Time running out for Greece and Europe

FRANKFURT

Default and rescue each hold consequences that many still hope to avoid

BY JACK EWING

Europe appeared to be lurching toward a moment of decision in its sovereign debt crisis Sunday, as Greece struggled to meet conditions for further aid amid rising German impatience with the cost.

Prime Minister George A. Papandreou of Greece canceled a planned trip to Washington to meet with his cabinet Sunday, in what looked like an increasingly desperate attempt to show foreign benefactors that the government can keep the promises it made in return for aid. Without the aid, the country would certainly default on its debt, an event that economists have warned could lead to bank failures in other countries and ignite another financial crisis.

"Greece's imminent default is assured," Carl B. Weinberg, chief economist at High Frequency Economics in Valhalla, New York, wrote in an e-mail Sunday. "Without an injection of cash within the next weeks, the nation will run out of resources to service its debt."

Other analysts are less pessimistic, arguing that European leaders will do what is necessary to save Greece once they are confronted with the ugly ramifications of a default. These might include having to rescue banks, particularly in France and Germany, that have large holdings of Greek bonds, as well as putting even more acute pressure on other highly indebted euro zone countries like Italy and Spain. In the worst case, the euro could come apart, setting back the cause of European unity by decades.

When political leaders do the math, they may realize it is cheaper to save Greece than engineer a bank rescue only two years after the last round of

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VOTERS IN BERLIN DENY MERKEL A LIFT

Mayor Klaus Wowereit won a third term, preliminary results showed. *PAGE 4*

BERLIN SEEKS INSPIRATION ON THE WEB

A lively bunch of entrepreneurs hopes to transform the German capital. *PAGE 4*

Time is running out for Greece and Europe

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bank bailouts, analysts said.

"You can stabilize the banking system and let the sovereign go through the roof, but that is not the most efficient way to do it," said Guntram B. Wolff, deputy director of Bruegel, a research organization in Brussels.

Still, political leaders outside the euro zone have displayed concern that the European approach to the crisis lacks urgency. Timothy F. Geithner, the U.S. Treasury secretary, attended part of a meeting of European finance ministers on Friday and Saturday in Wroclaw, Poland. It is rare for a U.S. official to attend such a meeting, known as Ecofin, and it was Mr. Geithner's first time.

"I can't remember the last Ecofin meeting a U.S. Treasury secretary has attended," said Nick Matthews, an economist at Royal Bank of Scotland. "It is a clear signal of how serious the sovereign debt crisis has become and an indication that it has gone beyond Europe and is threatening on a global dimension."

The finance ministers failed to make substantial progress toward resolving the debt crisis or to make any pledge to recapitalize Europe's banks.

Jacek Rostowski, the finance minister of Poland, who invited Mr. Geithner, said the U.S. official's attendance showed "unity within the trans-Atlantic family." Although Mr. Geithner's comments elicited grumbles from several European ministers, his plea for European politicians to make urgent decisions to shore up the euro zone was echoed Saturday by two ministers whose countries have remained outside the currency area.

"The euro zone leaders know that time is running out, that they need to deliver a solution to the uncertainty in the markets," said George Osborne, Britain's chancellor of the Exchequer, who told the BBC that he wanted to see action over Greece and the "weakness" in Europe's banking system.

Anders Borg, the Swedish finance minister, said that "the politicians seem to be behind the curve all the time." Citing a "clear need for bank recapitalization," he added: "We really need to see some more political leadership."

Despite the potentially grave consequences, the mood in Germany seemed to be turning increasingly in favor of letting Greece fail rather than bear the growing cost.

Wolfgang Schäuble, the German finance minister, on Sunday repeated warnings that Greece will not receive any more aid unless it keeps promises it made to the International Monetary Fund, the European Commission, and the European Central Bank to cut government spending and improve the economy. "The payments on Greece are contingent on clear conditions," he told the Bild am Sonntag newspaper.

German commitment to the euro seems to weakening as membership becomes increasingly expensive. The Ifo Institute, an economic research organization in Munich, said in a study released Saturday that if Greece, Italy, Portugal and Spain all became insolvent, Germans would be liable for €465 billion, or $642 billion. The institute has argued that Greece should leave the euro for its own good.

As the largest country in the 17-nation euro zone, Germany is the biggest contributor to a bailout fund designed to help Greece as well as Portugal and Ireland continue to pay their debts while their economies recover.

But Greece has not moved as fast as the I.M.F. and other overseers would like to reduce the bloated government work force, deregulate the labor market and remove other impediments to growth. Mr. Papandreou faces enormous political pressure at home from a public desperately weary of austerity measures and plunging economic output.

The European Central Bank also will play a role in the decision whether to continue aid to Greece and has a strong interest in preventing a Greek default. The E.C.B. has spent an estimated €40 billion to €50 billion buying Greek bonds in an ultimately unsuccessful attempt to hold down the yields, or effective interest rate, on the securities. The central bank might need to rebuild its capital if those bonds default and will do all it can to dissuade political leaders from allowing Greece to fail.

Jens Weidmann, president of the German central bank, said that the E.C.B.'s purchases of debt from countries like Greece and Spain create liabilities that might eventually have to be borne by taxpayers, the German newsweekly Der Spiegel reported Sunday on its Web site.

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"We have to reduce these risks, 27 percent of which are backed up by the German taxpayer," Mr. Weidmann said, referring to the country's share of E.C.B. capital. Mr. Weidmann is a member of the E.C.B.'s policy-making governing council.

Many Germans have come to see the euro as a burden, an alliance that makes them to prop up irresponsible partners. But most economists and business people see the country as one of the common currency's main beneficiaries. The euro is probably weaker than the Deutsche mark would be, helping to keep down the price of German goods when exported abroad.

German political leaders are well aware of the importance of the euro to the German economy and may tone down their rhetoric following elections Sunday in Berlin, which besides being the capital has the status of state. There is only one state election next year, in May in Schleswig-Holstein. With less need to appease restive voters, Chancellor Angela Merkel could, if she chooses to, use the time to push through some of the measures that are probably necessary to save the euro.

German banks would also be vulnerable to declines in the value of the government bonds they own, and they might require another round of government aid if Greece defaulted. Germany's 10 biggest banks need to increase their reserves by €127 billion, Frankfurter Allgemeine reported in its Sunday edition, citing a study conducted for the newspaper by the German Institute for Economic Research in Berlin.

The E.C.B. has signaled its determination to make sure that European banks have enough cash even if investors in the United States and elsewhere choke off funding. The central bank last week expanded a dollar credit line in coordination with the U.S. Federal Reserve and other major central banks.

But the E.C.B. cannot rescue failed banks or help weakened banks to rebuild their capital reserves. Mr. Weinberg of High Frequency Economics said that euro zone governments should be establishing funds "to assure the public that resources are available to prevent banks from failing no matter how big the hit to their individual capital bases."

"It is mega-urgent," Mr. Weinberg, "and I think this is the gist of what Geithner told them: protect the banks."

Niki Kitsantonis contributed reporting from Athens, and Steven Castle contributed from Wroclaw, Poland.