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E.U. leaders set to admit austerity is insufficient

BRUSSELS

Summit talks' statement will focus on growth, but quick action isn't likely

BY STEPHEN CASTLE

Ever had the feeling that the answer to your problems is staring you in the face even if you've been ignoring it for months?

Europe's leaders are about to have just such a moment when they meet on

NEWS ANALYSIS

Monday and issue a declaration admitting that what the debt-laden, sclerotic countries of their continent need is a dose of economic growth.

Bowing to mounting evidence that austerity alone risks stoking recession and plunging fragile economies into a downward spiral, a draft of the European Union summit meeting communiqué calls for "growth-friendly consolidation and job-friendly growth."

The bad news, however, is that agreeing on this is not the same thing as making it happen.

Instead, leaders will discuss long-term structural reforms and better use of E.U. subsidies, while avoiding mention of the one thing that could change the climate: a fiscal stimulus from Germany, the euro currency zone's undisputed powerhouse.

Then the summit meeting, which is to be held in Brussels and be greeted by a national strike in Belgium, will try to satisfy Berlin's desire for fiscal discipline by wrapping up talks on a new intergovernmental treaty.

With its emphasis on punishing euro nations that exceed deficit and debt level, the agreement, or "fiscal compact," has been described privately by one official as a plan to criminalize Keynesianism.

Nevertheless, the hope is that if it gets the treaty it wants on fiscal discipline, Germany will agree to far-reaching efforts to end the debt crisis.

And while some see the new, pro-growth rhetoric as empty — or even cynical — others believe that it marks a psychological turning point.

"I think it is an important shift, particularly from Germany but also from others, from the phase where it was all about fiscal balance and consolidation to a more comprehensive approach where you have an all-encompassing look at economic sustainability," said Nicolas Véron, senior fellow at Bruegel, an economic research institute in Brussels. "It is quite promising, but at this point I don't see it translating into immediate measures."

Those are badly needed in a Europe with more than 23 million people unemployed. Indeed, the lack of growth was highlighted by Standard & Poor's this month when it downgraded several euro zone nations, including France.

"We believe that a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with con-

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E.U. to assert austerity alone isn't enough

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sumers' rising concerns about job security and disposable incomes, eroding national tax revenues,'' S.& P. said.

Other analysts concur, and some highlight the need for those few nations with room to maneuver to stimulate demand.

''Even countries with relatively strong public finances such as Germany — the country's budget deficit fell to just 1 percent of GDP in 2011 — are tightening fiscal policy,'' Simon Tilford, the chief economist for the Center for European Reform in London, wrote recently. ''In so doing, European governments are standing conventional macroeconomic thinking on its head. Governments are withdrawing demand from their economies at a time of pronounced private sector weakness.''

Output in both the euro zone and the European Union is still around 2 percent lower than before the crisis.

The Spanish and British economies are still almost 4 percent short of their pre-crisis peaks, the Italian one nearly 5 percent, and the Greek and Irish economies 10 percent to 15 percent, Mr. Tilford added.

Greece's deep recession has thrown its financial rescue package off target, complicating yet further efforts to restructure its debt and create a second, larger, bailout.

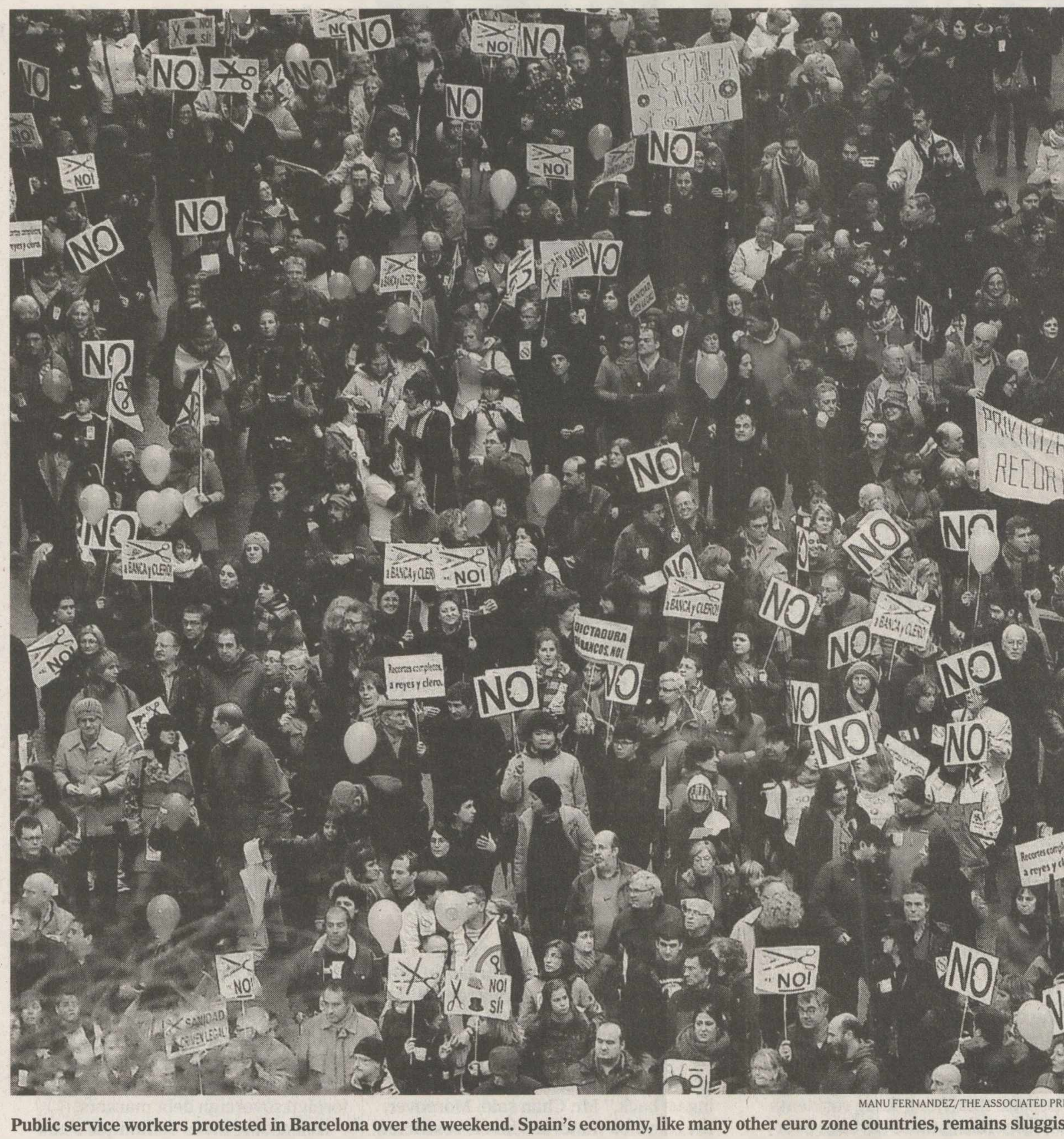
Germans increasingly accept that this is a dangerous outlook, said Joachim Fritz-Vannahme, director of the Europe program at the research institute Bertelsmann Stiftung.

''Many people now say that it will never work to push all the Southern European countries into austerity, hoping that, one day, they will pay back what they owe,''' he said.

In Germany, the opposition Social Democrats have been calling for a new Marshall Plan for Europe, a reference to the U.S. aid program for the Continent after the World War II.

All of this makes the disjunction with what is on the table at Monday's summit meeting more striking. The European Commission president, José Manuel Barroso, will propose better use of up to €82 billion, or about $108 billion, in E.U. subsidies, though it remains unclear whether national governments will agree and how much could be done quickly.

The 27 E.U. countries will also be asked to press ahead with a familiar list of proposals to liberalize their economies and remove bottlenecks — a long-term task that moves at a glacial pace.



MANU FERNANDEZ/THE ASSOCIATED PRESS

Public service workers protested in Barcelona over the weekend. Spain's economy, like many other euro zone countries, remains sluggish.

Meanwhile, several nations are also expected to champion the need for a financial transaction tax, a plan that one official study suggested could cut growth.

Mr. Fritz-Vannahme contends that domestic politics makes it difficult for Angela Merkel, the German chancellor, to move because there is little trust that nations like Greece will make necessary structural reforms unless they are under acute pressure. Many Germans still feel that they are being blackmailed into bailing out nations that will not do their own homework, he said.

And some consider that Germany's relatively healthy economy is already providing an economic stimulus to neighbors. German private consumption grew 1.5 percent last year compared with 0.6 percent in 2010, aided by a reduction in unemployment.

''The recognition is coming that austerity won't work,''' said Mr. Fritz-Vannahme, ''but how to get beyond austerity politics is completely unclear. There is no master plan under discussion in this country.''

Coalition in Greece seen backing more cuts

ATHENS

Premier's assessment comes amid progress in talks with creditors

BY NIKI KITSANTONIS
AND LANDON THOMAS JR.

As Greece tries to reach a debt-swap agreement with its private creditors, the country's prime minister suggested Sunday that the three leaders in his fractious coalition were prepared to back additional austerity measures and the changes needed to receive a second bailout.

Prime Minister Lucas D. Papademos had sought agreement among the coalition partners on the broad outlines of a deal with private creditors to erase €100 billion, or $132 billion, of debt as well as a recovery plan suggested by the European Commission, European Central Bank and International Monetary Fund, collectively known as the troika.

"We are in absolute agreement as regards the continuation of negotiations and the positions that we will support," Mr. Papademos said, referring to talks between government officials and the troika.

Athens also reported progress over the weekend between Greece's political leadership and Charles H. Dallara of the Institute of International Finance, the bankers' lobby representing most investors, over how much of a loss the private-sector creditors would be willing to accept on their bond holdings.

On Saturday, bankers and officials involved in the discussions who were not authorized to speak publicly said that the bondholders had made significant concessions with regard to the interest rate, or coupon, that the new Greek bonds would carry. Having insisted previously on an average rate above 4 percent, the creditors now seem willing to accept a rate below 4 percent for the 30-year bonds — perhaps as low as 3.6 percent.

The discussions were expected to continue, and officials said some type of announcement could come within days.

The statements Sunday by Greece's technocratic prime minister suggested that he had overcome some of the objections of the party leaders — his Socialist predecessor, George A. Papandreou; the conservative leader, Antonis Samaras; and the rightist leader, Giorgos Karatzaferis — to tough new austerity measures proposed by the troika. However, some bones of contention remained. The Greek media on Sunday quoted the three party leaders as saying that their only objections were to proposed cuts to wages in the private sector, as this would intensify a deep recession, and to reported German demands for a European Union commissioner to oversee Greek budget decisions.

Any potential new measures could face a struggle for approval by Parliament, where many lawmakers remain resistant to the unpopular steps.

Mr. Papademos said that the alternative to the completion of talks on a crucial debt swap and on a second bailout for Greece was a potentially catastrophic default. "If this process is not completed successfully, we will find ourselves faced with the specter of bankruptcy which will have serious re-

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Europe is pressed for a solution to debt crisis

DAVOS, SWITZERLAND

BY JACK EWING

World leaders have turned up the pressure on Europe to erect a more formidable wall of money against the sovereign debt crisis, warning that the euro zone continues to pose a severe threat to the global economy.

George Osborne, the chancellor of the Exchequer in Britain, said a bigger firewall was "a key to unlocking further confidence," while Christine Lagarde, managing director of the International Monetary Fund, said the fund should be big enough to eliminate any doubts about European resolve.

DAVOS 2012

"If it is big enough, it will not get used," Ms. Lagarde said during a panel discussion at the World Economic Forum on Saturday, the last full day of the event.

Echoing comments by U.S. officials, including Treasury Secretary Timothy F. Geithner on Friday, leaders in Davos said that aid to the euro zone from the rest of the world would be contingent on a larger commitment by Europe. Some critics have said it is perverse that the I.M.F., which is financed partly by developing countries, should be aiding wealthy Europe. "Europe has to be making more effort; otherwise, I don't think developing countries will want to pay more for the I.M.F.," said Motohisa Furukawa, the Japanese official responsible for economic and fiscal policy.

The firewall, known formally as the European Stability Mechanism, is set to have a lending capacity of €500 billion, or $661 billion, when it begins operating in July, replacing a temporary fund. European leaders are debating ways to increase the bailout fund's resources to aid heavily indebted countries, but they face powerful opposition from voters in countries like Germany and have so far failed to act boldly enough to reassure financial markets.

In the short term, though, leaders have gained some breathing room because of emergency cash that the European Central Bank has provided to banks, a measure that has calmed markets. Euro zone leaders are more focused on dealing with what they see as the more immediate danger of a Greek default, and less on testing their taxpayers' patience by increasing the size of the firewall.

Top officials and economists from outside Europe warned against complacency, and on Saturday they presented a much more pessimistic view of the European crisis than had been heard in previous days. While many European leaders and businesspeople have argued that the risk of a catastrophic breakup of the euro zone has declined, leaders of other regions said the crisis still had the potential to sow global misery.

MICHEL EULER/AP

"No one is immune," Ms. Lagarde said.

"I've never been as scared as now about the world," said Donald Tsang, chief executive of Hong Kong. He said the effect on the world financial system is unpredictable. "We do not know how deep this hole would be when the whole thing implodes on us," he said.

Ms. Lagarde said: "No one is immune. It's not just a euro zone crisis. It's a crisis that could have collateral effects, spillover effects around the world."

The undercurrent of their remarks was that European policy still lacked credibility in the eyes of the world.

"This has got to have an effect on influence, on perceptions of power in the world that are going to be significant for years to come," said Robert B. Zoellick, president of the World Bank.

Nouriel Roubini, a professor of economics at New York University who is known for his pessimistic views, predicted Saturday that Greece would have to leave the euro zone this year and said that there was at least a 50 percent chance that the euro zone would break up within three to five years.

Speakers on Saturday did not say how big they thought the European firewall should be. But, again echoing U.S. officials, they agreed it should be so enormous that no investor would question its integrity. That has not been true of Europe's financial commitment so far, which has consistently failed to restore market faith in the euro.

Without mentioning Germany by name, Ms. Lagarde said that European countries that are able to should do more to increase domestic consumer spending and slow down efforts to cut government outlays. "Some countries have to go full speed ahead and do that fiscal consolidation that is so much needed," Ms. Lagarde said. "But other countries have space and can do something."

The European Central Bank continued to draw praise for providing emergency cash to banks and avoiding a credit squeeze.

"There is not going to be a Lehman-style moment in Europe," said Mark J. Carney, governor of the Canadian central bank, referring to the collapse of Lehman Brothers in 2008, which helped set in motion the financial crisis. But he added, "That is different than having a well, fully functioning banking system."

As the Greek government made slow progress during the weekend on reaching a deal with creditors to reduce its overall debt, Mr. Osborne expressed amazement that such a tiny country con tinued to pose a threat to global stabilit

"The danger is that the tail wags th dog throughout this crisis," he said

More cuts seen ahead for Greece

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percussions for society and especially for the economically vulnerable."

"The unity of the political forces and their commitment to support the necessary changes are an essential demonstration of our credibility, will boost the effectiveness of economic policy and will allow us to negotiate better conditions," he said before preparing to fly tc Brussels for a meeting with other E.U leaders.

The talks with private creditors hav broken down twice before, largely be cause the I.M.F. and European leader have pushed for a larger debt reductic in light of Greece's worsening econom outlook, so there is the possibility th: these negotiations will founder, too.

Technical talks are continuing wi regard to a lump-sum payment of son sort that may be included in later yea if the Greek economy improves.

On top of the 50 percent nominal ' or haircut, already agreed on, the lo coupon would produce a total loss bondholders of more than 70 percent

It is a tense time for Greece. Offic from the troika are demanding anot round of spending cuts and reforms justify a release of as much as €90 bill in the months ahead.

A private-sector debt deal is seen a strict condition to Greece's securing next bailout installment.

Officials say that they expect that t deeper bond loss will allow Greece meet its goal of having a ratio of deb gross domestic product of 120 perc by 2020, a significant drop from 160 p cent now. The recent collapse of economy has made it more difficult Greece to hit this number.

Though a debt agreement may sp the next bailout installment, the deep loss being inflicted on bondholders ca ries the risk that many investors, in pa ticular hedge funds that in recent month have loaded up on bargain-priced Gree bonds in hopes of a payday this March will refuse to participate in the deal.

Greece will try to impose the terms or all investors by writing collective-actior clauses into the contracts of its old bonds By doing this, the hope is that the hold outs, who are estimated to be sitting on 1(percent to 15 percent of the €206 billion ir outstanding securities, will exchange their old bonds for new ones since the olc bonds may become worthless.

Some hedge funds that have bought a rock-bottom prices may decide to pursue legal action, although such a process could take years with small certainty of success.

Also undecided is what the E.C.B. which owns €55 billion of Greek bonds, will do. Despite public pressure that it, along with investors, accept a loss on its bonds, the bank has not budged.

Greek and European officials continue to discuss a plan that would allow the central bank to swap its Greek bonds for another form of Greek debt that, unlike the bonds it now holds, would not be eligible for a haircut. If such a swap were to occur, the central bank would not be affected if Greece were to invoke the collective-action clauses and force a loss on all bondholders.

Separately Saturday, the Greek government criticized as unacceptable a reported German proposal for greater E.U. oversight of Greece's national budget. The report, which appeared Friday in The Financial Times and was credited to anonymous German government sources, called for more direct European intervention in the Greek budget — a delicate subject in Greece, where populism and anger at a perceived loss of sovereignty is on the rise. "The government emphasizes that this area of competence belongs exclusively to the Greek government," Pantelis Kapsis, the Greek government spokesman, said.

Landon Thomas Jr. reported from London. Rachel Donadio contributed reporting from Athens.