Debt crisis splits Europe

Peter Schwarz
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On Wednesday evening the leaders of the European Union met for the second time in three days seeking a solution to stem the growing European debt crisis. They emerged without anything resembling the "ambitious and comprehensive response" that had been pledged.

One of the key sticking points was the size of the debt waiver or "haircut" on Greek bonds. As talks continued, Institute for International Finance Managing Director Charles Dallara, who has been leading the negotiations on behalf of the banks and private sector creditors, said there had been "no agreement on any element of a deal."

But at 4 a.m., after 11 hours of talks, French President Sarkozy finally announced that private investors had agreed to take a voluntary 50 percent "haircut" on the face value of their bonds.

The agreement for a voluntary cut had been considered vital in order to prevent a so-called "credit event" that would trigger credit default swaps, through which losses on Greek debt have been insured, with potentially severe consequences for the international financial system

How solid is the agreement is another question. Dallara said the IIF would need to work with authorities to "develop a concrete voluntary agreement" and "specific terms and conditions" to be agreed by all relevant parties in the coming period.

The "haircut" agreement was part of a new €130 billion bailout which is supposed to reduce Greek debt levels from more than 180 percent to around 120 percent of gross domestic product by the end of the decade.

Questions have already been raised over elements of the package, including what the *Financial Times* called "optimistic assumptions" about revenue Greece will raise from a sweeping privatisation program.

The FT cited one Hong Kong-based analyst who described the total package as "big on words but short on detail."

Earlier it had been announced that agreement had been reached on bank recapitalization, costing around €106 billion, to bring a key indicator of bank stability up to 9 percent by the end of June 2012.

There were no precise figures for the third key issue—expansion of the bailout capacity of the European Financial Stability Facility. Both German chancellor Angela Merkel and Sarkozy indicated that the size of the fund would be increased "four or five times" but no precise number was available because no one is clear how much money is available after the new Greek bailout.

The capacity of the EFSF will be increased through the provision of risk insurance on bonds issued by eurozone economies—one of the aims is to boost Italian finances—but the amount of losses to be covered has yet to be specified.

Amidst the unclarity surrounding the outcome, the only certainty is that the latest summit is another stage in a rapidly escalating crisis. Whatever decisions have been made will be rapidly overtaken by events. This has been the case with all previous such summits, some 14 of which have been held in the last 21 months.

Europe has changed fundamentally in recent months. The notion that the founding of the European Union and the introduction of a common currency could overcome the fragmentation of the continent into antagonistic nation states has proved a fallacy. Under the pressure of the international financial crisis, national conflicts are resurfacing in Europe with a vengeance.

European leaders are aware that more is at stake than economic issues. German Chancellor Angela Merkel ended a government statement on Wednesday before leaving for Brussels, with the words: "Nobody should believe that another half century of peace and prosperity is a given. If the euro fails, then Europe fails."

The fact that they confront the abyss does not mean that political leaders are willing, or able, to avoid it. On the contrary, all of the "solutions" in debate prior to the summit are only likely to exacerbate the crisis. They are characterized by narrow national interests and correspond to the dictates of the financial markets, which are determined to shift the entire burden of the crisis onto the backs of the working class.

The convening of the German parliament (Bundestag) at short notice on Wednesday must be seen in this context. After Merkel had long resisted having her hands tied by decisions made by the Bundestag, she turned to the parliament earlier this week in order to strengthen her negotiating position in Brussels. Should other governments reject her proposals, she can now claim that her room for manoeuvre is restricted by a mandate from the Bundestag.

In so doing, Merkel is relying on support not only from her coalition partners—the conservatives and Free Democrats—but also on the opposition Social Democrats (SPD) and Greens. All of the parties represented in parliament, with the exception of the Left Party, drafted a joint resolution which was adopted by a large majority in Wednesday's vote. The *Süddeutsche Zeitung* spoke of "the beginning of an informal grand coalition," i.e., a coalition of the conservative parties with the SPD.

Such a grand coalition not only has the job of strengthening the negotiating position of Merkel in Brussels. It is also designed to assume responsibility for enforcing further austerity measures in the face of growing popular opposition. The opposition parties, the SPD and the Greens, have left no doubt that they will step up to the plate when asked.

The Brussels summit discussed three basic issues: an expansion or "leveraging" of the euro rescue fund, the EFSF; the slashing of the Greek debt burden; and a recapitalization of European banks.

The EFSF, launched in May of 2010 in order to aid Greece and other countries with financing difficulties, is insufficient to tackle the burgeoning mountain of debt, despite the fact that its borrowing capacity was increased in July this year to €440 billion. With Germany and other donor countries unwilling to increase their guarantees for the EFSF, its capacity is now to be increased by other methods.

France has long urged that the EFSF receive a banking license, thereby allowing the fund to raise unlimited amounts of money at the European Central Bank (ECB). Germany has strictly rejected such a course, fearing inflationary consequences and the loss of the independence of the ECB.

It now appears that France has backed down. Prior to the summit, two versions of leveraging were in discussion. According to the first variant, the EFSF would act as a kind of credit insurance agency, guaranteeing each state a certain percentage of loans to be raised on the open market. The second option involves setting up a so-called special purpose vehicle (SPV) enabling other states such as China and Brazil to acquire shares in addition to the EFSF and the banks. This SPV would then support governments or banks with liquidity problems.

In both cases the EFSF would be liable for the initial losses when a state or a bank failed to repay its loans. This increases the risk that the guarantees for the EFSF will actually be called upon and additional billions will flow from governments to the banks. Far from this solving the debt problem, the crisis would be deepened and extended to all members of the euro zone.

The debt "haircut" for Greece is even more counterproductive. It resembles more a decapitation of the Greek economy. In public, such a debt reduction is presented as a generous act by the banks to relieve Greece of a large portion of its debt. This is far removed from the reality. Many banks have already sold off a large share of their Greek government bonds to the European Central Bank. And those banks which found themselves in trouble after the Greek haircut could count on government support or funding from the EFSF.

Only about a third of the total Greek debt of €350 billion is held by private international investors. Another third resides with the ECB, the International Monetary Fund (IMF) and national governments. According to the newspaper *Kathimerini*, this third would be exempt from a debt cut. The remaining third is in the hands of Greek and Cypriot banks and the Greek Social Fund.

In the event of a debt write-off of 50 percent, Greek pension funds, which are already losing half a billion euros in revenue for every one percent increase in unemployment, would face losses of €12 billion. The pension system would be practically bankrupt.

At the same time, the survival of Greek banks could be secured only with state funds amounting to tens of billions. A debt reduction, therefore, like the drastic austerity conditions attached to previous "rescue packages," would serve only to accelerate the economic and social decline of Greece.

The banks have little to fear, however. "All the talk about the general difficulties of banks is completely exaggerated," Finance Professor Christoph Kaserer from the Technical University of Munich told the *Süddeutsche Zeitung*. "The stock exchanges will react positively to the fact that a debt reduction is finally being undertaken in the case of Greece. Anything less would be a nightmare without end."

German banks have largely written off or sold off their Greek government bonds. According to one analyst from the bank Merck Finck: "A debt reduction of between 50 and 60 percent is not a serious problem for the private banks in Germany." The country's partially state-owned banks would be harder hit, but they can count on public financing. The major French banks are more exposed than their German counterparts, but they can also count on government support if they run into trouble due to Greece.

All the measures proposed by the European Union and European governments to solve the debt crisis effectively amount to providing the banks with additional billions in government money at a time when spending on social programs and services is being drastically reduced. The result is to deepen, not resolve the crisis.

The ruling elites of the European Union are defending their national interests in an increasingly aggressive manner. Divided into 27 countries, they are unable to unite the continent on a progressive basis. The economically integrated continent of Europe can be developed for the benefit of its peoples only on a socialist basis. The banks must be expropriated and placed under democratic control, and the vast resources of the financial aristocracy must be used to resolve urgent social needs.