EPC
EUROPEAN POLICY CENTRE

29.03.2010

Post-Summit Analysis

A deal for Greece, more work for the EU

Summary

The Spring European Council saw an end to the bitter divisions of recent weeks over how to respond to the Greek budget crisis, but reinforced impressions that the EU is going through a difficult transition period. This EPC analysis warns that the Union appears increasingly inward-looking and dominated by differing national agendas, and stresses the urgent need for the institutions created by the Lisbon Treaty to establish themselves as credible and effective players and raise the EU 'game' to a higher level.

Full report

The Spring European Council finalised the deal that the previous informal summit held on 11 February had not - namely the "mechanism" to prevent a possible Greek default - but failed to deliver on the planned 'Europe 2020' strategy for growth and jobs, which is now on the agenda of the next EU Summit in June.

While an end to the divisions of recent weeks - with a balanced solution to an intricate problem - is of course welcome, the impression remains that the EU is going through a difficult transition period. It appears inward-looking and driven (or rather bogged down) by different national agendas, and there are few signs that this unsatisfactory state of affairs will give way any time soon to a stronger awareness of the common challenges confronting Europe today, both internally and externally - unless the institutions (old and new) created by the Lisbon Treaty succeed in establishing themselves as credible and effective players, and raising the EU game to a higher level.

One down, one to go

The 25-26 March European Council was the first formal summit held under the Lisbon Treaty framework. As such, it did not include the foreign ministers of the 27 Member States (although Catherine Ashton did attend, in her capacity as High Representative for Foreign and Security Policy and Vice-President of the European Commission) and it was chaired by its new semi-permanent President Herman Van Rompuy.

The previous informal Summit on 11 February was called to have an open discussion on the scope and contents of the new strategy for growth and jobs (branded 'Europe 2020'), but ended up debating what to do about the mounting debt crisis in euro-zone member Greece - without reaching any firm conclusions. This time around, after weeks of internal controversy and about-turns, an agreement was reached but, yet again, the issue absorbed all the political energy of the EU-27 leaders and contributed to a further delay to the Europe 2020 Strategy.

However, this delay - also prompted by some concerns over both the method and the substance of the new strategy - may turn out to be a blessing in disguise, as it could allow for a more comprehensive approach to the issues involved, including the link between the short-term management of the euro zone and the longer-term competitiveness of the European economy.

EUROPEAN POLICY CENTRE

The Greek 'gift'

Virgil has experienced an unexpected revival in recent months, with his famous phrase "beware of Greeks bearing gifts" ['*timeo Danaos et dona ferentes*'] quoted or paraphrased frequently in international media coverage of the Greek sovereign debt crisis - mostly to underline how poisoned, alas, the gift was. Following the 25-26 March Summit, however, there is greater cause for optimism that the euro zone may not be undone by a new Trojan horse.

After weeks of conflicting demands from EU capitals, often accompanied by ugly rhetoric in some Member States, a deal was hammered out and made public on the evening of 25 March in the form of a "statement by the Heads of State and Government of the euro area" (EUR-16) - who convened in this format for only the second time ever (the first was in autumn 2008 in the wake of the financial crisis triggered by the collapse of Lehman Brothers).

The statement has four key elements. First, it states that the measures taken so far by the Greek government are "sufficient" to safeguard the 2010 budgetary targets and should therefore "allow Greece to regain the full confidence of the markets". Moreover, it emphasises that the Greek government has not requested any financial support. As a consequence, no decision had to be taken to activate the "mechanism" the EUR-16 have agreed upon to "safeguard financial stability in the euro area as a whole".

Second, this "mechanism" - which, in principle, is not meant only for Greece but for any euro-zone member - has two components: some financing from the International Monetary Fund (IMF), and some from euro-zone Member States through "coordinated bilateral loans", which would amount to a "majority" of the overall mechanism. No figures are mentioned in the statement, although numbers circulating in the corridors of the Summit suggest roughly €12 billion on the IMF side and some €22 billion on the EUR-16 side. Most importantly, this financing would "not contain any subsidy element", i.e. it would be geared towards setting "incentives to return to market financing as soon as possible". No gifts, in other words, just temporary and conditional lending at market prices.

Third, this mechanism "has to be considered *ultima ratio*": it is to be activated if - and only if - "market financing is insufficient" and in response to a request from the government of the country concerned. The evaluation of when exactly this would be deemed necessary and what amounts would be mobilised would depend on the particular circumstances. As for how this would be done, "any disbursement on the bilateral loans would be decided by the euro area members *by unanimity* [italics added] subject to strong conditionality and based on an assessment by the European Commission and the European Central Bank". All euro-zone members would (in principle) be expected to participate "on the basis of their respective ECB capital key", which reflects their relative size and prosperity.

The fourth and final element relates to the way ahead: as the mechanism is implicitly considered a temporary solution, the statement reaffirms "the need to strengthen and complement the existing framework to ensure fiscal sustainability in the euro zone and enhance its capacity to act in times of crises". This may entail reinforcing the "surveillance of economic and budgetary risks and the instruments for their prevention, including the Excessive Deficit Procedure", while "respecting the principle of Member States' own budgetary responsibility".

To achieve this, the leaders of the EUR-16 "ask the President of the European Council to establish, in cooperation with the Commission, a Task Force with representatives of the Member States, the rotating Presidency and the ECB, to present to the Council, before the end of this year, the measures needed to reach this aim, exploring all options to reinforce the legal framework".

This is unlikely to imply formal changes to the Treaties, despite initial claims to the contrary by Germany, partly because there is little appetite across the EU to engage in such an exercise, and partly because it could backfire politically. It is much more likely to translate into a review of the Stability and Growth Pact of the 1990s and, therefore, a secondary- (rather than primary) law type agreement on the overall management of the euro zone.

Indeed, this is the unfinished business of Economic and Monetary Union (EMU). One of the most hotly debated paragraphs in the statement reads as follows: "We commit to promote a strong *coordination of economic policies* in Europe. We consider that the European Council must *improve the economic governance of the EU* and we propose to increase its role in economic coordination and the definition of the European Union growth strategy" [italics added].

Background and players

The final agreement was reached on the basis of a Franco-German document circulated ahead of the EUR-16 Summit. However, most elements of the eventual deal were put forward well ahead of the European Council either by Economic and Monetary Affairs Commissioner Olli Rehn or by some finance ministers - and some Member States did not hide their irritation at the forceful way in which the deal was presented as an exclusively Franco-German initiative.

In fact, Paris and Berlin often found themselves at loggerheads in the run-up to the meeting, with France insisting on a purely euro-zone package (excluding the IMF) as evidence of internal solidarity, while Germany stressed the need for a more 'technical' approach (hence the short-lived debate on the possible creation of a European Monetary Fund) and highlighted the principles of financial stability and responsibility.

Behind these positions lie traditionally divergent views of EMU as well as domestic considerations, from French President Nicolas Sarkozy's reluctance to see IMF Managing Director Dominique Strauss-Kahn - a potential contender in the 2012 presidential elections - play a key role in the crisis, to German Chancellor Angela Merkel's concerns about the forthcoming regional elections in North Rhine-Westfalia (9 May), where the fate of a government led by the Christian Democrats (CDU) and the overall balance of power in the Bundesrat are at stake, and about possible objections from the Constitutional Court to the 'mechanism' infringing the Treaties.

The ECB and the Spanish EU Presidency appeared to back the French approach, while the Netherlands in particular - another country on the eve of important elections - sided with the Germans. Nuances could, however, be identified within each camp, twists and turns were not infrequent, and the debate was conducted with unusual bluntness, bringing lingering tensions between Member States to the surface. Alongside all this, a bitter war of words erupted, most notably between Germany and Greece, involving political representatives, public opinion and the media but, fortunately, not their respective leaders - which eventually allowed for a compromise that safeguards EU unity.

In fact, the partial involvement of the IMF makes sense, as it is the only institution with established procedures for conducting such interventions, especially in the short term, given that this is completely uncharted territory for the euro zone: indeed, the existing Treaties forbid resorting to "Community" means (the ECB or the EU budget) to bail out a Member State. On the other hand, a degree of solidarity had to be added to avoid the impression that the euro zone is incapable of solving its own problems.

The prevailing interpretation of the "mechanism" is that, even in the event of overnight lending to a country in danger (as happened, for example, with Hungary a few months ago), swift intervention by the IMF should henceforth be accompanied by at least some bilateral funding (although some Member States have more flexible procedures for doing this than others, which may need parliamentary authorisation).

On the whole, the 'mechanism' is regarded as a signal that the EUR-16 will not allow a Greek sovereign debt default. Between an all-out default and a further deepening of the current crisis, however, lies a grey area that international markets may still be tempted to explore. Nevertheless, the deal constitutes a sort of "loaded gun on the table", as European Commission President José Manuel Barroso put it in the nocturnal press conference following the EUR-16 Summit. It is, literally, a deterrent (rather than a lender) of last resort, although it cannot be regarded as a durable recipe to address imbalances inside the euro zone.

It was President Barroso himself who took the considerable risk, a week before the Summit, of insisting that a solution had to be found by 25 March - a call that generated additional pressure to find an agreed solution, after the 11 February damp squib, as failure to do so would have had a disastrous effect on the markets. It seems to have paid off: initial reactions to the deal were cautiously positive, at least in terms of narrowing the spread between Greek and German bonds.

In a characteristically European fashion, the final statement allows virtually everyone to declare victory. It was the only concrete decision adopted at the Summit, and it is one that imposes and requires a follow-up (the Task Force, called for most energetically by Germany), while keeping the specifics of the forthcoming review relatively open-ended.

Equally characteristically, the language adopted in the Declaration is revealing. For instance, the paragraph on the increased role of the European Council (which implies, by the way, a decreased role for ECOFIN) to "*improve the economic governance*" of the Union, was worded very differently in the original Franco-German paper, which said instead that "the European Council *should become the economic government*" of the EU. While the term "*gouvernement* économique" remains in the French language version (even though the term *gouvernance* is increasingly common in France), the German text speaks of "wirtschaftspolitische *Steuerung*", the Italian one of "la *governance* economica" and the Spanish of "el *Gobierno* economico".

Europe 2010-2030

As already mentioned, a decision on 'Europe 2020' has been put off until the June Summit. This does not mean that the issues related to the planned successor to the Lisbon Strategy for Growth and Jobs (2000-2010) were not discussed by the European Council. But some Member States raised last-minute objections to the draft presented by the Commission, which earmarked five headline targets to be met by 2020 - in the fields of employment, research and development, energy and climate action, education, and fighting poverty and social exclusion.

In particular, Berlin and London objected to the education-related targets on 'subsidiarity' grounds: in Germany, education policy is a prerogative of the *Länder,* which must therefore be adequately consulted and involved; and in the UK, no target has yet been set and it was seen as inappropriate for the EU to jump ahead, especially on the eve of important parliamentary elections (which also explains why an EU decision on regulating hedge funds has now been postponed until the late spring).

EU-27 leaders also spent some time discussing the targets for fighting poverty and social exclusion. Some objected that this is not an EU competence (although President Barroso pointed out that Article 151 of the new Treaty mentions it as a shared one); others that it is virtually impossible to agree on common standards for "measuring" poverty as Member States use very different ones.

The ball is now back in the Commission's court: its approach now seems to be that the targets still have to be fine-tuned and adapted to the different starting points in different Member States. They also have to be considered as signposts and benchmarks intended to generate impetus through monitoring of implementation and "flagship initiatives" - in light also of the disappointing

experience in this respect with the previous Lisbon Strategy - rather than legally-binding impositions from 'Brussels'.

Before the new strategy is finalised, however, the discussion is likely to be enriched by the final report on 'Europe 2030' to be delivered by the Reflection Group chaired by former Spanish Prime Minister Felipe Gonzalez in early May. This is expected to provide a longer-term perspective within which the 2020 headline goals could then be framed more credibly. At more or less around the same time, former European Commissioner Mario Monti will also deliver his report on the future of the Single Market, thus squaring the circle of EU structural policies to be updated and re-launched. That is why the delay to 'Europe 2020' may turn out to be a blessing in disguise, as it could become part of a broader and more comprehensive overhaul of all main common policies.

This cannot hide the widespread sense that the EU as a whole is going through a difficult phase. The relief and momentum generated by the eventual ratification of the Lisbon Treaty have been followed by the Copenhagen climate change fiasco last December (the EU Summit decided to proceed "stepwise" in this area) and the shocks of the Greek crisis. As a result, the Union appears to both its citizens and the wider world as increasingly inward-looking and dominated by infighting. The discussions and arguments over the establishment of the European External Action Service (another decision, incidentally, that risks being postponed until the late spring) also appear worryingly narrow-minded and dictated by short-term calculations on all sides.

There have been, however, some positive developments too: the new Commission is now up and running at last, and signalling a fresh willingness to fight to advance common EU interests; and President Van Rompuy and his team are successfully establishing themselves as the truly new player in the EU system.

Paradoxically, in spite of their very different nature and scope, the two institutions may come to discover that - not least given the current unsatisfactory 'state of the Union' - they share a core interest in pushing for more integration and more effective common policies, and in proving to everyone that "*l'Union fait la force*".