



## Europe's Continuing Risks

*Edwin M. Truman says that while Europe's debt crisis has eased, it still needs to expand its own financial safety net before getting help from the International Monetary Fund.*

*Transcript of interview recorded March 21, 2012. © Peterson Institute for International Economics.*

Steve Weisman: Has the shadow lifted from the European sovereign debt crisis and is there more of a role to play for the International Monetary Fund, the United States, and outsiders? This is Steve Weisman at the Peterson Institute with Ted Truman. Ted, has the situation in Europe stabilized?

Edwin M. Truman: I think it's a fair assessment. Whether the corner has been turned decisively, I think it's more difficult to determine in any crisis, and this one has been going for more than two years. You really don't know that it's over until at least three months, if not six months after you've reached the bottom. It's possible the bottom was reached at December of last year and things will turn up and at least not have another dip in this crisis.

But there are a lot of things that could go wrong, whether it's in Greece, politically or economically, or in Spain, or in the French elections, or in Portugal. And the whole issue of the European fiscal compact, could come unstuck. So there are a lot of accidents that could happen still. But one could be hopeful that things have actually at least stabilized.

Steve Weisman: One factor in stabilizing the situation is the creation of the so-called firewall to finance any kind of crisis and avoid further contagion. What progress has been made on that?

Edwin M. Truman: There are two sides to this: one is the European component of the firewall, and the other is the non-European component of the firewall involving the [International Monetary] Fund. The Europeans, later this month, are supposed to discuss whether they will put together their existing EFSF [European Financial Stability Mechanism] and their pending ESM [European Stability Mechanism] so that [they] could be run for a period of time side-by-side, and therefore augment the potential European contribution to any firewall. I prefer the phrase "safety net."

That is certainly a necessary condition for the non-European countries to step forward and respond to IMF director, Christine Lagarde's request for approximately \$300 billion to put into a special borrowing arrangement to backstop the Fund, lowering it to a \$200 million from the Europeans themselves. So if there is another big crisis, in particular in Spain and/or Italy, the resources would be there to deal with it, rather than having to spend six or eight months negotiating a way to increase the firepower of the Fund to help Europe out.

My guess is that the Europeans aren't going to be very clear at the end of the month and so the can will be kicked down the road. They might become clear by June. Some Europeans, particularly Germans, would just as soon [wish] the problem away. It may go away, but it is a bit like playing with fire to not plan in advance for things getting worse.

Steve Weisman: Some of the papers have suggested this is a difference between Christine Lagarde and [Chancellor] Angela Merkel of Germany -- that Lagarde has been seeking more initiative by Europe, and the Germans have been dragging their feet. How fair is that analysis?

Edwin M. Truman: I think it's certainly broadly fair. If there has to be augmentation of the European component that will require [Merkel] to go back to her Parliament with not entirely certain results, she can just as soon live without another bruising battle in the Parliament over Germany helping the rest of Europe, even though that's maybe justified on the merits.

So it would a problem that I think she would prefer to avoid and her interests in some sense, or completely coincident with those of Christine Lagarde, who has a different responsibility, which is to prepare the world for the worst. And Angela Merkel says, "We'll deal with that problem when it comes." And there's a difference in sort of time frame in that all, I think. Which is—so I don't think they'd disagree on the ends, and in the end, certainly, if more money is needed and the Germans have to come up with more money, they will, I'm sure.

But that's the quid pro quo for the rest of the world to step in behind Christine Lagarde. It may well be that the meetings in April here in Washington will end up with a great big fudge" "We'll continue to work on it and follow developments and cooperate and not have a big fight."

Steve Weisman: Where is the United States in this disagreement?

Edwin M. Truman: I was interested that [Treasury] Secretary [Timothy] Geithner yesterday was more reserved, at least in public. Maybe, like Christine Lagarde, he feels that the Fund doesn't need more money now and that if it needs more, he's sure that the Fund can get it, which is a correct statement. I'm pretty sure that the Fund in the end needs more money from non-European members -- this \$300 billion that Christine Lagarde in effect is asking for, the membership of the Fund, not including the United States, will come up with it.

That may be a little messy and scrambling. It is a correct statement that the fund doesn't need the money now. It's a timing issue. It's perfectly reasonable for the management of the fund to say, "Yeah we'd rather have lined [the funding] up than have to scramble at the last minute, because that's likely to exacerbate any crisis that's occurring at the last minute." But it's probably premature for the Secretary of the Treasury to bless that effort, especially since he, and other countries in the rest of the world are continuing to say to Europe that they need to do more to help themselves in this dimension.

Steve Weisman: Europe has not been especially welcoming to that message to the United States.

Edwin M. Truman: That's right. But this is a case with which the United States is in the same as the position as all the other major non-European countries. We are not isolated on this issue. I mean, it is a general perception. I understand that Christine Lagarde in China was asked recently, "Why should China poor country help Europe?" and she actually didn't have a very good answer to that.

Steve Weisman: The real answer should be that Europe should do more to help itself.

Edwin M. Truman: Right, which I think she agrees with.

Steve Weisman: But do you think that the stabilizing situation in Europe is making people complacent?

Edwin M. Truman: It's making people hopeful that they won't have to cross this bridge or that they've crossed the bridge. Now they're already on the other side, so they don't need another bridge. I think they're hopeful that having kicked the can down a few times, and put together some mechanisms, a lot has been done, that things will stabilize and Greece won't fall apart, and if it does fall apart, it won't exacerbate things in Portugal or Ireland.

Steve Weisman: And Spain.

Edwin M. Truman: And Spain ... And the political economy will remain broadly under control in the euro zone. And it's hopeful, you know money could be hopeful, but it's certainly far from a sure thing at this point.

Steve Weisman: Thank you, Ted.

Edwin M. Truman: My pleasure.

