Europe Split on Rescue Plan

World Urges Swift Action; Germany Opposes Expanded Bailout; Anxiety at IMF

By SUDEEP REDDY, BOB DAVIS and MARCUS WALKER

WASHINGTON—European officials are debating ways to boost the firepower of their financial-bailout fund after the world's finance ministers, worried about the potential for a market meltdown, ratcheted up pressure on euro-zone officials to act.

During meetings of the International Monetary Fund in Washington over the weekend, the U.S. and other major nations pressed European leaders to increase the effective size of their €440 billion ($594 billion) rescue fund to perhaps trillions of euros by borrowing against it.

The talks are at an early stage, and it is far from clear they can forge a political consensus to act. German officials say the idea is moot as long as the European Central Bank continues to reject it. Some European officials hope the central bank might soften its stance under incoming president Mario Draghi, but his views on the issue aren't known.

U.S. officials are urging quick action to calm the markets, but public opposition from Germany and Northern euro-zone countries suggests no agreement is likely before the Group of 20 industrialized and developing economies meet in early November.

Policy makers are "focused on their own internal restraints, so that we don't have the outcome that we need," Antonio Borges, head of the IMF's Europe department, said Sunday. While key players were understandably acting in self-interest, he said, it was generating "disastrous" collective results.

At one closed-door meeting, euro-zone officials revealed their reluctance to move forward too quickly because of politics at home.

"This is as fast as we can move. It's going to take six weeks" to weigh the options, one euro-zone official said, and others echoed his comments, according to one person in the room. In response, some leaders from outside the euro zone asked, "Do you have six weeks?"

Meanwhile, German Deputy Finance Minister Joerg Asmussen said on Sunday that Greece may have to wait longer than expected for a decision on the next disbursement of bailout funds, while the ECB, IMF and European Commission evaluate Greece's progress on policy changes, according to Reuters. Mr. Asmussen also said that a bond-exchange program, part of an earlier tranche of assistance, didn't yet have a fixed launch date.

On Monday morning in Asia, stock markets fell on global-growth worries. The Nikkei average fell 2.0%, and
South Korea’s Kospi Composite fell 1.9%.

At the weekend’s meeting of the IMF’s policy-setting committee, a parade of leaders from outside the currency bloc pressed euro-zone leaders to take quicker action. "If you're sitting in the [meeting] and every non-European is saying get it done, it makes quite an impression," another participant said.

The IMF and euro-zone officials are working on a variety of options for using leverage to make the resources of the rescue fund, called the European Financial Stability Facility, or EFSF, go much further, say those involved in the discussions. But such a plan would only be considered if all 17 euro-zone legislatures approve a July 21 agreement to broaden the bailout fund in other ways. Some European officials worry that even discussing the leveraging options publicly could make it harder to pass the July agreement.

Some of the options could be used to help prevent a Greek default, or to try to insulate the rest of the euro zone from such a default by pushing capital into European banks and building a fire wall around larger, vulnerable euro-zone nations.

Investors are questioning whether the bailout fund is large enough to respond effectively to the debt crisis as larger countries such as Italy and Spain face upward pressure on their borrowing costs. The ECB is reluctantly buying both countries' bonds to put a lid on yields, but has warned that it won't keep up its bond purchases for long.

In private conversations, the U.S. continued to push the Europeans, particularly the Germans, on the importance of coming up with large amounts of money, a position that European Commission officials accept. President Barack Obama has called German Chancellor Angela Merkel repeatedly in recent months to encourage her to take strong action to prevent the currency crisis from escalating further.

Treasury Secretary Tim Geithner has met with European leaders over the past three weekends, in France, Poland and now Washington. He is pressing euro-zone governments on several key points: expand the firepower of the rescue fund; forge closer ties between the European Central Bank and euro-zone governments; ensure that euro-zone nations can borrow at affordable rates; and ensure that European governments stand behind their banking systems.

"The threat of cascading default, bank runs, and catastrophic risk must be taken off the table, as otherwise it will undermine all other efforts, both within Europe and globally," Mr. Geithner said Saturday.

During one closed-door session, Mr. Geithner stressed the need for swift action and relayed some of his experiences addressing the 2008 financial crisis, when he was president of the Federal Reserve Bank of New York. Mr. Geithner also talked with finance ministers or central bankers from a number of countries.

Germany isn’t opposed in theory to leveraging the EFSF, but sees a number of practical problems with the idea and is refusing to be forced to make quick decisions, according to people familiar with the government’s position. Germany’s parliament is due to vote on Sept. 29 on legislation to increase the rescue fund’s lending capacity to €440 billion and give it new powers, including the right to buy bonds in secondary markets and provide funds for governments to recapitalize banks.

Mrs. Merkel is trying to prevent a rebellion within her coalition on the issue. Raising the specter of a more-radical revamp of the EFSF would make it even harder to keep her lawmakers in line. Growing hostility of German lawmakers and voters to more-generous bailout aid for euro members means that additional measures will be hard to ratify even after the Sept. 29 vote.
The German finance minister, Wolfgang Schäuble, told reporters that the bailout fund can only work within the legal framework of the European Union's treaty, and more specifically, within the agreement governing the bailout fund. Neither of those allows the facility to be leveraged, he said.

A number of ECB officials have rejected the leverage idea. But on Sunday, executive board member Lorenzo Bini Smaghi of Italy became the first ECB official to publicly throw his weight behind the idea of leveraging the bailout fund to stem the crisis.

—Charles Forelle, Nathalie Boschat and Geoffrey T. Smith contributed to this article.