

### **A Dis-united Union?**

For many centuries Europe had been integrated through inter-change of ideas in philosophy, mathematics and physics: also many European rulers were related through marriage or otherwise. Early in the 19<sup>th</sup> century, Napoleon, after conquering most of continental Europe, invaded Czarist Russia in a bid to create a single political entity. The dream ended when he had to retreat in a humiliating fashion. Later, 1814 was his Waterloo, and he was forced to abdicate the throne of France. A century later, an assassination in Sarajevo triggered the First World War which led to the triumph of communism in Russia, and a break-up of the Turkish Empire. The latter, in turn, created various states in today's middle-east, to accommodate the colonial ambitions of France and Britain: the region continues to be volatile a century later as the ongoing battles in Iraq and Syria witness. Could 2014 turn out to be equally momentous in terms of its impact on the European Union (EU)?

One reason for such thoughts is the results of the election to the European Parliament in May. Anti-immigrant, euro-skeptic parties turned out to be big winners in at least two major EU member countries – Britain and France. They will surely impact the direction in which the EU moves over the next few years: towards greater integration and even a common budget, or more powers to member countries and less for Brussels. The last major step towards greater integration, at least within the euro zone, was the common banking regulation.

More recent has been the confrontation between Britain on the one hand and most of the other members of the EU on the other. Britain was supported only by Hungary in opposing the appointment of the next President of the European Commission, whom the remaining 26 members supported. In many ways, Britain has been the “odd man out” in EU deliberations ever since it became a member in the 1970s. Mrs. Thatcher was always a euro-skeptic and, for a while, had brought all EU decision making to a halt

over the question of British contributions to the EU budget. A decade later, the pound was thrown out of the exchange rate mechanism of the European Monetary System, when it could not keep the exchange rate within the agreed band, despite very heavy intervention by the Bank of England. The result was that Britain is the only major economy within the EU which is not part of the euro zone.

The present Conservative Prime Minister of UK, David Cameron, like Mrs Thatcher, wants a renegotiation of the EU treaty, aimed at lesser power for Brussels and more for national governments, and has promised a referendum in the UK on the subject in 2017 – provided the Conservatives are re-elected next year. His recent humiliation over the appointment of the head of the European Commission may well influence how he handles the renegotiation process and the stand he takes in the referendum itself. There is a question mark of course whether the UK itself will remain united until then since there is a referendum in Scotland in September over the question of leaving the UK, as the Scottish Nationalists desire. Meantime, the political crisis and confrontation in Ukraine continues to boil, and the EU is threatening stronger sanctions against Russia.

Within the euro zone, the sovereign debt crisis seems to be well under control – in fact, 10 year yields on Spanish, Italian and Irish bonds are comparable to, if not lower than, US bond yields! The other side is that growth remains very slow and inflation, at 0.5% is at a 4 year low. Years of easy money have not led to creation of employment: in Spain, for example, youth unemployment is at an explosively high 55%!

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For students of international banking and finance, there have been two recent developments which are of interest. As may be recalled, Argentina defaulted on its external bonds in 2002; the outstanding debt was of the order of \$ 100 bn and most of the holders agreed to restructure the debt, writing off part of it. However, the defaulted bonds did not incorporate the so-called “collective action clause” which makes such restructuring, it is binding on all. In the absence of such a clause, holders are insisting on full payments. Most of such bonds are held by so-called “vulture funds” who buy

such bonds at dirt cheap prices in the secondary market. One large hedge fund sued the Argentinean government in US courts. The technical question before the court was whether the “pari passu” clause allows Argentina to service the restructured debt unless it meets its obligations to the hold-outs. Last week the highest judicial authority in the US has ruled against Argentina. Whatever the legal issues, this decision is one more example of how the rule of law often leads to injustice. After all, the very fact that the original bond had coupons much higher than the US sovereign debt meant that the holders were aware that it was a risky bond. It is difficult to sympathies with those who took the risk, tempted by the coupon: surely they should suffer now?

The second case involves BNP, the largest French bank, fined \$ 9 bn for contravention of US economic sanctions against Iran and Sudan. Clearly the exorbitant privilege of the dollar being the world’s dominant reserve currency is being used in pursuit of US’s political agenda!

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