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Tense talks leading E.U. closer to its first bailout

BRUSSELS

Under emerging plan, Germany and France would back Greek debt

BY STEPHEN CASTLE AND LANDON THOMAS JR.

In a tense game of brinkmanship, the European Union is moving toward the first bailout in the history of its common currency, a plan expected to involve loan guarantees from the German and French governments to encourage their banks to buy Greek debt.

But even as the negotiations continue, the bloc is insisting that Athens impose further, painful austerity measures, in part to overcome political opposition in Germany to providing aid to the Greeks.

During a visit scheduled to begin Monday, Olli Rehn, the E.U. commissioner for economic and monetary affairs, will press for more spending cuts and tax increases by Greece as a precursor to an emerging package of financial support.

With no structure in place for how to deal with a threatened default within the 16-nation euro zone, officials are making up the rules as they go along. That means that politics — as much as economics — is determining the outcome of the worst crisis in the euro's 10-year history, with battles being fought through leaks and behind-the-scenes briefings.

European officials say that any rescue is likely to involve the purchase of Greek bonds by state-owned lenders like Germany's KfW, backed by German government guarantees, and that has been one of the options under discussion for three weeks. A KfW spokesman said the bank would have no comment.

Other alternatives, including ones that involve more countries in the euro zone, are also being discussed. France's state-owned Caisse des Dépôts may be involved, a Greek newspaper reported Saturday, while the French finance minister, Christine Lagarde, told Europe 1 radio on Sunday that there were "a certain number of proposals in the euro zone, involving either private partners or public partners or both."

But the German chancellor, Angela Merkel, is not ready to sign off on a rescue before Greece has pushed through further cuts, officials said.

One European official, speaking on condition of anonymity due to the sensitivity of the subject, said that Greek offi-

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Germany and France may aid in Greek rescue

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cials appeared to be briefing journalists on the prospect of a big rescue package in the hope of pushing the European Union into a quick solution, or of convincing the markets that help was at hand.

"The Germans will not put a euro on the table until there is a credible austerity package," the official said.

Simon Tilford, chief economist at the Center for European Reform, said that France and Germany recognized that some form of bailout was now inevitable, but that for a bailout to be sold to a skeptical German public, the Greeks "have to be seen to be suffering."

Much of the negotiating revolves around George A. Papandreou, the Greek prime minister. On Friday, he met in Athens with Josef Ackermann, the chairman of Deutsche Bank. On March 5 he plans to visit Mrs. Merkel in Berlin. He also is set to meet President Barack Obama in Washington on March 9.

Lurking behind the discussion are a variety of power plays involving Brussels, Paris, Berlin and Athens. Germany, knowing that, as the euro zone's biggest economy, it will bear the brunt of the cost, is reluctant to approve any bailout. But France and Germany also believe that if Greece sought aid from the International Monetary Fund it would damage the prestige of the euro, highlighting the Union's inability to sort out its internal problems.

Moreover, the French president, Nicolas Sarkozy, is said to be particularly reluctant to see a rescue orchestrated by the I.M.F. The fund is led by Dominique Strauss-Kahn, a potential rival in the next French presidential election.

But in private, Greek officials are indeed threatening to go to the I.M.F., according to an E.U. diplomat who spoke on condition of anonymity due to the sensitivity of the issue.

The Greek government can be pushed only so far, said Daniel Gros, director of the Center for European Policy Studies. "Like any desperate person," he said, "Greece has a strong card."

Such brinkmanship on both sides was brought about by the lack of clarity from a European Union summit meeting this

WOLFGANG KUMM/EUROPEAN PRESSPHOTO AGENCY

Chancellor Angela Merkel discussed the Greek crisis during a TV broadcast on Sunday.

month at which leaders promised "determined and coordinated action" if it was needed to protect the euro's stability.

Refusing to specify what this would be, E.U. leaders sought to inject more rigor into Greece's deficit-reduction program.

Having concealed its true economic situation for years, and largely squandered the proceeds of a period of economic growth, Greece is not seen as a deserving cause in Berlin.

"Germany has, in the last 10 years, been through very painful social reform, which means curtailing rights and social benefits and pushing back the retirement age," said Thomas Klau of the European Council on Foreign Relations and author of a book on the birth of the euro. "The argument in Germany is 'Why should our workers work to the age of 67 to enable Greeks to retire earlier?'"

But Mrs. Merkel is under equally strong pressure from her European partners to protect the euro from the consequences of a Greek default. "She has to show leadership," said Mr. Klau, "in taking and pushing through a decision which is unpopular with her electorate and much of her party and is not backed wholeheartedly by her junior coalition party."

The Greeks have already agreed to freeze wages, cut bonuses, crack down on tax evasion and raise the official retirement age. But Union officials have made it clear that they do not believe these measures go far enough to narrow the budget deficit.

Athens is now weighing an increase of two percentage points in the 19 percent value-added tax, as well as higher fuel prices and the possible abolition of one of two additional months of pay received by public-sector workers and by employees of many private firms as an annual bonus.

The new austerity package is likely to be announced after Mr. Rehn's visit to Athens but well in advance of a crucial meeting of European finance ministers on March 16.

For weeks now the Greek government, which faces €23 billion, or $31 billion, in debt repayments in April and May, has been testing investors' diminishing appetite for its debt via a 10-year bond offering of €3 billion to €6 billion that it had hoped to bring off at an interest rate of around 6 percent.

That would be well above the roughly 3 percent rate investors receive on German bonds but not as costly as the rate of 7 percent or so that some investors claim is necessary to compensate them for the extra risk of buying Greek debt.

The offering itself is fairly small. But its significance for Europe and the bedraggled euro is far greater.

"I see this as a game of chicken between the markets and the German Finance Ministry," said Mr. Gros, of the Center for European Policy Studies.

Greece is pressing for as much detail as possible on rescue contingencies to ensure that its austerity measures will earn it some relief from the attacks it has suffered in the markets.

Greek officials have privately pointed out that when a country goes to the International Monetary Fund, it gets protection from the markets until its economy has stabilized.

For example, in November 2008, when Hungary went to the I.M.F., it received a standby loan worth about €12.3 billion, then $15.7 billion, of which €4.9 billion was on tap immediately. The remainder would be available in five installments, subject to quarterly reviews by the I.M.F. on the country's progress in meetings its economic goals.

Without similar help, the Greek austerity drive might prove counterproductive.

"Cutting public spending by this amount," said Mr. Tilford, of the Center for European Reform, "when there is no other source of demand in the economy when export demand is extremely weak and the country is running a huge current account deficit, is almost certain to push their economy into a slump."

Without the I.M.F., the only credible source of support to ease the shift in fiscal policy are the other European governments that rely on the euro.

"The Greeks are in a bad position," Mr. Tilford said, "but their bargaining power is stronger than some governments concede. If the euro zone doesn't come up with something, they will have little option but to go to the I.M.F."

Landon Thomas Jr. reported from London. Jack Ewing contributed reporting from Frankfurt.