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Haut du formulaire

Bas du formulaire

**Spanish bailout buys time for eurozone - but only a little**

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Spanish Prime Minister Mariano Rajoy: banks are bailed, but just a brief respite? AAP

The positivity off the weekend’s news that Spain’s banks will receive rescue loans of up to 100 billion euros from eurozone finance ministers appears short-lived.

Despite it being well-received in Asian markets the expected bounce has not been repeated on European and US market.

All eyes are now on the EU. The intervention for Spain’s banks was expected and in a certain sense inevitable. Some IMF estimates leaked on Friday indicate that the Spanish banking system requires a capital injection of about 40 billion euros.

Estimates by ratings agency Fitch and other institutions place the number somewhere between 50 billion and 100 billion euros.

Given the size of the Spanish economy, these numbers are not particularly large (less than 10% of Spanish GDP). However, it is obvious that in the present situation, the Spanish government has very little chance to mobilise any capital, hence the need for EU intervention to prevent an escalation of the crisis.

In fact, if the Spanish banking system were to collapse, other countries might be heavily affected. Signs of weaknesses in the European banking systems are already evident from the growing share of non-performing loans in several countries, including Germany and Italy.

In this environment, the Spanish crisis could quickly spiral out of control and infect other countries, thus leading to a Euro-wide banking crisis which would probably mark the end of the euro as a currency.

The details of the rescue plan are still undisclosed. However, in exchange for financial support, the EU might require the Spanish government to undertake a set of actions, even though the extent of this conditionality [should not be as tight](http://www.guardian.co.uk/world/2012/jun/09/spaniards-bleak-future-austerity-bites) as it was for other countries such as Greece.

Most likely, Spain will be required to work on new pension reforms, a restructuring of its very large civil service (which counts about three million employees when total employment is less than 18 million people and total population is 45 million), further fiscal consolidation and reforms of the governance of the banking sector in order to reduce political interference in board decisions.

**Can the EU deliver?**

Over the past few weeks, criticisms against the EU have been raised in political, diplomatic, and economic circles. In particular, the sentiment is that the EU has been unable, or perhaps unwilling, to provide adequate responses to the crisis that has hit its peripheral countries.

This “shyness” in tackling the problems has undermined investors and markets’ confidence, thus making it very difficult for the peripheral countries to mobilise affordable fiscal finance.

In this regard, the announcement of the EU intervention in support of Spanish banks comes as very good news and might suggest that the negative sentiment towards the EU actions is somewhat exaggerated.

Furthermore, as a partial justification of EU actions, one should stress that the current economic and financial problems in the peripheral countries are rooted in structural weaknesses that are primarily the responsibility of national governments.

Take Italy for instance. The debt crisis arises from the fiscal profligacy of the 1980s coupled with almost two decades of growth stagnation. It is not the EU that can undertake the reforms needed to relaunch the Italian economy. Similarly, high unemployment in Spain has been a problem since the early ‘80s and it can hardly be blamed on the EU and its policy approach.

Still, it is probably true that the current institutional architecture of the EU is a factor of vulnerability in crisis situations. The monetary union is not accompanied by a fiscal union. There is not such a thing as a European government, the EU commission being only in charge of ordinary administration in a limited number of sectors.

The process of political integration has stalled. Decisions, especially those on fiscal matters, need to go through lengthy negotiations between the governments of individual countries. The search for a consensus, or maybe just a compromise, often leads to slow and inadequate responses.

Presently, there is a fundamental conflict of views between Germany and several other countries on how the crisis should be treated. This conflict, of which the hard-nosed stance taken by German Chancellor Angela Merkel on Eurobonds is an example, is seen by many as the real “bottleneck” in EU policymaking.

In fact, blaming Merkel for the failure of the EU to provide more significant support to its Members States in financial turmoil is probably too harsh. For one thing, Merkel has already given in on a number of issues (for instance, the European Stability Mechanisms, the bail-out operations). For another, her position on some fiscal issues may be justified by her fear that moral hazard will compromise stabilisation efforts and ultimately result in the collapse of the fiscal compact.

Still, one wonders if Merkel is not missing the big picture, at least to some extent. Fiscal austerity may be necessary, but it is certainly not sufficient to get the EU out of muddy waters.

In fact, it does not look like peripheral countries can afford much more austerity these days. Recession at the periphery will eventually hit Germany.

The downgrading of some German banks last week is a sign that if the Euro area suffers, then Germany also suffers. Perhaps, if Merkel relaxed a bit her focus on the fiscal compact, then there would be less suffering for everybody.