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World Races to Avert Crisis in Europe

$955 Billion Bailout Plan for Euro Members Is Crafted; ECB Intervenes in Bond Markets; Fed Reopens a Rescue Program

By STEPHEN FIDLER And CHARLES FORELLE

Reuters

European Union Economic and Monetary Affairs Commissioner Olli Rehn, left, and Spain's Economy Minister Elena Salgado address a news conference at the end of a European finance ministers meeting at the EU Council in Brussels on Monday.

BRUSSELS—The European Union agreed on an audacious €750 billion ($955 billion) bailout plan in an effort to stanch a burgeoning sovereign debt crisis that began in Greece but now threatens the stability of financial markets world-wide.

The money would be available to rescue euro-zone economies that get into financial troubles. The plan would consist of €440 billion of loans from euro-zone governments, €60 billion from an EU emergency fund, and €250 billion from the International Monetary Fund.

Immediately after the announcement, the European Central Bank said it is ready to buy euro-zone government and private bonds "to ensure depth and liquidity" in markets, and the U.S. Federal Reserve announced it would reopen swap lines with other central banks to make sure they had ample access to dollars.

Asian stock markets opened higher on Monday, boosted by news of the EU package.

The giant bailout package reflects the gravity of the crisis gripping Europe and growing fears that the situation could grow so dire as to hamper the fragile rebound in the global economy. It casts aside long-held notions that each EU nation should manage its own finances, opening an era in which members of the common currency take on unprecedented responsibilities for each others' fiscal troubles.

In an indication of the world-wide concern, the White House said President Barack Obama on Sunday spoke with French President Nicolas Sarkozy and German Chancellor Angela Merkel to urge "resolute action to build confidence in the markets."

With a self-imposed deadline to reach agreement before Asian markets opened Monday

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morning, ministers from all 27 EU nations aimed to assemble a package impressive enough to arrest spreading worries about the debt problems of euro-zone governments. Once confident they could quarantine Greece's turmoil, the EU's leaders have been grappling with gathering worries about the debt problems of euro-zone governments such as Portugal, Spain and Italy.

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IMF Managing Director Dominique Strauss-Kahn said the IMF was "ready to support our European members' individual adjustment and recovery programs through the design and monitoring of economic measures as well as through financial assistance, when requested."

While the stabilization fund is welcome news for investors who had been calling for the EU to take bigger steps, perhaps more important is the news that the ECB will act to shore up the shaky european bond market. Many investors had been calling for the ECB to take this step, and the ECB's failure to announce such a plan following a ECB governing council meeting last week was a key contributor to a significant sell-off Thursday.

Such a step is "very good news," and could lead investors to head back into the kind of risky assets they had been selling out of late last week, such as emerging markets and stocks, said Sebastien Galy, currency strategist at BNP Paribas in New York.

The €440 billion pledged by euro-zone governments isn't immediately available cash in hand. Instead, a specially created off-balance-sheet entity will borrow the money, as needed, and then lend it out to the country or countries in trouble. The special entity's borrowings will be guaranteed by euro-zone countries—excluding the country asking for aid. This construction helps skirt the EU treaties' prohibition on one state's assuming the debt of another.

The guarantees are to be arranged in a "pro rata" manner, said EU Commissioner for Economic and Monetary Affairs Olli Rehn. Presuming they'd be divvied up under the same rubric used for earlier loans to Greece, Germany would have the largest share of guarantees, committing to back up to €123 billion of the debt in case of further loans to Greece; France would shoulder €92 billion, and even tiny Cyprus would be on the hook, for nearly €1 billion. Those figures would rise if a larger country like Spain needed money. However, this portion would need approval by the parliaments of contributing countries, something that could delay a rapid payout of funds.

The EU will be able to mobilize the €60 billion chunk more quickly. Those are funds dispensed under the overall EU budget—under a treaty provision for natural disasters and other "exceptional occurrences." The crisis "is a threat to financial stability of the euro area and the European Union, and therefore it is justified," Mr. Rehn said.

The European countries and the IMF are putting together a "shock and awe" strategy involving massive amounts of money to convince markets that they can handle any sovereign debt problem in Europe, said Eswar Prasad, a former senior IMF official who is now an economist at Cornell University. While that effort would "certainly be good for stabilizing markets in the short run, [it] could create wrong incentives in the longer term," by making loans too easy to obtain without requiring borrowers to make necessary reforms, he said.

Facing a darkening mood in markets, euro-zone leaders met in Brussels late Friday to seal a €110 billion bailout for Greece, then convened the ministers' meeting Sunday to provide what Mr. Sarkozy called a "systemic response" to a "systemic crisis."

The strains in markets have grown along with disappointment among investors over how European officials have handled the crisis in the months since it became clear Greece was having trouble refinancing its debts.

Last week, pressures began to build on European banks, where worries about their investment and loan exposure to Greece led to rising borrowing costs. It also sent the euro, the common currency of 16 EU countries, to its lowest levels since last March.

Spain and Portugal have decided to make additional spending cuts to bring down towering budget deficits more quickly, government representatives said. Spain plans to cut its budget deficit to 9.3% of gross domestic product this year, from 11.2% in 2009, and to 6.5% in 2011. It had previously pledged to lower the budget deficit to 9.8% of GDP this year. Portugal plans to cut its budget deficit to 7.3% of GDP this year, compared with an earlier target of 8.3%. Last year's budget deficit was 9.4% of GDP.

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French President Nicolas Sarkozy and German Chancellor Angela Merkel at a euro-zone summit in Brussels Friday.

Political uncertainties aren't helping. In Germany, projections showed Ms. Merkel's center-right alliance Sunday lost a crucial regional election amid a voter backlash against aid for Greece. That means her government is set to lose its majority in Germany's upper house.

One complication Sunday was that, while the mechanisms were being designed for the 16 countries of the euro zone, they also need agreement from some of the other 11 EU countries that don't use the common currency, such as the U.K.

Alistair Darling, the U.K. chancellor of the exchequer who attended the meeting, said Britain would back the balance-of-payments facility. But, he said, creating a "stability fund for the euro"—the larger part of the package—had to be "a matter for the euro-group countries." London faces uncertainty of its own, with the Conservatives scrambling to put together a coalition government in the wake of last week's inconclusive election.

With Sunday's deal, the EU is signaling that even small members of the euro zone are too big to fail.

The measures discussed in Brussels make clear how far the crisis is stretching the founding principles of the common currency. Those principles emphasize that each euro-zone country is committed to managing its own fiscal affairs.

This independence, however, has been one of the principal causes of the crisis, allowing Greece to build up government debts to levels that many investors deem unsustainable. To correct that flaw, euro-zone governments are growing more dependent on one another, a step likely to require much closer coordination over fiscal policy and penalties for spendthrift governments.

Until now, governments have resisted this interference with their independence to tax and spend as they choose. In the early days of the debate over the euro, Germany feared that by giving up the Deutsche mark, it would find itself pushed to yield its own fiscal rigidity in the name of the collective good.

The EU treaties contain a so-called no-bailout clause, which forbids the bloc or any member to "be liable for or assume the commitments of" another EU country. The treaties bar the European Central Bank from lending to countries or buying their debt directly. To get around these obstacles, European officials appear to be relying on vaguer parts of the treaties, or on novel interpretations.

Officials say "bilateral loans"—that is, lending from one country to another—are permitted because the lending countries aren't actually purchasing existing debt. Or, they argue that a part of the treaties permitting assistance in case of "exceptional occurrences" can apply, even though it seems intended for use when the exceptional occurrence is a flood, fire or hurricane.

—Adam Cohen, Tom Lauricella and Laurence Norman contributed to this article.

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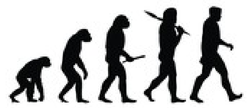

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