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European summit split over how to halt meltdown

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The leaders of Europe's largest economies announced a multi-billion fund to support small businesses last night, while calling for a global summit to redefine the world's financial order.

Crucially, however, the meeting hosted by President Nicolas Sarkozy failed to agree on the more ambitious €300 billion European rescue fund proposed earlier this week in the run-up to the Paris summit.

The £12 billion fund for small businesses hit by the credit crunch will be financed by the European Investment Bank, and a deal was reached to find a further £13 billion, taking the total available to £25 billion.

The European leaders demanded a global summit, to be held later in the autumn, aimed at finalising a successor to the Bretton Woods formula — the system created in 1944 that defines the world's financial relations.

The leaders also issued a threat that financial speculators who had behaved "immorally" would be held responsible, but they failed to make clear what sanctions would be used.

Sarkozy said: "Each member state will ensure that executives who have failed will be punished."

The French premier went on to issue an outspoken attack on the short-selling investors who have brought banks around the world to their knees. Sarkozy said: "We want entrepreneurial capitalism and not speculative capitalism. We want moral issues to be taken account of. When all is said and done, we will build a new financial world just as Bretton Woods did 60 years ago."

Gordon Brown, who attended the meeting along with the Italian prime minister, Silvio Berlusconi, and Chancellor Merkel of Germany, said: "We will continue to do whatever is necessary to preserve the stability of the financial system."

The leaders issued a rebuke to Ireland, which was not represented at the summit, for its unilateral decision to guarantee all deposits held in the country's banks. Merkel said: "We have requested the commission to enter a dialogue with Ireland. It is important to have a balanced approach with no undue disadvantages for any member states."

However, European nations remain divided on how to safeguard bank deposits and rescue failing institutions. Adding to the air of disarray, the president of the European parliament said the Paris meeting had no power to take EU-wide decisions.

Sarkozy's "grand projet" for a US-style pan-European bank rescue scheme appears to have received little support. The German economy minister, in an interview published today, said: "To ask the government to put taxpayers' money at risk . . . seems unjustifiable."

American lawmakers put aside such scruples last week and voted to bail out their bankers with up to \$700 billion of taxpayers' money.

While the scheme will help, many experts believe that it is too little, too late to stop a vicious financial squeeze. Campbell Harvey, an American professor of finance, concluded: "It is naive to think that the \$700 billion Tarp \ will solve our financial crisis.

"We face a significant number of bank failures . . . Mechanisms should be in place to have a contingency

plan for 750 to 1,000 bank failures over the next six months.”

Europe faces similar stresses after a slew of European banks had to be rescued last week. Bradford & Bingley, Fortis, Hypo Real Estate and Dexia — from Britain to Belgium, Germany and France, governments had to leap in to rescue institutions before they went bust.

The Eurosceptic MP John Redwood, a former banker, said: “We now know there are weaknesses in the banking system throughout the European Union and that some of these problems are home-grown. It’s not just that these banks have got sucked into bad mortgages in America.”

Some European banks are even more heavily “leveraged” — ie, they have borrowed more in relation to their capital — than American ones.

Last week the Irish government panicked when banks in the country came under pressure. Fearing a run, Dublin decided overnight, and unilaterally, to offer a full state guarantee on deposits in the country’s six biggest banks.

While it propped up the Irish banks, it immediately made other institutions appear less safe. Money began to flood out of other European banks and into Ireland.

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