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EU summit on 29 June 2012 - evaluations and interpretations

The crisis in public finance began in the eurozone in the second half of 2009 and has continued until today. First it affected Greece and in 2010 – Spain, Ireland, Portugal and Italy. The causes of the crisis are not identical in all of these countries. Greece lived beyond its means, which was reflected in a very high level of consumption. This consumption, financed mainly from abroad, constituted about 90% of the gross domestic product (GDP). Portugal did not manage to keep up with the structural transformations taking place in the global economy, which resulted in poor economic growth. Italy also did not develop very dynamically, which was caused by overregulation in the job market, weakness of certain parts of the service sector and excessive development of the state apparatus. Ireland and Spain experienced a banking crisis, which was a result of granting real estate credits on too large a scale and the „burst of speculative bubbles" on that market. The banks had to be aided by the state.

As a result of all these factors, in all the discussed countries of the eurozone, public debt grew significantly. For example, in 2010 in Greece, Italy, Ireland, Portugal and Spain it reached respectively 144.9, 118.4, 94.9, 93.3 and 61% of the GDP. As a consequence, it was extremely difficult or even impossible to manage public debt.

A range of common instruments were created in the EU to battle the crisis. This includes both temporary and permanent means. The former include aid programs for Greece and the purchase of loans emitted by the crisis-stricken countries by the European Central Bank (ECB). Among the latter - the „Euro Plus Pact", stricter resolutions of the stability and growth treaty and the fiscal treaty. The latter instruments will be expanded by the European Stability Mechanism (ESM) in the future. The adopted solutions were the result of difficult negotiations. Some of them were even contradictory to the Treaty on the Functioning of the European Union.

Important decisions were made during a meeting of the heads of governments or states of the eurozone on 29 June 2012 mainly because of the pressure exerted by Italy and Spain. In both of these countries the public finance crisis became more acute in June this year - the profitability of state loans with 10-year maturity in Spain reached a record level of 7.24% and in Italy it exceeded 6%. It is believed that a country taking out loans with 7% profitability is not capable of managing its debt in the long run. For instance, in the Federal Republic a loan of this sort brings profit of about 1.41%.

Even though the decisions of the heads of governments or states of the eurozone were made under the influence of Spain and Italy, both of these countries also had to agree to certain concessions towards other countries (especially the FRG). According to this resolution, the ESM will be able to directly recapitalize in mid-term scale banks having financial difficulties. Before, only indirect recapitalization was possible, that is by means of the funds devoted to saving banks already existing in the member states. When providing capital for banking institutions, the ESM could become their shareholder. If such a bank went bankrupt, the mechanism would be responsible for the losses of the creditors. The banking risk would therefore be europeanized. The funds coming from the ESM would not be counted as public debt.

The adopted resolutions make direct recapitalization conditional on two factors. Firstly, a homogeneous banking supervision mechanism needs to be created, most likely led by the ECB. Secondly, the bank receiving the additional funds needs to follow certain rules, for example regarding state aid.

The heads of governments or states of the eurozone countries demanded (in their resolutions) from the European Commission and Spain to quickly conclude an agreement regulating the conditions for financial help for Spanish banks with the European Financial Stability Facility (EFSF). The resulting debt would no longer be - which was undoubtedly a novelty - a priority (to service), but it would have to be treated like other financial obligations in Spain.

Finland, the Netherlands and especially the FRG were initially against direct recapitalization of banks as well as the removal of the repayment priority clause in the case of Spanish loans from the EFSF. They changed their minds when other member states accepted these resolutions, so that the members of the eurozone struggling with financial problems agreed to follow the established budget requirements. At the same time, the Federal Republic managed to force through their proposal to base the homogeneous supervision system on the European Central Bank. It considered the ECB to be a proven institution with extensive experience in banking.

The resolutions of 29 June 2012 met with mixed opinions. They were evaluated positively - which is understandable - by the participants of the session. The president of the European Commission, J. M. Barroso, was especially satisfied with the results. He said that „the EU and eurozone summit made decisions which would have been unthinkable several months ago."

On the other hand, the decisions of the summit were harshly criticized in an appeal, directed at the society and the politicians of the FRG, signed by 172 German professors of economy. It was initiated by W. Krämer from the Technical University of Dortmund, who prepared the appeal together with the president of the IFO Institute in Munich, H.-W. Sinn. The latter has long been among the determined critics of the actions taken by European decision-makers to overcome the debt crisis. He is, among other things, for the exclusion of Greece from the eurozone.

The signatories of the appeal considered the resolutions to be a step towards the creation of a banking union, which means „collective responsibility for the debts of the banks being part of the eurosystem... ." They warned that the implementation of this responsibility will save neither the euro nor the European thought. This will only help the creditors of those banks that have financial difficulties, which from the economic point of view is wrong and unjust, as professor Krämer emphasized. If the banks cannot pay their own debts, the creditors of these banks, the investors subscribing the loans of banking institutions, should suffer the financial consequences, not the European taxpayers. The investors possess adequate wealth and have to face the risk of their investments.

Chancellor Merker criticized the appeal of the 172 German professors, claiming that they misunderstood the resolutions of 29 June 2012. In her opinion these resolutions do not create a basis for the ESM to take responsibility for the debt of the banks. This was undoubtedly a statement for the German public opinion, which has a negative stance towards helping the crisis-stricken countries of the eurozone.

A group of economists gathered around prof. M. Burda (Humboldt University in Berlin), M. Hellwig (Planck Institute, Bonn), D. Snower (Institute of Global Economy in Kiel) and B. Weder di Mauro (University of Mainz) had a different opinion than the signatories of the appeal. They stated that „the banking union can secure the coherence of the monetary union." They are for the creation of durable, homogeneous structures at the European level, which can separate obtaining credits from the funding of states. That means the discontinuation of the failed interdependence of the banking sector and public finance of a country.

The harsh criticism of the summit from 29 June 2012 by the 172 German professors might raise certain doubts. If the homogeneous banking supervision mechanism works well, the negative consequences foreseen by the appeal may occur only to a limited degree.

The Polish economic press points out that only a week after the resolutions were adopted, the profitability of the Spanish and Italian state loans with 10-year maturity went up once more. On 6 July 2012 they were respectively higher than 7 and 6%. The reason for the increasing profitability was not only the general nature of the resolutions adopted during the summit, but also the disappointment of economic entities by the ECB Council meeting. Even though the Council reduced the main interest rate by 0.75 pp, some stock market players wanted more far-reaching actions towards the banking sector.

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