Greece told to bear the pain of fixing its finances

PARIS

BY STEVEN ERLANGER

With the Polish finance minister talking of "Europe in danger," France and Germany are pressing embattled Greece to stay the course, however difficult, to restore its economy, avoid a sudden default and remain within the euro zone, French officials said Wednesday.

President Nicolas Sarkozy of France and Chancellor Angela Merkel of Germany planned a videoconference call with the Greek prime minister, George A. Papandreou, Wednesday evening, in which they were expected to tell Mr. Papandreou that he must meet deficit-cutting promises to the European Union and the International Monetary Fund in return for subsidized loans and a second bailout.

At the same time, officials said, France and Germany would promise full support to Greece and their commitment to preserving the 17-nation euro zone. Together, they are pushing all euro zone states to ratify as soon as possible decisions made on July 21, which expanded the European Financial Stability Facility and allowed it increased flexibility to protect Greece and other heavily indebted members as they work to cut deficits and stabilize their finances.

The facility would be expanded to €440 billion, or $600 billion, to allow it to cover Greece, Ireland and Portugal, buy bonds in the secondary markets, aid troubled banks and offer lines of credit.

Mr. Sarkozy was not expected to make any public comments after the conversation, said the government spokeswoman, Valérie Pécresse. "We want a guarantee that the recovery plan will be put into action," she said. But she emphasized that France was determined "to do everything in order to save Greece."

France is also determined to save its banks, which are heavily exposed to Greek debt and which have not fully written down that exposure to a realistic level, given the wide expectation that it will need to be restructured, with a significant loss, or "haircut," to creditors, by the end of the year.

France suffered a minor blow Wednesday as two of its biggest banks, Société Générale and Crédit Agricole, were downgraded a notch by Moody's Investor Service, which cited their exposure to the Greek economy and the fragile state of bank financing markets. It kept a third, BNP Paribas, under review, but said its profitability and capital base provided an adequate cushion to

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In Brussels, a tempest on a flagpole

BRUSSELS

BY STEPHEN CASTLE

Outrage erupted Wednesday at a reported suggestion from a German member of the European Commission that the flags of the euro zone's weaker economies, or "deficit sinners," should be flown at half-staff.

Günther H. Oettinger, the European commissioner for energy, denied having made such a statement to a German tabloid newspaper. But displeasure at the report, which has been simmering since last week, burst into the open Wednesday when more than 150 members of the European Parliament called on Mr. Oettinger to retract his comments or quit.

Mr. Oettinger was reported in the newspaper Bild as saying that there had been a suggestion of flying the flags of "deficit sinners" at half-staff in front of E.U. buildings. Under the rules of the euro, countries are supposed to run deficits of no more than 3 percent of gross domestic product. He reportedly added that this "would just be a symbol, but would still be a big deterrent."

A Portuguese deputy, Rui Tavares, issued a statement describing Mr. Oettinger's comments as "scandalous," "completely unacceptable" and "inherently anti-European."

In Ireland, one of three euro-zone countries to seek an international bailout, the government also attacked the comments. "We certainly don't believe that is an appropriate suggestion to be making to the Irish people," who are "sacrificing a lot of their disposable income in order to get us back to growth and economic and financial health," Phil Hogan, minister for the environment, told The Irish Times.

A spokeswoman for Mr. Oettinger, Marlene Holzner, said the idea arose in conversation, and the commissioner did not propose it nor was he promoting it. "The idea regarding the flag is an unconventional one and, I would admit, probably misleading," she said, reading from a declaration by Mr. Oettinger.

France and Germany urge Greece to persist on economy

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support its exposure to Greek, Portuguese and Irish debt.

French officials insisted that the banks were strong and implied that Paris would do whatever was necessary to recapitalize them if necessary to cover any Greek losses.

In fact, French officials were relieved that the downgrade was modest, only one notch.

The U.S. Treasury secretary, Timothy F. Geithner, also sought to soothe nerves over a possible Greek default, saying in a CNBC interview that European leaders had the capacity "to hold this thing together." Before flying to an informal meeting of European finance ministers Friday in Poland, Mr. Geithner said "there is no chance that the major countries of Europe will let their institutions be at risk in the eyes of the market." He added: "They recognize that they have been behind the curve; they recognize that it will take more force behind their commitments." He was not specific about what needed to be done.

But the slow speed of Europe, where every country must approve any significant move, and where parliaments go on long August vacations, leads to market frustration and opportunities to profit on panic. The decisions of July 21 would have made a larger difference had they been implemented immediately; they are unlikely to come into place before mid-October.

But for now, with the European Central Bank intervening to buy bonds of countries like Spain and Italy to keep the yields down, and Spain and Italy working to cut their deficits and budgets, the importance of Greece is paramount. With Greece in recession after two years of austerity, making it harder and harder to balance its budget — even without debt repayments — it needs €8 billion in aid in October to pay wages and pensions. France and Germany are using that as leverage to get more cutbacks out of Athens.

At the same time, a sudden Greek default would create chaos and a run on other indebted countries, so the threats must be carefully gauged. In Greece itself, there is confidence that the government will do enough to get the October aid and that there is little chance of a default in the short term.

Part of the July 21 deal was a partial restructuring of Greek debt and an effort to push creditors to swap short-term Greek bonds for longer-term securities, which contributes some €54 billion to the bailout package. Greek bankers said they thought the deal would get done, especially with Greek debt trading at a 60 percent discount to its face value.

Europe also has had trouble with divisions within its own institutions, and a rivalry between the European Council of nation states, run by President Herman Van Rompuy, and the European Commission, the permanent bureaucracy, run by President José Manuel Barroso.

The long euro crisis has sidelined Mr. Barroso, who created something of a fuss Wednesday when he said he was close to proposing options for joint euro bonds — a collective bond backed by all the member states of the euro zone. Markets like the idea, because they would put the strong states behind all the debts of the weaker and more profligate ones.

But Germany, the Netherlands and France all oppose euro bonds as harmful before there is more economic coordination and harmonization among member states. Otherwise, they argue, their own creditworthiness will be used to support spendthrift states before they get their houses in order.

Mrs. Merkel's own coalition partner, the Free Democrats, also opposed euro bonds. There is also the question of whether they would be ruled constitutional by the German constitutional court, since they would not allow the German Parliament much say over the commitment of German taxpayer funds.

Euro bonds now would also put an enormous strain on the credit ratings and budgets of the most successful countries, and could deprive France of its triple-A credit rating. Mr. Barroso himself said such bonds "will not bring an immediate solution for all the problems we face."

"There is no chance that the major countries of Europe will let their institutions be at risk in the eyes of the market."

But the edgy mood was not helped by comments from the Polish finance minister, Jacek Rostowski, who told the European Parliament in Strasbourg that "Europe is in danger" and that "if the euro zone breaks up, the European Union will not be able to survive" — a view expressed by Mr. Van Rompuy many months ago.

Mr. Barroso, whose native country, Portugal, had to seek E.U. and I.M.F. aid, said that "this is a fight for the economic and political future of Europe."

Olli Rehn, the bloc's economic affairs minister, warned that "a default or exit of Greece from the euro zone would carry dramatic social, economic and political costs, not only for Greece, but also for euro area member states, other E.U. states, as well as global partners."

Like many, he said Europe needed a moment of clarity leading toward a more harmonized, federal future, "and that moment must start today."

Mr. Sarkozy, for his part, reportedly will travel together with Prime Minister David Cameron of Britain on Thursday to Libya, where they are credited for a diplomatic and military triumph in providing European leadership to defend the Libyan opposition and help overthrow Col. Muammar el-Qaddafi. They would be the first foreign leaders to visit "free Libya," even with the colonel still at large.

Liz Alderman in Paris, Stephen Castle in Brussels and Landon Thomas Jr. in London contributed reporting.