EU Nears One-Year Boost in Rescue Fund to $1.3 Trillion

By James G. Neuger and Rebecca Christie - Mar 28, 2012

European governments are preparing for a one-year increase in the ceiling on rescue aid to 940 billion euros ($1.3 trillion) to keep the debt crisis at bay, according to a draft statement written for finance ministers.

The euro-area finance chiefs will probably decide at a meeting in Copenhagen tomorrow to run the 500 billion-euro permanent European Stability Mechanism alongside the 200 billion euros committed by the temporary fund, a European official told reporters in Brussels yesterday.

Beyond that, they are also set to allow the temporary fund's unused 240 billion euros to be tapped until mid-2013 "in exceptional circumstances following a unanimous decision of euro-area heads of state or government notably in case the ESM capacity would prove insufficient," according to the draft dated March 23 and obtained by Bloomberg News.

The boost to the war chest would come after Chancellor Angela Merkel of Germany, the dominant power in two years of crisis fighting, this week warned of “fragility” in Portugal and Spain. It would also be designed to lure the rest of the world into putting more money into the International Monetary Fund's arsenal.

European policy makers are wrangling over amendments to rules written last year that limit total available bailout funds to 500 billion euros. The IMF has made additional aid contingent on Europe first doing more to help itself.

Crisis Buffer

Finance ministers may make changes to the draft statement at their meeting tomorrow. In yesterday’s briefing, the European official said the likeliest outcome is an anti-crisis buffer somewhere between 700 billion and 940 billion euros, without saying how long these amounts would be available.

The language in the draft also emphasizes the political hurdles to tapping the unused parts of the temporary fund, the European Financial Stability Facility. Merkel or any other euro-area government leader could exercise a veto.

Extra money won’t put the debt crisis to rest, said Jens Weidmann, who was Merkel’s economic adviser until he became head of Germany’s central bank last year.

“Just like the ‘Tower of Babel,’ the ‘Wall of Money’ will never reach heaven,” Weidmann said yesterday at Chatham House in London. “If we continue to make it higher and higher, we will, in fact, run into more worldly constraints,” which might include setting “incentives that lead to new problems in the future.”

Capital Call

In addition, an increase in the aid ceiling wouldn’t make the entire sum available upfront. It would require a capital call in an emergency to mobilize the ESM’s entire 500 billion euros before mid-2014.

Assuming that the temporary fund expires in mid-2013 without making further commitments, the permanent
aid ceiling would revert to 700 billion euros, according to the draft. The ESM’s provisions allow the finance ministers to raise or lower its capital at any time.

Discussion of the lending cap will coincide with a possible further speedup of the capitalization of the permanent fund. The first of five planned annual payments will be made in July and the second in October, the draft statement said.

The remaining payments may also be accelerated, with two in 2013 and the final installment in the first half of 2014, two years earlier than previously planned, the statement said.

As a result, Europe would be capable of making a theoretical three-year aid pledge of 500 billion euros on July 1 and having enough money to follow through, the European official said.

The firewall “has to be credible,” German government spokesman Steffen Seibert told reporters in Berlin yesterday when asked about calls for the backstop to be as much as 1 trillion euros. At the same time, “it’s regrettable that in this discussion no number is ever big enough.”

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