Euro Rebuilding Vision Fades as Merkel's Campaign Looms

Europe's leaders are losing the vision thing.

The word "vision" appeared seven times in a June outline for transforming the euro zone into an American or Swiss-style economic union. It dropped out of an October follow-up and is absent from a final roadmap to be discussed at a summit in Brussels today.

The scaled-back ambitions reflect ebbing pressure from financial markets, pre-election politics in Germany, a hardening of the ideological divide between northern and southern Europe, and the recognition that an overhaul of economic governance won't work without a banking-system fix.

"EU leaders might as well stay home," Guy Verhofstadt, a former Belgian prime minister who is now in the European Parliament, said in Strasbourg, France, yesterday. "The political reality is that we are all waiting for the German elections before taking the crucial steps to end the crisis."

The next stopgap is due this afternoon, when euro finance ministers are slated to approve a 34.4 billion-euro ($45 billion) loan disbursement to Greece. Still, creditor-country leaders such as Dutch Prime Minister Mark Rutte have said current aid pledges might not be enough to turn Greece around.

The array of crisis managers have descended on Brussels. All 27 finance ministers forged a bank-oversight agreement early today after 14 hours of talks. The 17 euro ministers among them are returning after some sleep to write the Greek check. The 27 leaders convene from 5 p.m. today and into tomorrow.

Little Margin

With the euro-zone economy in recession, there is little margin for error. Spain is resisting a sovereign bailout and the impending resignation of Italian Prime Minister Mario Monti risks upending the liberalization of Italy's economy.

Financial-market tensions have abated, thanks mainly to a pledge by the European Central Bank, first made in late July and yet to be acted on, to put a floor under the bond markets of vulnerable countries such as Spain or Italy as long as they bow to stringent conditions.

Spain now pays 403 basis points more than Germany to borrow for 10 years, compared to 611 basis points before ECB President Mario Draghi vowed on July 26 "to do whatever it takes to preserve the euro." Italy's bond spread has fallen to 331 basis points from 518 basis points.

Calmer markets have taken the pressure off German Chancellor Angela Merkel, the steward of Europe's largest economy.

Balking Merkel

Running for a third term in September 2013, Merkel has balked at offering more emergency aid or venturing into a longer-term euro remake that might increase the bill for German taxpayers, the main underwriters of 486 billion euros of rescue loans already granted to four countries.

The German strategy for the summit, the 22nd since Greece burst onto the EU's agenda in early 2010, is to avoid any extra commitments or costs. Innovations like a euro-area budget or economic-insurance fund are for the distant future, a Merkel aide told reporters in Berlin yesterday.

"The EU needs closer integration to increase confidence in the euro," Finnish Prime Minister Jyrki Katainen, a German ally, said in Helsinki yesterday. "There are limits, however, and for example joint borrowing cannot be considered."

Once publicly partnered with France in striking the compromises to keep the euro zone intact, Merkel's dominance of the crisis response is now undisputed. France's economic position has eroded, reflected in Standard & Poor's downgrade of its credit rating to AA+ from AAA in January.

Hollande's Opposition

France also lost leverage in Berlin after Francois Hollande made opposition to German-inspired austerity policies the theme of his campaign for president and, after taking office in May, sought allies in southern Europe as a counterweight to Merkel.

As a result, the brainstorming over the future shape of the euro zone has tilted further in the German direction. Proposals toward common issuance of new debts or redemption of old ones, still up for debate in June and October, were dropped from the final roadmap toward a "genuine" economic union published last week.

In place of euro bonds, EU President Herman Van Rompuy proposed the exploration -- after 2014 -- of a "common but limited" budget. Euro governments would pay into the fund and draw from it as the economy ebbs and flows, with a tight rein on disbursements to make sure it doesn't become a permanent transfer mechanism.

'Deeper Integration'

Still, the idea and the timeline were too much for Merkel. A draft summit statement dropped a three-stage timetable that would pave the way for the stabilization budget, saying it would be weighed only as the euro area "evolves toward deeper integration."

In contrast, Germany's plea for more binding economic discipline will be acted on sooner. Yesterday's pre-summit draft, obtained by Bloomberg News, foresees "individual arrangements of a contractual nature with EU institutions" to keep governments on the reform path.

The deadlock over what the euro will look like in five to 10 years -- and the required amendments to European treaties -- added to the urgency of setting up a banking supervisor in order to halt the spiral between bank and sovereign debt that has hit Spain and Ireland the hardest.

There was progress on that front as France and Germany settled their disagreements over the ECB's role. It will be in charge of all euro-area lenders. The new supervisor should be fully ready by March 1, 2014, with about 200 banks automatically qualifying for direct ECB oversight.

"The immediate thing now is the banking union," Hans Martens, head of the European Policy Centre research institute, told Bloomberg Television. "There's a lot of ideas on the table about treaty change, all those kinds of things -- I really think they'll be pushed backwards."

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