German-French conflicts deadlock European Union summit

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The much heralded European Union summit this weekend will not take any decisions to stabilize the euro due to unresolved differences between Germany and France. Instead, the 17 heads of state and government of the euro zone plan to reassemble in Brussels next Wednesday to decide on a package of measures.

The EU summit, originally scheduled for last weekend, was supposed to provide a comprehensive response to the European debt and banking crisis and calm stock exchanges and financial markets, which have been fluctuating wildly for months. Two weeks ago, however, the summit was postponed at short notice following a meeting in Berlin between German Chancellor Angela Merkel and French President Nicolas Sarkozy.

At that meeting Merkel and Sarkozy had, with much fanfare, announced a mutual agreement and promised to submit a "compelling and complete package" to solve the crisis by the end of the month. Since then, however, it has become clear that the differences are far deeper than officially admitted.

A surprise visit to Frankfurt by Sarkozy on Wednesday this week brought no solution. After two hours of talks with Merkel and leading representatives of European institutions, the French president departed empty-handed.

The central point of contention between Berlin and Paris is the distribution of the burden in the event of the bankruptcy of Greece or the restructuring of its debt, which, according to experts, seems increasingly inevitable. The discussions revolve around shielding other highly indebted countries against financial contagion and protecting the banks from collapse by a huge infusion of capital.

The general plan under discussion is to utilise the €440 billion European Financial Stability Facility (EFSF), which was launched in May of 2010 to provide loans to ailing euro zone countries, but its functions have since been continuously expanded.

It is already clear that the sum of €440 billion is insufficient should large countries like Spain or Italy face serious problems. Because Germany is unwilling to increase its €221 billion share of the fund, various schemes are being broached to increase the fund's firepower via financial leverage.

France proposes that the EFSF receive a banking license and so be able to borrow additional funds from the European Central Bank (ECB). This would enable it to award loans of up to €2 trillion.

Germany categorically rejects such a move. It fears that the ECB will degenerate into a money printing press and no longer be able to guarantee the stability of the euro. Furthermore, such leverage would increase the risk that Germany actually had to pay out the sums it has guaranteed. Losses incurred by the ECB must be carried by European states, with Germany as the main creditor.

The German government proposes another form of leverage. Instead of making loans itself, the EFSF is to be turned into a kind of credit insurance company, liable for a certain percentage of government bonds (there is talk of 20 to 40 percent) that indebted countries sell on the open market. This would increase the bailout potential of the fund to about €1 trillion.

In addition to differences regarding the leverage of the rescue fund, Berlin and Paris are unable to agree on the extent of losses to be incurred by holders of Greek debt as well as how the reserves of exposed banks should be restocked.

French banks are particularly exposed in Greece, and Paris favours a low level of debt write-off. Berlin, on the other hand, has indicated support for a write-off of between 50 and 60 percent. Sarkozy also wants to help vulnerable banks with funds from the EFSF, while Merkel insists that the banks should first increase their capital from their own resources, followed by funds from national governments, and that EFSF resources should be used only in the last instance.

These issues are now due to be discussed in Brussels in a marathon of meetings. Today the finance ministers of the euro group meet, to be followed on Saturday by the finance and foreign ministers of all EU member states. On Sunday the heads of state and government of the 27 EU nations will meet, followed by a smaller meeting of the heads of the 17 euro zone countries.

It is doubtful that an agreement will be reached. In addition to the leveraging of the EFSF, bank recapitalization, and debt restructuring for Greece, the agenda of the summit includes closer economic and fiscal policy coordination within the euro zone.

Germany in particular is demanding a price in return for its billions of guarantees. It insists that countries receiving financial aid yield part of their sovereignty and submit to the dictates of the EU Commission on financial issues.

Chancellor Merkel wants to change the Lisbon Treaty so that countries with excessive deficits can be sued at the European Court of Justice. German Foreign Minister Guido Westerwelle wants to empower the EFSF to intervene directly in the budgets of countries seeking help and organise a controlled default if they are bankrupt.

According to the *Süddeutsche Zeitung*, which has access to the plans of the German Foreign Ministry, the EFSF is to be empowered to force countries that fail to comply with EU guidelines “to carry out specific spending cuts or to establish new flows of revenue”, or to “actively support” the implementation of “administrative measures”, i.e., social cuts.

Should the summit fail to reach any agreement at the weekend, a violent reaction on stock exchanges and financial markets is expected on Monday. If a compromise is reached, it will inevitably, like the decisions of numerous previous summits, only inaugurate the next stage of the crisis.

The profound divisions between Germany and France indicate the advanced level of decay of the European Union. Ever since the 1957 Treaty of Rome, these two countries have formed the backbone of the EU and the entire project of European integration. The national antagonisms that dominated the continent until the middle of the last century are erupting once again.

The debt issue is only the trigger for the present crisis. Measured against gross domestic product, the debt of the euro zone (85 percent) is less than that of the US (94 percent) and Japan (220 percent). But the rivalry between European nation states and the subordination of their governments to the dictates of finance capital rule out any progressive resolution of the crisis.