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The sadly unpalatable solution for the eurozone

By Wolfgang Münchau

Aconsensus has gradually emerged among experts about the first necessary step to solve the eurozone crisis: a eurozone-wide system of banking resolution, prudential supervision and deposit insurance. The idea is essentially to take the nation state out of banking and to make the eurozone – or the European Union – responsible for everything. The notion of, say, a Spanish bank would cease to exist.

It is in many respects a very obvious solution to a big part of the crisis – the weakness of eurozone banks and their toxic relationship with national governments. The eurozone still needs solutions to its diverging competitiveness and low growth. But this would be an impressive start.

Economically, it is obvious that a monetary union requires an integrated banking sector. It can otherwise not handle a banking crisis. With such a system in place, it becomes possible for the central regulator to force banks to take losses or fire incompetent directors. It could take equity stakes in banks, force banks to merge, close them or fully nationalise them.

A centralised banking resolution and supervision system is probably only the bare minimum of an economic infrastructure that a monetary union needs. But there are also problems with this approach. First, it would only ever be a solution if the proposal were not fudged. If one remembers the palaver over the recently agreed extension of EU-level financial supervision, it would be naive to believe the EU could agree on anything of such a scale, fudge-free.

I am hearing from several advocates of this proposal the view that it would be politically less problematic than a eurozone bond. I disagree. First of all, it would still be costly. A proper resolution authority would require access to some €1tn in funds. This would presumably have to be funded by a debt security, which for all intents and purposes constitutes a eurozone bond. They may call it a financial stability bond, or whatever, but who cares? If you think that a joint and several debt security is unacceptable in principle, then surely so is this proposal.

Also, would Germany, above all member states, really accept such a transfer of power? Would the Germans really like a system where their friendly European regulator shut their neighbourhood Landesbank? Ordinary citizens do not see the Landesbanken with the same horror as a European Commission competition economist or a London-based banking analyst. For ordinary Germans, they have been a source of mortgages at below market rates, or for corporate loans that no private bank would have given them.

It is hard to conceive of Germany's corporate sector without its cosy relations with the banks. How would political parties exercise power and influence? An uncompetitive, highly geared and not profit-maximising banking sector lies at the very heart of German economic exceptionalism. Do we really think chancellor Angela Merkel is going to adopt the idea of a European banking resolution fund in her 2013 election manifesto?

The situation is not even that clear in Spain, a country that would undoubtedly benefit from such an arrangement. Would the centre-right government allow the banking conglomerate Bankia, for example, to go under a European hammer? That is a "super-caja" run by Rodrigo Rato, a former managing director of the International Monetary Fund and one of the ruling Popular party's most prominent representatives in the banking sector.

My guess is that among all crisis resolution choices, the centralisation of bank resolution and supervision will be among the least popular. Politically, it would be more realistic to expect the current rescue "umbrella" to take on that role. It would be a horrible fudge, and it would not solve the crisis. But it will be tried. It is technically possible, for example, for the European Stability Mechanism to lend money to Spain earmarked specifically for recapitalising the banking sector. But the ESM is constructed in such a way that Spain would become subject to the full blast of conditionality that any programme legally requires.

Spain would lose its sovereignty. Most important, such a programme would not solve the problem because it constitutes a swap from Spanish private debt to Spanish public debt. The ultimate responsibility for refinancing Spanish banking would remain in that country. A eurozone-wide bank resolution scheme would have the advantage – from a Spanish perspective – of the costs and risks inherent in a restructuring of the financial system being shared among all member states.

I am not saying a eurozone bank resolution fund is impossible. But it would have to be part of an immensely difficult political deal, in which various parties agree to do things they are definitely not willing to do today.

The only way I can see such an outcome would be for the crisis to get worse – a lot worse. That may well be happening, but it is not, of course, something one should wish for.