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## New ESM Won't Solve Euro-zone Woes

- By IRWIN STELZER



Groucho Marx once asked, "Who are you going to believe, me or your own eyes?" The euro-zone leaders' variant is to ask those who question their triumphant post-meeting announcements, "Who are going to believe, what we tell you, or what you can plainly see is the truth?"

Consider last week's announcement that the new European Stability Mechanism will have lending capacity of €500 billion (\$704 billion). A tidy sum, it seems. Let's break it down. The ESM will need €700 billion in order to borrow the €500 billion that will constitute its lending capacity. That's because creditors want a margin if they are to lend to the ESM at low rates, just in case some of the guarantors prove less than reliable. The ESM claims to have €80 billion in paid-in capital, but in fact, only €16 billion will be readily to hand, since the €80 billion will be paid in over five years, barring of course any governments willing to renege on their legal commitments. That leaves €620 billion of "committed callable capital" to be raised.

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Associated Press

Portugal's government will have to adopt an austerity plan to qualify for ESM.

Greece and Ireland combined will cough up or guarantee €31 billion. That's right—the two countries that are on euro-zone life support. Portugal, soon to join them, is expected to contribute €18 billion. Spain, although doing a bit better, is exposed to €77 billion of Portuguese debt, the credit ratings of 30 of its banks have just been downgraded, and so remains in the sights of the bond vigilantes: It is counted on for €83 billion. Belgium, its credit standing already being questioned because of its governmental chaos and high deficit, is to drop a cool €24 billion into the collection box in cash and guarantees, and Italy, hardly the gold standard of sovereign debtors, another €125 billion.

Oh, by the way. This bailout mechanism doesn't become available until mid-2013. That means that Portugal, a government-free zone, its banks dependent on the European Central Bank for funds, its economy contracting, its ratings cut again by Fitch and by Standard & Poor's, almost out of cash and facing debt repayments of €10 billion in April and June, will have to rely on the existing bailout fund. No worry: There is enough to finance a Portuguese bailout, even without the agreed increase (how the boost is to be funded has not been decided) in the current European Financial Stability Facility (EFSF). But to be eligible for the bailout money the new government will have to adopt an austerity program of the sort Portugal's parliament has just rejected.

The euro-zone summiteers seem to have concluded that if at first you don't succeed, continue making the same mistake. If bailing out troubled economies hasn't reassured markets, well, expand the program. If flawed bank stress tests leave investors unsatisfied, well, repeat them.

If you believe your own eyes rather than ministerial press releases, you can see what should be obvious to all save those who, in the words of Rodgers and Hart, practice the self-deception that believes the lie. Greece, Ireland and Portugal, what the European Council calls "the Southern Neighborhood," will have to restructure their sovereign debts. The euro-zone banks that hold their sovereign paper will take a hit, and have to recapitalize or call on their governments

for bailouts. Banks' creditors will have their hair cut, and future lenders, knowing that will be their fate some day, will add a risk premium to the interest rates they demand. That's the reality show the euro zone's masters will have to watch ere long.

The new ESM will offer assistance to member states "which are experiencing or are threatened by severe financing problems, in order to safeguard the financial stability of the euro area as a whole." All assistance will be available only with "strict conditionality," which consultants The Lindsey Group call "the fuzzy embrace of the EFSF with the concomitant loss of fiscal sovereignty" and Nicolas Sarkozy calls submission to "economic government." Any risk the ESM is assuming by lending to illiquid and probably insolvent member states "will be contained through adequate asset and liability management." Oh.

But there is no vessel strong enough to contain the toxic fumes from what is in essence a derogation of the quality of Germany's balance sheet as it guarantees the loans of less credit-worthy countries. If this is not a violation of the provision of the Lisbon Treaty prohibition of one country assuming the liabilities of another, it is difficult to think what might be.

But that is for lawyers to decide. Mere economists can only marvel as the euro-zone heads of state drown in the alphabet soup of the ECB, EFSF, ESM, IMF and others I might have missed. The basic problem is the lack of competitiveness of the southern-tier countries. Portugal's high-school dropout rate is twice the EU average, and only 28% of its adults have completed high school. This compares with 85% in Germany. The unskilled work of which these relatively uneducated workers are capable has long since moved to Asia, which is one reason Portugal's economy has not grown in decades and is now shrinking. The others are its very high tax rates and its inability to devalue its currency to reflect its underlying economic circumstance.

None of these defects will be addressed by the economic government Mr. Sarkozy has in mind. Indeed, Angela Merkel regards Ireland's low corporate tax, a huge attraction for foreign, job-creating investment, as "fiscal dumping." A bit of such "dumping" by her southern

neighbors just might help them to dig their way out of the hole dug for them by the combination of a fixed exchange rate, high taxes, and a work force equipped only for a world long gone.

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