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EDITORIAL COMMENTS

Weathering through the credit crisis. Is the Community equipped to deal with it?

Crises have always advanced the EU. The financial crisis seems to be no exception. It has created a very special bond between the heads of government and the French President Nicolas Sarkozy. At the end of the European Council meeting of 11 and 12 December last year, under French Presidency, Sarkozy and several male Prime Ministers parted with kisses on both cheeks. For the French President and the German Chancellor Angela Merkel this was not novel, but for the parting male heads of government this seems to be a relatively new phenomenon and an unexpected by-product of the frequent and intense recent meetings.

In September last year, some major financial institutions in the USA, Germany, Ireland[1] and the UK defaulted or threatened to default. This had an unexpectedly rapid knock-on effect on the banking system in Europe. In the weekend of 27 and 28 September, the Belgian and Dutch ministers of finance met in an effort to avert the imminent collapse of the Fortis bank. Both governments provided a sizeable capital injection which was agreed in close coordination with the Belgian and Dutch central banks. Soon after, the Dutch part of Fortis and ABN AMRO was nationalized. The following weekend the Belgian and French governments met to discuss the problems of Fortis, Dexia and BNP. In the weekend of 11 and 12 October 2008, Mr Sarkozy invited the heads of government of the Euro-group and the President of the European Central Bank to a meeting in Paris to discuss the banking crisis; this group is after all responsible for maintaining the value of the euro. He also invited the British Prime Minister Gordon Brown for a brief meeting before the actual talks within the Euro-group commenced. In the end, Gordon Brown was also invited to stay and participate in the Euro-group talks. The main outcome of the meeting was an agreement among the participating Member States to provide guarantees for their national banking sector. Three large Member States, the UK, France and Germany pledged 450 billion, 320 billion and 400 billion. Other Member States made equally impressive pledges. At that time there were no Community funds involved. Later the Commission proposed funds to be made

1. The Irish Government's unilateral decision to offer full guarantees to all bank creditors was widely criticized in particular in the UK for forcing the hand of other Member States and undermining the solidarity across the EU.

available to the financial sector. It should be noted that the British prime minister as well as other British officials have been involved in all the talks since then.

Action by the Commission

The Commission was involved in the talks in Paris. Commission members participated in the meeting called by the Presidency of the European Council, and the Commission started to draft plans. It developed its own plans, and published a Communication on 29 October: "From financial crisis to recovery: A European framework for action".[2] The Communication called for coordinated action by the 27 Member States. It prepared the ground for decision-making by the Council and the European Council. The Communication further proposed measures to tackle the shortcomings of the banking sector. For this purpose it established the Larosière[3] group, which will study the need to set up a new kind of supervisory system for the financial sector. The Commission further noted that the European Investment Bank, following the informal ECOFIN Council, put together a package of 30 billion euro for loans to SMEs, granted via commercial banks. It proposed further action by the European Bank for Reconstruction and Development. It also noted that some 350 billion euro will become available through the Cohesion funds for the period until 2010. In early November, the EU's Heads of State and Government agreed on the need for a coordinated response and invited the Commission to make proposals for discussion at their December meeting. The Commission broadened its approach and published a Communication on a European Recovery Plan on 26 November.[4] The plan has two pillars: the first one consists of a major injection of purchasing power into the economy. The second one stresses the need to direct short term action towards reinforcing Europe's competitiveness in the long term. The Plan proposes a counter-cyclical macro-economic response to the crisis in the form of an ambitious set of actions to support the real economy.

With its proposals the Commission fundamentally changed the nature of the action taken so far. Whilst the previous actions consisted of rescue action for the financial sector, the Commission's November plan has all the features of a classical Keynesian approach. An approach that is not shared wholeheartedly

2. COM(2008)706 final.

3. Jacques de Larosière was Managing Director of the IMF from June 1978 to Jan. 1987, and Governor of the *Banque de France* 1987–1993. He was President of the European Bank for Reconstruction and Development 1993–1998. The other members of the group are Leszek Balcerowisz, Otmar Issing, Rainer Masera, Callum McCarthy, Lars Nyberg, José Perez Fernandez and Onno Ruding.

4. COM(2008)800 final

by the governments of all Member States, in particular the German Government. The German finance minister Peer Steinbrück observed: "Our British friends are now cutting their value-added tax. We have no idea how much of that stores will pass on to customers. Are you really going to buy a DVD player because it now costs £39.10 instead of £39.90? All this will do is raise Britain's debt to a level that will take a whole generation to work off. The same people who would never touch deficit spending are now tossing around billions. The switch from decades of supply-side politics all the way to a crass Keynesianism is breathtaking."[5]

Action by the European Council

The European Council meeting of 11 and 12 December 2008 devoted a major part of its attention to the financial crisis. The meeting largely consolidated the different actions and proposals so far.[6] The Presidency Conclusions report the view of the European Council that, as the economic and financial crisis is a global one, it necessitates cooperation and coordination with the EU's international partners. The Council and Commission were requested to prepare this work and report to the Spring 2009 European Council. The European Council stressed the need to implement fully the measures agreed at EU level, such as guarantee mechanisms, in order to reduce the cost of financing for the benefit of firms and households. As financial markets are still fragile, the European Council urged vigilance, the continued implementation of the measures envisaged by the ECOFIN Council road map, and rapid adoption of the legislative decisions on which the Council has generally agreed.[7] The European Council mentioned the other priority issues (especially credit rating agencies, financial supervision and accounting standards) where decisions need to be taken.

Recalling that the Union as a whole is threatened with recession, the European Council declared that "Europe will act in a united, strong, rapid and decisive manner to avoid a recessionary spiral", and that all available instruments will be employed, so as to maximize the effect of the measures taken by the Union and the Member States. The European Council agreed on a European Economic Recovery Plan, to provide a coherent framework for action at Union

5. Interview in Newsweek 6 Dec. 2008.

6. See the full text of the Presidency Conclusions at www.consilium.europa.eu/showPage.asp?id=432&lang=en&mode=g

7. In recent months, the Council has, in a very short timescale, determined its position on four key draft directives: solvency of insurance companies ("Solvency II" directive), banks' capital requirements, the functioning of UCITS (undertakings for collective investment in transferable securities), and bank deposit guarantee systems. The Council reached agreement on these directives at the Ecofin meeting of 2 Dec. 2008. This package is referred to as "the road map." www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/104530.pdf

and national level. In line with the Commission communication of 26 November 2008, this involves in total around 1.5 % of European Union GDP. Point 10 of the Conclusions reports: "In this context, the European Central Bank and the other central banks have considerably reduced their interest rates: they are thereby supporting non-inflationary growth and contributing to financial stability." It is worth quoting the measures listed in point 11 of the Conclusions in full:

> "As regards action by the European Union, the European Council supports in particular:
> – an increase in intervention by the European Investment Bank of EUR 30 billion in 2009/2010, especially for small and medium-sized enterprises, for renewable energy and for clean transport, in particular for the benefit of the automotive industry, as well as the creation of the 2020 European Fund for Energy, Climate Change and Infrastructure ("Marguerite Fund") in partnership with national institutional investors;
> – simplification of procedures and faster implementation of programmes financed by the Cohesion Fund, Structural Funds and the European Agricultural Fund for Rural Development with a view to strengthening investment in infrastructure and in energy efficiency;
> – on the basis of a list of specific projects which will be presented by the Commission, taking into account a suitable geographical balance, the mobilisation of the possibilities, in the context of the Community budget, for strengthening investment in these sectors and, through regulatory incentives, developing broadband internet, including in areas that are poorly served;
> – rapid additional action by the European Social Fund to support employment, especially for the benefit of the most vulnerable groups in the population, paying particular attention to the smallest undertakings by reducing non-wage labour costs;
> – mobilisation to promote employment in key sectors of the European economy, in particular by the European Globalisation Adjustment Fund, including through the improvement and speeding up of its procedures;
> – the possibility, for the Member States that so wish, of applying reduced VAT rates in certain sectors: the European Council requests the ECOFIN Council to settle this issue by March 2009;
> – a continued general and significant reduction in administrative burdens on business. The European Council invites the European Parliament, the Council and the Commission to adopt the necessary decisions, including, where appropriate, as regards the regulatory framework, in full compliance with the current financial perspective and the procedures of the Interinstitutional Agreement, in accordance with as speedy a timetable as possible."

After acknowledging individual action taken by Member States, depending on their specific circumstances, the European Council went on to lay down a number of guidelines for coordinating further efforts. These specify that measures to support demand must aim to produce immediate effects, must be of limited duration and targeted at the sectors which are most affected and most important for the structure of the economy; they may take the form of increased public spending, reductions in tax burdens or social security contributions, aid for certain categories of enterprises or direct aid to households, especially those which are most vulnerable; they should be oriented towards increased funding for investment and infrastructure, improving the competitiveness of enterprises, greater support for SMEs, and the promotion of employment, innovation, research and development, as well as education and training.

Under point 13, the Conclusions state that "The European Council emphasises that the revised Stability and Growth Pact remains the cornerstone of the EU's budgetary framework. It affords the flexibility for all the Recovery Plan measures to be implemented. Aware that the latter will temporarily deepen the deficits, the European Council reaffirms its full commitment to sustainable public finances and calls on the Member States to return as soon as possible, in accordance with the Pact and keeping pace with economic recovery, to their medium-term budgetary targets."

The European Council also recalled the need for fast and flexible action by the Commission in applying the competition rules, welcoming the Commission's adoption of new guidelines for financial institutions.

The European Council concluded by expressing its confidence in the recovery plan, and its intention to evaluate, from its March 2009 meeting, how well it has been implemented and whether it needs adapting. It ended by inviting the Council and the Commission to initiate a dialogue with the oil producing countries to seek ways of achieving stable energy prices, and expressing its hope for a successful conclusion of the Doha Development Agenda within the WTO.

It is, of course, interesting to observe that the Keynesian approach proposed by the Commission in its November plan has been endorsed, notwithstanding the scepticism of some government leaders. The reference to the evaluation in the European Council meeting in March may be seen as an acknowledgement of the concerns of the sceptics. The proponents of the Keynesian approach will undoubtedly be strengthened in their beliefs by the demand stimulation policy of the new US administration.

State aid

In autumn 2008, the Commission approved a large number of rescue operations for banks,[8] and did so after an unusually short expedited examination period.[9] Some decisions were adopted in two days. The Commission's special task force for State aid in the financial sector worked flat out, including weekends, during that time. On 13 October 2008, the Commission adopted a Communication on The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ("the Banking Communication").[10] On 5 December it adopted a fresh Communication, "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition".[11] The Commission's approach follows the well-known principles of the guidelines for rescue and restructuring.[12] The Communication is in line with the recommendations of the ECB. It is based on the principle that State support for banks should not provide the recipients of aid with an artificially advantageous competitive position over banks not

8. The Commission provided an overview in the IP of 4 Dec. 2008, "State aid: Overview of national rescue measures and guarantee schemes". Such overviews are published regularly on the website of DG Comp.

9. It should be recalled that the preliminary examination period for notified State aid according to Art. 4(5) of Reg. 659/1999 is 2 months. The formal investigation period is another 18 months, which may be extended by common agreement according to Art. 7(6) of Reg. 659/1999. Given their impact on competition and their complexity, decisions in the financial sector would normally have been taken only after the opening of the formal procedure. By contrast, the decisions on the financial crisis were taken within 2 weeks: Decision K(2008) 6422, N 512/2008, Credit institutions in Germany; C(2008) NN 48/2008, Guarantee scheme for banks in Ireland; C(2008) 6616, N 524/2008, Guarantees for banks in the Netherlands. The decision in the case of C(2008) 6936, N 528/2008 Aid for the ING Bank was taken after 3 weeks, because additional information was needed. Other decisions were adopted within 2 days: e.g. C(2008), N 507/2008, Financial support measures to the Banking industry in the UK; C(2008), N 533/2008, Support measures for the banking industry in Sweden; C(2008) 6989, N 567/2008, Guarantee scheme for banks in Finland. Some measures were not notified i.e. Denmark case NN 51/2008, O.J. 2008, C 273/2, but approved after the Commission contacted the Danish Government. The Commission approved, originally not notified, State aid for Irish banks in decision C(2008) 6059, NN 48/08. After intensive contacts with the Commission, the Irish authorities submitted the finalized scheme on 12 Oct., addressing issues raised in the discussions (see MEMO/08/615). The Commission found the revised scheme to be compatible with EU State aid rules, because it was an appropriate means to remedy a serious disturbance in the Irish economy (Art. 87(3)(b) EC), while avoiding unnecessary distortions of competition. In particular, it now provides for non-discriminatory access to banks with systemic relevance for the Irish economy, regardless of their origin, fair remuneration of the guarantee, it is limited in time, and contains appropriate safeguards to avoid abuses. The Irish measures are therefore now in line with the guidance just issued by the Commission (see IP/08/1495).

10. O.J. 2008, C 270/8.

11. C(2008)8259 final, Brussels 5 Dec. 2008

12. O.J. 2004, C 244/2.

receiving aid. The legal basis for the communication is Article 87(3)(b) EC,[13] "aid to remedy a serious disturbance in the economy of a Member State". The approval is subject to the condition of review after six months. Member States have to submit a report for that purpose. The report should *inter alia* provide complete information on "the path towards exit from reliance on State capital".

The institutional aspects

Thus far the headlines. Let us have a further look at what exactly is being done and proposed and by whom. Within the Community there are several actors on economic and monetary policy. In order to assess the developments of the past months we have to be aware of their respective powers. The institution responsible for decisions in this field is the ECOFIN Council. The Council is empowered to take decisions on the basis of Articles 98–104 EC. There have been no formal decisions on these matters by the ECOFIN Council, although that body has met several times. The actions so far have been taken by the Member States, individually or in a coordinated manner. This took place in the framework of the Euro-group. The measures were taken by the Member States and not the ECB. The banks needed new capital and that is what only governments could provide (the ECB can help with short-term liquidity). Such measures have to be assessed according to the State aid rules, as was discussed above.

Member States may also take measures with a general application e.g. a reduction of the VAT rate will not be caught be the prohibition of State aid since it is not selective. Government measures reducing the level of the VAT have to be in line with the EC rules on indirect taxes. Point 11 6th indent of the Presidency conclusions, quoted above, refers to the possibility of measures applying reduced VAT rates in selected sectors. Such measures have to be decided on the basis of Article 93 EC by unanimous vote, lowering VAT rates across the board not.[14] Moreover, it should be observed that even if measures to stimulate the national economy are compatible with the Treaty rules, there is nevertheless a need for coordinated action. Without coordination there is a

13. The Commission has used Art. 87(3)(b) as a legal basis before. The dismal performance of the Italian economy in the early 1970s prompted the Commission at the time to authorize the Italian government to grant "conservation aid" under Art. 87(3)(b) to firms facing grave problems (see Second Report on Competition Policy, April 1972, pts. 120 and 123). Similarly, when as a result of the oil crisis of 1973 all Member States were hit by a severe economic recession, during the following years – and with the Commission's blessing – substantial aid programs were implemented in order to allow important industrial sectors (shipbuilding,textiles etc) to tide over the crisis (Fifth Report on Competition Policy April 1976, pts. 130–133). To our knowledge, since that period no further use has not been made of the derogation provision of para (b) in relation to conjunctural aid measures.

14. Directive 2006/112, O.J. 2006, L 347/1, Arts. 96–99.

risk that national measures will be less effective, because the effect of the extra expenditures will seep away to other Member States, as happened with the French measures to stimulate the economy in the early years of Mitterand's Presidency.[15]

It should be recalled that, even if Member States are free to take financial measures supporting their banks, they must nevertheless observe the Treaty rules of Article 99 EC. According to this provision, Member States shall regard their economic policies as a matter of common concern. Member States will have to abide by the broad guidelines of economic policy. For that purpose Article 99(3) provides for the multilateral surveillance mechanism. Even more important are the rules of Article 104 EC, the excessive deficit procedure and the rules of the stability pact. These rules are considerably more onerous than the broad guidelines.[16] The mechanism lays down the well-known 3% rule for the government deficits of the Member States.[17] It is important to note that the procedure of Article 99 applies to all Member States i.e. also those with a derogation (the ones not participating in the Euro-zone). Article 104 also applies to all Member States, but the provisions containing sanctions, Article 104(9) and 104(11), do not apply to non-members of the Euro-zone.[18] It is not difficult to imagine that the observance of the 3% rule will come under strain with the guarantees of some 400 billion and more. There will undoubtedly be pressure to apply the rules of the stability pact leniently. A precedent for such behaviour was set in the episode that led to the ECJ judgment in Case C-27/04, *Commission* v. *Council*.[19] The Court did not answer the question whether, in the context of the procedure of Article 104(9) EC, the Council is under an obligation to take measures. The European Council, in the conclusions cited above, under point 13, recognizes the difficulties in this respect by calling on Member States to return as soon as possible to their medium term budgetary targets.

15. See e.g. Kapteyn & VerLoren van Themaat, *The law of the European Union and the European Communities*, 4th revised ed. (Kluwer Law International, 2008), p. 885.

16. Id. p. 889.

17. The additional rules of the stability pact are laid down in Reg. 1467/97, in particular Art. 9.

18. Art. 122(3) EC.

19. Case C-27/04, *Commission* v. *Council*, [2004] ECR I-6649. In its judgment the ECJ held that the Council could not decide to hold the excessive deficit procedure in abeyance. The Court did not express an opinion on the question whether or not the Council is under an obligation to take a decision under Art. 104(9). In para 90 it held: "It should be added that, in accepting that the procedure may de facto be held in abeyance simply because the Council does not succeed in adopting a decision recommended by the Commission, the Court does not express a view as to whether, pursuant to Article 104(9) EC, the Council could be required to adopt a decision where the Member State persists in failing to put into practice its recommendations under Article 104(7) EC, a question which the Court is not called upon to answer in the present proceedings."

The restructuring of the banks could lead to mergers. To the extent that mergers have a Community dimension, and many will, they have to be approved by the Commission on the basis of the merger control rules. It is quite common for the Commission to lay down obligations or ask commitments from the merging companies in order to alleviate the distortions of competition. This happened for example in the case of the original Fortis-ABN AMRO merger.[20] The possibility to follow a coherent policy for the banking sector through the application of the merger control rules is, by its very nature, restricted to incidental and *ad hoc* measures. Moreover, the Commission can only act when there are mergers with a Community dimension. The banking sector is still dominated by national players, and mergers between banks in several Member States are not frequent. On the other hand it is not excluded that the exceptional circumstances will lead to transnational mergers.[21]

The actions of the governments are closely monitored by the ECB in order to decide whether or not its monetary policy needs to be adjusted, i.e. whether it should lower interest rates. This was referred to in point 10 of the European Council conclusions, quoted above. The ECB has therefore been closely involved in the decision-making process.

The international dimension

The problems discussed so far involved financial institutions in the Community. Some Community citizens were confronted with defaulting banks in third countries – in particular Iceland. After some initial individual actions, the Member States concerned undertook coordinated action to address this issue. This is just one example of the increasing globalization of international financial markets. Point 5 of the European Council conclusions notes the need to work together with the international partners.[22] For that purpose the President of the European Union Council, accompanied by some colleagues, travelled to Washington for talks with the US Government. Further talks are planned for April this year.

20. According to the Commission, Fortis was to sell the activities of some parts of ABN AMRO: decision 3 Oct. 2007, case Com/M4844, Fortis/ABN – AMRO assets. Since then Fortis had been engaged in talks with the Deutsch Bank. After the weekend in September, the talks were discontinued.

21. It should be noted that Dir. 2007/44 is specifically designed to facilitate cross-border mergers in the financial sector.

22. The increased globalization, and interdependence, is well illustrated by the fact the Peoples Republic of China is now the biggest holder of US debt with some USD 565 billion, the next biggest creditor is Japan with some USD 500 billion debt, and the third biggest is the UK with some USD 320 billion. These enormous holdings of US government debt create delicate mutual relationships.

Conclusions

The developments in the financial sector demonstrate the intricate interaction of Member State and Community actions within their respective spheres of competences. The absence of clear Community powers to grant the type of aid that is required by providing massive guarantees, makes it all the more necessary that the Member State actions are closely coordinated. Decisive actions by ministers of finance of several Member States and by the French presidency, under the leadership of President Sarkozy, have made it possible to establish a clearly defined coordinated action. For some, the overall European approach compares favourably with the US approach. It is to be hoped that this pattern of decision-making will have set an example to be followed by future Presidencies of the EU and that it will not be a one-off performance. This episode may therefore serve as an example of how an appointed European Council President could secure more effective policy coordination. The events of last autumn may have weakened the position of the Commission. It is difficult to draw firm conclusions in this respect, since personalities played an important role. The decision-making process for the measures to safeguard the financial sector also demonstrate that it is very difficult to distinguish between the prerogatives of the ECOFIN council and the Euro-group. Given the design of the Treaty rules, briefly outlined above, it was always going to be difficult to draw a clear line between the closely coordinated economic policy and the common monetary policy. For the former the ECOFIN is responsible, for the latter it is, in the absence of the introduction of the Euro by all Member States, the Euro-group.

The Commission for its part has displayed a remarkable agility to cope with the sudden surge in massive State aid support. One is therefore left wondering how to understand the remarks by cabinet ministers of some Member States criticizing the Commission for its slow decision-making. When confronted with the Commission's powers to control State aid, politicians in Member States tend to formulate their displeasure in the form of criticism of the Commission's actions or as in this case claimed inaction.

It also seems clear that the frequent and intensive meetings of the heads of government and the French President have developed a sort of close relationship over this period that goes beyond formal ties, and that this allows them to rise to the occasion.