



## BULLETIN OF THE INSTITUTE FOR WESTERN AFFAIRS

### ■ Towards a compromise? The state of Franco-German talks on the eurozone

Karol Janoś, Jacek Kubera

As he received the Charlemagne Prize in Aachen on May 10, 2018, President Emmanuel Macron once again urged Germany to engage in effective collaboration with France on the eurozone reform project. He had delivered the same message on two previous occasions: at the European Parliament in Strasbourg on April 17, 2018 and during his Berlin meeting with Chancellor Angela Merkel on April 19, 2018. As was announced at the time, the two politicians would jointly present their change proposals prior to the European Council Summit of June 29, 2018.

The positions of France and Germany, as presented thus far, point to the transformations of the Economic and Monetary Union that both countries accept and that relate to discussions on the eurozone budget, the establishment of the European Monetary Fund, the completion of a banking union and the appointment of the European Minister for Economy and Finance.

Successive French governments have argued that the fundamental problem with the eurozone lies in the lack of a separate budget to which the countries that use the single currency would contribute a few percent of their GDP. The budget could help eliminate - mainly by way of investment - the macro-economic disproportions that persist between the north of the zone (among them Germany, the Netherlands, Austria, and Finland) and the southern states (Italy, Greece, Spain, Portugal, and Cyprus). The French propose to have such a budget managed by a eurozone minister reporting to the European Parliament (supervised by e.g. MEPs from eurozone countries). President Macron has made the creation of the eurozone budget one of his main campaign promises. He appeared in Athens (September 7, 2017) and in the Sorbonne in Paris (September 26, 2017) arguing

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that the EMU needed a budget to support investment, reduce economic inequalities within the zone and respond effectively to economic shocks.

Ever since the establishment of the Economic and Monetary Union (EMU), Germany, which used ordoliberalism as the tenet of their policy, has opposed the creation of such mechanisms, rejecting the idea of a “transfer union”. The country remains equally skeptical about increasing the influence of European institutions (minister, parliament) on the zone’s economic policy at the expense of individual member states. In its opinion, the majority of the woes that have plagued the eurozone since late 2009 result from the failure of the southern states to observe the principles of responsible fiscal policy. Before adopting the eurozone budget, they would have to go through a painful process of economic reform and reduce their debt risk. Since the establishment of the EMU, Germany has opposed having the eurozone as a whole assume the obligations of its individual states. Therefore, many German economists and politicians criticize the European Central Bank which, inter alia, has been buying out government bonds of indebted eurozone countries since 2010. Despite German Chancellor Angela Merkel’s commitment to make compromises on changes in the eurozone, it is very unlikely that Germany would accept a separate eurozone budget.

This idea was opposed by Wolfgang Schäuble (CDU) during his time as finance minister and, in particular, during the Eurogroup meeting in October 2017. His successor, Olaf Scholz (SPD), although representing the party that favored Macron’s Plan more than any other in the Bundestag, is also likely to be against it. Scholz’s fraction of the Social Democrats views extensive eurozone reforms in a more moderate light. Following his assumption of the ministerial office, Scholz kept Schäuble’s main advisers. Days before Macron’s visit to Berlin, he argued that the French president was well aware that it was impossible to implement all of his proposals.

More importantly, the creation of a eurozone budget is opposed by the majority of MPs from the Merkel group, comprised of the CDU and the CSU, as well as the other parties in the German parliament, i.e. the FDP and the AfD. In her revealing statement regarding the budget made on April 16, 2018, which followed prolonged deliberations by the party’s management, CDU Secretary General Annegret Kramp-Karrenbauer announced that the creation of a eurozone budget and the appointment of a eurozone finance minister was not Germany’s priority at that time and that President Macron could not expect the country to alter its position in all matters. Kramp-Karrenbauer also admitted that she did not consider it appropriate to create a new budget as there already was an EU budget in existence.

The CDU, CSU and SPD coalition agreement of February 7, 2018 lacks direct references to the eurozone budget and only alludes to earmarking funds in the new EU financial perspective (2021-2027) for economic stabilization and the support of social convergence and structural reforms in the eurozone. Expectedly, therefore, Germany could support the current European Commission (EC) proposal to set up a dedicated eurozone budget line in the overall EU budget aimed not only at funding structural reform assistance and protection against asymmetric shocks in the single currency area but also at furthering convergence with non-member states and helping the concerned states to prepare for the adoption of the euro. Funding from this EU budget

line would certainly be conditional, as required by Germany, upon the beneficiary states adhering to financial discipline.

Germany, in its turn, has championed debates on transforming the European Stability Mechanism (ESM) into the European Monetary Fund (EMF). The relevant proposal was put forth in October 2017 by Minister Schäuble as an alternative to the French idea of establishing a eurozone budget. However, Germany did not want EMF assistance to take the form of permanent and unconditional transfers and envisioned it as mere stabilization loans that would be unlocked in crises provided that the beneficiary carries out major reforms. Paris considered this far from sufficient. During his election campaign, Macron argued that, at times of crises, the stabilization role of the ESM should be taken over by the eurozone budget. Both countries agree it is advisable to create the European Monetary Fund, although some commentators in France, including Rémi Bourgeot of the IRIS, believe that the idea, which appears to lack ambition from the French perspective, may appear to be overly radical to Minister Scholz. One can nevertheless presume that in the absence of a compromise on other issues, Germany will support the establishment of the EMF within the EC-proposed framework.

In principle, therefore, the Fund would operate like the ESM: it would be managed by a board of governors, requiring 85% of the shares for qualified majority. This would enable Germany, which currently holds over 26% of the shares, to block fund transfers. The fund would provide aid to any zone countries that fall into serious financial trouble and - as an additional function not available in the ESM - would provide a safeguard for the Single Resolution Fund (SRF), which constitutes the second pillar of the banking union. However, it is highly unlikely that the decision to establish the Fund will be taken during this term of the European Parliament scheduled to end in the second quarter of 2019. Especially that, as declared by Chancellor Merkel to CDU MPs (April 18, 2018), the ESM can only be transformed into the EMF if the European treaties are amended.

A challenge much greater than the EMF will be to reach a compromise regarding the third pillar of the banking union, which France would like to see completed as soon as possible. In connection with the eurozone crisis, the EU member states agreed to establish the Single Supervisory Mechanism (SSM) and the above-mentioned Single Resolution Mechanism, which have already been adopted. The third envisioned mechanism is the European Deposit Insurance Scheme (EDIS) designed to lend credibility to those European (and especially Italian) banks whose balance sheets feature too many bonds of states that pose a high insolvency risk. EDIS implementation has been delayed due, in part, to the skepticism of Germany and other northern eurozone members. CDU and CSU politicians are particularly unwilling to start talks on Germany's protection to the banks that are at risk of bankruptcy unless such banks refuse to significantly reduce the volume of bad loans they have extended at the expense of their own national (e.g. Italian) taxpayers.

In view of the differences of opinion on the systemic transformation of the EMU, the discussion regarding the appointment of the European Minister of Economy and Finance seems to be secondary. France proposes the position of a minister of the eurozone alone, who would report to the Parliament. This would limit the influence

of the European Council and individual European governments. Germany, however, prefers the idea proposed by President Jean-Claude Juncker, which is to appoint a Minister of Economy and Finance of the entire EU, combining in a single post the duties of a Vice-President of the European Commission and the President of the Eurogroup. Such a minister would report to the European Parliament without encroaching on the powers of the Member States, overseeing the spending of funds from the EU budget, compliance with economic laws and the activities of the European Monetary Fund. France considers these proposals to be insufficient and will most likely seek to increase the powers of the European Minister of Economy to enable him or her to work more effectively. Although the German coalition agreement does not mention the creation of such a post, the German Chancellor has expressed readiness to start talks on the matter. She will probably want to enshrine the rules governing the work of such a minister in European treaties, as postulated previously by Minister Schäuble.

Notably, Merkel has on many occasions raised the possibility of renegotiating European treaties with a view to modifying the eurozone. Such occasions included the aforementioned meeting with CDU MPs on April 18, 2018, the day before Macron's arrival in Berlin, and a press conference during his first visit to Germany on May 15, 2017. On the latter occasion, Merkel admitted that the eurozone needed strengthening in ways other than intergovernmental efforts and that "Germany would consider changes to the treaties as long as they were sensible". Meanwhile, France insists on speeding up decision-making capabilities and, where possible, would prefer to see new solutions adopted through intergovernmental agreements, which in fact was Merkel's original preference during the sovereign debt crisis in the eurozone. The launch of a treaty amendment procedure would entail referendums in many Member States and the possibility of either downright rejection or a significant delay in the implementation of the French proposals. This option is the least desirable for the Élysée Palace, which explains France's current effort to adopt tough reforms with the need to, among others, increase its credibility with European partners.

Paradoxically, a failure of Macron's plan for Europe could boost the popularity of the French politicians of the extreme right and left, who criticize further empowering EU institutions and who talk of a German dictate over Europe (Marine Le Pen and Jean-Luc Mélenchon, who - between them - garnered 42% of the vote in the first round of the presidential election). In Germany, in turn, the "transfer union" and the commonality of debt are opposed by the parties that directly compete for voter support with the CDU / CSU. The parties are, on the one hand, the anti-establishment AfD, positioned to the right of the Christian Democrats and, on the other, the center-right liberals of the FDP. It is therefore difficult to expect, in the face of resistance from conservatives in their own party and in the run-up to the state parliamentary elections in Bavaria scheduled for October of this year, that Merkel might make significant concessions regarding the eurozone in the wake of Macron's proposals. Besides, still to be convinced are the countries of the North, which, led by the Netherlands, in a document made public on March 6, 2018, strongly opposed the granting of further powers to EU bodies and the transformation of the ESM into the EMF. Other than the Netherlands, the signatories of the document included both eurozone countries, such as Finland, Ireland, Lithuania, Latvia and Estonia,

as well as those using their own currencies, namely Sweden and Denmark. Other non-eurozone states, among them Poland, lean toward the German model of fiscal and community policy, which is opposed to the French approach to European integration based on the concept of a two-speed Europe.

Merkel's statement, originally made during her first meeting with the new French president, was recalled on the occasion of Macron's recent visits to Strasbourg and Berlin. During that first visit, Merkel cited Hermann Hesse's line: "magic resides in every beginning" ("Jedem Anfang wohnt ein Zauber inne"). After Macron waited for Merkel's response for a year, commentators began to wonder just how much magic really remains in German-French relations. Macron is presumed to have hoped that his effort to reform France despite strong public opposition would spur Germany to make concessions on European matters. The German *Der Spiegel* asked rhetorically whether Merkel was not becoming "Madame Non" (April 16, 2018). The French press, in its turn, wrote about the end of a honeymoon and a return to reality, neither of which makes an agreement impossible. The view that an agreement might in fact be forged should not be underestimated, as both countries declare a strong commitment to engage in open dialogue.

The leaders of France's and Germany's top political parties may recall how concerned everyone was about the chances of Marine Le Pen winning the French national elections. The specter of the growing popularity of politicians skeptical towards the current design of the EU and the fact that the current term of the European Parliament is coming to an end raise the urgency of finding solutions that would demonstrate that the EU continues to be politically and economically appealing to the countries of both the South and the North. Therefore one may expect that Merkel and Macron will indeed propose ways to transform the eurozone at the June summit of the European Council. And yet, their proposal may resemble a roadmap rather than a package of ready-made solutions. In parallel, mainly on the initiative of France, work may be undertaken to amend EU legislation regarding key areas of the economy without disturbing the existing institutional order. Germany may see such amendments as less important, which may prompt it to make greater concessions to its French partner. An example is Berlin's support for the posted workers proposals. It is quite likely that in the future there are going to be considerably more matters of this kind that are also of importance to Poland and that nevertheless remain in the background of the eurozone debate.

The statements expressed herein reflect solely the opinions of its authors.

**Karol Janoś** - analyst at the Institute for Western Affairs, graduate from the Faculty of Journalism and Political Science and Interfaculty Individual Humanities Program of the University of Warsaw. His research interests include the foreign, security and defense policies of Germany.

**Jacek Kubera** - analyst at the Institute for Western Affairs, Ph.D., Sociologist and Romanist, author of works in sociology of migration, nations and ethnic relations, with research interests in French foreign policy and especially Franco-German relations.

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