Special Issue on the EU June Summit - July 2012

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Editorial

Among the 20 summits the EU has held since the financial crash in 2008, the June 2012 summit had some prominence. This is why we have decided to issue this special edition of our newsletter, which only deals with the main results of this summit.

The summit on 28-29 June took place in a dramatically worsening economic environment, with the EU entering into a recession and Spain and Italy becoming the target of speculative attacks. In this situation, simple business as usual would have meant a worsening of the crisis and perhaps a final collapse.

At first glance, the summit result might appear as a turning point. The showdown between Merkel on the one side and Hollande, Monti and Rajoy on the other turned out to be a compromise; every leader said that he or she was successful and the markets – irrational as always – reacted almost euphorically.

In fact, there is one area where a new element has surfaced: the decoupling of pub-lic from private sector debt has been envisaged, and Germany has given up its resistance to add stimulus measures to the strict austerity program.
However, although both decisions are not wrong, they are far from being a breakthrough or even bringing a definitive solution to the crisis. There are also some legal, procedural and political obstacles on the way to implementation. And finally, there still remains the option of vetoing a bailout by a single country.

The logic of “too little, too late” persists. Therefore, muddling through will continue. Beyond all critiques of the individual capacities of leaders, this has structural roots. The EU has become such a complex machinery that it is extremely difficult to obtain changes and reforms dealing adequately with the depth and the range of the problems.

Results of the EU Summit from 28-29 June 2012: Titanic Announces it Will Reduce Speed by 2 Knots – Next Year

By Peter Wahl, WEED

This summit had been expected with particular high suspense. In recent weeks, the economic situation in the euro zone had deteriorated dramatically, with the resurgence of the banking crisis in Spain, and with Italy and Spain being obliged to pay unsustainable interest rates for their bonds above 6% (see last issue of this newsletter). The political tension in the crisis countries has also been rising. In Italy, Berlusconi threatened to attempt a comeback with the slogan Let’s get rid of the euro. The euro volcano was on the brink of eruption these days.

Also, it was the first summit with the new French President, who during his electoral campaign had promised to correct the strict austerity course dictated by the Merkel government (and followed by former French President Sarkozy). Additionally, at the G20 summit in Mexico the week before, the leaders’ declaration had pressured the euro zone to solve its problems, among others with a stimulus program for growth (g20.utoronto.ca/2012/2012-0619-loscabos.html).

Given the pressure of the problems and that coming from the international community, many people expected this summit to be a qualitative step towards deeper integration of the EU. Otherwise, a breakup of the euro zone would become more and more probable.

Also in the weeks prior to the summit, measures to stimulate growth were accepted in principle by the Germans and their allies, mainly the Netherlands and Finland. In a pre-summit meeting in Rome the day before the EU summit, Monti, Rajoy, Hollande and Merkel agreed to make 120 bn. euros available for growth and to combat youth unemployment.

The high expectations were also nourished by the fact that a committee with Barroso (EU Commission), Van Rompuy (EU Council) and Draghi (ECB) had worked out a proposal suggesting the establishment of a light version of Euro Bonds and steps towards a political union. But already before the summit, Merkel had harshly rejected the proposal.

Decoupling private from public debt – with triple circuit breaker

As for the hard core of the German intransigence – the refusal to accept any additional common responsibility for the debt of the crisis countries – the result of the
The summit is less sensational than some media headlines insinuate. Merkel continues to categorically refuse the establishment of Euro Bonds or even a common fund, which could serve as a kind of “bad bank” for sovereign debt above the 60% limit. In that sense, the summit has changed nothing.

However, the German Chancellor made a real concession by accepting that the future European Stability Mechanism (ESM) would be allowed to lend money directly to private banks in distress, and not only to governments. This is what Rajoy, in particular, had wanted for the Spanish banks, as well as Monti in case Italy’s situation deteriorates.

The idea behind this is the decoupling of private sector debt from national public debt. A vicious circle was triggered with the financial crash of 2008: banks were bailed out by their governments. This increased public debt. In return, increasing public debt was weighing on the entire economy and hence further destabilising the banking sector. If private banks could be bailed out directly by the ESM, this money would not be counted as part of the public debt of the respective country. This also means that the government does not have to comply with the strict conditionality, as was the case with Greece, Portugal and Ireland. To prevent such a loss of sovereignty over their own budget was a major concern for Italy and Spain, the third and fourth largest economies in the euro zone.

Furthermore, the ESM would give up its status as preferred creditor. This was a concern of the private investors, who distrusted Spanish or Italian bonds, because in the case of default they would be paid back only after the ESM was first paid back. Abolishing the ESM’s preferred creditor status is meant to contribute to “calming the markets” and reduce pressure in the short term on the interest rates for sovereign bonds.

Merkel’s concession is a step in the right direction, but far from a breakthrough. Not only because the decision is embedded in the overall framework of the Fiscal Pact (see newsletter nr. 10 from February this year) but also because the implementation first has to run through a complicated law-making process, with many occasions for throwing sand in the wheels. And even if it were implemented, there would still be the possibility of vetoing a bailout. Let’s have a look at the details.

A lot of leverage for brakesmen and -women
As a precondition for the bailout mechanism through the ESM, Merkel has insisted on establishing a European banking supervision scheme under the ECB. This is a new role for the ECB and would require a change in the rules, not only in the euro zone but the entire EU-27. This requires unanimity. At the moment, it is unclear what the new system will look like. But according to the summit declaration, any bail out would be conditioned, with details still to be elaborated (tagesspiegel.de/zeitung/diegipfelerklaerung-imwortlaut-den-teufelskreis-durchbrechen/6817718.html). The Commission is mandated by the summit to work out a respective proposal by December 2012.

But even if the decision is implemented, several safeguards still remain in place before it can be applied:

- The governors council of the ESM has to unanimously agree, which would give a veto right to every single country; (european-council.europa.eu/media/582311/05-tesm2.en12.pdf)
- In the German case, the Bundestag has to decide beforehand on the vote of the German governor in the ESM. On the one hand, this brings a democratic element into the procedure; on the other hand, it slows down the process and increases uncertainty.

But as soon as all these details are known and the concrete negotiations start, things will become very difficult.

For instance, it is more than doubtful whether the UK will agree on European banking supervision under the ECB. There
were already EU directives establishing a new system of EU supervision that was heavily watered down by the UK. The directives about the European Banking Authority (EBA) and colleges of supervisors entered into force in 2011 without really improving the effect of supervision. Otherwise the resurgence of the Spanish banking crisis would not have come as a surprise. Only one day after the summit, Prime Minister Cameron poured British water into the Euro-wine, when he wrote in an article for the Telegraph: “We won’t stand behind Greek or Portuguese banks, and our banks will be regulated by the Bank of England, not the ECB.” And: “Far from there being too little Europe, there is too much of it.” (telegraph.co.uk/news/politics/david-cameron/9367479/David-Cameron-We-need-to-be-clear-about-the-best-way-of-getting-what-is-best-for-Britain.html)

This is a clear announcement that unanimity on the new supervisory system will not be reached. The euro zone will then have to come back to inter-governmental cooperation and might be obliged to set up a different institutional arrangement than the ECB. The situation is similar to a rotten computer programme: if you repair it at one end, you create two new problems at the other.

**Time factor is crucial**

But even if the project is implemented in 2013, it might be too late for solving the public debt problem. In the meantime, further speculative attacks on Spanish and Italian bonds might continue. The decoupling of national public from private debt is a right step, but it is only one dimension of the crisis. Italy has deep-rooted structural problems in terms of its competitiveness and the political situation is not very stable. The country has entered into recession. Spain is in a recession as well and has a dramatic problem with unemployment. The EU as a whole will be in recession in 2012 and several countries will remain there in 2013 too. It would be surprising if institutional speculators were to neglect the occasion and keep quiet over the next months.

In addition, there is a special moral hazard problem: the Spanish government will take no immediate measures, but will wait until the decoupling has entered into force. The reasoning is: Why pay now if the ESM will pay in eight or ten months? This will increase the debt burden of banks and increase instability, while for the ESM, the bailout of the banks will be in any case more expensive.

**Blackmailing instead of consensus**

It is also very interesting to see how the concession from the German Chancellor was obtained. If Merkel agreed to the compromise described above, it was not so much deeper insight into the necessity of such a move, but a simple blackmailing set up by Monti. He knew that on the eve of the summit, Merkel would need the Bundestag support of the Social Democrats (SPD) for the Fiscal Pact, because the German Supreme Court had ruled that the decision would require a two-thirds majority. In negotiations previous to the summit, the government had accepted the proposal of the SPD to complete the Fiscal Pact through a growth component. Otherwise the SPD would not vote for the Fiscal Pact.

Although Monti was, just as the SPD, Rajoy, Hollande and the entire rest of the EU, in favour of such a stimulus programme, and although he had agreed on the amount and further details in the pre-summit meeting, he used it as a negotiation chip and refused to accept it during the summit, as long as Merkel did not make some concessions.

Although the German position cannot be defended, such Machiavellian methods throw an instructive light on how “consensus” in the EU is sometimes achieved.

**Growth Pact – a drop in the bucket**

The summit has given the green light for a “Compact for Growth and Jobs,” which amounts to 120 bn Euros. Fifty-five bn Euros come from left-over money from the 2012 and 2013 EU budgets in areas with under-spending. Sixty bn Euros represent additional credits from the European Investment Bank (EIB), which requires a capital increase of 10 bn Euros to be
matter of their individual capacities, of their mentality as “realistic” politicians, but has systemic roots. The European integration process has in some areas and to a certain extent gone beyond the nation state. Germs of supra-national governance have emerged, but there is no full-fledged system of governance in place which could equal the capacities of a nation state. In parallel, the nation state is still very strong, and so too are national inter-ests. The EU is like a house under construction. The cellar, parts of the first floor and a garden house are already built and can be used provisionally. The second and third floor and the roof are still missing, and there is no water supply or sewage system yet. As long as the weather is nice, there is no problem. But if a hurricane like the financial crisis comes along, things become more difficult and serious damages will occur to the unfinished building. It has now become clear that the whole construction has to be changed if the building needs to be able to resist extraordinary challenges. Under the present conditions, more and more people have the feeling that their old homes would still be better, while the architects have different opinions on how to finish the building. There is no common blue-print.

The conglomerate of national interest in the EU and its institutionalisation has produced a complex mechanism, which only works as long as there is no serious external shock. There is a kind of path dependency for this machinery. Once it is en route, it is very difficult to change its direction. Unfortunately, path dependency is also valid for the path into the abyss.
This newsletter is produced by SOMO and WEED and is intended for wide circulation to interested parties. We appreciate receiving feedback as well as announcements of research reports, campaign actions, and meetings, which can be sent to m.vander.stichele@somo.nl.