

Wishing won't make it so

François Hollande's claim that "the crisis in the eurozone is over" says more about the wishful thinking of many European leaders than it does about economic and social reality, argues David Rowe

Alan Greenspan was nominated as chairman of the Federal Reserve Board six months after I left his employ. As word circulated at my new employer, an animated trader came up to me and asked, "Does he know that from now on if he stirs his coffee clockwise it means one thing and if he does it counter-clockwise it means something else?"

The consequence of this unremitting scrutiny is that public officials are unlikely to be completely candid when they are asked awkward questions. Some degree of evasion and subterfuge is inevitable.

Despite this realisation, sometimes the statements of public officials become so disconnected from reality that they appear ridiculous. Such was the case in early June, when French president François Hollande blithely told an audience in Japan that the crisis in the eurozone was over. He went on to say: "Europe has become more stable, but it must now be orientated toward growth. I believe that the crisis, far from weakening the eurozone, will strengthen it. ... Now we have all the instruments of stability and solidarity. There was an improvement in the economic governance of the eurozone, we set up a banking union, we have rules on budgetary matters that allow us to be better co-ordinated and have a form of convergence."

All this may come to pass, but as things stand the statement is a breathtaking example of wishful thinking. Hollande's comments were based on a statement of consensus he released jointly with German chancellor Angela Merkel – but it remains a feeble foundation for Hollande's sweeping claims.

First, the statement only outlines proposed general principles that have been agreed by the two countries – admittedly, the two most powerful in the eurozone. Full institutional approval is still some way off. Second, the statement itself, even if fully implemented, falls well short of Hollande's assertions.

A true banking union requires three essential pillars to be effective:

- a common supervisory authority;
- a consistent administrative and legal framework for triggering a resolution process and adjudicating competing claims over insufficient assets; and

■ a common fund to finance the delivery of core obligations such as legally guaranteed deposits.

Of these three pillars, the first is probably closest to being realised, with a proposal that the European Central Bank be given supervisory authority over all eurozone banks. Even this is still under debate but it appears likely to be implemented.

Regarding the second pillar, the Merkel-Hollande statement says the resolution mechanism should be based on "a board involving national resolution authorities". Needless to say, this leaves considerable room for nationalist special pleading when an actual bank is the subject of discussion rather than a grand general principle. Such an arrangement is at best a half-hearted attempt to impose consistent resolution criteria across the eurozone.

The statement also says any costs of resolving failed banks would be borne by "national private backstop arrangements" financed by contributions from banks. It appears contributions to this fund would take 10 years to reach critical mass even assuming minimal claims on its resources in the meantime, hardly a prospect in which anyone should be highly confident. There is also no indication that such a fund would have a fallback claim on national treasuries similar to that of the Federal Deposit Insurance Corporation in the US. As described, this facility is a pale shadow of a genuine eurozone-wide bank resolution fund.

As *The Economist* so succinctly put it, the Franco-German proposals constitute at most one-and-a-half of the three pillars described above. It falls well short of Hollande's bizarre claim to have "set up a banking union".

The joint statement also argues that "a stronger euro area requires stronger euro-area governance and a stronger legitimacy". As I have argued previously, imposing ever more centralised European governance in the teeth of widespread popular opposition is bound to weaken, not strengthen, the legitimacy of such institutions. Perhaps even more telling, the joint statement came in the wake of an outburst by Hollande against the European Commission, in which the French president said it was not up to the commission to dictate reforms to the French economy. When France's own national interest is on the table, it seems Hollande's support for "stronger euro-area governance" is quickly forgotten.

Far from being over, the eurozone crisis lumbers on, sustained in no small measure by the straitjacket of monetary union without popular support for the financial and political union needed to make it sustainable. ■

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