<u>EUROPE'S HAPPY DAYS</u>
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"Oh friends, not these tones!
Rather, let us raise our voices in more pleasing
And more joyful sounds!
Joy! Joy!" Ludwig van Beethoven's Ninth Symphony, the "Ode to Joy"

<u>SOME GOOD NEWS</u>

The European Council's economic summit concluding on June 29, 2012 seemingly was a stellar success. First- and importantly given the modest (or low) expectations preceding the meetings, the rendezvous did not end in disastrous collapse. Players did not exit uttering unpleasant comments about or noisy threats toward their fellows.

Participants did not merely stress their desire to stabilize (protect) the European Monetary Union. Pacts, declarations, statements, and remarks by participants and politicians offered near-term support for the Spanish banking (sovereign debt) problem (though quite a few details remain).

Spanish banks will be recapitalized directly via the EFSF/ESM (the ESM stage assumes the ESM going into effect). Thus bailout money for this purpose will not go to the Spanish government, reducing Spain's potential government indebtedness. European Council President Herman Van Rompuy's "Remarks" also declare: "Financial assistance to Spain will be provided without seniority status for the financing provided by the EFSF/ESM." The ESM (assuming the ESM comes into effect) can do this if there is a single supervisory mechanism over and appropriate conditionality for banks. The hope is for this to occur by end 2012. See also the President of the European Commission, Jose Baroso's comments. Assistance to Spain "that is now going to be provided by the EFSF will be transferred to the ESM, without gaining seniority status".

In addition, leaders made promises regarding European banking supervision. Talk of a single banking supervisor probably means the European Central Bank (some call this a "step toward 'banking union'", Financial Times, 6/30-7/1/12, p2) There also now are greater hopes for Europe-wide bank deposit insurance.

Moreover, the extensive official statements related to budgets, fiscal union, and related matters were hopeful hymns to many enraptured audiences.

And no one can deny the sunny revival movements expressed via the sharp stock, interest rate, currency, and commodity forums following the conference.

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Regarding the European Council and Eurozone summit, EC President van Rompuy chirps: "So the start of my second mandate was a difficult one but if you can be happy in politics, for the upcoming hours, not more than that, I am a happy man."

<u>SKETCHES OF SPAIN, CONTINUED</u>

Despite some progress at the summit, Spain's banking repair has some notable loose ends. Baroso's "Statement" speaks of "short term stabilization measures" in regard to Spain. Short term stabilization does not equal long term repair. Also, the summit fix proposal for Spain assumes the ESM comes into effect. This is probable, but not certain. The supervisory mechanism, such as the European Central Bank, likewise is probable but not definite. Ditto on the conditionality issue. Plus, much can happen between now and calendar 2012's close. The ongoing European sovereign debt/banking challenge and the ongoing worldwide economic crisis itself manifest this. Recapitalizing banks via EFSF/ESM directly and not going through the Spanish government does not eliminate the banking bad debt problem. Recapitalization remains recapitalization. And even though the Spanish government debt burden is less due to the embrace of this method, someone else's (the rest of Europe) is greater.

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What the summit decided in relation to Spain probably has implications for Ireland's banks.

Yet where was Greece in the summit's news headlines? Sounds of silence related to Greece's massive sovereign debt and banking problem stand in opposition to the congratulations regarding Spain.

SUMMIT LYRICS

"Well, I never kept a dollar past sunset,
It always burned a hole in my pants." "Happy", by the Rolling Stones

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The intertwined and complex guidelines (vision) expressed in the European Council's documents reflect the interrelated challenges and complexities of the European crisis itself. It often is difficult to cut through the tangled language, and differences in its interpretation surely will exist.

However, a review of the lyrics in the documents issued by or directly related to this important European Council gathering shows that leaders made little progress in solving the underlying economic (fiscal, debt; structural, political) problems confronting Europe (and particularly the Eurozone). Thus widespread happiness regarding this summit probably will not persist. This money summit arguably makes more urgent appeals than prior ones. It does speak fondly of road maps, architecture, and building blocks. Talk of unified banking supervision and deposit insurance is some progress. However, as in other recent summits, fundamental problems are handled with vague language and nebulous standards. Issues of how to resolve such ambiguity thus permeate the documents. And binding mechanisms by which to effectively enforce current (and any future) fiscal standards for the various nations remain lacking.

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The "Compact for Growth and Jobs" (the Annex of the European Council Report) speaks of "Action to Be Taken at the Level of the Member States". Section 2 refers to implementation of "country-specific recommendations". Yet these are not binding requirements. Besides, as they are to occur at the "level of the member states", where is an overarching and binding fiscal structure and related rules? The "Conclusions" of the EC summit similarly speaks of "country-specific recommendations to guide Member States' policies and budgets." The key words are "recommendations" and "guide".

Member States "will put particular emphasis" on various aspects in this implementation process. That in Section 2 (a) is especially important for assessment of this June summit's progress.

Section 2 (a) talks of "pursuing differentiated growth-friendly fiscal consolidation, respecting the Stability and Growth Pact and taking into account country-specific circumstances". Pursuing" does not equal a requirement. "Differentiated" and "country-specific circumstances" suggests loophole potential and future wrangling among various European nations and between a given country and various supranational bodies. Indeed, "growth-friendly fiscal consolidation" is a noble goal, not only for Europe, but also the United States. To what extent in practice can fiscal repair be growth-friendly? For countries with high budget deficits or enormous government debt (or both) how likely will genuine consolidation be growth-friendly, at least for the near and medium term? Anyway, "particular emphasis" does not look like an enforceable rule.

Keep in mind that Europe has long had government debt and budget "rules". In practice, these have been little more than guidelines. Assorted summits, including this June 2012 one, have not changed this.

Also in 2 (a), the European Commission "is monitoring the impact of tight budget constraints on growth enhancing public expenditure and on public investment." Does such monitoring wordplay look like fiscal discipline is on the way? Hardly. It "will report on the quality of public spending" as well as "the scope for possible action within the boundaries of the EU and national fiscal frameworks". This murky phrasing likewise does not point at fiscal stringency.

The other paragraphs of Section 2 offer unsurprising policy talk (rather than truly binding rules or even specific guidelines) about "restoring normal lending to the economy", "urgently completing the restructuring of the banking sector", "promoting growth and competitiveness", and "tackling unemployment and addressing the social consequences of the crisis effectively."

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Section 3, "The Contribution of European Policies to Growth and Employment" underscores: "Further urgent measures are needed at the level of the European Union". Agreement on the need for urgent measures obviously does not create agreement on the substance or details of those strategies, much less put them into effect anytime soon.

Its paragraph 3 (n) is particularly important in the current sovereign debt and banking crisis situation. First, a helpful melody: "Financial stability is a prerequisite for growth." It continues. The European Council generated a report, "Towards a Genuine Economic and Monetary Union" (6/26/12) that "sketches out important ideas in that respect." A "sketch" sure is not a finished drawing, much less an oil painting. Anyway, the European players (audience) still must decide what "ideas" to include in their artwork. Besides, how clear and enforceable will these ideas be?

Some of this Compact requires European Union legislation (see "Conclusions", I. 1.).

Regarding the "Genuine Economic and Monetary Union" report, EC's 6/29/12 release ("Conclusions", II. 4) notes there was: "an open exchange of views, where various opinions were expressed". That EC "Towards" 6/26/12 report introduction confesses: "This report is not meant to be a final blueprint", only "suggests a working method", and "proposes to move, over the next decade, toward a stronger EMU architecture". A decade certainly is not soon. The report speaks of four "building blocks", all of which "are necessary for long-term stability and prosperity in the EMU". They "will require a lot of further work, including possible changes to the EU treaties at some point in time." Thus audiences should not rush to believe that many specifics (especially enforceable ones) will be enacted anytime soon. An interim (additional) report is targeted for October 2012, with a final one before end 2012. Yet although that "report" is a step toward a fiscal union, it is not one or even anything close to it.

Moreover, although there is a wonderful invitation to develop "a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union", some other details suggest that genuinely joyous substantial solutions to current European sovereign debt and banking (and leverage) problems are not imminent. Member States "will be closely associated to the reflections and regularly consulted." Meetings upon meetings, right? The European Parliament also will be consulted. Regarding the road map, the drafters "will examine what can be done within the current Treaties and which measures require Treaty change."

Scanning the 6/26/12 "building blocks" report underlines that the June 2012 European Council summit made at best very modest progress. "But to ensure stability and growth in the euro area, Member States have to act and coordinate according to common rules. There have to be ways of ensuring compliance when there are negative effects on other EMU members." How much coordination has there been to date, and how soon will it arrive? And where is the compliance mechanism now?

Overarching European banking supervision (an "integrated financial framework") may boost overall marketplace confidence and faith in many banks. Resolving and supervising banks may reduce a crisis. Some guarantees of customer deposits generally are welcome, for it may reduce the risk of dangerous runs on banks. However, these programs do not eliminate the current individual national or the overall European sovereign debt and banking problems. It also is questionable whether they can resolve them as a matter of principle. The United States has a rather integrated financial framework and has not solved its national (including households) debt challenges.

What about the building block of "An integrated budgetary framework to ensure sound fiscal policy making at the national and European levels"? First, where is that framework now? Also, what is a "sound fiscal policy"? Who decides it? How does one balance or coordinate this at both national and European levels? Not only does this require "coordination" and "joint decision-making", but also "greater enforcement". Again, look at the European enforcement record to date. Within the Euro area, how will there be "greater pooling of decision making on budgets commensurate with the pooling or risks"? Methods and specifics, where are you? This 6/26/12 report notes the essential need for "effective mechanisms to prevent and correct unsustainable fiscal policies in each Member State". Talking about this has been going on for a long time. No "effective mechanisms" appear in the report, either.

Despite talk of "commensurate steps toward common debt issuance" in this framework, how soon (if at all) will Germany (and possibly other nations) embrace this? After all, there remains a need for a "robust framework for budgetary discipline" (and competitiveness) "to avoid moral hazard and foster responsibility and compliance".

The "accountability of decision-making within the EMU" and "joint exercise of sovereignty" are not waiting around the corner ready to come into effect. In regard to movement "Towards an integrated economic policy framework, the "framework for policy coordination" should be made "more enforceable to ensure that unsustainable policies do not put stability in EMU at risk". A "framework for policy coordination" itself lacks specificity. And how much decision making on budgets will nations cede in practice, and how soon will this occur? "Decisions on national budgets are at the heart of Europe's parliamentary democracies."

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The summit documents and related songs of confidence may buy politicians, central bankers, and other economic officials some time. However, the result is about the same as that from other recent European choruses- not much fundamental advance toward solving debt and leverage problems for Europe as a whole. It is way too soon to shout hallelujah. The persistence of the crisis (and especially further worsening of it) eventually may speed progress toward a solution.

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