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Euro plan scrutinized amid fears it isn't enough

FRANKFURT

Aides ironing out details on bank reserves, but markets seek bolder steps

BY JACK EWING, GAIA PIANIGIANI AND LIZ ALDERMAN

As European officials worked Monday to iron out details of a plan to save the euro, fears were growing that the end result might be another example of European leaders doing as little as they think they can get away with.

After marathon talks in Brussels during the weekend, Angela Merkel, the chancellor of Germany; Nicolas Sarkozy, the president of France; and other leaders decamped to their respective capitals. But high-level aides remained to work on issues like debt relief for Greece and measures to strengthen European banks.

In Italy, Prime Minister Silvio Berlusconi did little to ease the discomfort as he struggled Monday to get his own allies to support pro-growth measures that he first promised in August. During the weekend, Mrs. Merkel and Mr. Sarkozy were openly disdainful of Mr. Berlusconi's progress so far.

Investors seem to hope that when the leaders reconvene Wednesday, they will take more decisive action than they have in innumerable past summits. Major stock indexes in Europe rose Monday, as did the euro against the dollar.

But one of the most concrete results of the weekend talks — a plan to compel banks to bolster their emergency reserves — disappointed expectations and suggested that Mrs. Merkel and Mr. Sarkozy were still hesitant to commit resources to a problem that threatens not only the survival of the euro but the world economy.

Banks would be required to raise their reserves by about €100 billion, or $139

YVES LOGGHE/AP

Nicolas Sarkozy and Angela Merkel were openly disdainful of Silvio Berlusconi.

billion, for the euro area as a whole. That sum is at the very low end of analysts' estimates, and is well below what many analysts consider adequate to remove doubts about the creditworthiness of European banks and to restore their access to international money markets.

"The key to reestablishing confidence is to reassure markets you have dealt with the weak links," said Nicolas Véron, a senior fellow at Bruegel, a research organization in Brussels. "It seems the parameters they have agreed on do not accomplish that."

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Skepticism over euro plan

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Mr. Véron said the standards applied appeared to be so lenient that even the troubled French-Belgian bank Dexia would not be required to raise more capital, if it were not already the focus of its second government rescue in three years.

The tentative plan would give banks until June 30 to increase their reserves, which they could achieve by selling new shares, retaining profits or selling assets. But taxpayer support would be required for weaker banks.

In response to criticism that the time span was too long, some officials in Brussels were arguing to move the deadline to the end of the first quarter.

The recapitalization plan seems to be based on the costs of a default by Greece, but investors have already shifted their focus to Italy and the risk that Rome's dysfunctional politics could endanger the country's ability to service its debt.

The amount being discussed is not enough to reassure investors about the risks emanating from Italy, said Jon Peace, an analyst in London for Nomura. "We're going to need potentially much more capital to provide that comfort."

If there were a positive message to emerge from the meeting, it was the acknowledgement by European leaders that the crisis required a battery of measures, including the bank recapitalization.

"The Europeans have now come to the conclusion that something needs to be done about the capital of the banks, and they should do it well, consistently and in a coordinated fashion without missing the target," said an official who has participated in the talks, who spoke on condition of anonymity because the discussions were continuing and confidential.

Talks with banking industry representatives in Brussels were also continuing over a steeper devaluation of Greek debt, perhaps as much as 60 percent, to a level the country has a chance of repaying. But banks, which agreed earlier to a 21 percent "haircut," seemed to be taking a hard line.

One of the main negotiators for the banking industry warned of dire consequences if banks were forced to accept losses against their will.

"Any approach that is not based on cooperative discussions and involves unilateral actions would be tantamount to default, would isolate the Greek economy from international capital markets for many years, and would impose a harsh burden on the Greek people as well as European taxpayers," said Charles H. Dallara, managing director of the Institute of International Finance, a banking group.

"It would also likely have severe contagion effects, which would cost the European and the world economy dearly in terms of employment and growth," Mr. Dallara said in a statement.

The banks are insisting on assurances that Greece will eventually be able to repay its debts on its own, without the help of international bailouts. The International Monetary Fund said last week that would be a tall hurdle, since Greece's economy had deteriorated so much that it might need to rely on international assistance for as many as nine years.

In the weekend meetings in Brussels, the sense of frustration with the banks was palpable among some policy makers, said the official who participated in the talks. Given that investors might no longer be surprised if Greece did default, several member states said one should be allowed to, according to the official.

Nonetheless, with the painful memory of Lehman Brothers' demise in 2008 still fresh, Europeans recognize the dangers of allowing a Greek default. A default would be dangerous "because we don't have a clue of what it would be like, just like with Lehman," the official said. "Little did we know what the consequences would be."

"We're going to need potentially much more capital."

The European leaders also seemed to be paying more attention to the need to do more than just preach austerity. There is general agreement that they need to find a way to restart economic growth not just in Greece and other stricken countries but throughout the Continent.

"Without growth, Europe is at risk of struggling permanently with debt sustainability," the economists Zsolt Darvas and Jean Pisani-Ferry wrote in a paper published Monday by Bruegel, a policy research group in Brussels.

New data Monday underscored what the paper called a "growth emergency." The Markit Eurozone purchasing managers' index for industrial and services companies fell to its lowest point since July 2009, led by a steep decline in business sentiment in France. The survey data reinforce expectations that Europe is headed for a recession, which could depress tax receipts and make it even more difficult for governments to reduce their budget deficits.

In Italy, Mr. Berlusconi is due to propose changes to the pension system, the most controversial measure within his center-right coalition. Other measures under discussion include loosening de facto professional cartels, making the labor market more flexible and reducing government bureaucracy to encourage growth. The government would also raise revenue by selling state assets and imposing a wealth tax.

Mr. Berlusconi worked on the measures Monday instead of testifying in a corruption trial in Milan, where the prime minister was accused of bribing a British lawyer, David Mills, to lie in court to protect him.

The government had announced the measures to encourage growth in August, soon after Parliament passed the €54 billion in austerity measures. But the growth plan has so far stalled.

Mr. Berlusconi said in Brussels on Sunday that one of the most urgent measures was to raise the retirement age to 67 from 65. But Marco Reguzzoni, leader in Parliament of the Northern League, said that the nominal allies of the prime minister were strongly against any increase in the retirement age.

"The League has always been against any pension reforms," Mr. Reguzzoni told Italian television.

Another issue that European leaders are trying to resolve is how to increase the financial clout of the euro area's bailout fund. One plan favored by Germany involves setting aside money from the fund to guarantee bonds from countries like Italy or Spain against a first cut of any losses that buyers might suffer.

Because neither Germany nor France want to pump even more taxpayer money into the €440 billion fund, a second, more intense debate has sprung up over the idea of creating an accompanying fund, known as a special-purpose vehicle, that would theoretically attract money from emerging market nations or other countries to help Europe contain the crisis.

Gaia Pianigiani reported from Rome and Liz Alderman from Paris. Stephen Castle contributed reporting from Brussels.