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Economies: Europe adopts common position: it's broken

In the 1990s, as Dell and Compuserve opened offices in Dublin and Amsterdam respectively, they soon learned that Europe may have been legally and politically united but economically and socially it was a long way from being a "united states of Europe." In short, American companies saw what they thought was an embryonic USA-style country. They learned that Europe is not a country. It wasn't then, and as events are showing, it isn't now.

Now there is a bigger question: Has the financial crisis broken the European ideal, and the Eurozone in the process?

The theory of the Eurozone is that concerted action by the Central Bank will stabilise economies across the region. And the theory of Europe is that centralised decision making on a range of issues will provide a competitive environment between member countries.

But in the first financial crisis worthy of the name to hit the region since the formation of the EuroZone in 2000, the casualties are those theories.

The core point is this: European countries have long criticised Britain for remaining outside some of the European principles including accepting the routine centralisation of decision making and the formation of the Euro.

And in the past month, the UK government has pushed aside not just UK competition laws but EU laws, too. In doing so, it raised the ire of some federalists in particular Germany.

Also, it is just a year since the EU criticised the UK for its support of Northern Rock, the first major bank to fail in the UK in a generation. Government support for private industry is *verboten* under EU law, said the Germans.

But twice in the past week, the German government has pumped money into Hypo Real Estate - a bank with a profile not too dissimilar to Northern Rock.

And it's not the only one.

There are two governments in Brussels: the Belgian one and the European one. The Belgian central bank is supposed to have all but surrendered control of its economy to the European one. But a state-sponsored rescue of Fortis, killed by unwise borrowing to fund global aspirations that were far beyond the reach of what is, in global terms, a small bank, fell apart. The Belgian government now has a dilemma: let it die or take it over. It is almost certain to take it over.

Across Europe, governments that signed up to let Europe take the major decisions are breaking ranks. They are approving takeovers that are undeniably anti- or at least counter-competitive. The UK government's approvals of allowing Santander, already a massive UK high-street presence, to cherry pick the best bits out of Bradford and Bingley. It bought the close-to-collapse Abbey in 2004 and in July this year did a deal - still not completed - to buy Alliance and Leicester at what some then said was a knock-down price. A&L has said that if the deal is not completed, its future is in doubt. That was six weeks ago: right now, with apparently strong banks failing, A&L must be looking increasingly vulnerable. With the B&B deal, that gives Santander three of the top ten banks that used to be building societies (personal bankers and home loan specialists) and, depending on how the figures are cut, should raise an almost automatic competition inquiry at both UK and EU level.

On 16th September, the European Commission issued the following release:

IP/08/1325
Brussels, 16th September 2008
Mergers: Commission approves proposed
acquisition of Alliance & Leicester by Banco Santander
The European Commission has cleared under the EU
Merger Regulation the proposed acquisition of the UK bank Alliance &
Leicester by the Spanish bank Banco Santander.

The same day, A&L shareholders approved the takeover.

Just 13 days later, the UK government agreed a deal to transfer the branches and staff of B&B, with deposit accounts but not lending, to Santander, giving it an estimated close-to-30% of consumer bank accounts in the UK, and a branch network to rival the very largest banks.

The deal strikes at the heart of the European ideal.

1) the UK pumped money into a failing business

2) it sold its assets at a knock-down price to another business

3) it retained the debt, thereby providing support to the acquiring business

In short, the deal is not intervention, but state support which is prima facie illegal under EU law. And it provides a single company with a position which, if not a technical monopoly or, in European terms, "a dominant market position" is certainly one which would fall under that description in the ordinary use of those words.

Last month, central banks around Europe began to break ranks and push money into supporting the financial sectors. On 28th September a combined equivalent of GBP384,000 million had been pushed not into currency support but into measures to prevent widespread banking collapse. And on 6th October, the European Central Bank (ECB) put an additional euro37,000 million into the interbank lending market, again raising the spectre of illicit support for banks in the Eurozone at the expense of the wider European ideal of common and level markets.

Last week, Ireland stepped out of line which the UK says is un-European: to prevent the risk of a run on its banks, which are the holders of a significant amount of foreign investment due to a favourable tax regime, it announced that it would guarantee all money held in Irish banks. Others countries provide limited support: until last week, the UK's was GBP35,000 per depositor, for example - until 3rd October when it was increased to GBP50,000. The USA's limit is USD100,000 . But whilst publicly decrying the idea, it is widely thought that Germany's Angela Merkel was privately investigating whether Germany could do the same - and on Sunday 5th October announced that it would. On Monday 6th, Austria followed suit. They were not the only ones: Greece had also issued a full guarantee on 2nd October. Yesterday, Spain, which had been a staunch supporter of centralised decision making (possibly on the basis that it transfers risk to the ECB and away from Spain) said that if the ECB did not provide full guarantees, Spain would issue its own. This is a defensive measure on several levels. Collapsing banks are a bad thing and runs on banks are demoralising for the population at large.

Had it remained the only one with this policy, Ireland could have fully expected to see significant inward capital flight from countries where deposits are at risk - including the USA and other EU

countries. This would, critics say, distort the EU. They don't say it would also provide exactly the kind of mass-market movement of capital within the Eurozone that its proponents said would never happen.

Late last night, Iceland which is not in the EU but due to extensive investments across the European Union was close to total financial meltdown with the country on the verge of calling for international support. It announced a government guarantee for all deposits in its banks. At the same time, as all of its banks faced simultaneous collapse, it froze all dealings in shares in six major banks and faced a plummeting krona.

Back in the UK, interbank lending rates remain high and caution is the watchword. After all, everyone imagines the bank they work for is well run and if it is in trouble then by definition any other bank wanting to borrow money is a riskier prospect. Calls for interest rates to be cut by at least half a percent would only offset the mass increase of around a quarter percent in borrowing rates imposed by UK banks last month, and expected to be increased by another quarter later this month.

The above is just a sample of unilateral actions being taken by EU governments and the central banks that were supposed to be emasculated by closer integration.

Whether this crisis has broken Europe or merely demonstrated that many of its supporters have been misleading themselves over the success of integration will be cause for debate for years to come. But for today there is a common position: Europe isn't working.

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Nigel Morris-Cotterill heads the international group of companies that publishes The Chief Officers' Network.

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