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This newsletter contains a selection of  
the articles published in «Défense  
Européenne» Nos. 56, 58 and 59.

These articles (with exception of page 2)  
have been translated into English by  
students at [ISIT Paris](http://www.isit-paris.com)

## Editorial

First-time published in Oct 2017



While the concept of Permanent Structured Cooperation (PESCO) dates back to the draft EU Constitution of 2002 and the Lisbon Treaty, approved in 2008, makes explicit provision for the possibility of using this form of cooperation to strengthen the ties between Member States, not one single measure has, in fact, been taken to this end in the past nine years. However, the positive momentum generated since the beginning of this year by the EU's new concept of strategic autonomy, approved in 2016, in the field of Defence and Security seems to have given PESCO a second chance.

On 22 June 2017, the European Council agreed on the need to develop 'inclusive and ambitious' permanent and structured cooperation, giving Member States three months to produce a common list of criteria and binding commitments.

This draft was submitted to all the Member States and to Federica Mogherini during the summer and seems, in general, to have received a warm reception, at times even the firm support of many Member States. The informal meeting of Defence Ministers on 7 September in Tallin even managed to reach a broad consensus on the conditions for embarking on PESCO, paving the way for an accelerated approval schedule targeting a formal decision in December 2017. In this connection, Member States have already tabled some thirty specific cooperation projects they would like to see undertaken or supported.

A number of points will still require clarification in the coming weeks. It will also be

vital to maintain a reasonable balance in the choice between the somewhat contradictory objectives suggested by the adjectives "inclusive" and "ambitious". It would be unfortunate if, in a bid to bring on board the largest possible number of Member States from the outset, the criteria and binding commitments were to be overly watered down. Admittedly, disparities in capabilities between Member States are bound to complicate procedures.

There seems to be a clear political determination, both within a majority of Member States, not least Germany and France, and in the European institutions, which strongly support this initiative, to bring PESCO to a successful conclusion before the end of 2017. Despite Angela Merkel's unexpectedly close-run victory in the German elections of 24 September, the momentum will hopefully be maintained and permanent structured cooperation achieved by the end of the year: Europe's future is at stake.

With the establishment of the MPCC (Military Planning and Conduct Capability) in spring 2017 and the European Commission's new proposals with regard to defence investment still in the finalisation stages, European Defence and Security plans have truly been given a new lease of life, all of which represents tremendous progress. It will now be vital to inform Europe's citizens about these developments, presenting them in a positive light, as soon as specific proposals start to emerge.

**Patrick Bellouard**

Major General (Engineer, retired).

President of EuroDéfense-France

# European defence on education, training and simulation

EWG 23 - Chaired by EuroDefense-Netherlands

## Executive Summary

European defence cooperation on education, training and simulation has many important advantages to enhance skills, share European military culture for our military men and women, and reduce costs.

The importance of cooperative training and the intention to make training an element of the Permanent Structured Cooperation has been agreed in the Lisbon Treaty. This intention was reinforced in more recent papers on European cooperation, but omitted from the European Defence Fund. Simulation technology for training goals was never mentioned. Hence, we believe cooperation on education, training and simulation needs more attention.

In this document of EURODEFENSE and the Federation of European Defence Technology Associations (EDTA) the most important potential areas of cooperation are described as well as technological and funding opportunities.

The main conclusion is that cooperative education and training improves procedural and cultural interoperability in the European armed forces. It promotes similar responses to the same situation and facilitates mutual understanding, integration and team building. For individual military men and women it builds lifelong personal networks that will help them to better understand their fellow Europeans.

## Recommendations:

In military education a specific military culture is created and camaraderie is born. To stimulate European cooperation exchange programmes should be extended throughout all Member States. Especially in regions with overlapping cultures

and bridgeable language barriers. National identity should however be recognised in basic training.

To better organise training throughout Europe, training should be integrated in just a few major European Commands. The issue of sovereignty is less important in training and exercises and other hurdles that often hamper cooperation in actual operations are also absent in these circumstances. The training model for naval ships and task forces in use by FOST in the UK could be applied for European armies and air forces.

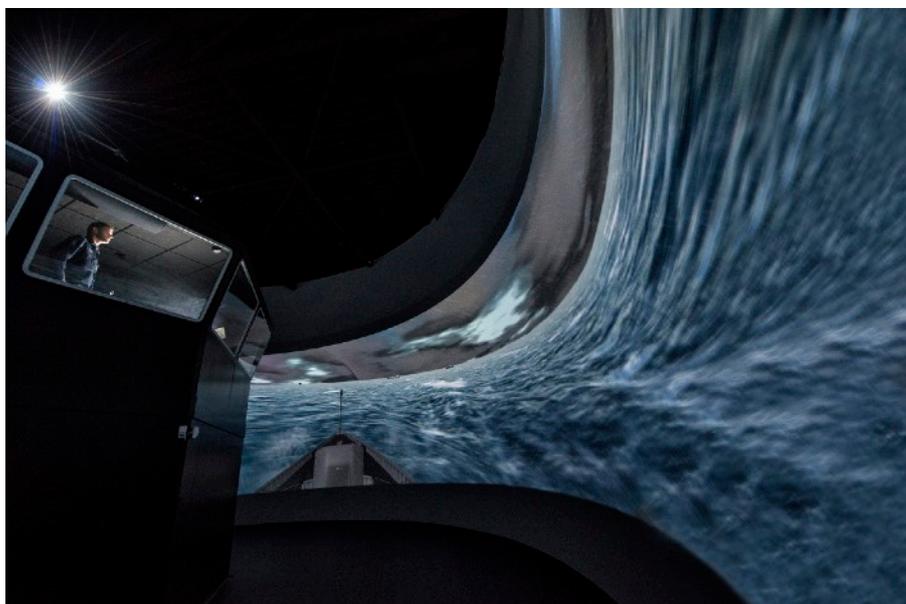
Simulation for training has become an essential tool to meet training needs of forces in a national and multinational context. Technical developments have made simulation more realistic than actual training and exercises in many cases.

Realistic training through simulation should be stimulated Europe wide. A European technological advantage in this area could be achieved by making the R&D window of the European Defence Fund available. NATO panel and US dominance should be avoided where Europe pursues strategic autonomy.

Some training needs to be performed in large and complex facilities. It could be effective to use private funding for investment in these expensive systems. The use of these facilities could then be shared between military and other users on a pay-per-use basis.



EURODEFENSE



The full document can be consulted at [www.eurodefense.fr](http://www.eurodefense.fr)

*Ship Handling Simulator of the Royal Netherlands Naval Academy. An example of a very realistic training system that can be coupled to other simulators elsewhere in the world and also to real ships. Trainees can 'sail' together with others without actually being there.*  
Photo: RNLNavy, LT Vanessa Stribosch

# France's big comeback

By Hartmut Bühl

Editor of "The European - Security and Defence Union", Berlin

After his resounding victory in the presidential elections and his subsequent absolute majority in the parliamentary elections, Emmanuel Macron now needs to take advantage of this golden opportunity to embark on his comprehensive programme of reforms. With the support of his brand-new party, he has succeeded in brushing aside all the established left and right-wing parties and breaking the beleaguered political mould. A rocky road still lies ahead, however, if France and its people are to be rescued from the doldrums.

Macron's rise to power was Ciceronian, his enthronement majestic and his first steps on the international scene with Vladimir Putin and Donald Trump hallmarked by his charisma.

His address to Congress on 3 July 2017 in Versailles, where Louis Napoleon Bonaparte had convened Parliament for the first time, was both Gaullist and imperial.

Will Macron defer to Parliament? His allegiance is more towards General de Gaulle, the founder of the Fifth Republic, in whose steps the young President is keen to follow. The pattern has already been established, with Macron setting strong political guidelines and leaving his Prime Minister to govern, as stipulated in the Constitution.

It is necessary to hark a long way back in time to find other examples of such a meteoric rise to power. The first to come to mind has to be Cicero, the ultimate orator who, in 64 BC, emerged from nowhere to become consul at 40 years of age. His plan was to control the empire's destiny and the various power centres that had been feuding for centuries in order to establish the *Concordia ordinum*, as a means of guaranteeing peace at home and abroad. Cicero's success lay in his personality and his ability to address the ordinary man in ways he could understand. He also embodied the "feel good" factor, untarnished by previous elections. Similarly, Emmanuel Macron, largely unknown a few years ago, has suddenly become the nation's Jupiter, France's saviour from impending chaos. For him, dignity is the watchword!

His avowed goal is to reconcile the different parts of French society and to restore their belief in their influence and place in history. And it would seem that they have begun to understand that internal stability and a strong Europe are essential for France to retain its reputation as great power.

To achieve this goal, the French President will need to show common sense in the exercise of his responsibilities. He will be able to count on an inclusive Government and will need to involve the political elites currently left on the side-lines, since their contributions could be invaluable to the success of his social transformation plans.

The President has already unveiled his vision for a better Europe and made it perfectly clear that France will fulfil its obligations to restore its credibility vis-à-vis the EU. At home,

he now has to explain his ambitious plans to the French nation – before it is too late!

Emmanuel Macron has the charisma essential to revamping France's image and enabling Europe to make progress together with reliable partners. He knows that, to rise to the challenges facing the continent, Europe needs a strong France, a France with the requisite self-belief.

Hopefully Emmanuel Macron will succeed in showing that France as a force to be reckoned with is back on track!

## Hartmut Bühl

*Military Attaché of the German Federal Republic in Paris (1996-2000) and Vice-President of Airbus (2000-2005), founder member of EuroDéfense with Pierre Schwed and Jochen Schöller. Awarded the rank of Chevalier de la Légion d'Honneur (Knight of the Legion of Honour) in 2004, Hartmut Bühl lives in France and in 2007 was elected town councillor in Berchères-sur-Vesgre (Eure-et-Loire département)*

### London, 14-16 September 2017

The theme for the EURODEFENSE International Conference was **"Threats to European peace and security over the next ten years"**. It was a successful event, in a very high quality environment and with high profile British speakers for the public symposium. Exchanges were rich and fruitful, including on the topic of the Brexit and its possible consequences, and the reiteration of Britain's alignment to NATO for European Defence and Security.



# Europe, the USA and the “subprime” crisis

by Pierre Lépinoy

Board member of EuroDéfense-France

The subprime crisis, which first broke out in the USA in 2007, hit Europe with a force from which it has yet to recover nine years later. In the end, Europe’s economy was more directly affected and it is still struggling to get back on its feet, while in the USA growth has been quicker and stronger to return.

This relatively poor performance is largely due to the incomplete status of the European Union.

In this article, we will begin by analysing the root causes of the crisis, then the role played by the European Union in attempting to put matters right before drawing a number of general conclusions.

## 1. Root causes of the 2008 financial crisis

The global financial crisis followed a long period characterised by abundant liquidity and low interest rates.

“Lax” monetary policies, particularly in the USA in the wake of the “dot.com” crisis of 2000, caused a credit expansion which stimulated consumption and investment in the USA, thus creating a property bubble.

In addition, global macroeconomic imbalances increased within the decade up to 2008, largely through an upsurge in the USA’s external deficit, mirrored by surpluses in Asia (especially in China) and in oil exporting countries (Middle East, Russia).

These surpluses were invested in American treasury bonds and other low-risk assets, driving down long-term interest rates.

### Investor underestimation of risk

In this context of abundant liquidity and low interest rates, the banks created increasingly innovative tools to produce the high yields demanded by investors. Accordingly, hundreds or thousands of mortgage loans and loans granted to SMEs were poured into vehicles financed by issuing securities (securitisation). These were then at times grouped into other vehicles funded by issuing further securities (collateral debt obligations [CDO square]).

Initially, the advantage of securitisation was that it reduced the financing costs of SMEs and private individuals by enabling the purchasers of these securities to spread the risk among a large number of borrowers.

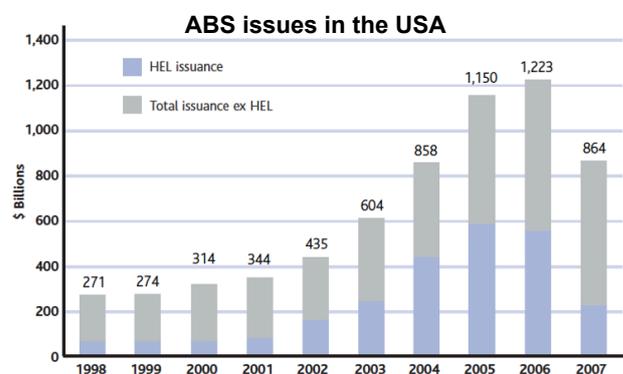
To satisfy investors hungry for returns and driven into a state of euphoria by the constant increases in property prices, the merchant banks resorted to ever growing leverage and underlying credits of increasingly mediocre quality (“subprimes”).

At the same time, the growing sophistication of securitisation tools blinded the credit rating agencies and

investors to the poor quality of the underlying assets, which automatically led to an underestimation of the cost of risk.

These practices prompted a spectacular extension of the leverage effect within the overall financial system.

As a consequence, in the USA the number of ABS<sup>1</sup> issued went up fourfold, from 337 billion dollars in 2000 to more than 3000 billion in 2006, while the number of RMBS<sup>2</sup> issued rose from some 100 billion dollars in 2000 to 773 billion in 2006 (see chart<sup>3</sup>).



Source: Thomson Financial Securities Data, Deutsche Bank

Banks significantly multiplied their leverage (relation between commitments and equity) by more than 30, at times by as much as 60, which made them extremely vulnerable to the slightest decrease in property asset value.

After exploiting the possibilities offered by securitisation to excess in the United States, American banks turned to the European market. In retaliation, some European banks embarked with a vengeance on a process of securitisation on their domestic markets (Spain, UK). However, the sums involved in Europe always remained much lower than in the United States (€478 billion in 2006 in Europe as against €2,456 billion in the United States).

But, given its large number of private savers, Europe was a major purchaser of the ABS issued in the United States. In the middle of 2007, it held around 20% of these ABS for an estimated amount of \$4,185 billion. The rest of the world owned around 4%.

## 2. Europe at the onset of the crisis

With the benefit of hindsight, we can identify the main factors that caused this crisis, initially limited to a single sector in a single country (the real estate sector in the United States),

<sup>1</sup> ABS = Asset-Backed Securities

<sup>2</sup> RMBS = Residential Mortgage-Backed Securities

<sup>3</sup> HEL = Home Equity Loans

## Europe, the USA and the “subprime” crisis

(Cont. from P. 4)

to spread to Europe, triggering the biggest financial crisis since 1929, the effects of which are still being felt today.

At the time, the European financial system was peppered with a number of structural weaknesses.

### 2.1 Fragmented financial supervision

Until 2008, European financial institutions were overseen by the national authorities, whose powers varied considerably from one State to the next.

Admittedly, the EU had created 3 committees in order to supervise these national authorities:

- Committee for European Banking Supervisors (CEBS)
- European Insurance and Occupational Pensions Committee (EIOPC)
- Committee of European Securities Regulators (CESR)

However, since their powers were purely consultative, these committees were unable to override the differences between national traditions to create a cohesive supervisory body.

The results were a fragmented regulatory framework and unevenly applied financial supervision within the EU. Thus, when Lehmann Brothers went bankrupt in October 2008, it was impossible to gauge the extent to which the European financial system had been contaminated, the reliability of bank declarations about their financial situation being extremely variable from one country to another.

It was, therefore, impossible, at any given moment, to appreciate the extent to which the subprime crisis had permeated the European financial system, or to assess its systemic nature.

While securitisation was supposed to spread the risks inherent in the financial system more evenly, the nature of the system made it impossible to check if the risk was really shared or simply concentrated on the less visible parts of the system. This spawned uncertainties about the credit status of the counterparts, a loss of confidence and from this, the transfer of tensions to other parts of the financial sector.

The EU financial supervision system also had no reliable mechanisms for resolving disputes over transnational financial activities.

### 2.2 Fragmented Bank and Financial Regulations

The regulations in force in Europe lacked consistency, a situation largely ascribable to the fact that the EU Member States had the choice among several options when applying community decisions. These options resulted in a wide diversity of national transpositions, sometimes mutually incompatible, depending on local traditions, laws and practices. The fundamental cause of this lack of harmonisation was that, for political reasons, community decisions all too often leave it to the States to choose their national options, ostensibly to maintain national sovereignty.

The results of this diversity in prudential measures were:

- Distortions in competition between financial institutions
- An incentive to regulatory “shopping”
- For cross-border groups, inefficient risk management and capital appropriation
- Specific difficulties over crisis management in the event of the collapse of cross-border institutions

Their powers extending solely to their national territory, the regulatory and supervisory authorities concentrated on micro-prudential supervision of individual financial institutions, paying insufficient attention to systemic risks affecting the EU as a whole.

In addition, tough international competition among European financial centres put the national regulatory authorities off the idea of embarking on unilateral action which, even if it could have served the general purpose, would have simply shifted the problem (and the capital) to another less demanding financial centre.

### 2.3 Compartmentalised information

When the problems took on crisis proportions, major difficulties were encountered over exchanging information and in obtaining collective decisions from the central banks, supervisory authorities and Finance Ministries. Frequently, the financial supervisory authorities were not in possession of all the relevant information about the real scale of this excessive leverage, or received this information too late, failed to understand or properly evaluate the extent of the risks and were disinclined to share their information with their counterparts in other Member States or in the USA.

### 2.4 Multiplicity of tax rules

Major differences in the tax systems of the 28 EU Member States encouraged financial traders to operate in the most accommodating jurisdictions, at times the least transparent (Luxembourg, Ireland, etc.).

### 2.5 Lack of Coordination between Political Powers

While this plethora of imbalances and risks was generally recognised and remarked upon, no major consensus was reached, whether among the political decision-makers in the individual countries or among the regulatory authorities, as to the seriousness of the problem and the action to be taken.

In terms of prevention, the national authorities failed to agree on coordinated emergency measures. For example, the German ban on “short selling” on its territory had no effect, since the practice continued to be authorised in other European countries.

Recovery measures put in place by the different EU members were equally uncoordinated, even though the IMF had clearly demonstrated the failure of unilaterally decided national recovery plans during earlier crises.

## Europe, the USA and the “subprime” crisis

(Cont. from P. 5)

In 60 years, the EU has pursued a policy of economic integration with the explicit goal of reinforcing de facto solidarity among its members. The aim of economic integration has been largely reached, as borne out by the growing proportion of intra-European dealings in its members' foreign trade (around 70%), making the EU the most integrated economic zone in the world. However, while interdependence may exist in practice, the European institutions showed a regrettable lack of solidarity when the biggest financial crisis in 70 years occurred.

### 3. Epilogue

In a nutshell, the fragmented nature of the EU's financial and political institutions made them particularly fertile ground for the sustained development of the subprime crisis in Europe.

In February 2009, Jacques de Larosière, former IMF Managing Director, who was entrusted by the European Commission with the task of finding solutions to the crisis, highlighted these various malfunctions in his report and drew the following conclusions:

*“We must work with our partners to move towards strict international standards, through the IMF, the FSF, the Basel committee and the G20 procedures. This is vital. But we must also accept that these standards can only be effectively and sustainably enforced and applied if the European Union, with the biggest capital markets in the world, has a robust and integrated European regulatory and supervisory system.*

*In spite of progress made, the European Union still has a highly-fragmented framework.”*

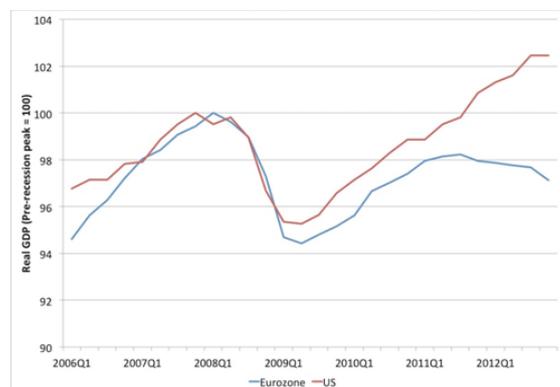
*“In essence, we have two alternatives: the first being ‘every man for himself’, the second stronger, pragmatic, sensible European cooperation for the general good and for an open world economy. The economic advantages of this latter approach are obvious, and this is therefore where our preference lies.”*

Unlike the situation in Europe at the start of the crisis, the US financial supervisory and regulatory institutions were either directly managed by the federal State (SEC, FDIC, “Fed”, etc.), or firmly under its supervision. This difference in structures between the USA and Europe goes some way towards explaining why Europe performed less well in the subprime crisis even though the crisis itself had originated in the USA (see next chart).

Since 2009, substantial progress has been made along the lines recommended by Jacques de Larosière in his report:

**May 2010:** Creation of a €750 billion relief fund, the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM), to help countries in financial difficulty, both replaced in 2012 by the European Stability Mechanism (ESM), to facilitate direct recapitalisation of Eurozone banks, without aggravating the debts of the individual States.

### USA and Eurozone GDP



Comparison of real GDP, base 100 : before recession

**March 2012:** Ratification of the Treaty on Stability, Coordination and Governance, which established the principle whereby the budgets of public administrations must be balanced or show a surplus (“golden rule” or “balanced budget rule”)

**December 2012:** European Banking Union agreement establishing the principle of a single supervisory authority, superseding the national authorities, for Eurozone banks. Since March 2014, the ECB has been solely responsible for supervising major banks, intervening in the event of bank failures and protecting the depositors and creditors of these banks. Fiscal Union, a necessary complement to Banking Union, is under consideration.

### Conclusions

- When a systemic crisis occurs in Europe, the problem is not Europe but rather the lack of Europe, i.e. insufficient coordination of national policies and practices, under the umbrella of the different national sovereignties.
- If governing means thinking ahead, it is the duty of the politicians to institutionalise the means of preventing and managing crises, *before* and not *after* they occur.
- The Banking Union, supplemented by a Fiscal Union, will enable the eurozone better to overcome the next financial crisis.

**How long will it be before a similar organisation is established for defence?**

By **Pierre Lépinoy**

Board member of EuroDéfense-France

# Franco-German relations: Prospects

with *Hakim El Karoui*,

Founder of *Volentia*, Strategic Consultants firm,  
Former Advisor at *Matignon* (French PM's office)

The relationship between France and Germany is decisive, despite the paradox of their economic or even political differences. More than anything else, the French need to be aware how little they know about Germany and vice versa. In addition, the Germans think ahead to the long-term, while the French tend to reason on a short-term basis.

## 1/ A few figures

- Internationally, France and Germany together count 147 million inhabitants (thereby ranking in 9<sup>th</sup> position). Together their economies rank third in the world, they are the 2<sup>nd</sup> biggest exporters of goods and services, the 1<sup>st</sup> importers of services, the 2<sup>nd</sup> importers of goods and the 3<sup>rd</sup> biggest investors. The Franco-German duo is therefore a major economic force.

- In the EU, 60% of French and German trade exchanges are with other EU countries. This represents 3.5 million export sector jobs. The weight of France and Germany together within the EU is decisive.

- Bilaterally, the two countries are vital partners for each other. Germany remains France's leading export partner, while France is in second position for Germany (behind the Netherlands because of activities in Rotterdam). China's share is growing fast.

For example, French sales to Germany in the transport, chemical products, machines, equipment and metals sectors are substantial, as are those of intermediate goods.

## 2/ Differing cultural and political relations

First of all, the two partners are generally ignorant of each other's cultures and languages. In the 19<sup>th</sup> century, the French elites spoke German, which is not the case today. Comparatively, the Germans have a better knowledge of French, though the proportions are still small.

However, their administrative and institutional ties run deep: bilateral meetings between Heads of State and Government or Franco-German Councils of Ministers within the EU.

## 3/ Common challenges faced by both countries against this cultural and political backdrop

### a/ Immigration

The problem is not new in Germany as the country has already lived through three waves of immigration:

- In the 60s, with an influx of Turks for purposes of redeveloping the country's industry (today, there are 3 to 4 million Turks in Germany, a number similar to that of North Africans in France);
- The second wave was in the 90s at the time of the war in the Balkans (an influx of Serbs and Bosnians);
- Lastly, the influx of Syrian refugees (1 million people in 2015 and 400,000 in 2016), Angela Merkel's decision to

open the country's borders being motivated by ethical and demographic factors.

France has adopted the opposite attitude, taking in just 4,000 refugees despite all it might have to say on Human Rights and the fate of the Eastern Christians. The Germans have taken a dismal view of this behaviour.

Where integration is concerned, the Germans have been more successful than the French because geography is on their side: there are no major metropolises such as Paris, only big cities and industrial hubs dotted across the country. Immigrants tend to be spread over the whole territory, although there are admittedly concentrations of Turks, Moroccans and Poles.

Efforts to encourage assimilation take place quite unpretentiously within the local community. The Germans are conscious that France has more experience with integration, even though they may criticise us, awarding us a success rate of 75% against 25% of failures, even though in France it is the failures that we hear most about. One of France's weak spots is training and education in general, including for immigrants. Never forget that the boss of Siemens started his working life as an apprentice.

### b/ Islam

Germany is even more backward than we are. It has 3.5 million Turks and a million other Muslims from Syria, Iraq, Afghanistan and Morocco. It is Turkey that pulls all the strings, providing the funds and the imams via the Prime Minister's Office in Ankara. Every Friday, the text of the sermon arrives from Turkey. Up until now, the Germans found this normal, but Erdogan has now started to take a harder line and has reignited the conflict with the Kurds. And one third of all refugees in Germany are Kurds. Berlin has therefore forbidden the Turkish authorities from holding meetings in Germany to stem the potential spread of anti-democratic ideas and internal conflict. However, for the moment, the Germans have yet to come up with an alternative policy.

For its part, France considers that it is perfectly acceptable for Islam to be managed by foreign countries (Algeria, Morocco and Turkey but, contrary to popular belief, neither Saudi Arabia nor Qatar, whose only role is financial, although we have no idea of the sums involved). Of the 300 imams in France, 150 are bankrolled by Turkey, the others by either Algeria or Morocco. This system has its roots in the colonial era and no longer works. An alternative solution needs to be found.

### c/ Turkey

While Turkey is France's No. 1 partner in the Levant with 14 billion euros in trade exchanges, Germany is in an even stronger position (25 billion euros) and there is a large Germano-Turkish community in Turkey. What can be done in this regard, especially given the situation in Syria and recent anti-democratic trends in Turkey? For the moment, we have no answer, since Turkey holds all the cards in relation to the EU because of immigration and the EU has not dared say a single word about Erdogan's methods of government.

## Franco-German relations: Prospects

(Cont. from P. 7)

### d/ Russia

Links between Russia and Germany are strong on the energy front. Russia is Germany's main supplier and German companies are very powerful in Russia. France is less dependent on Russia but is still faced with issues and challenges similar to those of Berlin.

### 4/ There are no serious cultural or political differences of interest: it is in the economic arena that France and Germany are no longer on a common course

Germany's strengths lie in its family businesses, social model and industrial base, all assets that France does not possess. But Germany is weaker than France in terms of large global companies, the robustness of its banking system and the energy mix (comeback of coal).

France's problems may be explained by the lack of competitiveness of its businesses and its public deficits. For fifteen years, since the Schroeder era, Germany has had an economic strategy: using the strength of its industry and its exports to drive down the price of its products, which were too expensive. Germany has managed to cut the cost of everything forming the industrial backdrop: services, social protection (only three choices for unemployment), public expenditure, and salary caps. This policy was dictated by German retirees, who were worried about how their pensions would be funded and who insisted that there should be no inflation, no transfers and zero public expenditure.

In France, salaries have risen faster than productivity and competitiveness, which is one of the worsening differences with Germany now impacting on Europe. The current situation is similar to what happened in France in the 19<sup>th</sup> century when the advent of the railway removed the obstacles to the flow of goods and people on the domestic market. This led to the impoverishment of rural areas. Along similar lines, in Italy, economic integration was the ruin of regions in the south, forcing many people to emigrate. The euro has prompted a similar phenomenon by creating differences within Europe. It has abolished borders, leaving capital to gravitate to where it is the most productive and where industry is the richest (Germany, the Netherlands, Denmark). Southern Europe, for its part, tends to specialise in services and "low-cost" industries (Portugal, Spain). Wealth is, therefore, concentrated in the north (intellectual and industrial production, universities, start-ups). The south does not produce enough wealth; countries are, therefore, opting for specialisation. France is somewhere in the middle. In general, however, a country cannot survive economically if it does not produce enough wealth. The reforms imposed on countries in the south (i.e. Greece) cannot hope to lessen their deficits because they do not have the requisite wealth.

The euro has played a part in exacerbating disparities because there is no real migration and few capital flows within the European Union. The creators of the euro have developed a hemiplegic currency, given the absence of public capital flows and individual mobility.

This is the challenge that will be at stake in future elections. If the Germans reject all transfer policies and refuse to admit that their trade surplus is, in the end, a real problem, the

National Front will emerge victorious in 2022. **If Germany chooses the world over Europe, Europe will take its revenge and disappear.**

**The speaker had the opportunity to provide the following explanations in response to questions raised by the audience:**

- The Erasmus system had proved positive but remained insufficient (only 300,000 young people);
- French economic difficulties impacted on the country's role within the EU, making it no longer the driving force it used to be. To what extent should we accept that our interests may diverge? Only concerns about the euro are likely to prompt a change in the position of the Germans, since they are increasingly influential in northern and eastern Europe.
- French policy should not consist of playing the UK off against Germany or the south against other countries. France should rather work with the Germans with due respect for its federal structures and certainly not describing them as "provincial";
- With regard to defence, nothing is really being done to develop a common project, other than a few collaborative programmes, while France and the UK share a number of common projects.
- Theoretically, Brexit will offer France and Germany the chance of greater rapprochement, but the Germans are suspicious (cold reception of President Macron by the German press: how much will he cost us?)
- In Germany, it is the Minister, Wolfgang Schäuble, who dictates the doctrine. The Social Democratic Party (SPD) has turned out to be weaker than expected. Germany was the "sick man" of Europe in 2000 but the Germans managed to tighten their belts. Other countries should do the same. "Carry out the necessary reforms and then we will talk" is the mantra of some German opinion-formers who think the EU is now a problem and that France is the problem within the EU.
- Are we going to have to start banging our fists on the table or adopt the empty-chair policy so skilfully used by General de Gaulle? France would be better advised to develop a closer political relationship with Germany: France has a history, a culture and a global vision that the Germans envy. They are also curious to know more about France's way of managing Islam or the standard of the training we dispense to our engineers. Bridges need to be built between the two countries.
- Admittedly, Germany's current power, which goes back to the 19<sup>th</sup> century, cannot be solely ascribed to the euro but the euro is nevertheless a contributory factor in the economic gap now emerging between our countries.

# Greek crisis, Euro crisis, EU crisis?

with *Jean-Loup Kuhn-Delforge*,

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Just over a year ago<sup>1</sup>, the European Union was threatened by two existential crises: the Euro crisis and the Schengen crisis, both directly linked to Greece. Greek bankruptcy in spring 2015 threatened to bring down the single currency. The migrant crisis threatened the free movement area. Today, neither of these problems have been resolved but have merely been contained.

For the EU, the important thing was to minimise the potential knock-on effects of the Greek crisis. Unfortunately, all it could do was play for time to maintain the status quo as far as possible. The recent economic crisis is undeniable but it was, above all, indicative of something far deeper rooted: the crisis affecting the whole of Greece's political system. It also spotlighted some of the past malfunctions of the EU and the eurozone, which have now largely been put to rights.

## Historical reminder:

There is an ambivalence to Greece of which very few Europeans are aware. Greece is a Mediterranean country but also part of the Balkans, in other words part of the former Ottoman empire. This ambivalence is both geographical and psychological in nature.

The 20<sup>th</sup> century was particularly tragic for Greece whose current borders have only existed since 1948:

- 1919-1922 "the Asia Minor Catastrophe": The Greeks, who had advanced into Anatolia, were defeated by Atatürk and driven back to the Aegean. Greece, a small developing country, a country of 4 million people, was forced to take in more than a million refugees returning with even less resources than the people repatriated from Algeria to France.
- In the 30's: series of coups d'état and dictatorships
- 1941-1944: German occupation, one of the toughest in Europe, with the loss of 300,000 lives.
- 1944-1949: civil war

In order to prevent Greece from falling into the Soviet camp, which would have contravened the Yalta Agreement, the British and, more particularly, the Americans, supplied the often collaborationist royalist factions with arms. The Americans set up what was, in fact, a protectorate which lasted from 1949 to 1974, and of which the Greek military junta (1967-1974) was the logical outcome. (The film "Z" with the assassination of the deputy Lambrakis was not set in the period under this dictatorship but four years earlier, in 1963).

The 20<sup>th</sup> century was therefore a terrible time from which it was impossible for people to emerge unscathed, either materially, or, above all, psychologically, just like that.

## Financial reminder:

- 1893, first Greek bankruptcy or default

The creditor States of the time, namely France, Great Britain, Russia, Austria-Hungary, Germany, Italy, etc. set up an international commission based in Athens. This had veto rights over the Greek budget and controlled its execution. The commission remained in place for at least two decades.

Today's European Troika strikes an unhappy chord with the Greeks, who have long memories.

- 1932: second bankruptcy

The Second World War and, subsequently, the Cold War were to freeze settlements, with the result that Greek debts were only cleared in 1969.

We often hear reference being made to the Greek crisis today. However, it would be more correct to talk about "crises", as there are several at one and the same time. Unlike the Spanish, Portuguese or Irish crises, in the Greek case we have a financial crisis, which is not the worst, a social and moral crisis, a crisis of values... plus the dying spasms of the Greek "system", which resembles a sort of magic "cube" in which touching one thing automatically impacts on all the rest. By "system", we mean the oligarchs, the wealthy families, the entrepreneurial elite, who often own the major media, the church, political circles but also general attitudes, which remain very Middle Eastern other than among the very cosmopolitan Greeks encountered in Paris or elsewhere. The average Greek will say "You, in Europe!", like his counterparts elsewhere in other parts of the Ottoman world. In the Greek national subconscious, Europe starts in Vienna and with Catholicism.

## Financial and economic crisis:

Greece has received three financial assistance packages (MOUs), in 2010, 2011, 2015, amounting to a total of 250 billion euros. The ongoing saga, with its convoluted, very difficult to follow plot, and over and beyond what can be read in the press, may be summed up in one key point, namely that because of its financial difficulties, Greece no longer has access to international banking markets. The eurozone's idea is, therefore, that of lending Greece money to keep its head above water and give it time to make the reforms needed to find its own salvation.

In return, the Greeks have been asked to make the following reforms:

- Competition: consumer prices, in an economy where everything is imported, are higher than those in France or Germany, because of the margins added by multiple middlemen.
- Labour law: a review of the collective bargaining agreements with their layers and layers of different benefits that are an absolute scourge and a barrier to the development of foreign investment.
- Use of structural funds.
- Taxation.
- Government reform.

These measures are in the interests of Greece, the EU, and eurozone member states ... but they are admittedly intrusive.

The origin of this crisis is simple if we think about it. Greece is an economy based on consumption. It is financed by savings and guaranteed income from European Funds, through borrowing. In the past, when debt exceeded a certain

<sup>1</sup> Editor's note: Reminder that this conference took place in January 2017

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threshold, devaluation was the obvious solution. With the Euro, this is no longer impossible. On top of this, proposing German interest rates to a country "hooked" on debt, simply makes the addiction, although to a degree welcome, even worse. And so, the whole country, spurred on by the banks, the excitement of the Olympic Games, etc. has been consumed by a form of collective madness.

Greece is, doubtless, the country that has received the most financial assistance from the EU. Its loans represent 4% of the GDP each year, an annual average of 3 billion euros, all funds taken together. Instead of acting as a stimulus like in other Member States, this guaranteed unearned income tends to have an anaesthetic effect on Greece. The funds are not being used for reform, nor are they being put to intelligent use. Why? Because there is no real economic policy. For that, you have to have a government, public authorities, with sufficient authority and a medium and long-term vision.

In summary, the European funds are treated as income, creating artificial prosperity based solely on imports.

### **Social crisis, moral value crisis:**

Greece has the highest unemployment rate in the EU. In 2013, it peaked at 28%, before falling to 23%. Two years ago, youth unemployment reached 50%.

Unemployment benefits have been extended from one year to two. But when they come to an end, the people involved are no longer entitled to free healthcare.

All this is partly offset by the existence of a huge parallel economy, which is estimated at almost 20% of the GDP. The "European" figures have therefore, as the Greeks would say, to be taken with a pinch of salt, for we are blinded to certain aspects by our "western" way of seeing things.

Major cuts were made to salaries and pensions. Purchasing power dropped by 30% and salaries by 20%. Pensioners have even been known to receive letters announcing backdated cuts of 20, 30, 40% in their pensions. This means, therefore, that for two to three months they will not receive a cent to compensate for the amounts already "overpaid". At the same time, taxes have surged, since Greece's creditors (the Troika, EU institutions and the IMF) are insistent on tax increases so the country can turn itself round.

The social crisis has also been fuelled by cuts in the social and education budgets. In 2013, for example, there were no textbooks available at the start of the school year.

Above and beyond all this, it is the whole social model that is coming under fire. Admittedly, the older generation has already seen it all before. However, for younger Greeks, including those up to the age of 40, the whole society in which they grew up is now disappearing. The society of Erasmus, the Euro, the Olympic Games, the society where Greeks had money to spend, to travel, to pay for their children's higher education... It is a whole social model that is collapsing overnight.

More dramatically, the middle classes are increasingly being proletarianised. Since Greece joined the EEC in 1981, a real middle class had emerged in this developing country, particularly thanks to the PASOK socialist party and its major public service sector recruitment. Nowadays, this class is the hardest hit by the crisis. We are now witnessing social

inequalities in Greece worthy of a third world country. There are the very rich and those who are really suffering.

### **Crisis in the Greek "system":**

The Greeks, and the Europeans to an even greater degree, seem hell-bent on refusing to face facts. In 1981, when Greece joined the EEC, its economy was stable, its debt was limited. The country had a number of assets. Yet, it failed to converge with the other EEC countries. It even diverged still further. Why? And why are we apparently only noticing this now?

The first problem is the government itself. This cannot be said often enough. In 2011, when the Troika gained entry to the Greek Ministries in connection with the financial assistance MOUs mentioned before, it examined the records. Admittedly it was meddling in another country's business but, and here I quote, "Europe was finally able to understand the extent of the problem". It was clear that the government was not working properly, that there was no spirit of public service, no inter-ministerial relations, a total lack of awareness of the general interest, all this compounded by a cronyism in which votes could be bought against a post in the civil service. Everything is highly politicised, every change of government means a complete change of top personnel. The public sector is completely overinflated: in the 80s, the ratio of public sector to private sector was at levels found in Soviet bloc countries.

Greece remains a profoundly and inherently oriental country. Yet, the word "Greece" immediately conjures up ancient, romantic and neoclassic visions in our minds. When we say Greece, we automatically think of Plato. Since the end of 19<sup>th</sup> century, we have been trying to bully the country into accepting political and administrative institutions imported from abroad.

While Greece may have three major assets: tourism, agribusiness and start-ups, it has no national policy in any of these three sectors.

Greece has another problem: tax. The Greeks pay taxes, but it is an extraordinary country where only people with low incomes actually contribute, since tax is deducted from their earnings at source. All employees and public servants therefore pay income and property taxes. But these property taxes, which the government has difficulty collecting, have substantially increased in a country where 80% of the population are homeowners. By contrast, VAT is not reclaimed. 90% of companies have fewer than 10 employees. The possibilities for fraud are limitless.

The refusal to pay tax stems from an Ottoman tradition: at the time the population was determined not to give a penny to the Turks and, moreover, when you pay the government, you are entitled to expect sovereign services in return. But the public is convinced that if they paid tax, it would go straight into pockets of corrupt officials, not serving the public interest at all.

There are also problems with regard to official texts, no clear tax code having ever been established. Under the Greek administration there is no separation between inspector and inspected. In some small villages, but not only, the result is easy to imagine.

### **Migration crisis:**

This is a problem recently "rediscovered" and, at that, with some acuity. In reality, it has existed for the last 10 years. Responsibilities are divided.

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**Turkish responsibility:** the aggressive policy of Turkish Airlines, Turkey's decision to abolish visas for all neighbouring countries, central Asian countries and those of sub-Saharan Africa. When a trip from Kabul to Istanbul costs 500 euros, who would opt to struggle across Iran's difficult deserts? When you can buy a Casablanca-Istanbul ticket for 200 euros, a Kinshasa-Istanbul ticket for 400 euros, why cross Africa and the Mediterranean with all the risks inherent in such a journey? And, once in Istanbul, a potential immigrant is only two hours away from the Schengen area.

**Greek responsibility:** this is the direct result of all that has been said above about the absence of government, policies and vision. And there are no border guards.

**EU responsibility:** the difficulty in understanding that Greek borders represent the outer limits of Europe. But this is changing and efforts are being made.

Nowadays, Greek financial assistance packages (MOUs) are themselves a problem, since crisis follows crisis and the threat of bankruptcies etc. looms large.

First of all, these MOUs beg the question of democracy, of sovereignty, which stems directly from creditor lack of confidence in Greek politicians: the first MOU was published on a Monday to be voted at an emergency meeting the following Thursday. It comprised 19 articles on "minor" and "banal" issues such as social security reform, taxation, the energy market, the railways, public transport, the price of prescription drugs, etc. The second MOU consisted of an article approving a 400-page appendix very poorly translated from English into Greek. Here again, the document had to be approved within three days. And once again, in July 2015, the government was given but a few days to vote a new Code of Civil Procedure that was already done and dusted.

Imagine: in February 2012, just before the legislative elections, we, as creditors, asked all the politicians to sign a written commitment to comply with specific articles with regard to crises and reforms.

We were putting Greece under duress and obliging it to achieve in a few years what many have trouble in achieving in two decades. The immediate consequence of these bulldozer tactics was the difficulty in ensuring that the Greeks themselves take ownership of the process.

Implementation of these MOUs is monitored by the Treasury Directors and, ultimately, by the Finance Ministers via their Eurogroup meetings. Quantity is therefore favoured over quality. There is a general obsession with budget surpluses while, for Greece, the real problem lies elsewhere. The Greeks are perfectly capable of achieving a budget surplus. All they have to do would be to stop paying pensions, chop 40% off the salaries of the civil servants and freeze all spending on social services and education. A primary surplus is easily obtained!

When compared to our own situation, the figures are, moreover, staggering. In 2016, the Greeks had a 0.5% primary surplus and their targets for 2017 and 2018 are, respectively, 1.7% and 3.5%. There are also budgetary reduction mechanisms that will kick in automatically, if these targets are not reached.

None of this resolves the core problem, namely that of the previously mentioned reforms.

**Refusal of reform:** the problem with reform is that it would be harmful to the specific interests and benefits of a particular group of cronies. It is easier to knock 4% off salaries and pensions than to set up a government General Secretariat or reform the Greek Court of Auditors. At the end of the day, the protesters are very few in number. The Greek paradox is indeed that, for the government, it is easier to adopt a short-term, quantity-based austerity policy imposed by outsiders than to embark on reform.

The political situation is therefore paradoxical: the elections democratically brought to power anti-Europeans who are now forced to submit to the dictates of the country's creditors. For the creditors, the situation is "ideal": an "anti-European" government whose programme has been "written" by us and that has committed to reforms, a conservative opposition that will remain silent and supports this anti-European alliance which is a combination of extreme left and extreme right. The result is rather fragile and shaky. In the short term, the government is not threatened and no one wants to take its place. But at some point, the "real" part of the reforms will have to be enforced.

There are three things to be done as a priority. These are easier said than done: government, taxation and justice. Augeas, Sisyphus, Danaid..., all Greek myths.

Is reform possible in a time of austerity? This does not only apply to Greece. The banks, whose outstanding credits include 45% of toxic loans, are very chary of lending money to companies. This, compounded by exchange and import controls, paralyses the economy.

The birth rate is declining: it has fallen to 1.3 and the number of young graduates emigrating is high.

That said, the Greeks always reserve surprises and there is the possibility that growth will return.

Greece is seen as a burden. Is it a dagger poised to stab Europe in the back?

If the answer to this question is 'yes', then the dagger is in two pairs of hands: the Greek political elite and the EU Member States. So far, the dagger has struck three times:

- The first was linked to the conditions under which Greece joined the EEC in 1981: no transition period. Contrary to the Commission's recommendations of 1976, unlike Spain and Portugal, which had had to go through a five-year transition period, or the CEEC, where the period was of around ten years, Greece gained entry Europe within a mere two years. Greece was seen as a "small country" bound to meet the convergence criteria sooner or later and, above all, as a typical Mediterranean country.

- Secondly: the structural funds. Between 1989 and 2008, Greece received 80 billion euros, in other words 4% of the GDP that falls into its lap every year like manna from heaven without attendant conditions or responsibilities. The country does not even know how to spend this money and Brussels has to send experts to lend it a hand.

- Thirdly: the "unchallenged lie". It has been calculated that there was a 2.2% GDP difference between the budget announced and the real budget.

In all three cases, nobody wanted to go and see what was really happening, and this for two reasons: firstly out of respect

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for Greek sovereignty, and then for fear of creating a precedent that could subsequently apply to other Member States. Naivety, blindness, complacency...

But Greece is still there, in the eastern Mediterranean, which begs a number of geopolitical considerations.

First of all, Greece was one of the first Balkan countries to join the EU, thus escaping the turmoil of the Balkan crises of the 90ties.

Nowadays, Greece is stuck while everything around it is on the move. It is therefore weak, in particular vis-à-vis post-putsch Turkey. By way of reminder: Between 1928 and today, the ratio of the Greek to the Turkish population has gone from 1 to 2 to 1 to 9. The GNP per habitant is 3.7 in Greece and 1 in Turkey.

Therefore, seen from the Balkans or Turkey, Greece has the status of an economic "giant". In the Balkans, this has a perverse effect and is the source of much euroscepticism. If the EU is able to mete out such hard treatment to a "giant" like Greece, what would it do to lesser countries?

At the same time, and above all from an American point of view, the fear was that Greece might slide towards the Middle East. You only need to remember the temptations facing Papandreou in the 1980ties, when he organised a meeting between Gaddafi and Mitterrand. There was a looming threat of "non-alignment", while Greece was still seen as the southern flank of NATO and the EU.

It is interesting to remember that Caramanlis's main argument for joining the EU was primarily to do with safety rather than with democracy or economics.

This is another example of Greek ambivalence: Greece is part of the Balkans and therefore tends to be defensive, with a siege mentality, which explains its difficult relationships with Bulgaria, Macedonia and Albania. But it is also European, which means, open to opportunities.

Similarly, what about European defence? It is generally said that the Greeks are very keen. This is true, since the circle excludes Turkey.

Greece also had its fingers burned by the Cyprus business, when it had ample opportunity to discover how useless NATO was over an issue that was vital in its eyes.

China is also investing strongly in Greece (maybe because it sees the country as a "weak link"). Piraeus is the nearest port for linking China to the EU, right opposite the end of the Suez Canal. China has established a huge base in Djibouti and has invested heavily in Greece. Every day, an impressive flow of Chinese containers arrives in Piraeus which, given the laxity of the Greek government and the shortage of budgetary resources, are not submitted to customs controls. These containers can therefore head directly off to central Europe, Slovakia, Hungary, on a railway built by these same Chinese. Products bearing the EU label can thus be manufactured in Chinese factories without the slightest difficulty. For China, it is all about economics.

Greece is also important for Russia. Admittedly cultural and religious links do exist, but these should not be overestimated. Greece is a "weak link" and Russia is attracted by weak links: by transiting through the port of Thessaloniki, the Russians can bypass the straits by rail-freighting goods via Ukraine. It is therefore very difficult to get the Greeks to accept any resolutions proposing sanctions on Moscow.

The same can be said about Iran with regard to sanctions, it being the only country prepared to supply oil to Greece on credit.

In response to various questions, the speaker clarified the following points:

- On Cyprus, Greece had let slip a number of opportunities. The speaker was not optimistic.
- On the army and the defence effort, 2% of the GDP was earmarked for the defence budget. The Greeks had a persecution complex in relation to Turkey and other countries (conspiracy theory). Its army was stuck in the 1960ties, fossilised, based on conscription and with obsolete equipment (no more blue water frigates). The Navy and the Air Force were struggling.
- Church and State were not separate (historical role in defending the nation under the Turkish occupation) and the church was tax-exempt (social role today). Tsipras was the first leader to refuse to take a religious oath. Orthodoxy makes Greece closer to Belgrade than to Moscow.
- Exiting the euro? The Greeks had no wish to go back to the drachma.
- The present government was a coalition of former communists, Maoists, etc. tolerant towards Europe and the extreme right, a coalition for which there was no apparent alternative between now and the end of the electoral period.
- The debt issue? Greece only represented 2% of the EU's GDP but its debt amounted to 180% of the Greek GDP. Faced with the risk of bankruptcy, should part of this debt be erased? Germany was opposed to any such suggestion. The EU considered that it had already been very generous, since in 2012, the slate had been wiped clean of all private debt, a move without precedent in financial history. Public sector debt remained and mainly concerned the EU. The IMF, which the Greeks wanted nothing more to do with but whose presence was demanded by Germany, would only contribute to recovery if Greek public debt were cut by 30%...
- Relations between Greece and Turkey? There had been air traffic incidents, provocation on the part of Turkish ships in the name of the right of innocent passage. Erdogan has suggested that the Lausanne treaty is not cast in concrete. But economically, there were no particular problems. On the continental shelf (Cyprus issue), both were jockeying for position. With regard to migration, the Turks were letting people through overland via Greece (1 million irregular migrants in 2012 out of a 11 million population). From 2012-2013, Greece had sent guards to man the land border between the two countries. It was the islands that were now feeling the brunt. In many ways, Turkey had a hold over Greece through the migrants. Greece was having to bear the burden on its own while, for the Commission, Greece was not using the credits it had received.

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