Chancellor Angela Merkel’s government agreed to underwrite the debt of Germany’s states, backing a form of burden-sharing that she is resisting at the euro-area level to combat the financial crisis.

The federal government, facing pressure from the 16 states over tighter European Union budget rules that risked worsening a deficit squeeze, unexpectedly backed a form of shared liability to help the states meet constitutional budget limits. The two layers of government plan their first joint debt sale in 2013, the government press office said in an e-mailed statement.

Merkel’s government backed down in a deal the opposition, which controls the upper house of parliament, said will help secure ratification of the EU’s fiscal pact in Germany. The accord doesn’t mean Germany is ready to assume similar liability for the euro zone, Finance Minister Wolfgang Schaeuble said.

Joint debt sales in the 17-nation currency region “don’t make sense” as long as budgets are set by national governments, Schaeuble told ZDF television late yesterday. “As long as the national states make the decisions, they have to be liable. If you can spend money on my tab, you won’t be thrifty.”

Bavaria, one of Germany’s richest states and home to the world’s two-biggest makers of luxury cars, Bayerische Motoren Werke AG and Audi AG, has deployed the same argument against shared debt sales in Germany, saying so-called Deutschland bonds would weaken budget discipline. Merkel’s spokesman, Steffen Seibert, said in March that she opposed the measure.

Merkel Concessions

Pressed by the Social Democrat-led opposition that could block the fiscal pact in parliament, Merkel has now agreed to the policy. Besides Deutschland bonds, concessions by Merkel’s coalition include 580 million euros ($729 million) in one-time federal aid to local governments and a commitment of 75 million euros annually for day care, plus an unspecified amount of federal help to states to care for the elderly, said Kurt Beck, the Social Democratic premier of Rhineland-Palatinate state.

“We reached a solution that makes it clear there will be approval” of the fiscal pact in the upper house, the Bundesrat, Beck said yesterday in an ARD television interview.

Germany’s SPD, buoyed by the election in France of Socialist Francois Hollande as president, has won additional concessions from Merkel in the lower house, the Bundestag, where she needs opposition votes to pass the fiscal pact with the required two-thirds majority and associated legislation setting up the permanent rescue fund before the summer recess on July 6.

Hollande Talks

At the SPD’s behest, Merkel is pushing for a financial transaction tax among a smaller group of EU nations after negotiations among all 27 states foundered. The SPD also aligned with Hollande in demanding measures
to spur growth in Europe, and Merkel backed plans to lobby EU leaders meeting in Brussels on June 28-29 to accept a growth plan of as much as 130 billion euros, or about 1 percent of the euro-region’s economic output.

Even so, she signaled her rejection of joint euro-area debt sales, another policy backed by the SPD and her European partners including Hollande and Italian Prime Minister Mario Monti. Merkel said as recently as June 23 that “liabilities and controls” must “go together.” She is due to meet with Hollande for dinner in Paris on June 27.

With paths to closer European union on the agenda for the EU summit, Schaeuble told this week’s Der Spiegel magazine that a national referendum on further integration is possible, saying that he didn’t expect the euro region to break up and that a dissolution of the EU would be “absurd.”

Germany’s economy, Europe’s biggest, might shrink by as much as 10 percent in the year after a breakup of the euro and the number of jobless rise to more than 5 million from less than 3 million at present, the magazine cited an unpublished Finance Ministry study as concluding.

As a result, the cost of rescuing the euro may be the lesser evil compared with a return to national currencies, Spiegel cited an unnamed Finance Ministry official as saying.

Germany wants “more Europe” and is ready to consider ceding powers to achieve it, Schaeuble said on ZDF. “That can happen very quickly” if EU leaders reach agreement at their Brussels summit this week. “If the others are willing, that’s good. Last time, the U.K. really held us back.”

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