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Europe rewrites its rule book in creating fund to contain financial crisis

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ATHENS -- The massive emergency fund assembled to defend the value of the euro is backed by a political gamble with an uncertain outcome: that European governments will rewrite a post-World War II social contract that has been generous to workers and retirees but has become increasingly unaffordable for an aging population.

The trillion-dollar program, to be underwritten largely by the 16 nations that use the euro and by the International Monetary Fund, represents a virtual discarding of Europe's rule book.

Under the rescue unveiled early Monday, governments that broke the currency union's spending restrictions are being offered a commitment of solidarity, with weak links such as Greece and Portugal supported by the creditworthiness of Germany's strong economy.

The European Central Bank will act as a bond broker of last resort for troubled European governments, a role so distant from its conservative, inflation-fighting personality that Jean-Claude Trichet, the bank's president, emphasized that the ECB remained "fiercely and totally independent" of political concerns.

The news invigorated investors. U.S. stocks had their best day in more than a year, with the Dow Jones industrial average rising 3.9 percent, the Standard & Poor's 500-stock index 4.4 percent and the Nasdaq composite index 4.8 percent. European stocks, which last week had their worst week in 18 months, soared. The Stoxx Europe 600 index was up 7.2 percent.

And though economists and other analysts generally agreed that the program was necessary to prevent a full-blown financial crisis, they also agreed that it won't work unless European governments follow through on promises to bring down their large deficits and restructure their economies to become more competitive. Otherwise, the "breathing room" created by the new fund will quickly disappear.

Government debt has been flagged by the IMF as a chief risk to economic recovery, particularly in the developed world and in such high-debt emerging economies as Hungary.

"We can't finance our social model anymore -- with 1 percent structural growth we can't play a role in the world," European Council President Herman Van Rompuy said Monday in remarks at the World Economic Forum in Brussels, just hours after European Union finance ministers approved the new program. European growth rates are lagging behind those in the United States and the rest of the world as the recovery takes shape, with Spain and Greece still in recession.

Access to the fund will be conditional: Countries that think they need help will have to show they are willing to make the changes needed to bring their deficits under control, similar to the process Greece went through in arranging a $140 billion bailout.

But the political challenge looms large, cutting to the heart of Europe's postwar identity. Particularly in the south, unions and socialist movements have established generous work rules and social welfare programs.

Greece, for example, is considered by the IMF to be one of the most inefficient economies in Europe because of the patchwork of rules governing its labor markets -- including the public sector's "employment for life" practices; the syndicates that keep control over pharmacies, law offices and other professions; and the array of early-retirement rules that drive up pension costs.

The government is pushing through changes to the pension plan this week, and the unions are gearing up for a fight.

"The rights of workers are not 'privileges.' The privileges are being enjoyed by the industrialists and big businesses," said George Perros of the executive committee of the Pan-Hellenic Workers Front. "Our position is clear: stable and enduring work for all."

The size and unconventional nature of the new European program -- it uses a "special purpose vehicle" to skirt government lending restrictions, along with pushing the ECB into unfamiliar territory -- were needed to halt a crisis over government debt that began in Greece but was also putting Spain and Portugal at risk.

On a day when the euro's value began recovering from a recent slide -- and with stock markets up -- analysts agreed that the European finance ministers had won an immediate victory.

The program "will bring some semblance of stability, at least in the short run," by ensuring that eurozone countries will have a source of funding if world bond markets turn against them and make borrowing too expensive, as happened with Greece, said Eswar Prasad, an economics professor at Cornell University.

But there was also concern about the risks being introduced, particularly whether the indebted Portugal, Ireland, Italy, Greece and Spain would make the changes needed to avoid further crises.

Greece's adjustment program is underway and bringing down its annual deficit. Spain and Portugal have pledged to accelerate their debt-control programs, and Irish workers have accepted wage cuts.

Still, the full social impact of the programs has not been felt, though they have triggered deadly protests in Greece, and economists warned that any wavering among national leaders would make the weekend's dramatic statement of support for the euro an empty gesture.

The new program "does not alter the fundamental need for an enormous fiscal squeeze across large parts of the eurozone," said Jennifer McKeown, senior European economist for the London-based Capital Economics consulting firm. "The peripheral economies are still in for a long period of extreme economic weakness."

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