Editorial

The EU- and Euro-crisis is fully back: Cyprus is now bankrupt. Slovenia too. In Bulgaria the government had to resign as protests of citizens against austerity became overwhelming. Spreads for Italian bonds are increasing again and the rating agency Fitch has again downgraded the country. Even the UK rating has been downgraded.

At the same time the official forecast of the EU (see European Commission (2013). European Economic Forecast. Winter 2013. Brussels.) predicts a further shrinking of the GDP in the Euro Area (-0.3 per cent) while for the EU 27 the forecast is almost zero growth (+0.1 per cent). The figures for the US are 1.9 per cent and Japan 1 per cent.

A real disaster are the data for unemployment. In the Euro area the rate for 2013 is predicted at a historic high of 12.2 per cent and at 11.15 per cent in the EU 27. In the US unemployment will be at 7.6 per cent and 4.3 per cent in Japan.

All this has to be seen against the background of an unresolved banking crisis particularly in Spain. But also in the rest of the EU the financial sector is still fragile. The IMF has just released a report, in which the fund voices its concern over the stability of the EU banking system (see IMF: European Union -Financial System Stability Assessment). Furthermore, the austerity programmes do not bring positive results.
Public debt is continuing to grow, while popular protest is increasing massively. For instance, more than one million Portuguese participated under the slogan ‘Troika go to hell’ in demonstrations in 30 cities on 2 March. The country has 10 million inhabitants.

But there is also some light in the darkness: as a result of the election in Italy the austerity strategy has received a heavy blow. Monti, who was following the neo-liberal course of Berlin and the Troika of the IMF, the EU-Commission and ECB, has been marginalised with 10 per cent of the votes. Bersani, from the social democratic party is on top with 29 per cent, but cannot govern without the new political party Cinque Stelle (received 25 per cent of the votes), with its charismatic leader Beppe Grillo. In order to get the new political party or at least parts of it as an ally, Bersani has now presented a proposal under the title *Let’s get out of the prison of austerity.* In it he promises to advocate a ‘revision of the European stability policies’ and to get rid of the ‘vicious circle of recession and austerity’ (from faz.net/aktuell/wirtschaft/europas-schuldenkrise/italien/regierungsbildung-italiens-wahlsieger-bersani-will-vor-allem-geld-ausgeben-12105170.html).

This movement is an interesting phenomenon. Although participating in national elections for the first time, it received 25 per cent of the votes, which is unique in the history of parliamentary democracy worldwide. Although many media and politicians in Germany and other Northern member states try to discredit the movement as ‘populist,’ Cinque Stelle reflects a deep frustration over what Habermas calls Façade Democracy and Colin Crouch Post Democracy. This frustration exists in most industrialised countries. But with the Mafia and corruption inside the political system and Berlusconi’s dominance over traditional mass media, Italian citizens have some more reasons to be angry. The support base of the movement is politically and socially heterogeneous. Many young people of 18-25 years have voted for the party, as well as 40 per cent of the workers, 31 per cent of free professionals and 42 per cent of unemployed (Osservatore Elettotale LaPolis; Università di Urbino). The political profile of the programme of Cinque Stelle is clearly centre-left.

As the French president has so far been too weak to really push an alternative to the Merkel and Troika type of crisis management, Italy might shift the balance of power. A first indicator for such a shift might be the warnings of Mario Monti at his last appearance at an EU summit (14/15 March) against too strict austerity policies (see the article in this issue on the results of the March EU-summit: *Innovative Approach in Cyprus bailout*).

And there is not only Italy. Although not part of the EU, Switzerland held a referendum in which an overwhelming majority spoke out for strict limitations of the income of top managers. The spirit of social justice and fairness is gaining ground in Europe. The winds of change begin to blow.

The European thriller will continue in 2013.
Summaries of the articles in this newsletter

Innovative approach in Cyprus bailout - the results of the March EU-summit

NOTE: This text was finished before the decision of the Cypriot parliament to reject the Proposal of the Troika.

While the recent EU Council meeting (14-15 March) did not address major issues of the EU crisis, the rescue package for Cyprus has interesting new features, which might point beyond the special case of Cyprus. The bail-in component for creditors has been decided without negotiations with the creditors and leaves them no chance to escape. This might be a model for the rest of the EU and finally put debt relief - at least partially at the expense of the creditors and not the tax payer – on the agenda, writes Peter Wahl.

For the full detailed article see below.

Derivatives regulation almost not applied to non-financial corporations

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For the full detailed article see below.

Addressing an arch evil of globalisation: the asymmetry between transnationally operating capital and political regulation.

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Innovative approach in Cyprus bailout - the results of the March EU-summit

By Peter Wahl, WEED

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While the recent EU Council meeting (14-15 March) did not address major issues of the EU crisis, the rescue package for Cyprus has interesting new features, which might point beyond the special case of Cyprus. The bail-in component for creditors has been decided without negotiations with the creditors and leaves them no chance to escape. This might be a model for the rest of the EU and finally put debt relief - at least partially at the expense of the creditors and not the tax payer – on the agenda.

With agriculture and fisheries on the agenda and foreign policy questions such as the controversy over the arms embargo for the Syrian rebel forces, progress in the most burning issues of the EU crisis was postponed: the conflict over the balance between promoting growth on the one hand and austerity on the other. This issue remains smouldering.

However, a slight change can be felt in the rhetoric. Mario Monti used – under the impression of the Italian elections – his last summit participation to warn against too strict austerity. He was supported by François Hollande, who stressed the need for a stronger growth orientation (from elysee.fr/videos/conference-de-presse-a-l-039-issue-du-conseil-europeen-3/). Also the Commission was putting more emphasis on jobs than ever (from presentation of the President of the European Commission, Barroso).

All this can be taken as a slight shift in the discursive balance of power, where the strict German position is increasingly in the defensive. But this shift has not yet reached the level of hard core decision making.

And this will not change until the German federal elections in September. Southern Europe and France will wait and see whether they get rid of Merkel and hence can hope for a more flexible attitude from Berlin. In the meantime muddling through will continue.

Only for Cyprus, which already in summer 2012 had admitted that the country was at the brink of bankruptcy, emergency measures were taken. The rescue package has some new and interesting features, which could have wider repercussions, if applied to the entire EU, although Cyprus only counts for 0.2 per cent of the total EU GDP.

The Cyprus deal

Cyprus is a special case among the European crisis countries. The Greek speaking part, which is part of the Euro zone, only has 0.8 million inhabitants, comparable to the Spanish city of Valencia or Kraków in Poland. But statistically the country is the second biggest exporter to Russia in the EU. The background for this astonishing fact is that Cyprus is a fiscal paradise. Already since its independence as British colony in
1960, the country had close relations with the Soviet Union. Russian oligarchs and rich Russians invest their money in Cyprus and the profits are exported back home. This is why there is the reasonable suspicion that Cyprus is also a huge money-laundering machine for the Russian oligarchy. 500,000 Russians visited Cyprus last year and more than 10,000 have a permanent residence permit. The biggest investor of the biggest bank of the country, the Bank of Cyprus, is the Russian billionaire Dimitri Rybolowlew (from welt.de/finanzen/article113277723/ Russland-rettet-seinen-Geldwaschsalon-Zypern.html).

Russian investments in Cyprus are estimated at 26 bn. Euro, while the Cypriote GDP is 18 bn. It is therefore not surprising, that already in 2011 Russia granted a 2.5 bn. Euro emergency credit to Cyprus.

These close relations to Russia lead to an interesting debate in the fore field of the summit. Never before was the option of refusing help to a Euro member state so openly discussed. Fuelled by anti-Russian feelings in many EU countries, the question was raised whether a rescue package would be bailing out the oligarchs. Even German finance minister Schäuble raised doubts in public, whether Cyprus would be really systemically relevant for the Euro. This relevance is formally a pre-condition to be eligible to receive money from the ESM.

But at the end of the day, the reasons in favour of a rescue-package prevailed:

- The image of the EU would have suffered considerably, if the EU would not have shown solidarity. As Cyprus had the presidency of the EU in the second half of 2012, a no-bailout would have been of spectacular visibility.
- A no-bailout would have been a dangerous signal for the financial markets, with consequences for other crisis countries.
- There are close interconnections between Cyprus and Greece, and a failure of Cyprus would have further negative effects on the most troubled Euro country.
- Besides Russians, also many UK investors are engaged in Cyprus. This made it easy for Cameron to agree.
- The overall economic perspectives of Cyprus are not bad: recently important sources of natural gas have been discovered in the Mediterranean around the island.

**A de facto debt relief**

All in all Cyprus needs 16 bn. Euro. Ten billion will come from the ESM and the IMF. The share of the Fund has still to be negotiated. The rest, and this is a surprising new element, has to be covered by the investors through a one off charge. Deposits below 100,000 Euro have to pay 6.75 per cent and above 100,000 the rate is 9.9 per cent (for details of the rescue package: Eurogroup Statement on Cyprus).

While the ESM and IMF share of the package is a credit, which, has to be paid back (at least theoretically), the compulsory haircut for the investors is lost money for them. It functions de facto as a debt relief for the banks. This is why some comments speak of ‘expropriation’ (from deutsche-wirtschafts-nachrichten.de/2013/03/16/ zypern-rettung-ein-guter-deal-fuer-die-russischen-oligarchen).
The money will be used both to bail out banks and to support the governmental budget.

Unlike the haircut in the second Greek rescue package, which was negotiated with the institutional creditors, this charge has been imposed overnight without negotiations with the creditors and without any possibility to escape. The special law is in force when the banks open again after the weekend of the 18 March. The respective amounts at the accounts have already been locked and precautionary measures against capital flight taken. The Cypriot parliament has been convened immediately for the weekend after the summit decision. The opposition parties have already announced to vote against the package. When this text was finished, the results of the vote in Cyprus were not yet known. If the package should not get the majority, this would be a sensation and a completely new situation would emerge. In that case two basic options exist: either the EU accepts to renegotiate the package – a precedent for other countries too - or Cyprus would go bankrupt.

Hence this rescue package contains a bail-in element for the Russian oligarchs. It is a scandal, however, that it hits small deposits of ordinary people at the same time, among them many Greek small savers, who had transferred their money to Cyprus.

Of course, Cyprus has to fulfil the usual conditions. The Memorandum of Understanding foresees cuts in fiscal spending by 4.5 per cent of GDP, structural reforms (the usual weakening of labour rights, social security systems) and privatisation. Candidates for the latter are telecommunication, the energy sector and the harbours.

Also the extremely over-dimensioned banking sector has to shrink until 2018 to a level, which corresponds to the EU average. The corporate tax has to be increased from 10 per cent to 12.5 per cent. And finally, an independent audit will check whether Cyprus complies with the EU standards against money laundering. Furthermore, the EU will negotiate with Russia, to make it participate in the cost of the rescue package.

Several parliaments have still to agree to the package, among them in Estonia, Finland, Germany and Slovakia and problems may occur in the further process. In Germany, for instance, Merkel needs the approval of the Social Democrats and the Greens, which have already declared that the conditionality does not go far enough and therefore ask to include, for example, the implementation of the Financial Transaction Tax into the conditions.

The Cyprus deal marks a new stage in handling the debt crisis. In particular the bail-in of investors and the measures to enforce them without negotiations and leaving no loopholes, could serve as a model when it comes to making big institutional investors participate in the costs of the crisis. What was possible for the Russian oligarchs should also be made possible for Deutsche Bank, Barclays, Goldman, BNP Paribas etc.

The flip side of the proposal is the impact on small savings. But an EU wide deposit insurance scheme, which protects savings of - let’s say - up to 100.000, could be implemented and used in similar situations in any EU country. The idea is discussed, but even if it would be agreed upon, the implementation would take some years. In such a scheme bail-in rates for creditors should progressively increase above the modest 9.9 per cent, as is now the case for the Russian oligarchs.
In the debt crisis of the developing countries in the eighties of the last century, it took ten years for the IMF and the Western creditors to accept that, as in most historical debt crises, the only way out is debt relief also at the cost of the creditors. The European debt crisis is now three years old. Maybe the learning process will be faster this time.

Addressing an arch evil of globalisation - strong measure against tax avoidance in Commission’s draft for FTT
By Peter Wahl, WEED

The new draft of the EU-Commission for the Financial Transaction Tax (FTT) has presented an additional measure against tax avoidance: the so-called ‘issuance principle.’ It allows to tax transactions also outside the geographical realm of the countries participating in the FTT. The importance of this proposal goes far beyond the FTT as such. It addresses an arch evil of globalisation: the asymmetry between transnationally operating capital and political regulation.

It was a pleasant surprise, when the EU Commission tabled its new draft for the Financial Transaction Tax last February. It not only kept the positive elements of the version for the EU-27 from September 2011, but introduced in addition the so-called ‘issuance principle’ against tax avoidance.

Issuance principle means that all assets – shares, bonds, derivatives – issued in a country that participates in the FTT, have to be taxed even if they are traded outside the countries participating in the FTT. For instance, if a Wall Street broker trades a share of Volkswagen or a derivative issued by BNP Paribas between a Japanese and an Australian hedge fund, the tax is due. Both sides, seller and buyer, have to pay, although geographically they do not fall under the legislation of the FTT.

This proposal reduces the possibilities for tax avoidance drastically and goes far beyond the importance of the FTT as such. It finally addresses an arch evil of globalisation: highly mobile capital can move out from a country with a mouse click and thus abscond from regulation and taxation, because capital can operate transnationally without limitations, while regulation is tied to the nation state and hence its national borders. Liberalisation has thus established a fundamental asymmetry between finance and the capacity of governments to control it. With the issuance principle the draft of the Commission now presents an instrument, which can contribute to reducing this asymmetry in order to gain more control over finance.

The proposal refutes the frequently heard argument against regulation: ‘yes, regulation is necessary, but under conditions of globalisation it is only effective if all countries participate’. The draft proves that where there is the political will, there is a way.
It is therefore not surprising that the finance industry and its governments mobilise strongly against the draft of the Commission. In the working group on 21 February the Grand Duchy of Luxembourg, a fiscal paradise with a population of half a million, threatened to go to court, if the proposal would be adopted. The country states that it does not comply with the European treaties and that the issuance principle is against international law. Also the UK threatened to take legal steps, if the interest of the City would be infringed. Sweden and the Czech Republic also voiced strong opposition.

As a reminder: the FTT is now negotiated in the framework of ‘enhanced cooperation’, i.e. a coalition of the willing of eleven EU member states. The non participating member states cannot vote, but they can participate in the negotiations and express their opinion.

Interestingly, the British Stamp Duty, which taxes the purchasing of shares of British enterprises everywhere in the world, uses the issuance principle since many years.

It will be interesting to see, whether the issuance principle survives the negotiations. The chances are better than one might think, because in this case one can argue that it protects the interests of the markets as it makes relocation meaningless and hence protects the competitive position of the market places under the FTT legislation.

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Derivatives regulation almost not applied to non-financial corporations

By Markus Henn (WEED)

In August 2012, the European Market Infrastructure Regulation (EMIR) was put into place to regulate the over-the-counter trading of derivatives (on the contents see March 2012 newsletter and information from the FSA) but some technical standards were to be implemented later. In March 2013, important technical standards proposed by the European Securities and Markets Authority (ESMA) and the EC have finally been adopted. However, there was an opposition in the European Parliament against important details of the standards. A group of conservative and liberal MEPs attempted to weaken the standards by proposing large-scale exemptions for over-the-counter (OTC) derivative activity by non-financial ‘real economy’ corporations. Their proposal would have meant that industrial and commodity conglomerates would have had carte-blanche to speculate far beyond their actual need to hedge risks from their commercial activity. However, due to opposition from other MEPs and civil society organisations, the attempt failed in the final vote. Despite this victory, the extent and safety of speculation with OTC derivatives, that will be possible for corporations under the final EMIR regime, is still somewhat unclear.
Food speculation on the back burner

The other important revision of the derivatives law, the Markets in Financial Instruments Directive (MiFID), is still halted in the Council of Ministers, as already reported in a recent newsletter issue. Due to other urgent reforms like that on capital requirements (CRD-4/CRR) and the banking union, and due to certain issues within MiFID such as the access to clearing houses (Germany versus United Kingdom which means Deutsche Börse versus London Stock Exchange), the negotiations have not proceeded in the last months. An agreement in the Council could first be decided in general terms in May 2013, but is currently not expected to be decided in full by the Finance Ministers until the second half of the year, so that trilogue negotiations and the final text will not be finalized before autumn 2013.

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Short overview on some reforms currently moving forward

**Banking:** The European Parliament (EP), the Council of Ministers and the EC agreed on certain aspects for the revision of the capital requirements directive in their trilogue negotiations on 28 February 2013, such as limiting remuneration in the banking sector. However, the compromise on final text is not yet available and some decisions still need to be taken. In addition, the EP process on the banking recovery and resolution plans is moving forward. For more details, see the calendar and the next newsletter issue.

**Money Laundering:** The European Commission (EC) has published a draft revision of the EU’s anti-money laundering directive on 5 February 2013, which is the start of the co-decision making process at the European Parliament and the Council of Ministers (see next newsletter).

**Key information documents (KID) for packaged retail investment products:**

Individual investors’ investment products (PRIIPs) will be required to give more information but will not be regulated on what assets they contain. The European Parliament’s rapporteur draft report is being amended and the vote in the responsible EP committee is scheduled for 27 May 2013.

**Credit Rating Agencies:** On 16 January 2013, the European Parliament has approved the compromise which had been agreed on in December in the trilogue (see previous newsletter). With this EP decision, the review of the credit rating agency regulation has now also been formally finalized.
Calendar of official events

For more background to the official agenda of European institutions, see the following websites:

The European Commission (EC)
The Economic and Financial Affairs Council (ECOFIN)
The Economics and Monetary Affairs Committee (ECON) of the European Parliament

The links made in the following calendar refer to the procedure files on which you can find the dates of the different stages (past and future) of decisions by the EC, EP and Council on the particular draft EU law.

2013

March

- **20, ECON (Brussels):** Consideration draft report on Reforming EU banking structure, and amendments on the Fight against Tax Fraud
- **20, EC (Brussels):** Scheduled launch Green Paper consultation on long term financing of the European economy, and publication of next steps to reinforce the Economic and Monetary Union
- **20, WTO (Geneva):** Committee on Trade in Financial Services discussion of financial reforms and GATS/WTO rules
- **21, ECON (Brussels):** Vote on UCITS V (remuneration & depositary functions)
- **26, ECON (Brussels):** Meeting
- **27, ECOFIN Coreper level (Brussels):** approval of final version of CRD-4 and CRR
- **26-30, Tunis (World Social Forum):** Annual meeting
- **?, EC (Brussels):** Proposal for a European Framework for Money Market Funds (Shadow banking)

April

- **5, ECON:** Deadlines for amendments on draft report on Reforming EU banking structure
- **11, ECON (Brussels):** Discussion Implementing enhanced cooperation on FTT
- **12-13, ECOFIN (Dublin):** Informal meeting of Finance Ministers
- **17, EP (Strasbourg):** Vote on CRD-4 and CRR in plenary scheduled
- **18-19, G20 (Washington):** Finance Ministers and Central Bank Governors’ meet
- **19-21, IMF/World Bank (Washington):** Spring meetings
- **23, ECON:** deadline amendments Implementing enhanced cooperation in the area of FTT
- **24-25, ECON (Brussels):** Meeting
- **?, ECON:** voting on amendments of bank crisis management / Recovery and Resolution Directive

May

- **7, ECON (Brussels):** Discussion amendments Reforming EU banking structure report
- **14, ECOFIN (Brussels):** Finance Ministers meet (preceded by Eurogroup meeting): scheduled decision on general approach on MiFID-II and MiFIR
- **24, European Council (Brussels):** one day Summit meeting of heads of state
- **27, ECON (Brussels):** Vote scheduled in consumer information about investment products (part of
Implementing enhanced cooperation in the area of FTT

28, ECON (Brussels): Vote on amendments Reforming EU banking structure report and on report on Implementing enhanced cooperation in the area of FTT

June

6, ECON (Brussels): Meeting
6-7, G20 (St. Petersburg): Finance Ministers’ and Central Bank Governors’ Deputies meeting
11, EBA (London): Deadline consultation technical standards on bank recovery plans
14, ECON (Brussels): Deadline public consultation on coherence of EU legislation on financial services
17-18, ECON (Brussels): Meeting
17-18, G 8 (Enniskillen, Northern Ireland): Summit, chaired by UK
21, ECOFIN (Luxembourg): Meeting of Finance Ministers, preceded by Eurogroup meeting
24, ECON (Brussels): Meeting
27-28, European Council (Brussels): Two-day Summit Meeting of heads of state

July

1, EP (Strasbourg): Indicative plenary vote on UCITS V
2, EP (Strasbourg): Indicative plenary vote on implementing enhanced cooperation in the area of FTT

2-4, EP (Strasbourg): Plenary vote Reforming EU banking structure report
1-4 ?, EP (Strasbourg): Scheduled Plenary vote Implementing enhanced cooperation in the area of FTT
8-9, ECON (Brussels): Meeting
18-19, G20 (Moscow): Joint G20 Finance and Labour Ministers meeting
19-20, G20 (Moscow): Finance Ministers and Central Bank Governors’ meet
?, EC (Brussels): Proposal on Reforming EU banking structure (Liikanen report follow up)

September

2-5, G20 (St. Petersburg): Finance Ministers’ Deputies meet
5, ECON (Brussels): Meeting
5-6, G20 (St. Petersburg): Leaders’ Summit chaired by Russia
16-17, ECON (Brussels): Meeting
23-24, ECON (Brussels): Meeting
30, ECON (Brussels): Meeting

October

8, EP (Strasbourg): Estimated plenary vote on MiFID-II and MiFIR
10-11, G20 (Washington): Finance Ministers and Central Bank Governors meet
11-13, IMF/World Bank (Washington): Annual meetings
14, ECON (Brussels): Meeting
24-25, European Council (Brussels): Two-day Summit of heads of state
November

- 4-5, ECON (Brussels): Meeting
- 25-26, ECON (Brussels): Meeting

December

- 2, ECON (Brussels): Meeting
- 5, ECON (Brussels): Meeting
- 16-17, ECON (Brussels): Meeting
- 19, European Council (Brussels): Two-day Summit of heads of state

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