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E.U. summit opens amid signs of a standoff

BRUSSELS

French-German divide dampens hopes for bold steps to halt debt crisis

BY PAUL GEITNER, JAMES KANTER AND STEPHEN CASTLE

President François Hollande of France arrived here Thursday for a European Union summit meeting demanding "rapid solutions" to the euro's problems, but the German chancellor, Angela Merkel, gave no sign of softening her resistance to such measures.

Heading into the meeting, Ms. Merkel brushed aside questions about the mounting pressure on Spain and Italy, where borrowing costs rose again Thursday to ever-more-painful levels.

Mr. Hollande showed no such reticence.

"I have come here to get very rapid solutions to support those countries that are in the most difficulty on the markets, and that have made considerable efforts to shore up their public accounts," he said.

E.U. summit meetings were once scripted in advance, with Paris and Berlin releasing a "Franco-German letter" just before other leaders arrived. But a string of advance meetings in recent days failed to result in a common, far-reaching proposal to secure a future for the euro.

Ms. Merkel has given her French counterpart a headline: A European economic growth pact that Mr. Hollande demanded during his presidential campaign. But the two leaders have made little effort to disguise the differences when it comes to issues like a proposal that euro zone member states pool their debt in a bid to reassure markets and avert a breakup of the currency union.

Mr. Hollande's predecessor, Nicolas Sarkozy, forged a close relationship with Ms. Merkel in a bid to influence Germany and moderate its dominance in E.U. policy making. The new French president, in contrast, has tried to enlist the Italian and Spanish leaders to provide a counterbalance to Germany's power.

"The current disconnect between Paris and Berlin is destabilizing the euro," Charles Grant, the director of the Center for European Reform, a research organization in London, wrote this week. "In the long run the euro is not sustainable without a grand bargain between France and Germany."

No such accord seems possible. During a speech Wednesday to German lawmakers that was enthusiastically received by all the major political parties, Ms. Merkel argued that short-term solutions for the euro zone, like pooled debt, would be counterproductive unless they were preceded by a political and economic union among the 17 euro zone members. Without mutual responsibility and control over national budgets, she argued, there cannot be mutual liabilities that could turn into blank checks

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E.U. summit hobbled by French-German divide

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for profligate governments.

Italy and Spain may simply have to put up with higher borrowing costs as they work to make vital changes to their economies, German officials argue. They hint that Italy and Spain may be able to tap the euro zone's existing bailout funds to backstop their borrowing and insure bond buyers against losses.

Reminding officials of the plight of the two countries, yields on Spanish 10-year bonds rose briefly above 7 percent early Thursday, a level that even the country's prime minister describes as unsustainable, and Italy paid sharply higher rates to sell long-term bonds.

Financial markets appear to have resigned themselves to the prospect that the summit meeting will accomplish little. Instead, they are looking ahead to the next meeting of the European Central Bank amid speculation that it will have to step in again with fresh funding for ailing banks, or cut interest rates in a bid to stimulate the region's moribund economy.

The E.C.B., however, has indicated it will not to make any move until it sees concrete progress from politicians.

''How the E.U. summit pans out will be a key influence on what the E.C.B. opts to do,'' Ken Wattret, an economist at BNP Paribas, wrote in a research note. ''The E.C.B. is willing to assist but does not want to step in first.''

Officials intend to sign off on a spending program intended to stimulate the euro zone economy. The program, announced last Friday in Rome by the leaders of France, Germany, Italy and Spain, would deploy up to €130 billion, or $163 billion, but the money would come largely from E.U. funds that had already been allocated but not yet spent.

They will also try to work out an outline for a euro zone banking union, as well as make progress on longer-term proposals that could see the creation of a finance ministry for the currency area.

Despite the gulf between Germany and France, E.U. leaders will try to reach consensus on measures to ease the pressure on Spain and Italy. One idea is to leverage the euro zone's current bailout fund, the European Financial Stability Facility, to give it more firepower to intervene in primary and secondary bond markets to lower government borrowing costs. The facility only has about €250 billion left in its war chest. The E.C.B. has already spent a similar amount for its bond-buying program, to limited effect.

FRANÇOIS LENOIR/REUTERS

President François Hollande of France, center, joined Prime Minister Elio Di Rupo of Belgium, left, and Prime Minister Mariano Rajoy of Spain at the meeting in Brussels on Thursday.

In addition, the Eurogroup of 17 euro zone finance ministers has promised to commit up to €100 billion to bail out Spanish banks. That money may have to come from the stability facility as well. There has also been a proposal to allow euro zone bailout funds to directly recapitalize ailing banks, rather than funneling the money through national governments. In return, the E.C.B. would be given supervision of the banks — something that might allay Ms. Merkel's objections to having the euro zone take on risk without commensurate controls.

The prime minister of Finland, Jyrki Katainen, who has generally stood with Ms. Merkel in the camp demanding fiscal prudence, suggested that vulnerable euro zone countries could issue ''covered bonds,'' backed by government assets or by specially earmarked tax revenue, to gain access to funds at lower interest rates.

''This is what Finland did in a difficult economic situation in the 1990s and it is standard practice for banks today,'' Mr. Katainen said.

The Italian prime minister, Mario Monti, has said he is willing to stay in Brussels all weekend to secure a deal that would ease his country's borrowing costs. Last November, Silvio Berlusconi was ushered out of office in Rome and a government led by Mr. Monti was installed when Italy's borrowing costs rose above 6 percent — the level where they are today. If Mr. Monti returns from the meeting without tangible results, his government will be severely weakened.

"The euro is not sustainable without a grand bargain between France and Germany."

Ms. Merkel, however, has made clear she intends to be back in Berlin by Friday evening for an important vote in the Bundestag on the euro zone's permanent bailout fund, the European Stability Mechanism, and a fiscal treaty she has championed.

It was unlikely that neither Ms. Merkel nor Mr. Monti would have much time to follow the German and Italian soccer teams as they faced off Thursday night in the semifinal match of the Euro 2012 contest. Ms. Merkel attended Germany's last match in the contest, when her team defeated Greece's. This time she would have to be satisfied with glimpses of the match on a television set up near the meeting room.

The Polish prime minister, Donald Tusk, joked when arriving in Brussels that Ms. Merkel would not be able to watch the match at all, because if she left the room the other leaders might vote to issue euro bonds.

Stephen Castle reported from London. Steven Erlanger contributed reporting from Brussels, Melissa Eddy from Berlin, Rachel Donadio from Rome and Raphael Minder from Madrid.