New Hurdles For Europe In Crisis Over Debt

More conflict on the eve of an important gathering of leaders.

By STEVEN ERLANGER and RACHEL DONADIO

PARIS — New fissures and disagreements emerged on Tuesday on the eve of a European Union summit meeting promoted as the moment for agreement on a comprehensive solution to the two-year-old euro crisis. Crucial financial measures were left unresolved and Prime Minister Silvio Berlusconi of Italy faced strong opposition inside his governing coalition to major changes demanded by the Europeans.

The overall euro deal being discussed is complicated, including a deep restructuring of Greek debt, injecting new capital into European banks made vulnerable by exposure to sovereign debt and expanding a bailout fund so that it can ward off a financial panic in the large economy of Italy as well as in tiny Greece and Portugal.

On several previous occasions, European leaders have promised systemic changes to resolve the euro's troubles, only to come up with a patchwork that fails to mollify the markets and just delays the day of reckoning. From all appearances this week, this could be another disappointment, an agreement on a general plan but without many specifics, and probably without the massive "wall of money" to protect vulnerable Italy and Spain that the markets have demanded.

In addition, a meeting of European Union finance ministers, set for Wednesday before the summit meeting, was abruptly canceled on Tuesday, largely because of continuing negotiations with banks over a reduction in the face value of Greek debt — a so-called haircut — of up to 60 percent from the 21 percent previously agreed to but considered grossly inadequate by most economists.

The Europeans want the banks to agree to the losses voluntarily, to avoid a formal default that would incite unpredictable events. But the banks have negotiating capital, too, and are stretching out the talks. At the same time, officials in Brussels said, it was difficult to sign off on bank recapitalization — considered pretty much a done deal — until they were clear about the real value of the Greek debt in the banks' portfolios.

The Europeans also want Mr. Berlusconi to live up to his promises to do more to reduce Italy's huge accumulated debt — about $2.65 trillion euros, or 120 percent of gross domestic product, among the highest in the developed world — and to promote economic growth in a largely stagnant economy. While Italy's annual deficit is modest, the debt overhang means that speculation is driving up the cost of financing that debt, which if unchecked, could tear holes in the budget.

Chancellor Angela Merkel of Germany, and President Nicolas Sarkozy of France, upbraided Mr. Berlusconi on Sunday for not following through on his promises. But the sense of urgency about the fate of the euro that is building in other European capitals seems not to have arrived yet in Rome, where the near-lifeless Berlusconi government is deadlocked in an internal power struggle.

"I think Italian policy makers are unaware of the spillover that our behavior exerts on the Euro zone," said Tito Boeri, an economics professor at Bocconi University in Milan. "They're still playing at pork barrel tactics, defending specific lobbies and the interests of their own voters."

The current crisis has placed Mr. Berlusconi between two irreconcilable forces: his fellow European Union leaders; and Umberto Bossi, the leader of the powerful Northern League who holds the fate of the Berlusconi government in his hands and is bound to Mr. Berlusconi like an inoperable Siamese twin.

For months, Mr. Bossi had refused to back a plan to raise the retirement age to 67, relenting only on Tuesday for everything except seniority pensions, still leaving the government at risk of collapse on the issue. That change had been demanded by the European Union in return for its support.

The European Central Bank demanded various changes as the price for buying up Italian debt at a reasonable, nonmarket price. But as soon as the bank stepped in, Mr. Berlusconi failed to propose a convincing package of measures, let alone put them into effect, infuriating his European counterparts and the bank.

Given reasonable progress made by Ireland, Portugal and Spain to fix their fiscal problems, the vulnerability of the far larger economy of Italy is the main reason why the Europeans are trying to enlarge, or leverage, the size of their bailout fund, the European Financial Stability Facility, which at around $600 billion is considered less than half as large as needed to cover Italy's debts. At least $200 billion of this fund is already committed to Greece, Ireland and Portugal, and European leaders have not yet agreed


International
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Nuove difficoltà per l'Europa nella crisi del debito (sg) on at least two options they are considering for enlarging the fund.

One idea is to try to attract outside investors, possibly with the help of the International Monetary Fund, but it is unclear what guarantees outsiders would demand.

A parallel idea, which could run simultaneously, is to use the fund to limit losses bond holders might suffer in the future.

However, Mr. Bossi said that he remained pessimistic about finding a way through the thickets to a comprehensive rescue plan for the euro.

"The government still risks falling on the question of pensions," he said. "Now we have to see what the E.U. says."

Mr. Bossi added that he refused to budge on a plan to raise the retirement age to 67 in the case of workers who had worked 40 years and contributed to the public pension plan.

On Tuesday evening, however, an 11th-hour accord seemed to be emerging under which the retirement age would be raised but people who have been paying for 40 years could retire.

Details of the proposed growth measures Mr. Berlusconi will present to Brussels have not been made public, but Italian news media reported that they would include privatizations, liberalizing Italy's professions and simplifying bureaucratic red tape.

But some critics dismissed the proposals as window dressing.

"They will send the letter, but there's the risk that they will only be empty promises with no real ability to carry out reforms if they are still missing a strong agreement with the Northern League," said Stefano Folli, a columnist for the economic daily Il Sole 24 Ore.

Italy's fundamentals, other than its enormous debt, are relatively strong, but its fragile political leadership adds to market uncertainty, said Marco Fortis, an economist at Milan's Cattolica University. "The only thing that's missing is a government that can make decisions and gives signals to the markets that the country is not at risk," he said.

On Tuesday, Italy's president, Giorgio Napolitano, urged the government to act quickly and "make our commitment to lower the debt and boost economic growth more credible."