EU nations divided in run up to G20 summit

Stefan Steinberg
21 June 2010

Leaders of the 27 nations of the European Union meeting in Brussels last Thursday failed to arrive at a joint position for the G20 conference due to take place in Toronto next week.

Thursday's meeting in Brussels took place in the shadow of the continent's biggest financial crisis since the 1930s and under mounting pressure from the US administration. European leaders proved completely incapable of developing a common economic strategy.

A recent report by the European Central Bank confirmed that European financial system stood at the brink of complete collapse at the beginning of May. The ECB report declares that the situation for European banks was more serious than in the immediate aftermath of the collapse of Lehman Brothers in the autumn of 2008, with a number of major European banks facing bankruptcy due to their investments in heavily-indebted Greece.

A collapse of the European banking system was averted only at the last moment, when European leaders took emergency action at a hastily-called meeting on the weekend of May 8-9 to agree a massive rescue package of €750 billion for possible bankruptcies in the Eurozone. Since then, the ECB admits that it has bought up huge amounts of state bonds from ailing European economies to stabilise the situation. Nevertheless, financial markets remain panicky, with the euro dropping to a four-year low against the dollar last week.

Nervousness on European stock markets has been compounded by new figures, relaying the extent of foreign bank involvement in four of Europe's most exposed economies. According to the latest quarterly report of the Bank of International Settlements, total foreign bank exposures in the economies of Spain, Ireland, Portugal and Greece amount to more than $2 trillion, with half of this sum resting with German and French banks.

Leading European finance experts are now warning that further massive government bail outs will be needed to defend exposed banks. On the eve of the EU conference in Brussels, the Spanish prime minister and a number of EU politicians sought to deny that Spain was on the verge of applying for IMF emergency credits to forestall state bankruptcy. On his website, financial analyst Wolfgang Münchau warned: "[G]lobal investors have realized a deep underlying truth about our European sovereign debt crisis—that at its core, it is not a sovereign debt crisis at all—but a highly interconnected banking crisis about to blow up".

In addition to the growing dangers of a second bank crash, economists are also warning that the huge austerity packages recently agreed by one European economy after the other threaten to strangle economic growth and plunge the economies of Europe and the world into a new recession. In a June 17 piece for the *New York Times* titled "That '30s Feeling", columnist Paul Krugman writes from Germany that "a few scholars see parallels to the policies of Heinrich Brüning, the chancellor from 1930 to 1932, whose devotion to financial orthodoxy ended up sealing the doom of the Weimar Republic".

The fears of a second, precipitate economic recession due to huge austerity programs are certainly very real, but the arguments raised by Krugman have been taken up by no less than the US administration in an attempt to resolve its own economic crisis at the expense of its main rivals, Europe and China.

The conflict between the US and Europe emerged earlier this month, when US Treasury Secretary Timothy Geithner clashed with ECB president Jean-Claude Trichet over economic policy for Europe. Trichet argued in favour of tight fiscal restraint and austerity measures, while Geithner pleaded for increased investment in European economies to stimulate demand.

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For some time the US has been using the weakness of the dollar compared to other international currencies as a means of trade war against its main rivals. Now the US administration is concerned that a slump in the value of the euro, combined with shrinking consumption resulting from austerity measures imposed across the continent, will hurt American trade and business interests.

In a letter to world leaders prior to the G20 meeting, US President Barack Obama issued a warning addressed in particular to China and Germany. Obama called upon them to rein in their export surpluses and take measures to stimulate demand. "I am concerned by weak private sector demand and continued heavy reliance on exports by some countries with already large external surpluses", Obama wrote.

At the end of their deliberations, the measures agreed by European leaders in Brussels last Thursday bore no relation to the huge economic and financial problems they face, and in fact only underlined the disunity existing in European political circles.

The leaders of the 27-nation bloc failed to agree to proposals, favoured by the French and Spanish governments, for a form of "economic government" with specific powers to intervene into the economies of the 16 nations comprising the Eurozone. French President Nicolas Sarkozy has been pressing the Eurozone for some time to hold regular summits and maintain a permanent secretariat. The failure of his proposal was primarily due to opposition from the German chancellor Angela Merkel, who in turn was able to draw support from an avowed opponent of European integration: the new British Prime Minister David Cameron.

Instead, the EU heads of state agreed on a non-committal declaration of intent, leaving the task of drawing up future proposals for economic governance to the European Commission. In addition the EU leaders approved a 10-year plan to boost the 27-nation bloc's competitiveness, which remained vague in terms of specifying measures to achieve its targets.

The EU summit also agreed to publish so-called "stress tests" for European banks along the lines of the tests introduced by the US administration. In fact, the tests drawn up for 25 of Europe's leading banks are highly selective. They do not include recent figures dealing with the drop in the value of government bonds as a result of the Greek debt crisis. Nor do the "stress tests" include the majority of smaller European banks, such as Spanish savings banks and the majority of Germany's long-ailing state banks, where much of the continent's bad debt resides.

Other measures discussed at the summit to be presented as European initiatives to the G20 summit in Toronto included a tax on financial transactions—favoured by Merkel and Sarkozy—and a special levy on banks to set aside funds for the next financial crisis. Media commentators have already described the EU measures as "dead in the water".

The EU failed to unite on a financial transaction tax, in the face of opposition spearheaded by the British prime minister and the banking community of the City of London. The second measure—a general levy on banks—is opposed by a number of leading G20 countries, such as Japan, Australia, Canada, China and Brazil.

The clearest indication of the current disunity in European ranks was the hearty welcome given to the most pronounced "Euro-sceptic" at the Brussels meeting, David Cameron.

Cameron declared he was "pleasantly surprised" after being greeted with a full English breakfast by the EU Commission president, José Manuel Barroso. At the end of the summit, Cameron praised it for a "healthy degree of consensus" that had "delivered good outcomes for Britain". At the same time, Cameron insisted that he would move to block any further moves towards greater integration.

In a deliberate snub to other EU conservative leaders, Cameron held discussions with Michal Kaminski shortly before the summit began. Kaminski is the Polish MEP who leads the virulently nationalist and anti-Europe ECRG (European Conservatives and Reformists Group). Last year Cameron took the decision to pull Tory from the main European conservative grouping—the European People's Party—and join the ECRG.

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