2 leaders offer modest changes for euro zone

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Merkel and Sarkozy urge cooperation but rule out bonds to share debt risk

BY STEVEN ERLANGER

The leaders of France and Germany said on Tuesday that they would jointly propose closer coordination of economic policies among the 17 countries of the euro zone, support a requirement that each nation incorporate a law regulating spending and debt and push for a new tax on financial transactions.

But the much-anticipated meeting between President Nicolas Sarkozy of France and Chancellor Angela Merkel of Germany produced little that would provide quick relief to the anxieties of bond traders, who are becoming increasingly worried that slow growth in both Germany and France will make it harder to overcome Europe's debt crisis.

And markets will be disappointed, although hardly surprised, that both leaders ruled out collective "eurobonds" to share responsibility for government debt and opposed a further increase in a bailout fund that will not be put into place until late September at the earliest.

Their joint proposals were as modest as German officials had forecast. And their most ambitious idea — that all euro zone states incorporate a "golden rule" into their national constitutions by the end of 2012 to work toward balanced budgets and reduced sovereign debt — is unlikely to be accepted by all member states. It may not even get through the constitutional process in France, because Mr. Sarkozy does not have a large enough majority in Parliament.

"We all hope for a single lever to pull to solve all our problems," Mrs. Merkel said, but there is "no magic wand" for the euro zone. She emphasized her view that the only way "to restore confidence" is a longer-term effort to harmonize economies and taxes, increase growth and establish better fiscal discipline throughout the euro zone.

To help accomplish that goal, Mrs. Merkel said, the European Commission should be empowered to redirect structural funds away from infrastructure projects so that they "promote competitiveness and growth."

Both leaders cited the agreement to jointly propose a financial-transaction tax by 2013 as "an example of convergence" needed in the entire euro zone. But such a tax faces an uphill struggle, particularly if Britain, which is outside the euro zone and has Europe's biggest financial center, continues to resist the idea.

They also said they would work to harmonize French and German economic assessments and, down the road, corporate tax rates.

"France and Germany are committed to strengthen the euro," Mrs. Merkel

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said. "To that end we need to better integrate our economies" and "to see that the stability pact will be acted on."

The stability pact, a key element of the treaty that launched the euro zone, is an oft-broken commitment to keep fiscal deficits to 3 percent of gross domestic product and total sovereign debt under 60 percent of annual G.D.P.

Their meeting at the Élysée Palace in Paris came after a dizzying week in the markets, a general gloom about the lack of political leadership on the euro and lower growth numbers across much of Europe.

Analysts said investors were looking for a clear direction out of the euro's difficulties, but the leaders instead emphasized more long range solutions.

"We are certainly heading for greater economic integration of the euro zone," Mr. Sarkozy said after the two leaders proposed twice-yearly meetings of the 17 euro zone heads of state and government under the presidency of Herman Van Rompuy, who is already the president of the European Council of all 27 member states.

In essence, the meetings, if agreed upon, would make concrete a "two-speed Europe" that many warned about when the European Union expanded so rapidly after the collapse of the Soviet Union in the early 1990s.

On July 21, at the last emergency summit meeting on the euro in Brussels, the two leaders had agreed to meet to discuss "joint proposals for the reform of the governance of the euro zone." But

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they made it clear in the past few days, despite market gyrations and doubts about their commitment to keeping the monetary union intact, that collective eurobonds would not be on the table here.

Mrs. Merkel arrived undoubtedly chastened by the sharp slowdown of German growth, which only rose one-tenth of a percent in the second quarter. That figure, released on Tuesday, combined with France's flat economy in the same quarter, brought new gloom to the euro zone in indicating that countries will find it harder to grow their way out of debt. Germany and France have the two largest economies in Europe.

To some degree, the German figure was inevitable, given the slowdown in the rest of the world, because Germany depends heavily on exports. But Germany is considered the main driver of European growth, and figures also released on Tuesday showed an overall slowdown in the euro zone, promising more stagnation and budget difficulties.

Spain and Italy have come under fire recently in the bond markets over concerns about their economic prospects, forcing the European Central Bank to intervene heavily to buy up their bonds. Growth in Spain slowed slightly to two-tenths of a percent, while the Italian economy picked up a bit, growing by three-tenths of a percent against one-tenth of a percent in the first quarter.

Given the problems in the euro zone — sovereign debt, undercapitalized banks, aging populations and imbalances between northern and southern countries in trade, growth and competitiveness — many analysts and some officials, too, have been pushing for the introduction of eurobonds, which would combine the collective credibility and collateral of all the member of the currency union.

But that could lead to a rise in borrowing costs for Germany and France, and a considerable rise, too, in risk, something neither country is currently prepared to accept beyond the July 21 bailout fund.

France is already having trouble meeting its commitments to cut its fiscal deficit to 4.6 percent of G.D.P. in 2012, an election year, and desperately wants to meet that target to hold on to its triple A bond rating.

Still, Mr. Sarkozy, who has strong presidential powers and a majority in both houses of Parliament, and who likes to talk about "European governance," can do pretty much what he wishes. By contrast, Germany is a federal state, and Mrs. Merkel, cautious by nature, governs in a coalition that is hampered by a weak partner, the pro-business Free Democrats.

Her own Christian Democrats are largely opposed to writing blank checks for Europe; the German constitutional court may not find it legal and the Free Democrats are opposed, wanting instead to revive tax cuts to help bolster their waning popularity. Mrs. Merkel could probably find support among the opposition Social Democrats and Greens, but that would divide her party and undermine her government.

She is going to have enough trouble in getting approval in Parliament of the July 21 agreement to expand the bailout fund to €440 billion.

Some Germans, to be sure, have been talking about supporting eurobonds, but Mrs. Merkel opposes them, as do leaders in the Netherlands and Finland. In any case, the price for them may be steeper than the rest of Europe wants to pay.

As the chancellor's European-minded finance minister, Wolfgang Schäuble, said to Der Spiegel over the weekend, "I rule out eurobonds as long as member states conduct their own financial policies and we need different rates of interest in order that there are possible incentives and sanctions to enforce fiscal solidarity."

In other words, he favors a European finance ministry with the capacity to override national sovereignty on issues of budgets, taxes and other matters.

That might be digestible for Greece or Portugal, which have already given up chunks of sovereignty over their finances in return for bailouts. But it is not likely to go down very well in Italy or Spain — or even France, for that matter.

Nicola Clark contributed reporting.