

Sarkozy, Merkel push euro integration
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PARIS, Aug 17 — The leaders of France and Germany unveiled wide-reaching plans yesterday for closer euro zone integration, including deficit limits and biannual summits, but said joint euro bonds could only be a longer-term option.

Under heavy pressure to restore confidence in the euro zone following a dramatic market slump, President Nicolas Sarkozy and Chancellor Angela Merkel stopped short of increasing the bloc's rescue fund but vowed to stand side-by-side in defending the euro and laid the groundwork for a future fiscal union.

Their message was that the focus should be on further economic integration rather than signing bailout cheques, and suggested that straying from euro zone rules and fiscal targets would no longer be tolerated.

In a further rap to financial market players, whose panic-selling this month wiped some US\$4 trillion (RM12 trillion) off global stocks and sparked a temporary ban in Europe on short-selling, the two leaders also proposed taxing financial transactions.

In plans to be sent on Wednesday to European Council President Herman Van Rompuy, the two leaders want a president to be elected to represent the euro zone and twice-yearly meetings of the leaders of the embattled 17-nation bloc.

US stocks dropped more than one per cent and the euro slid as the proposals failed to ease worries about a debt crisis markets fear is spreading to the euro zone's core. Traders had hoped for signals that the issuance of common euro bonds, or an increase of the EFSF, were live options.

"We have exactly the same position on euro bonds," Sarkozy told a joint news conference with Merkel after their talks.

"Euro bonds can be imagined one day, but at the end of the European integration process, not at the beginning," he said.

The joint proposals were still ambitious, given Germany's past reticence on ideas like institutionalising regular summits of euro zone leaders, and respond to criticism that market confidence in the euro zone has been undermined by a cacophony of differing policymaking voices in recent months.

In one of the most far-reaching ideas, Sarkozy said the French and German finance ministers had been asked to prepare proposals aimed at having a common corporate tax base and tax rate in France and Germany from 2013. He said the two countries would keep a closer track of each others' economic outlooks.

Analysts queried the feasibility of a financial transaction tax, which was an unexpected proposal, given opposition from some European countries and the European Central Bank.

Julian Callow, senior European economist at Barclays Capital, said that while markets needed to see "more flesh on the bones" of the proposals, it was significant that the two leaders had broken into the August holiday period to meet.

"They are pledging a commitment to economic governance which is a step forward and there is also a commitment to a debt brake, although it remains to be seen whether that will be significantly strong," he said.

"Each side is surrendering some sovereignty which in the end could pave the way to much closer political union and so prepare the ground for the issue of euro bonds."

The full details of the written proposals to Van Rompuy will be made public today, Sarkozy's office said.

Van Rompuy will evaluate the proposals as he puts together a package on economic coordination for an EU summit in October.

Sarkozy and Merkel — under pressure to convince markets the euro zone is sound or risk watching it unravel — said their first proposal was for "a real economic government" for the euro zone, with a president elected for two-and-a-half years.

"Germany and France feel absolutely obliged to strengthen the euro as our common currency and further develop it. And it is entirely clear that for this to happen, we need a stronger interplay of financial and economic policy in the euro zone," said Merkel, who went on to a working dinner with Sarkozy.

Sarkozy said that if adopted, their proposal that euro zone governments should enshrine deficit-limiting rules into their constitutions would be obligatory, not optional.

"The euro has allowed us a lot of economic progress but the euro is not just a right, it's a set of rules, a duty, a discipline," he said. "Consequently if the rule is to be adopted by the 17, it will not be an optional rule but obligatory."

While it was unclear how governments could be forced to adopt politically difficult constitutional changes, Sarkozy's tone suggested there would be no more tolerance for straying from rules and even raised the spectre of a two-speed union.

"With the tougher governance proposals it increasingly looks as though we are headed for a two-speed Europe, with the 17 countries transferring more and more power for fiscal competency to Europe and forging a tight political union, while the remaining 10 countries remain a looser free trade zone," said Stephane Deo, senior European economist at UBS.

Many experts believe the only way to ensure affordable financing for the bloc's most financially distressed countries would be for the euro area to issue joint euro bonds.

Officials in Paris and Berlin played down expectations ahead of Tuesday's meeting, saying euro bonds would not be on the agenda, but markets were still disappointed.

"Rather than the additional check-writing by core European governments that certain markets were looking for, including a new euro bond, they are getting a fiscal discipline golden rule, stronger economic governance, and a new financial transactions tax," said Mohamed el-Erian, co-chief investment officer at Pacific Investment Management Co in California.

Ordinary Germans have opposed more help for their weaker neighbours even while their economy has been roaring. Data yesterday showing German GDP barely grew in the second quarter suggests a slowdown is starting to grip, making underwriting of euro zone debt an

even harder sell politically.

Sarkozy and Merkel had already planned to meet this week to discuss their proposals on euro zone governance, but the stakes were raised when France was slammed in last week's market rout.

Investors dumped shares in French banks, which are exposed to Italian debt, as rumours circulated — denied by rating agencies — that France's AAA-rating could be at risk.

That sell-off was evidence markets were not convinced by a July 21 deal to give new powers to the euro zone's EFSF rescue fund and for proposals to be made on closer economic governance.

Some still saw yesterday's ideas boosting the euro, however.

"Sarkozy talks about common governance for the euro zone, which I think is one step closer towards a fiscal union. That's positive for the euro overall," said currency strategist Richard Franulovich at Westpac in New York. — Reuters

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