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US, Emerging Markets To Press Europe At G-20 Summit On Debt Crisis Plans

By Ian Talley

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WASHINGTON (Dow Jones)--President Barack Obama and key emerging market leaders will this week press Europe on how it plans to build a EUR1 trillion firewall to stem its sovereign debt crisis, concerned over whether the euro zone plan will pack enough punch.

Last week, officials from the major Group of 20 industrialized and developing countries offered qualified approval for the rough rescue package euro zone leaders forged early Thursday. But there are also unanswered questions about whether the mechanics of Europe's strategy will have enough firepower to deal with the debt crisis decisively. Watchers of the G-20 say that leaders may promise at the summit to be held Thursday and Friday in Cannes, France, to support Europe's efforts if euro zone officials provide details to a sufficiently strong debt-crisis strategy.

European Union leaders agreed earlier in October to more than double the write-downs on Greek debt, boost the strength of its emergency rescue fund to around EUR1 trillion and beef up banks' capital cushions.

"It's important to all of us that this strategy be implemented successfully--including building a credible firewall that prevents the crisis from spreading," Obama said in an editorial Friday. Monday, Mike Froman, U.S. deputy national security adviser for international economic affairs, told reporters, "Obviously, there is more discussion to be had among leaders about the next steps in that process, including the fleshing out of the details."

Europe plans to leverage up the cash in its existing rescue fund, roughly EUR440 billion, to build a bailout fund with the effective capacity of EUR1 trillion and contain the debt crisis to its epicenter in Greece. Specifically, Europe wants to insure a percentage of new bonds from ailing countries such as Italy and Spain. That, they believe, will yield a four-to-five fold impact. By using EUR50 billion to insure 25% of the first losses on Italy's bonds, for example, Europe can push down Rome's borrowing costs for around EUR200 billion in bonds.

But economists question whether Europe is being overly optimistic. For example, many believe that the 50% writedown on private holdings of Greek debt is insufficient to make the country healthy, and instead expect further restructuring or even a default. Given the risk, Cornell University economist Eswar Prasad said he thinks it's unlikely investors will buy Italian bonds for less than 40% to 50% insurance coverage. That dramatically cuts down the leveraging factor.

European officials also have to contribute cash to promised bailout programs in Greece, Portugal and Ireland and say they plan to help banks boost their capital buffers. That will further reduce the amount of cash available.

To supplement their cash base, Europe also plans to create a special new facility funded by sovereign wealth funds, direct loans from countries and private markets. Euro zone officials are also discussing boosting the International Monetary Fund resources to help pad their bailout response. There's likely to be a discussion about the adequacy of the IMF's resource base at the G-20 summit. But so far, Washington and others are skeptical those effort will gain much support until Europe delivers the details of plan that offers enough assurance any cash contributions aren't going to be poured into a losing cause.

Some emerging market officials say they're unlikely to contribute any cash to Europe's effort without a commitment for a greater role from the European Central Bank. The ECB has trillions of euros at its disposal on its balance sheet. The U.S. and the IMF have previously urged Europe to combine the power of the ECB with its EUR440 billion bailout fund, creating the type of facility they believe could decisively douse the debt fires from spreading.

Amar Bhattacharya, director of the Group of 24 emerging and developing markets secretariat, said countries such as India, China and Brazil will push Europe in Cannes to use the ECB as the only effective backstop to the euro zone crisis at the G-20 leaders' summit.

"At the moment, the ECB's role is not clear," Bhattacharya said. "That's unfortunate, because that's where, in our view, the firepower lies."

The U.S. is also concerned about another key tenet of the European plan: how its banks will raise their capital buffers to cover their exposure to bad euro zone debt. Selling assets, as opposed to raising capital, would likely undermine the economic growth necessary to pulling many of the euro members out of debt.

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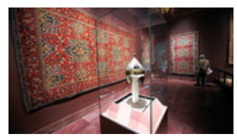

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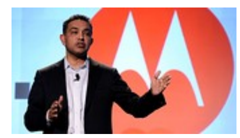

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