Sweeping change weighed for euro rules

BERLIN

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Euro zone leaders are discussing an agreement among themselves to institute strict new budget rules for the countries using the currency, circumventing the lengthy European Union treaty process in a bid to reassure the markets and encourage the European Central Bank to do more to fight the deepening sovereign debt crisis.

Markets clearly have been unconvinced thus far by European leaders' intermittent efforts to demonstrate that they are prepared to protect countries like Italy and Spain, the third- and fourth-largest economies in the euro zone, after Germany and France, from financial contagion. The Germans want a new euro zone treaty, but the French believe that any agreement would come too late to matter.

Now France, Germany and Italy are prepared to move ahead more quickly to establish firm rules on fiscal issues, including debt limits, and to encourage more coordination of economic and fiscal policy, the French budget minister and government spokeswoman, Valérie Pécresse, said Sunday.

The idea would be "a new governance that would be a governance with real regulators and real sanctions, that would give real confidence," she said during an interview on the television channel Canal Plus. "Germany, France and Italy want to be the motor of a Europe that is much more integrated, much more solid and with regulatory mechanisms that are virtuous, that don't allow a cheater, so that there is no one who can exempt themselves from the rules that are set."

"Countries need to make a complete commitment to cutting their debt levels and increasing budgetary convergence," Ms. Pécresse said. "Then European institutions will be able to play their full role," she added, naming the European Commission, the European Council and the E.C.B.

The agreement would not just be among France, Germany and Italy, Ms. Pécresse said, but among as many of

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HIGH PRICE OF RESOLVING EURO CRISIS

Euro zone policy makers face intense pressure to act, but all potential courses have serious consequences. *PAGE 16*

TAX REBELS GAIN MOMENTUM IN GREECE

As real estate taxes fall due, growing resentment in parts of Greece could hurt the country's political stability. *PAGE 15*

Pressure keeps building for a solution to euro zone morass

LONDON

All potential outcomes raise financial, legal and political concerns

BY LANDON THOMAS JR.

PATRICIA DE MELO MOREIRA/AGENCE FRANCE-PRESSE

A general strike in Lisbon last week to protest government austerity measures. Europe has been unable to resolve how to get money from the few countries that have it, mainly Germany, to the many that need it, including Portugal.

It can appear as if the endgame for Europe is fast approaching: It either splits apart or binds ever closer together.

Neither outcome is certain, of course — Europe's leadership may well keep on its current path of offering piecemeal solutions that have quickly been rejected by an investor community that has lost all patience with the euro zone's inability to act decisively.

And each of these potential outcomes, from Greece exiting the euro zone to, conversely, a deeper union in which a federal Europe takes control of national budgets, would bring with it serious political, legal and financial consequences.

But with financial panic now threatening to move from Italy and Spain to Belgium, France and even Germany, the euro zone's paymaster, the pressure upon Europe to arrive at a solution has reached its most intense point yet.

Even the British satirical weekly Private Eye has weighed in, proposing last week that the answer was for Europe itself to leave the European Union.

Underlying these possibilities, however, from the absurd to the less so, has been Europe's persistent inability to rectify the central conundrum of its common currency project: how to get money from the few countries that have it, mainly Germany, to the many that need it — Greece, Italy, Spain, Portugal, Ireland and perhaps even France.

The potential consequences of continued inaction are dire. Uncertainty and austerity have killed the euro zone's growth prospects, and analysts now expect the euro area's economy to shrink 0.2 percent next year.

U.S. banks are among the worried onlookers. According to the Institute of International Finance, American financial institutions have $767 billion of exposure via bonds, credit derivatives and other guarantees to private- and public-sector borrowers in the euro zone's weakest economies.

And as the European Central Bank continues to hold back from printing money, as its peers in the United States and Britain have done, investors now see a much higher likelihood of a broad market crash and a worldwide recession.

Such anxieties were on display last week when Vítor Constâncio, the vice president of the E.C.B., gave a speech to investors in London. It was billed as an address on the international monetary system, but given the circumstances, there was little interest from investors in Mr. Constâncio's views regarding fixed versus floating exchange rates and quite a lot in terms of what steps the E.C.B. might take to address the crisis.

One somewhat frantic investor said that it was not only the Italians and the Spanish who were having problems selling their bonds; even the Germans were having problems. What was the E.C.B. going to do about it? he asked.

Mr. Constâncio mentioned making loans available to banks and the bank's bond-buying program, but he was blunt in saying that unless countries like Greece and Italy followed treaty rules to reduce their budget deficits, there was not much he could do.

''The countries must deliver,'' said Mr. Constâncio, a former governor of the Portuguese central bank. ''In the end, it is governments that are responsible for the euro area — it is not just the E.C.B.''

But it is this policy approach that many analysts are now saying is making the situation worse as countries throughout the euro area — including even Germany — cut spending and raise taxes to meet budget deficit targets.

In a recent paper, Simon Tilford, the chief economist of the Center for European Reform in London, said that imposing more rules in place of a federal framework whereby the euro zone could commonly transfer or borrow money — as the United States can do through the Federal Reserve — would end in disaster.

''The solution to the problem has become the problem itself,'' he said. ''And investors see this. You cannot just keep cutting spending in the teeth of a recession.''

Bernard Connolly, a longtime critic of European policies, estimates that it would cost Germany, as the main surplus country in the euro zone, about 7 percent of its gross domestic product a year to transfer sufficient funds to bail out the deficit countries, including France.

That amount, he has argued, would far surpass the $400 billion World War I reparation bill forced upon Germany by the victorious Allied powers — the final payment of which Germany made just last year.

Obviously, any such move to a full-fledged transfer union would be resisted by Germany. And it is this unbending attitude by Europe's richest country that it not become responsible for the debts of the weaker economies that has so far resulted in little progress on the widely supported proposal that the euro area be able to issue its own collective bonds.

All of this has pushed investors to consider more extreme possibilities — for example, the exit from the euro zone of a country like Greece.

Such a result, however, would have dire consequences for the departing country, from default to a collapse of the banking system, analysts say.

A recent report by UBS estimates that in the first year, the citizens of the departing nation would suffer a cost of as much as €11,000, or about $14,500, a person on top of the austerity-induced pain already incurred.

It might also be legally impossible. There is no provision in any European treaty for a country to leave or be expelled from the 17-country euro zone — a conscious choice by the framers to force the inevitability of the project.

"The solution to the problem has become the problem itself. And investors see this."

It is also true that if a country made such a decision, under the governing treaties, it would have to leave the 27-member European Union as well, thus entering a more profound state of exile.

In fact, a view is now taking hold that the ever-worsening crisis might lead to steps giving Brussels direct control over the budgets of countries that continue to run excessive deficits — a proposal made recently by the euro's most passionate advocate, Jean-Claude Trichet, who recently retired as president of the E.C.B.

''The will to make this thing work is stronger than you might think,'' said Larry Hatheway, an economist at UBS and one of the authors of the report on the cost of a euro breakup.

In this vein, several economists at Bruegel, a research institute based in Brussels, have come out with a plan for a euro area finance minister, elected by the European Parliament, who would have limited revenue-raising powers on a federal level. These are radical measures, to be sure. Not only would they challenge the sovereignty of nations, they would require time and treaty changes.

Which is why, with time in very short supply, the pressure is building on the E.C.B. to defy German objections and buy more distressed government bonds, although there is little sign that the bank has changed its view in that regard.

Mr. Constâncio of the E.C.B. actually took pride last week in explaining to investors that the bank's bond-buying effort so far was equivalent to just 2 percent of the euro area's G.D.P. — compared with an intervention by the Federal Reserve in the United States equivalent to 11 percent of G.D.P. and one equivalent to 13 percent by the Bank of England.

''We are not financing the deficits of countries,'' he said.

Euro zone leaders weigh sweeping changes in fiscal rules

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the 17 countries that belong to the euro zone as possible.

But it is by no means clear that even such an agreement, made by the end of the year, would convince markets that the European Union, the E.C.B. and euro zone governments stand behind Italy and Spain.

The German chancellor, Angela Merkel, has firmly opposed both an expanded role for the E.C.B. and also bonds issued jointly by the euro zone countries — commonly known as euro bonds — as answers to the sovereign debt crisis. Instead, Mrs. Merkel has proposed changes to European treaties that would dictate budget discipline, ensuring that such a crisis could not happen again.

But on the E.C.B.'s role, Germany is ever more isolated in its stand. Even officials from once-staunch supporters from the northern bloc of deficit hawks like Finland and Austria are publicly raising the prospect of a larger role for the E.C.B. in the deepening crisis, to provide a backstop to Italy.

There are mounting signs that contagion from the crisis that began with Greece has spread, including an unusually weak bond sale on Wednesday in Germany, painfully high interest rates on sovereign debt for Italy and Spain, and signs that interbank lending in Europe has begun to dry up.

The Italian newspaper La Stampa reported that the International Monetary Fund could potentially bail out Italy with a rescue package of nearly €600 billion, or nearly $800 billion. There was no confirmation of the report and the size of such a package would be unusually big for the fund. But the Europeans have failed so far to expand their own bailout fund, and surplus countries like China have said they would prefer to invest in Europe, if at all, through the I.M.F.

As the crisis deepens and the very survival of the euro has been called into question, Germany may have begun to lose its grip on decision making.

On Friday, the Finnish finance minister, Jutta Urpilainen, told reporters in Berlin: ''If there is nothing else left, then we can think about strengthening the role of the E.C.B.'' On Saturday, the Austrian chancellor, Werner Faymann, told the Austrian press agency APA that the E.C.B. could play ''a stronger role'' than it has up to this point.

On Sunday, the German newspaper Welt am Sonntag quoted an unidentified central banker as saying, ''If politicians can agree to a truly comprehensive step, the E.C.B. will jump in and help.''

Bypassing the European Union treaty process could well raise an outcry from Britain and other European Union members that do not use the euro that the gap between those countries using the currency and those still using their own currencies was widening irrevocably.

Fissures within the euro zone have led to increasing speculation that the countries willing to follow Germany's lead toward a stability pact, restricting deficit spending and submitting to more invasive budget surveillance, could form a bloc within the currency bloc. The headline in Welt am Sonntag declared: ''Merkel and Sarkozy Found a Club of Super-Europeans.'' The article said that there had been secret negotiations over the bilateral agreements.

''There are no secret German-French negotiations,'' a German government official said Sunday, adding that treaty changes remained the goal. ''There is the previously announced, intense cooperation between Germany and France on proposals for limited treaty changes as the necessary political answer to the debt crisis.''

Intergovernmental agreements have always been an option in the euro crisis, although to some degree they go against the principle of solidarity and consensus in the 27-nation European Union. There is precedent for such agreements. The Schengen agreement that covers visa-free travel among most of the E.U. member states could provide a model for the new fiscal rules. That agreement, which began with a treaty, now covers 22 of the 27 E.U. members, as well as three non-E.U. countries. Similarly, any new euro zone pact may not cover all the countries in the euro zone.

In France, the government of President Nicolas Sarkozy is frustrated with Mrs. Merkel's unwillingness to allow the E.C.B. — supposedly independent — to act as a creditor of last resort for the euro zone, to work to cap interest rates on bonds from troubled euro zone governments, to buy bonds directly from euro zone nations, or to loan money to the euro zone's bailout fund, the European Financial Stability Facility.

PHILIPPE WOJAZER/REUTERS

President Nicolas Sarkozy and Chancellor Angela Merkel agree that E.U. treaties should be changed, but the process would take years.

The French themselves agree with the Germans that collective euro zone bonds are a bad idea now, because they would put too much burden on the creditworthy parts of the euro zone — namely Germany, France, Austria, the Netherlands and Finland — raising interest rates for them. Such euro bonds might be plausible once there is agreement on stronger fiscal rules, there is more convergence among euro zone economies and market pressure has relented, French and German officials agree.

But Germany believes that this is a moment for the transformation of the European Union, to create ''more Europe'' and more federalism for the countries committed to the euro. That may mean, in a longer-term treaty, a euro zone finance minister and treasury, new rules for limits on sovereign budget deficits, central intervention in national budgets, and more convergence of policies like pension ages and tax rates.

But a new treaty would take three years to draft and ratify, most analysts believe, and to answer the anxiety of the markets, a quick inter-governmental agreement among the main countries of the euro zone might help. Such an agreement would presumably require parliamentary approval in each country. But since it would not be a treaty change, referendums in each country might be avoided.

Still, even such an agreement would not necessarily take the heat off vulnerable countries like Spain and especially Italy, both with new governments that vow to make structural reforms and pursue a new austerity.

Steven Erlanger reported from Paris.

Tax rebels taking root in Greece

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ployees and pensioners, who have little way to hide their income. Meanwhile, seven out of 10 self-employed workers — including doctors, dentists, engineers, accountants, taxi drivers and small business owners — indicated on their tax forms that they had made less than €12,000 a year, a figure that most experts find laughable.

The Greek Public Power Corp. recently announced that of the 86,000 property tax bills that came due recently — a tiny fraction of the 5.5 million households in Greece — 73 percent were paid. Its news release struck an optimistic tone, suggesting the rate of payment was unchanged from before.

But critics point out that such a percentage means that the government could be facing the prospect of ordering tens of thousands of shut-offs in the middle of winter.

Some of the rebellion against the tax has bordered on the humorous. For instance, the Health Ministry in Athens was in the dark for four hours last week, courtesy of the power company's unionized workers. Since government ministries owe the power company €135 million, the union argues, why shouldn't they suffer cut offs?

There are also half a dozen legal protests pending. And a YouTube video describing how to hook your electricity back up if you get cut off has gone viral.

In Nea Ionia recently, Mr. Chatzis was passing the day near an electric heater in the front of his friend's hardware store. His wife, who has Alzheimer's disease, no longer remembers their son, who died three years ago. She has not left her bed in four years. The apartment they share is so small that he can hardly turn around in it. But his new tax bill is roughly half his monthly pension check.

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