not in talks with Spain on possible financial support as an I.M.F. mission prepared to visit Madrid for annual economic consultations, Reuters reported from Washington.

A fund spokesman, Gerry Rice, told a news briefing that Managing Director Christine Lagarde would meet the Spanish deputy prime minister, Soraya Sáenz de Santamaría, for talks on economic developments later Thursday.

Mr. Rice said an I.M.F. mission would be in Spain on Monday for regularly scheduled talks on the state of the country's economy.

The debt crisis has escalated in recent weeks with the possibility that Greece, facing a critical general election June 17, could exit the euro zone and as worries increase over the need to recapitalize troubled Spanish banks.

"The I.M.F. is not drawing up plans that involve financial assistance for Spain nor has Spain requested any financial support from the I.M.F.," Mr. Rice told reporters.

Later a Dow Jones news report, quoting unidentified officials, said the I.M.F. was in talks with Spain on contingency plans for a rescue loan. The report caused Wall Street stocks to sharply pare back their losses.

The I.M.F., reacting to the report, said it was always assessing different scenarios in all of its member countries and repeated that the global lender was not in talks with Spain on financial help.

"The fund's job is to assess the economic situation, monitor developments, and discuss different scenarios in all of its member countries," an I.M.F. spokeswoman said. "That is part of the fund's surveillance work."

The European Commission's top economic official, Olli Rehn, warned Thursday that the euro zone could disintegrate without a stronger crisis-fighting mechanism.

Mr. Rice, of the I.M.F., said the fund had long been talking up the need for strengthened crisis management tools and a clearer, stronger vision on the overall architecture of the euro zone.