Europe's 750 billion euro bazooka

AT two in the morning on May 10th, European Union finance ministers agreed a huge increase in their political will to defend Europe's single currency, backed by a stunning €750 billion in aid for weak links in the 16 member eurozone. Simultaneously, the European Central Bank took a revolutionary shift away from its inflation-fighting mission, announcing a scheme to buy up government bonds on the financial markets.

That new sense of resolve is good news. The more troubling news is that it took 11 hours of bitter wrangling to get the ministers to that point, and—thanks to continued German anxiety about undermining eurozone discipline by bailing out the profligate—there will be three separate mechanisms to deliver that €750 billion, of such fiendish complexity that EU officials are still not quite sure how it will all work. In a nice irony, the ministers—who have spent weeks denouncing financial markets as wicked speculators—only stopped arguing and agreed a plan in the early hours of this morning because they knew markets were about to open in Asia, well-informed sources say.

Does the good news trump the troubling news? Yes: as long as lingering disagreements and uncertainties do not hold up the rescue plan. Europe is building its own financial bazooka to warn off the markets, to borrow Hank Paulson's image. If it is ready to fire when needed, then complexity probably does not matter for now.

What has been agreed?

First off, a €60 billion rapid reaction stabilisation fund, controlled by the European Commission, and able to send ready money to eurozone countries that are in a financing crunch. The mechanism is modelled on an existing scheme for non-euro economies, the "balance of payments facility". The money is borrowed by the commission on the markets, using the EU budget as collateral. Because the EU budget cannot legally go into the red, that means that all 27 EU members are on the hook if money from this €60 billion pot is disbursed and not paid back: to simplify, all members would have to pay extra into the budget to top it up. Britain, for instance, would be on the hook for 12% of any losses: Alistair Darling, still the British chancellor of the exchequer, approved this after consulting his Tory counterpart, George Osborne, by telephone.

Secondly, a "special purpose vehicle" (don't call it a fund or Eurobonds, or the Germans will be very cross), which will be created in the next few days by an intergovernmental agreement among eurozone members, and which will raise up to €440 billion euro on the markets using a blend of loans and loan guarantees from the 16 members of the single currency club. The European Commission wanted formal control of this warchest, using a clause of the Lisbon Treaty, Article 122 that allows the commission to rush emergency aid to countries hit by natural disasters or exceptional crises beyond their control (Article 122 will be used for the €60 billion pot).

The Germans, Dutch, Finns, Austrians and others, backed by the British, said no, and in the end won this argument: the commission may be invited to manage the warchest, which is also described as a temporary three year creation. The Germans were also insistent that the fund should work in the same way as the €110 billion rescue package just agreed for Greece: meaning it should involve money and budget discipline measures from the International Monetary Fund, and meaning that it should be a package of bilateral loans from each of the 16, rather than open-ended loan guarantees. The French, in particular, dreamed of open-ended loan guarantees and an EU-only structure: ie, something very close to a permanent Eurobond bailout instrument. Germany said no, but that may or may not look in the future like a victory on process, not on the substance.

Thirdly, the finance ministers demanded that Spain and Portugal should work harder on consolidating their budgets this year and next: that was politically very hard for the Spanish (who were nominally chairing the meeting). The Spanish have asked to come back with a plan next week.

Fourthly, there was a stunning announcement that the IMF would match every two euros of EU rescue money with one of its own. That could take the IMF contribution up to €220 or €250 billion, depending on whether they are matching the €60 billion too. In a slightly surreal moment, the Spanish economy minister Elena Salgado could not decide whether that extra €30 billion was part of the deal. Some of us are old enough (ie, we were alive three weeks ago) to remember when the EU as a whole thought €30 billion was enough money on its own to put on the table and order markets to back off.

Finally, and perhaps most importantly, the European Central Bank went off and agreed exactly the thing that banks and politicians had been urging it to do: ie, start buying up government bonds on the financial markets. Where does that leave ECB independence? In a tricky place, not to mention the ECB's central mission to fight inflation, which is in danger of being trumped by political demands from the national governments of the eurozone.

One of the gripping stories of this crisis has been the roller-coaster fortunes of the ECB boss, Jean-Claude Trichet. About nine months ago, Mr Trichet was one of the undisputed winners of the meltdown, hailed for his calm and decisive management of the banking crisis. The last few months have been brutal for this urbane Frenchman. First he said it would be a "humiliation" for the IMF to be involved in rescuing Greece, only to have to eat his words. Then he said it was as clear as a mountain stream that the ECB could not make an exception for Greece alone, when it came to accepting Greek debt as collateral even if it was downgraded to junk by credit rating agencies. Then he had to eat his words on that too.

So, what does this all mean politically? Is it the birth of Eurobonds, and a fiscal transfer union, in which the rich and strong pay for the weak? A sneaky way out of that question is to say that we have effectively had Eurobonds for ages, in the form of the balance of payments mechanism (which was used only recently for Hungary and Latvia) and that we have had transfers from rich to poor in the form of structural and cohesion funds (ie, aid for poorer regions).

But that would be a cowardly answer. I have been saying for ages that I did not believe that the political will was there to move to the sort of political or economic union that some in Brussels have always said was needed to make the euro work. Do I still think I am right?

I think that the politics have shifted dramatically in the last few days, and that the euro is looking less German and more French, even if Angela Merkel has won some late victories on process by insisting that national governments should not give open-ended loan guarantees to the European Commission to play with. I think that the EU has developed a much stronger external narrative, telling markets that they should treat the eurozone as a single whole, which is strong and solvent, and not try to pick off weaker members because they will get their fingers burned.

But, and I think this is still a big but, the political narrative inside the eurozone is still lagging way behind. If the markets outside are being told to treat the eurozone as a single fortress, defended by unlimited budgetary firepower from the rich members of the club, voters in places like Germany, the Netherlands or Finland are absolutely not being told that they now inhabit a single economic entity, in which big chunks of the budget are pooled. Instead, the political messages being delivered internally are heading in quite different directions.

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One, the Germans and co are still insisting that the point of constructing a vast bazooka is to avoid ever having to fire it. In other words, whether or not you think the leaders are stumbling backwards into a fiscal transfer union, that is certainly not their purported intention: the intention is for none of this money ever to be needed.

Two, the political ground is not being prepared for a fiscal union: Angela Merkel has not gone on German television to tell German voters that the euro is incredibly important to their way of life and their prosperity, and that defending it may cost painful amounts of money.

Instead, the anti-market rhetoric is being stepped up to fever pitch. Markets are wicked speculators, or "wolf packs" if you listen to the Swedish finance minister. there is an international conspiracy to destroy the euro, says Jean-Claude Juncker, prime minister of Luxembourg.

In concrete terms, leaders like Mrs Merkel have yet to make the positive case for saving the euro, instead preferring to make the negative case for punishing speculators (though, I note, those evil speculators magically turn back into "international markets" when the EU wants to raise €440 billion in a short space of time).

A political quid pro quo is being prepared to buy off voters furious at the idea of sending money to weak or profligate members of the club, involving much tougher regulation of those wicked markets. Mrs Salgado last night talked of probing the role played by credit ratings agencies, and much tougher regulation of derivatives. There is constant talk of financial transaction taxes. Nobody is denying that regulation will not need to change in the future, but the suggestions so far have much more to do with populism than common sense.

The idea of a publicly funded European Credit Rating Agency, supported by France and Germany, is particularly asinine: if the ECRA is much more bullish about EU sovereign debt than the commercial ratings agencies, markets will assume it is no more than a man next to a fax machine, taking orders from Paris and Berlin. In which case it is not obvious what good it will do. On the other hand, if its ratings match those of the commercial ratings agencies, it will change nothing in the markets, and it is not obvious what good it will do.

I think this bellicose talk of fighting battles with markets and being at war with perfidious bankers (to quote Mrs Merkel) may point to a useful analogy for what is going on in terms of political integration here, at least at this point. I wonder if this new intergovernmental warchest of €440 billion, working with the intergovernmental IMF, is a bit like the mutual defence clause, Article 5, in the NATO treaty, that says an attack on one member of NATO is an attack on all. That is hugely important, and commits each member government to big and serious things. But it is not the same as those member countries agreeing to pool their militaries.

A wise colleague makes the point that the oddity for years was that markets gave all eurozone countries almost the same rates, ie assumed (wrongly) that default risk had gone. In many ways the past few months have been healthy as that assumption no longer holds. But the corollary is indeed the discovery that heavy borrowers can lose some of their independence. But, he points out, big borrowers often lose some sovereignty, because markets set limits on debts. Greece has lost fiscal independence not because it is moving towards being a part of a federal state but because it cannot any longer raise money in the markets.

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