THE DARK SIDE
WHEN POP ART TURNS SINISTER
PAGE 12 | CULTURE

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Elections help shape euro strategy for Merkel

BERLIN

Tradeoffs between what is good for Greece and good to win a 3rd term

BY NICHOLAS KULISH

It is becoming ever clearer that a lasting solution to the euro crisis, nearing its three-year anniversary with no end in sight, is not going to be possible without some kind of sacrifice on the part of Germany — political or financial, but more likely both.

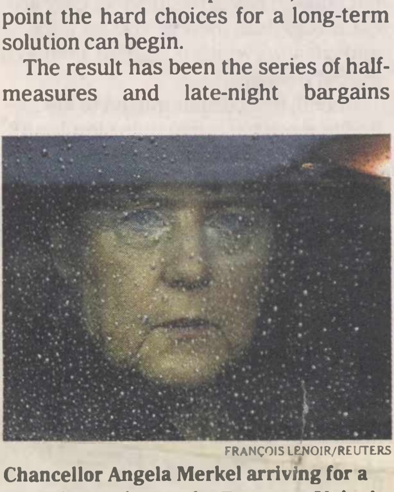
With a parliamentary election 10

NEWS ANALYSIS

months away, however, one that will determine whether Angela Merkel returns as chancellor for a third term and could well help determine her legacy, she is in no mood for either sort of concession.

At home, Ms. Merkel is celebrated for staying tough on debtor nations, but at the same time she is expected to protect the euro from the sort of instability and uncertainty that a Greek exit from the currency would almost certainly bring. Rather than confront this contradiction head-on, she has staked her reputation and her re-election chances on the belief that Greece's shaky finances can be held together until German voters cast their ballots next September, at which point the hard choices for a long-term solution can begin.

The result has been the series of half-measures and late-night bargains



FRANÇOIS LENOIR/REUTERS

Chancellor Angela Merkel arriving for a summit meeting on the European Union's long-term budget in Brussels on Friday.

struck by negotiators in Brussels. No sooner had euro zone finance ministers announced on Tuesday the details of their latest early-morning agreement on how to keep their rescue of Greece from collapsing in the face of its contracting economy than the calculators came out, followed quickly by the criticism.

"They did not solve a single problem in any long-term way," said Lüder Gerken, head of the Center for Euro-

GERMANY, PAGE 3

SKIES STILL CLOUDY FOR GREECE'S FUTURE
The country could still face a painful exit from the euro zone despite concessions offered by its lenders. *PAGE 14*

O.E.C.D. WARNS OF RECESSION RISKS
The group predicted slower economic growth, saying that European and U.S. crises could cause a downturn. *PAGE 14*

World News

Euro weighs on German politics

GERMANY, FROM PAGE 1

pean Policy in Freiburg, Germany. "They merely agreed to buy a little time for a lot of money."

The deal left Greece's debt at more than 170 percent of economic output, a figure that will only grow as the economy continues to contract. Reducing Greece's debt to the sustainable levels required by the International Monetary Fund "means with certainty a debt reduction later on, because the goal can't be reached any other way," said Claudia Schmucker of the German Council on Foreign Relations.

The agreement may have prevented a catastrophe in the near term, but significant debt restructuring — and with it losses for the lenders, including Germany — appears increasingly inevitable.

"That's also clear to the federal government, even if they continue to reject it publicly," Ms. Schmucker said.

The German finance minister, Wolfgang Schäuble, did just that, saying at a news conference in Berlin, "It was clear to everyone, including the I.M.F., that this is no solution for the problem."

Mr. Schäuble instead repeated the line popular with the German electorate that only Greek discipline could fix Greece's problems.

"If Greece does not implement the necessary difficult reforms and adjustment measures step by step itself," he said, "then it's a 'Mission Impossible.'"

But those very reforms have been part of the vicious cycle that has driven the Greek economy into a depression.

German officials may be more aware of that than they let on publicly. Der Spiegel, the weekly newsmagazine, said Mr. Schäuble had recently told Christine Lagarde, the managing director of the International Monetary Fund, and several other colleagues that Germany could later be open to debt restructuring.

"The debt cut has not been avoided — it has been postponed to a time after the parliamentary elections," Frank-Walter Steinmeier, parliamentary leader of the Social Democrats, said on Tuesday on ZDF television. "We are realistic and try to tell the people honestly and sincerely what's going on. Schäuble and the present government try once more to finagle their way around the truth."

But there are legal concerns as well. A "haircut" for public-sector holdings might be struck down by the Constitutional Court in Germany for violating the no-bailout clause. There are also concerns that other program countries like Ireland and Portugal would demand similar concessions.

"Our endeavor was to prevent sending the wrong signal that a public-sector debt cut would represent, reducing the pressure to make adjustments not just for Greece but for all the program countries," said Norbert Barthle, a senior member of the Ms. Merkel's party who opposed debt restructuring that included losses for public-sector institutions, including the European Central Bank.

RAFAEL MARCHANTE/REUTERS

A protest on Tuesday in front of the Portuguese Parliament. What happens politically in Portugal can be a factor in Germany's decisions.

The latest agreement is expected to pass the German Parliament easily because of the support of the Social Democrats and the Greens. It is in the ranks of Ms. Merkel's own coalition of Christian Democrats and Free Democrats that the most opponents to further bailouts and debt relief stand. Opinion surveys suggest that the likeliest government after elections next year would be a so-called grand coalition with the Social Democrats, giving Ms. Merkel a broad majority and perhaps even the mandate she needs for unpopular decisions.

As the Greek debt talks grind on, a familiar pattern has come to the fore once again: It all comes down to tradeoffs between what is good for Greece and the euro and what is good for Ms. Merkel and her party in domestic German politics. Every calculation of interest and principal for Greece's unmanageable debt burden is matched by yet another political recalibration of the latest surveys over attitudes among German voters.

In Athens, the governing class is obsessed with the question of what Germany wants to do with Greece.

In past months, "the discussion was about Europe," said George Malouchos, a columnist for To Vima, a daily newspaper. "Now we're discussing about Germany," he added. "This is something new and important."

Solutions constructed to pacify the German electorate rather than bring Greek debts under control are, inevitably, short-term. The hodgepodge of breaks on interest rates and promises of a new round of debt buybacks are fooling few people, not even the German voters they were designed to pacify.

"There has to be a debt cut," Jochen Slotta, 57, a taxi driver in Berlin, said on Tuesday. "Greece can't get back on its feet any other way, but the politicians just don't want to say it, that's all, because then they won't be re-elected."

Thomas Risse, a professor of international politics at the Free University in Berlin, said, "I don't think that Merkel right now is prepared to go ahead and tell the Germans, 'Folks, this costs us some billions and say goodbye to them.'"

Ms. Merkel, through her public comments here in Berlin and the symbolic weight of her visit to Athens, has cautiously signaled her support for Greece.

But few in Greece are fully convinced that Germany wants to keep Greece in the euro zone.

"I don't think there's one German opinion on that, so I don't think it's been definitely answered," said Aristos Doxiadis, an economist and venture capitalist in Athens.

In part that is because a disconnect has grown over just how much Greece is suffering. Germany views the cutbacks as a virtuous and necessary period of belt-tightening. Greeks see themselves cutting so deep into the functions of the state and the economy that they are teetering on the brink of anarchy.

"The issue," Mr. Risse said, "is really when to tell the Germans how much money we actually lost."

Chris Cottrell contributed reporting from Berlin, and Rachel Donadio from Rome.

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Debt deal doesn't clear cloud over Greek future

BRUSSELS

A painful exit from euro could still lie ahead even with aid and 'haircuts'

BY JAMES KANTER

Finance ministers from the euro zone and the International Monetary Fund bridged their main differences over a bailout for Greece early Tuesday, bringing closer the release of long-delayed emergency aid.

But what they left undecided in their

NEWS ANALYSIS

12-hour meeting means this long-running Greek drama — and the cohesion of the euro currency union — is far from settled.

The deal allows Greece to avoid an imminent default on its debts and diminishes the prospect of a Greek exit from the euro union. But analysts said Greece could still be forced eventually to leave the euro, largely because the agreement would do little to revive its stricken economy or wean the government from the need for outside financial aid for years to come.

Markets reacted positively to the deal on Tuesday. But analysts said the final outcome of three stormy late-night meetings in as many weeks had been a weak compromise.

Even Christine Lagarde, the managing director of the I.M.F., appeared somewhat hesitant about the deal during a news conference early Tuesday morning.

"How solid is it?" Ms. Lagarde said. She also questioned whether the ambitious debt-reduction targets set for Greece in the next eight years could be enforced. But she insisted that she was satisfied with the outcome and that those goals could be met.

She warned Greece's creditors that they needed to ease the repayment terms for Greece immediately, and then offer even more relief once the country hit budget targets, to put the it on a path to manageable debt by the end of the decade. But she did not spell out what that additional relief would entail.

And she said the I.M.F. would not give a green light to the next disbursement of aid to Greece until completion of a key plank of the agreement: a program of more loans for Greece to enable it to buy back its debt at a discount.

The measures decided early Tuesday include longer maturities for Greece's bailout loans and lower interest rates on those loans. And central banks in countries that use the euro currency would agree to return to Greece any profits made on Greek bonds purchased by the European Central Bank.

The program also still needs approval by some national parliaments in the euro area, including in Germany, where the prospect of sending new bailout money to Greece is seen as politically untenable, at least until after German elections next year.

Lawmakers in Berlin have begun debating the agreement on Greece, which still requires approval from Germany's lower house of Parliament, the Bundestag.

The German finance minister, Wolfgang Schäuble, indicated that he hoped approval could be obtained by the end of the week.

The deal — at best — bought more time for Germany and other major creditors before they might need eventually to accept outright write-downs, or "haircuts," on their debts, according to analysts.

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Using guarded language, Mr. Schäuble said early Tuesday that once Greece had "fulfilled all of its conditions, we will, if need be, consider further measures for the reduction of the total debt."

Fabio Fois, an economist at Barclays, wrote in a briefing note on Tuesday that "an outright haircut on E.U. loans of at least 20 percent" would still be needed. He also suggested that "the positive response of the market might prove short-lived."

And there will almost certainly be further sparring over Greece in years to come, particularly as Germans, backed by the Dutch and Finns, remain extremely wary of forgiving Greece's debt.

Among key concerns on Tuesday was the lack of clarity about the details of the buy-back plan. Analysts said they expected euro area states to lend Greece money that the government could use to buy back its own bonds from private investors at discounted prices. But there were questions about the plan on Tuesday, including when the buy-back would take place whether bondholders would accept the terms.

And to complete the buyback, the Greek government would have to use money that it does not have, and instead borrow about €10 billion, or $13 billion, to execute the operation.

Until those details are resolved,

EURO, PAGE 17

Deal doesn't ease Greece's path

EURO, FROM PAGE 14

Greece is not supposed to receive the next installment of bailout money — a tranche of around €34.4 billion — that has already been long delayed.

In Athens, Prime Minister Antonis Samaras on Tuesday hailed the agreement as the start of a "a new day for all Greeks," but his coalition partner, Evangelos Venizelos, the Socialist leader, hinted at concerns. The Eurogroup deal was "undoubtedly positive" but there were "things to note in the details," Mr. Venizelos said.

Despite the unresolved issues, analysts expect the emergency aid to be paid to Greece in mid-December, with further payments during the first quarter of next year on the condition that Greece continue to fulfill its pledges under the bailout plan.

The aid has long been touted as vital for preventing Greece from defaulting on its loans.

The delay before the next disbursement of aid means that the Greek government's unpaid bills, which stood at €8.3 billion at the end of September for goods like medicines and services like construction, "will continue to grow for at least a couple of weeks," warned Janet Henry, the chief European economist at H.S.B.C.

Some analysts predict problems arising from the I.M.F.'s continued insistence on ambitious debt-reduction targets for the beginning of the next decade. The new target is a reduction of the debt to 124 percent of gross domestic product by 2020. That would be down from the current level of 175 percent.

Zsolt Darvas, a fellow at Bruegel, a research organization, said reaching that target would require "perfect implementation and a lot of luck will be needed, including a rebound in growth." Otherwise, he warned, Greece's financial problems will continue and "the social pressure on the government and the parliament could increase."

The coalition government could eventually collapse, "leading to a euro-exit with disastrous consequences inside and outside Greece," Mr. Darvas said.

Currently, the economy is contracting at a 6.4 percent annual pace and is expected to continue to stagnate next year. Promises to cut an additional €9 billion out of the economy could further aggravate an increasingly agitated society weary from austerity and undermine the fragile coalition government.

Liz Alderman contributed reporting from Paris, Melissa Eddy from Berlin and Niki Kitsantonis from Athens.