Merkel Offers No Magic Bullet

Stressing Budget Cuts, German Chancellor Doesn't Present New Cures for Europe Crisis

By STEPHEN FIDLER and GEOFFREY T. SMITH

DAVOS, Switzerland—German Chancellor Angela Merkel, sharply criticized for her government's prescriptions of austerity as a cure for the euro zone's sovereign-debt crisis, said labor-market reforms and greater European integration also were needed to correct flaws in the makeup of the common currency.

But in a speech formally opening the World Economic Forum, she gave no sign that Germany would be willing to pour more resources into the euro zone's inadequate bailout funds—a boost viewed by many analysts as essential to combat a debt crisis that has threatened to spread to Italy and Spain. She warned against putting faith in such vehicles.

Ms. Merkel's speech was closely watched to see if she would open the way to new approaches to dealing with the debt crisis. She didn't.

The crisis, now in its third year, is dragging on amid worries that a messy default by Greece could unleash a new wave of instability; talks on Greek debt restructuring continued Wednesday in Paris. Though immediate pressure on the currency area has been lifted by European Central Bank action to provide euro-zone banks with huge volumes of three-year liquidity, few analysts believe that alone is sufficient to finally settle the turmoil.

Senior European officials said on Tuesday that lifting the €500 billion ($652 billion) cap on the size of the bailout funds was necessary before governments from outside the euro zone would agree to boost contributions to the International Monetary Fund—another way to help the bloc's debt-stricken economies.

That increase in the size of the bailout funds has already been delayed by months of political haggling among euro-zone governments.

Ms. Merkel’s government has imposed fiscal austerity on struggling euro-zone economies as the price for bailouts. On Wednesday she continued to emphasize budget cutting as part of the answer.

The further changes she laid out—overhauling labor markets to boost competitiveness and create jobs—followed along the lines of changes introduced by Germany a decade ago.

The euro zone’s crisis is now viewed as the world economy's No. 1 problem, and analysts have criticized Germany's emphasis on austerity as being responsible for making it worse.

Veteran financier George Soros, at a lunch earlier Wednesday in Davos, sharply criticized Ms. Merkel’s policies.
"The austerity that Germany wants to impose will push Europe into a deflationary debt spiral," Mr. Soros warned. The political disintegration of the European Union would inevitably follow, he added.

He said Ms. Merkel’s other proposals wouldn’t be adequate to resolve the crisis. "Structural reforms alone will not do it," Mr. Soros said. A fiscal stimulus is needed from the EU governments acting jointly, he said, adding that "euro bonds are needed in one form or another."

Ms. Merkel assured her audience that her country is committed to greater European integration, but said there were risks in pledging a big expansion in bailout funds that governments couldn’t provide.

"What we don’t want is that we promise something that we can’t deliver," Ms. Merkel said. "In that case Europe would have a really vulnerable flank."

The German leader said she saw a future Europe with more centralized powers. The European Commission, the EU’s executive arm, would act "more and more like a government with all the powers" needed to govern. The European Parliament would be more important, and national governments would be more like a second legislative chamber.

Ms. Merkel said the euro zone’s current crisis can’t be solved overnight, because it is the product of years of diverging competitiveness.

However, she insisted that the unemployment problem in Europe is "solvable," and said she was "profoundly convinced" that other European countries could emulate Germany’s success in bringing joblessness down by overhauling their labor markets.

She struck an upbeat note by saying that changes now under way from Greece and Ireland to Italy and Spain "show more movement than we have seen in many years."

Ms. Merkel, acknowledging the failure so far to complete the Doha Round of trade negotiations, also expressed support for a free-trade agreement between the U.S. and the European Union.

The chancellor also appeared to rule out proposals suggesting Germany should act to curb its trade surpluses with other euro-zone economies as a way to address the big financial imbalances inside the currency area. It was a "lowest common denominator" approach to suggest that Germany should reduce its competitiveness to deal with the region’s crisis, she said.

— Laurence Norman in Brussels contributed to this article.

Write to Stephen Fidler at stephen.fidler@wsj.com and Geoffrey T. Smith at geoffrey.smith@dowjones.com
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