Sarkozy and Merkel Meet on How to Save Eurozone

The bad news from the European Union is growing almost daily. Germany, the largest economy in Europe, had almost no economic growth at all in the last quarter The entire 17-nation European Union grew at the miniscule rate of .2 percent from the prior quarter. The prior quarter's eurozone economic growth had been .8 percent, larger than last quarter but still far short of what is required to create confidence that the sovereign debt crisis can actually be managed. That represents the slowest economic growth since late 2009. The French economy also stalled during the quarter and the Italian economy grew only .3 percent.

French President Nicolas Sarkozy and German Chancellor Angela Merkel met to discuss how to address the sovereign debt crisis that began in Greece and Ireland, quickly spread to Spain and Portugal, and now threatens to produce tremendous stress on the European Union. Furthermore, the recently announced Italian plan for a combination of austerity and tax increases may not work. Sarkozy has called for a "new economic government" for Europe that would meet at least twice a year with European Union President Herman Van Rompuy. The French President offered few other details or indications that the body would have real power. Merkel and Sarkozy also called for all eurozone nations to enact constitutional amendments requiring balanced budgets.

The two leader said they wanted this change accomplished by the next summer, noting that the moment was not right to replace 17 government bonds with a single one allowing weaker nations to borrow in cooperation with the powerhouse economies of France and Germany. A growing number of experts are calling for a "eurobond" as a way to prevent the unaffordable interest rates that have driven Greece, Ireland, and Portugal to seek bailouts from EU member states and from the International Monetary Fund.

Martin van Vliet, senior economist at ING Groep NV in Amsterdam, expressed the general fears:

> Growth may virtually stagnate in the second half and there's a threat of a renewed recession. It's up to Merkel and Sarkozy to prevent further contagion to the economy; the longer the turbulences persist, the higher the risk of a recession.

Chief economist Alexander Krueger at Bankhaus KG in Dusseldorf noted: "With Germany's economy faltering the euro region didn't have any significant growth impulses. The second half will show only a modest expansion overall." Volkswagen last month warned that the European market with be burdened by government fiscal problems. Other German companies expressed similar concerns. For instance, Kion Group GmbH, a German forklift firm, warned that austerity measure could stifle any economic growth.

The euro is actually declining against the dollar, after America's sovereign debt was downgraded for the first time. European stock markets are also taking a beating. Euro-area exports declined to a seasonally-adjusted 4.7 percent in June from the prior monthm, and imports also slumped, but by a smaller figure of 4.1 percent. Manufacturing declined in July and economic confidence is at the lowest level in a year. Crucially, German investors were the most pessimistic, and their investment in financial markets is key to preventing a meltdown. Thomas Herrmann of Credit Suisse Group in Zurich noted: “A slowdown was to be expected” after an “extremely strong first quarter. The important question will be to what extent the recent financial turmoil and debt crisis will have knock-on effects on confidence.” Judging by the drop in German confidence, the answer to part of that question is already known.

In a marvel of understatement, European Central Bank President Jean Claude-Trichet noted “ongoing tensions” in the financial markets. Fear of the budget crises among the so-called PIIGS nations (Portugal, Ireland, Italy, Greece, and Spain) has spilled over and led to an 11-percent decline in the Stoxx Europe 600 Index in the last two months; Germany’s DAX Index has dropped 15 percent.

The ongoing purchase first of Greek and then Portuguese and Spanish sovereign debt has not increased economic confidence. Stephen Barrow of the Standard Bank PLC said in an email: “The best we can hope for is policy-rate stability through the rest of the year,” noting that the chance of a second rate cut was “more dependent on a downward spiral in the region’s debt problems than a lurch toward recession. The current sovereign-debt crisis could have a material adverse effect on our business, financial conditions and results of operations. There could be another downturn or so-called double-dip recession.”

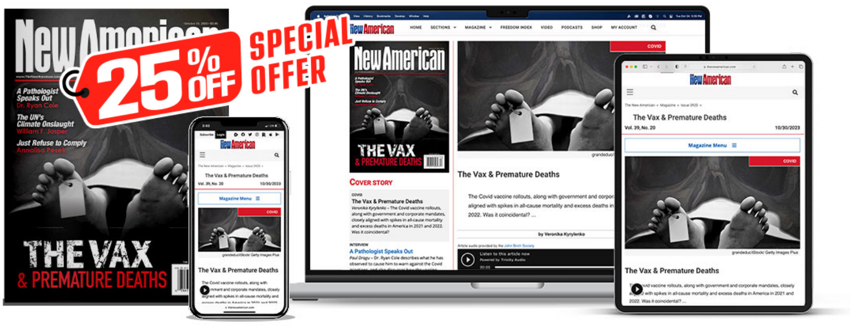
Complicating solutions are conflicts between the more thrifty northern nations, which historically have higher savings rates, and the nations of the Mediterranean that have spent earnings at a higher rate. Immigration issues — particularly those that put a strain on the social welfare systems of nations closer to North Africa — are another problem. Some nations are yearning for the days in which their national currency was not so much at the mercy of eurocrats and other nations who spent and obligated funds at higher rates.

National governments are also weak now. Merkel’s Christian Democrats recently took a beating in state elections. Sarkozy faces a tough reelection battle. Cameron’s Conservatives rule only through a coalition with the Liberal Party. Italy’s Premier Silvio Berlusconi, personally plagued by scandals, governs a coalition whose constituent parts will face some tough cuts from the national government.

The necessary cuts in pensions, benefits, and subsidies to local governments have already clogged the streets with Greek rioters. The Italian labor unions are threatening a general strike if the Berlusconi austerity program is passed. Belgium, which may be headed for bisection into two nations, has set a world record for the longest time without a government. And, of course, all over the world non-Europeans are immigrating into the continent — many of them productive physicians and engineers, but also veritable hordes of angry and unemployed young men.

At some point, the European Union may simply have to declare itself a failure and Europe will divide into its constituent parts — bound, if at all, by the loose ties of general and benign treaties and understandings that govern free trade, copyrights, currency exchange rates, legal immigration, and resolution of territorial and related disputes. How far the continent will have to descend into supranational and multicultural anarchy before reaching that point, however, is anyone’s guess. A lot of powerful elite still have an interest in the United States of Europe.

Photo: French President Nicholas Sarkozy and German Chancellor Angela Merkel pose with delegates of the Junior summit during the G8 summit *in L'Aquila, Italy on July 9, 2009.: AP Images*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