Sharp divisions on eve of EU summit

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European leaders meet on Wednesday to discuss the deepening European crisis. On the eve of the summit, the Organization for Economic Cooperation and Development (OECD) issued a report that confirms the intensification of recessionary trends.

The OECD Economic Report released Tuesday warns that the "fragile, extremely uneven" international recovery "could be derailed by the crisis in the euro area."

The OECD has downgraded its prognosis for growth in its 34 member states from an annual rate of 1.8 percent in 2011 to 1.6 percent in 2012. The report makes clear that the chief culprit in dragging down world growth is Europe. "The crisis in the euro zone remains the single biggest downside risk facing the global outlook," said OECD chief economist Pier Carlo Padoan on Tuesday.

In what amounts to an indictment of the austerity policies imposed by the "troika"—the European Union, the European Central Bank and the International Monetary Fund—the report highlights the risk of a renewed banking crisis across the continent. It states: "Adjustments in the euro area are now taking place in an environment of slow or negative growth and deleveraging, prompting risks of a vicious circle involving high and rising sovereign indebtedness, weak banking systems, excessive fiscal consolidation and lower growth."

The report confirms the trend towards deepening recession in large parts of Europe noted by Eurostat earlier this month. Eurostat reported that seven of the 17 countries in the euro zone were officially in recession. The only reason Europe as a whole has avoided recession is the stronger growth of the German economy, which has been able to compensate for weaker markets in Europe by expanding its exports to other parts of the world, notably China, the US and Asia.

Paralleling the growing economic gulf between individual European countries, political differences are also growing on how to deal with an economic crisis rapidly spiraling out of control.

In the course of the G8 summit held at the end of last week at Camp David, US President Barack Obama sided with France against Germany. At the end of the NATO summit in Chicago on Monday, Obama returned to the theme of the European crisis to explicitly support a number of proposals made by France to prevent a collapse of the Greek economy and banking sector spreading to Spain and Italy.

The French proposals include a major increase in EU bailout funds, primarily through the introduction of a new pan-European financial instrument (so-called euro bonds), lower interest rates, an EU "growth strategy," and more massive sums of money to be given to the banks.

While not mentioning Germany by name, Obama's comments were widely interpreted as an attempt to increase pressure on Europe's biggest economy and the fourth biggest economy in the world to come up with substantially more money to fund bank recapitalisation and selected infrastructure programs. The French plan also has the support of the British government and Italian Prime Minister Mario Monti.

Worried about the threat of a run on his country's banks, Spanish Prime Minister Mariano Rajoy complained that the implementation of euro bonds would take too long and made clear he was looking for more immediate means of financial support.

On Monday, the French finance minister, Pierre Moscovici, told journalists that the French government was intent on placing euro bonds along with a number of other measures on the agenda of Wednesday's summit.

The response from Berlin came the same day and was blunt. Speaking on behalf of the German finance ministry, Steffen Kampeter told German public radio: “We have always made it clear that as long as fiscal policy in Europe is not integrated, we flatly reject common financing via euro zone bonds.”

Influential sections of German business stressed their own support for the stance of the German government and finance ministry. The Tuesday edition of the *Handelsblatt* newspaper was filled with contributions by leading businessmen and economists arguing vehemently against euro bonds or any major new financial injections by Germany to bail out ailing European economies.

Another significant figure to enter into the pre-summit debate was Jörg Asmussen, who represents Germany on the board of the European Central Bank. In a speech Monday in Frankfurt am Main, the seat of the ECB, Asmussen called for a firmer fiscal regime for the euro zone and stressed that there could be no renegotiation of the existing fiscal pact. He made clear that a “growth component” had to have at its centre labour market “reforms”.

Asmussen also ruled out a euro bond solution, and proposed that his plan for a two-tier Europe be funded by monies raised from the European budget and a financial transaction, or Tobin, tax. Asmussen also argued that proposals to expand the EU into the Balkans and Turkey be dropped for the foreseeable future.

While there are significant divisions in Europe on what a growth component should consist of and who should pay for it, there is broad agreement on the part of all European governments, the US and also the OECD that austerity measures should be continued, together with the introduction of labour market “reforms” based on the German model and aimed at establishing a huge low-pay sector in every country.