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Sarkozy offers Greece support for new bailout

PARIS

He says French banks are willing to extend maturities of debt

BY MATTHEW SALTMARSH

French banks have agreed to shoulder part of the cost of a new rescue package for Athens by extending the maturity of their holdings of Greek debt, President Nicholas Sarkozy said Monday.

Under the plan, agreed upon between the government and French lenders, banks would reinvest most of the proceeds of their holdings of Greek debt maturing between now and 2014 in new long-term Greek securities.

Mr. Sarkozy said he hoped other European countries would adopt a similar plan. Germany had previously pushed hard to obtain a tough, compulsory private-sector involvement in the Greek bailout but backed down amid opposition from France and the European Central Bank.

"We've been working on this with the banks and insurance companies," Mr. Sarkozy said at a news conference in Paris. "We're committed to going from a principle — the voluntary participation of the private sector — to concrete reality."

While the plan is being sold as voluntary, for the French banks any sacrifice looks better than the alternative of a default by Greece and the risk that other debt-ridden countries, like Ireland and Portugal, might follow the same path.

"If it wasn't voluntary," Mr. Sarkozy said, "it would be viewed as a default, with a huge risk of an amplification of the crisis."

Jean Pisani-Ferry, director of Bruegel, a research institute in Brussels, said the announcement reflected Europe's

MICHEL EULER/AP

Mr. Sarkozy said Monday he hoped other E.U. countries would adopt similar plans.

problems in coming to grips with the Greek crisis.

"A year ago, it was a short-term plan," he said. "Now, it's becoming a much longer-term bailout."

France has never wavered in its view that banks should be involved in the debt workout on a voluntary and limited basis. According to data from the Bank for International Settlements, French lenders would lose more from a collapse of Greek banks than those from other countries. Aside from that, Paris is also

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MERKEL DANCES AROUND THE EURO

Mrs. Merkel rejects the idea of issuing common euro zone bonds, but that could change, Paul Taylor writes. *PAGE 20*

Sarkozy offers Greece hope for new bailout

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worried about the impact that a Greek default would have on the euro, and that it could bring a repeat of the problems engendered by the collapse of Lehman Brothers in 2008, through financial ripple effects.

In announcing the plan, Mr. Sarkozy was confirming a report in the newspaper Le Figaro on Monday. French bankers and a government official, who were not permitted to speak publicly, filled out the details, acknowledging that the banks, in return for agreeing to roll over 70 percent of the bonds falling due from July 2011 to June 2014, would be able to pocket the remaining 30 percent for themselves.

Of the amount to be rolled over, just over two-thirds would be reinvested in new Greek securities with a maturity of 30 years that paid a coupon close to the current official interest rate on the loans to Greece. If Greece's economy improved beyond current projections, a sweetener would be added in the form of a higher interest rate.

The remaining securities, just under one-third, would be invested in a separate "guarantee fund," consisting of zero-coupon bonds with triple-A ratings. Government officials did not say who would guarantee the bonds, but analysts said the only possible candidate for such a role would be the French government or some other institution like the International Monetary Fund, the European Central Bank or the European Union.

Officials said the deal, which still needs to be worked out in detail, was the fruit of recent meetings between the presidential Élysée Palace, the French Treasury, the Bank of France and the French banking federation.

The initiative is likely to be supported by Jean-Claude Trichet, the outgoing president of the European Central Bank, who had stood against plans to automatically impose "haircuts," or losses on banks.

Large French banks, including Société Générale and BNP Paribas, declined to comment on the announcement individually or through their national banking federation.

The French plan was presented separately for discussion at a meeting of Greece's creditors that was convened in Rome on Monday by the International Institute of Finance, which represents many of the largest global finance institutions, and the Italian Treasury. The I.I.F.'s managing director, Charles Dallara, who attended the meeting, said participants had "engaged in a constructive exchange of views on Greece and progress was made in advancing the discussions."

The reaction from France's partners was muted.

A finance official from a euro zone country said France had not briefed other members on its plan, which he said sounded similar in parts to the Brady Plan, an initiative started in the late 1980s that allowed creditors of Latin American countries to swap defaulted bank loans for a choice of new, more secure bonds, usually collateralized by U.S. Treasury bonds.

"France is showing leadership, it has the largest exposure to Greece," he said. "But this is not a done deal."

In a statement, the British Treasury said it was "monitoring the situation closely but no specific proposals for private-sector involvement have been tabled."

"We are conducting our own talks," a German Finance Ministry official said Monday. "The French plan is the French plan. We are not commenting yet on what we might do."

Gilles Moëc, an economist at Deutsche Bank, said there would be "quite a few hurdles" for the French plan. Apart from needing backing from Germany and other European countries, he said that the Union's structures created to bail out struggling economies would need to be altered to create the "guarantee mechanism" and that could necessitate national ratifications.

"This does not protect against a political meltdown in Greece this week if the government can't manage to get its austerity plan endorsed by Parliament," he added.

A vote on Greece's latest austerity measures is scheduled for Wednesday, to be followed by another vote Thursday on separate legislation to implement the reforms. If the measures are passed, the European Union is expected to announce the size and details of a second bailout package at the meeting of ministers July 3.

But many economists say that even if Greece passes the austerity measures this week, it will merely delay an inevitable restructuring because Greece is effectively insolvent.

A quandary for Merkel on euro's fate

Paul Taylor

INSIDE EUROPE

BRUSSELS On a rainy Friday night in Berlin, sometime in the next 18 months, Chancellor Angela Merkel of Germany might receive a telephone call from the president of the European Central Bank. Let us imagine how it might go. Any resemblance with reality, as they say in the movies, would be coincidental.

Greece has once again fallen behind on its deficit reduction goals, in large part because of its inability to collect taxes. Privatization plans are behind schedule and investors are shunning asset sales because of labor unrest and political instability. A second bailout plan from the European Union and International Monetary Fund, cobbled together in September 2011 and forced through reluctant parliaments, is falling apart.

The board of the I.M.F. is no longer willing to approve more aid for Athens, which will run out of cash within days, causing the euro zone's first sovereign default.

"Madame chancellor, it's not looking good," Mario Draghi, the president of the E.C.B., tells Mrs. Merkel. "There was a run on a Greek bank today with savers lining up to withdraw their euros. There is carnage on the financial markets. It's hitting the bond spreads of Spain, Italy, Belgium, even France."

"We have been pumping liquidity into the Greek banking system but we cannot go on," he continues. "If there is no European decision by Monday, Greece will default next week. And if Greece goes, it will hit banks across Europe, spread panic in the stock and bond markets, and drag down other stressed euro zone sovereigns."

There follow several calls from Christine Lagarde, the director of the I.M.F., and José Manuel Barroso, president of the European Commission. The calls confirm that Greece has reached the end of the road and plead for a decision by European leaders within 48 hours on a plan to protect the euro from the consequences of a Greek default.

"Since last year, we have declared we will do everything it takes to preserve the euro," Mr. Barroso says. "Well, now's the time," he declares, requesting that E.U. leaders gather for an emergency meeting Sunday.

No one is advising a third bailout for Athens, as the first two failed to put the country's public finances back on a sustainable path. It appears to be generally recognized that Greece is insolvent.

Around midnight, President Barack Obama calls Mrs. Merkel. "The fate of the global economy hinges on what you in Europe do this weekend," he says. "If you take bold action to resolve the crisis, the United States will support you."

The options available to Mrs. Merkel all appear grim. How is she to explain to the German Parliament that perhaps half of the €35 billion, or $49 billion, she pledged in bailout loans to Greece will be lost, not to mention the extra money needed to recapitalize German banks exposed to Greek debt?

Imagine the headline Monday across the front page of the popular daily newspaper Bild: "Broke Greeks burn our billions."

> **Germany "always signals they'll go national, but in the end, they go European."**

Will she be blamed for her hesitation early in the crisis, when Greece might have been saved at a much lower cost, and go down in history as the German who sank the euro?

How can she reassure Germans that their money is still safe? Will she succumb to domestic pressures to push Greece out of the euro area, and at what political and financial cost? Or is there a way out of the crisis that could strengthen the euro in the future and mitigate the huge losses that are inherent in a Greek default?

The German finance minister, Wolfgang Schäuble, the most pro-European member in Mrs. Merkel's cabinet, raises an idea that has been discussed quietly but intensively among an inner core of E.U. finance officials for months, despite public denials.

To limit the market meltdown and restore confidence in the wider euro zone, why not swap Greek government debt at a heavy discount for bonds issued by the euro zone's rescue fund, the European Financial Stability Facility, or E.F.S.F.? These new instruments would be jointly guaranteed by euro zone member states and accepted by the E.C.B. as collateral in its refinancing operations, keeping Greek banks alive.

Greece's debt mountain would be roughly halved, to 80 percent of its annual economic output, in a restructuring deal with creditors. Banks and insurers would take steep haircuts, as write-downs are called, but would get new bonds underwritten by the European rescue fund. Most private investors would be well prepared by then.

There would inevitably be an outcry in Germany. Critics in her center-right coalition and the news media would howl, "eurobonds through the back door" or "Merkel accepts transfer union."

The Free Democrats, Mrs. Merkel's liberal coalition partners, might walk out of government, but they are a dwindling force anyway. Rebels among Mrs. Merkel's Christian Democratic Party could try to bring her down, but they have no viable alternative candidates.

If Mrs. Merkel decides to try the route of European bonds, she will most likely find support among the opposition Social Democrats and Greens. Based on her government's record during the crisis, there are grounds to believe she might ultimately choose the Eurobond solution "to save the euro" that fateful weekend.

The German government "always signals they'll go national, but in the end, they go European at the very last second," Henrik Enderlein, professor of political economy at the Hertie School of Governance in Berlin, has said.

Mrs. Merkel vowed not to bail out Greece before later agreeing to do so. She insisted there would be no general bailout fund, only to accept one. She said the European rescue fund would be temporary, then allowed a permanent rescue mechanism. She demanded compulsory private sector involvement in future bailouts, then settled for a voluntary solution.

Until now, Mrs. Merkel vehemently rejected the idea of jointly issuing common euro zone bonds, but that too could change in extreme circumstances.

"There is no real constraint on Germany as long as there is pro-European leadership," Mr. Enderlein said. "They wouldn't call it Eurobonds but E.F.S.F. bonds."

Paul Taylor is a Reuters correspondent.

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