

EU Economic Governance:

**The French
and German Views**

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Werner Mussler
and Stefaan De Corte

CREDITS

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Introduction

‘In every crisis there is opportunity’. This saying can be applied to the economic and financial crisis that Europe has been facing over the past three years. One could view the crisis as an opportunity to make up for past mistakes or past reluctance to do what was necessary. This was the approach adopted by the European institutions when they came up with their proposals on economic governance.

Although these proposals are innovative, they were not invented on the spot. They are the product of different, often diverging views on what a European model of economic governance should look like.

The Centre for European Studies (CES) has invited two authors, one French and the other German, to provide insight into the thinking of French and German policymakers when it comes to the issue of how the economic governance of the European Union should be organised.

In his contribution, Jean-François Jamet starts by describing France’s frustrations with Europe’s past economic governance. He then goes on to describe how the economic crisis has been perceived in France as a window of opportunity to make up for the missed opportunities of the past. Werner Mussler begins his article by explaining the different conceptions of economic governance held by France and Germany. He then describes how the German views of a monetary union and of the economic crisis have influenced the German conception of economic governance, and goes on to explain how they have shaped certain German propositions during the reform discussions. In the

last section of this debate paper, CES's Stefaan De Corte describes the European governance model as it has been and is being decided upon, before providing conclusions on several of its specific features.

EU economic governance: the French view

Jean-François Jamet¹

Summary

The economic crisis has forced European leaders to reopen the debate on European economic governance. Traditionally, France has emphasised the importance of closer cooperation on economic policy in the EU. This paper analyses the main structural factors that influence the French stance, notably its illiberal economic culture, characterised by the preference for government intervention; the importance given to discretion with regards to economic policy; the French fiscal position; the relationship with Germany; and the fear of decline in a globalised world. A spectrum of French perceptions and reflections on economic governance is presented, taking into account relevant positions of actors such as French public opinion, government, and political and economic elites. As a result, the 'French view' may be characterised by the following proposals for the reform of EU economic governance:

1. increased institutionalisation of macroeconomic policy coordination in the eurozone,
2. more comprehensive macroeconomic supervision,
3. strengthened financial regulation at the EU and international level,

4. growth-oriented economic strategy based on a European industrial policy, and
5. protection against perceived dumping from emerging economies.

Introduction

When Angela Merkel spoke in February 2010 about the need for a European economic government it came as a surprise to many observers. The European economic government was thought to be a French idea opposed by the Germans who saw it as a temptation to political interference in the independence of the European Central Bank (ECB).

The expression was indeed coined by François Mitterrand in 1990 based on the recommendation of the Delors report published in April 1989, which pointed to the need for closer cooperation on economic policy that would not be limited to monetary issues.² The idea was then pushed unsuccessfully by Mitterrand and his Prime Minister Pierre Bérégovoy during the negotiation of the Maastricht Treaty. In the preparation of the Treaty of Amsterdam, which created the Stability and Growth Pact (SGP) in 1997, then Prime Minister Lionel Jospin again promoted the idea, leading to the creation of the Eurogroup, a gathering of the Finance Ministers of Member States who share the euro.³ It remained largely an informal institution until the Lisbon Treaty. France has been more silent, however, regarding the precise definition of European economic government during the recent crisis. Its contribution seemed confined to President Sarkozy's proposal for a regular, official meeting of eurozone leaders to strengthen economic guidance.

Merkel's appropriation of the expression 'economic government' was probably a tactical move to take the initiative on the reform of economic governance and define its objective in accordance with the German view of a rules-based government. At the same time, it was a way to force France to go beyond the slogan and make more precise and practical proposals.

Together with the Greek crisis, Merkel's initiative led to a revival of the debate about European economic governance/government in France and beyond. A number of decisions had to be made: what kind of macroeconomic supervision, which crisis resolution mechanism, and what kind of medium-term growth strategy and political leadership? The issues were complex not only on economic grounds. It was also difficult to know what Member States could agree on and what was feasible within the legal framework of the Treaty. Finally, the articulation between the EU and the eurozone remained a question mark.

Several months later, a number of projects are on the table. The Commission has proposed a strategy for growth (Europe 2020) and made a comprehensive legislative proposal on macroeconomic supervision. A European Financial Stability Facility (EFSF) was created in May 2010 to provide financial assistance to eurozone states in difficulty. The European Council of 28–9 October 2010 agreed on a modification of the Treaty to create a permanent crisis resolution mechanism.

Has a clearer French view on EU economic governance emerged within this context? It is important to distinguish between the internal French debate and the position defended in Brussels by the French government. The former is influenced by political positioning in view of the upcoming

presidential election while the latter is developed taking into account the need to find a compromise at the European level. However, both are influenced by a number of structural factors. First, France has an 'illiberal' economic culture,⁴ meaning that the French are more afraid of market failures than government failures and have therefore developed a preference for regulation rather than a market-based economy. The economic crisis has been interpreted as proof that French mistrust of the market was justified and that the Anglo-Saxon neo-liberal finance-driven model was deemed to fail. Second, France traditionally gives more importance to discretion than Germany in the debate about economic policy, especially in times of crisis. While this position weakened when the financial crisis turned into a public finance crisis (the French government is now explicitly defending its AAA rating), France still has a larger view of economic governance than one based only on rules for macroeconomic supervision, and still believes in government-driven growth-oriented policies. Third, France is preoccupied with its role in the EU and by the competition for influence with Germany. The European project has been seen from the beginning as a way for France to project its power but this implies that compromises found at the European level are acceptable and do not put France in the minority. Support for European integration has recently been in decline in France as a result of a perception that French proposals (for instance, exchange rate policy, tax harmonisation, industrial policy and protection of services of general interest) are being marginalised. Finally, the French debate is animated by a fear of decline in the context of globalisation. De-industrialisation, offshoring and exposure to competition from emerging economies play an important role in public opinion.

This paper is organised as follows. Section one describes France's frustrated expectations vis-à-vis European economic governance. Section two explains that the crisis is being perceived in France as a window of opportunity to advance French-style economic governance. The article seeks to provide a spectrum of French reflections on economic governance and to identify common features and differences that emerge from an examination of the positions of relevant actors, notably French public opinion, government, and political and economic elites.

French frustrated expectations vis-à-vis European economic governance

The lost second pillar of the Economic and Monetary Union

While Germany prefers stable and automatic rules and automatism, France views rules as one of many instruments. It also sees a need to respond to economic cycles, which means that some importance must be attributed to discretionary policies supporting growth and employment.

In 1989, the Delors Report⁵ emphasised the need to extend European economic policy beyond monetary policy and, therefore, proposed increased coordination of economic policies among Member States. The Economic and Monetary Union (EMU) could not rest only on a monetary pillar (the single currency and the monetary policy of the European Central Bank) but needed a framework to make decisions on broader economic policy issues. This 'second pillar' of the EMU was not, however, part of the compromise

found in Maastricht. Germany agreed to give up the Deutschmark but imposed its culture of economic stability based on rules, implying that an independent ECB should not be exposed to political pressures that might come from a European economic government.

From a French perspective, the economic pillar of the EMU was therefore lost in Maastricht. Subsequent attempts to restore it, such as the negotiation of the Amsterdam Treaty, were only partly successful and institutionalised to a limited extent. The Eurogroup and the macroeconomic dialogue indeed remained two very informal forums for discussion. Recently, Jacques Delors⁶ drew attention to the fact that it is important that citizens understand that the urgent need to intervene and reform is not only a result of the Greek crisis, but also partly a response to a very weak and inefficient Eurogroup.

France traditionally prefers government rather than rules-based governance, which is perceived as suffering from a democratic deficit.⁷ There is, for instance, a certain mistrust towards the ECB because its prime objective, keeping inflation low, is seen as leading to unnecessarily reduced activity and employment⁸ as well as deflationary risks.⁹ Many French economists and politicians¹⁰ favour a democratic institution that would counterbalance the ECB and to which the ECB would be accountable, along the model of the relationship between the US treasury, the Congress and the Fed. France would also like to see a greater importance attached to an exchange rate policy, a view supported by Jean-Pierre Jouyet¹¹ (who was the French Minister of European Affairs during the French presidency of the EU in 2008), Louis Gallois (EADS' CEO), and the Conseil d'analyse économique.¹²

Moreover, there is a clear French preference for discretion. In this view, in order to be able to respond adequately to different economic cycles, not only monetary policy but also fiscal policy needs to play a central role.¹³ In a heterogeneous and, therefore, also sub-optimal monetary union, national fiscal policies must play a countercyclical role to dampen the asymmetric shocks that affect some Member States more than others. In this context, the 3% deficit rule has been perceived as both too tight (in periods of economic downturn) and too lax (when the economy is booming).¹⁴ This perception was revived by the economic crisis. The French government and most French economists have emphasised the importance of fiscal stimulus and proposed the coordination of stimulus policies at the European level.¹⁵

Another aspect of the discussion of the missing economic pillar of the EMU is the debate about the European budget. Traditionally, the French thought the EU budget too small.¹⁶ More recently, however, in line with the general climate of austerity, and taking into account the fact that France has become a net contributor to the budget, the government has been reluctant to increase the EU budget.¹⁷

The internal market: French priorities denied EU dimension?

The French are more reluctant to trust their fellow citizens and institutions than other Europeans.¹⁸ This mistrust can be closely linked to the functioning of the French social model, based on corporatist rules which are detrimental to social dialogue and the transparency of solidarity mechanisms. The weakness of social dialogue and the mistrust vis-à-vis the market in turn justify government intervention,¹⁹ which often

consists of defining protective regulations, redistributing revenues and awarding special status to interest groups, thereby reinforcing corporatism.

Since the French favour government intervention in the economy, French priorities include social policy, industrial policy, tax harmonisation and services of general interest, all elements they want developed at the European level but which have been put on hold, to French dismay. One exception can be found in the Common Agricultural Policy (CAP), which still represents a large part of the European budget.

An analysis of the French 'no' to the referendum on the European Constitution in May 2005 shows the underlying factors governing the French perception of the EU.²⁰ Roughly two-thirds of the no vote came from left voters, mainly affiliated with the French Socialist Party (Parti Socialiste, PS).²¹ Left leaders calling for a 'no' emphasised the danger that the Constitution posed to French social benefits. Observers commenting on the no vote focused on the importance of the social climate in France and workers' discontent with the politics of the French government at the time.²² In addition, the fierce debate about the 'Bolkestein' directive²³ on the liberalisation of services played a significant role, as it was associated with the fear of 'social dumping'.²⁴ Many in France saw the 'ultra-liberal' approach by Brussels as a direct threat to their social rights.²⁵ This was an important element to the French 'no' as France seemed increasingly in a minority in the debates over liberalisation policies.

Further disagreements with Brussels over issues inherently linked to French culture, such as the production of rosé

wine,²⁶ led to the French raising doubts about whether internal market policies could achieve better outcomes than national policies, or whether they were rather a threat to French aspirations.

French mixed feelings about the euro

Even if there is no consensus in the French elite on the benefits of the EMU and the internal market, one can argue that the way they developed actually led to some frustrations in France. More generally, a vague feeling of disenchantment towards European economic governance has developed.

According to polls, the French already had mixed feelings regarding the definitive adoption of the euro in 2002.²⁷ In fact, the difficult adoption of the Maastricht Treaty²⁸ in 1992 revealed reluctance from a significant segment of the French vis-à-vis a single currency and the development of the EMU.²⁹ After 2002, the euro³⁰ was perceived as the main cause of a weaker purchasing power³¹ as, after steadily increasing from 1998 to 2002 by about 3% per year,³² purchasing power faltered from 2002 onwards. This correlation opened the doors for Euro-sceptics. The perception of the euro as inflationary undeniably weighed on its general image.³³

In remarkable contradiction with this perception, many French also believe that the focus of the ECB on its inflation target and its refusal to consider debt monetisation are ideological and come at the expense of economic activity and employment. Criticism used to come from the French far-left such as Le Nouveau Parti Anticapitaliste (NPA) and

the anti-globalist group Attac,³⁴ asking for an end to ECB independence. More recently, leaders of centre-right parties have also criticised the ECB's policy: Nicolas Sarkozy has focused on its interest rates³⁵ and Nicolas Dupont-Aignan³⁶ on its independence. These criticisms have led to a loss of trust in the ECB. As a Eurobarometer poll pointed out in September 2009,³⁷ a majority of the French interviewed did not trust the ECB.

As a result, the perception of the euro in France has become negative. The German Marshall Fund's poll shows that only 33% of the French interviewed thought that the euro was good for the economy.³⁸

Revised French expectations about European governance

In nearly 60 years, the French perception of the European project has radically changed. Expectations have decreased, especially with regard to economic governance. Initially, one of the main reasons explaining French support for a strong European Union was its own objective of becoming stronger.³⁹ The European Union was seen as a power multiplier (*multiplicateur de puissance*) for France.⁴⁰ However, the EU was increasingly perceived as a constraint to power politics. For instance, French businessmen were 'irritated' by competition rules or environmental and health standards that they considered too tight and detrimental to France's competitiveness. In fact, Europe is now perceived by some as a straightjacket.

The French preference for a federalist type of economic governance is also declining and a shift towards a more

intergovernmental vision has taken place. Typically, according to President Sarkozy, economic governance is a matter for heads of state and he argues that priority should be given to the Council, a view emphasised during the French presidency in 2008. Defiance and mistrust of the European Commission (EC), seen as a purely bureaucratic institution disconnected from citizens' preferences, have increased. The French socialists' programme is no longer openly federalist and even Commissioner Michel Barnier remarked that 'the EU is a community of nation-states . . . We will never be a nation, a European people.'⁴¹

Nevertheless, exceptions do exist and can be illustrated by the European project of Les Verts/Europe Ecologie⁴² and the recent creation of the Spinelli group⁴³ on the initiative of French Members of the European Parliament (MEPs).

Essentially, one can say that France fears being in the minority within the EU. The French have realised that according to the 'democratic rule', decisions can be imposed without their agreement. This leads them to believe that important matters should not be decided at the European level. In other words, there is little reason to 'invest' in the EU. Nevertheless, even if this fear exists, the EU remains an essential component in the plans of the French government and elites. They have perceived the economic crisis as an opportunity to push a reform agenda that is more consistent with French preferences on economic governance.

The crisis as an opportunity: a renewed claim for French-style economic governance

The French position in the current debate about the reform of European economic governance

Reinforced supervision. During the Greek crisis, France and Germany presented conflicting proposals. France originally refused the intervention of the International Monetary Fund (IMF) and recommended direct aid to Greece. In contrast, Germany envisaged the possibility of excluding a Member State from the eurozone, initially refused a bailout plan for Greece and requested that any aid plan be decided by the EU rather than by eurozone countries with the active involvement of the IMF. A compromise was finally reached under pressure from financial markets on 9 May 2010 to provide conditional loans to Greece with the financial and technical support of the IMF. Since the Greek crisis, several proposals have been made to reform European economic governance based on an agreement on the need for reinforced economic and financial supervision. In a Franco-German paper⁴⁴ published in July 2010, followed by a common declaration on the occasion of the Deauville summit in October 2010, agreement was reached between France and Germany on economic and political sanctions for countries which did not respect the Stability and Growth Pact. Even the suspension of voting rights in the Council was approved by the French government.⁴⁵ However, the proposal did not find enough support during the European Council of 28–9 October 2010.⁴⁶ More generally, the French government supports the reinforcement of multilateral budgetary surveillance through a better coordination of national fiscal policies and the SGP,⁴⁷ although this view has

been criticised by left parties which see strict austerity measures as a threat to the economy.⁴⁸ On the contrary, enlarging supervision to aspects of competitiveness, structural reforms, private debt and financial stability seems uncontroversial in France. This has led the French government to support the German proposal of a competitiveness pact demonstrating the commitment of European leaders on that point. This pact has been endorsed by the European Council on 25 March 2011 under the name 'Euro-Plus Pact' and the 23 governments that have signed it will hold a summit to assess the results of its implementation.

From the French point of view, tackling imbalances at the European level should include efforts towards tax harmonisation. The French government has taken steps in that direction by putting pressure on Ireland to accept a harmonisation of the corporate tax base and by announcing that it intends to make France's tax policy similar to the German model. At the same time, the French government has recommended action against excessive surpluses by supporting domestic demand,⁴⁹ a subject of disagreement with the German government, which considers that deficit countries should reform their economies rather than asking Germany to underperform.

After some initial misunderstandings, the European Commission's proposal of a 'European semester', where all Member States present their budgets to the Commission starting from March 2011, has been endorsed by the French Parliament.⁵⁰ An influential French MEP, Alain Lamassoure, has even proposed that the review should include a comparison of the largest spending categories in order to better assess the Member States' commitment to the SGP

and the Europe 2020 strategy. He also supports the creation of an interparliamentary conference which would ensure that national parliaments own the review of national budgets and allow the exchange of best practices.⁵¹

A crisis mechanism. The French government and most French economists have supported the creation of a crisis resolution mechanism.⁵² There have been discussions about what such a mechanism should look like and whether it should be modelled along the lines suggested by the German government. In March 2010, German Finance Minister Wolfgang Schäuble proposed a European Monetary Fund in order to be able to provide emergency liquidity aid to reduce the risk of default by eurozone Member States who find themselves in financial trouble. However, the French government was opposed from the beginning to the creation of a European Monetary Fund despite its support of the creation of the EFSF and the fact that the idea first appeared in France.⁵³ There are two reasons for this: first, the French government is reluctant to give the impression that it wants to create a regional competitor to the IMF in the context of its G-20 presidency; second, it is concerned that envisioning a sovereign default in the eurozone, as supported by Mayer and Gros in the most detailed proposal for a European Monetary Fund so far,⁵⁴ would lead to financial markets requesting higher-risk premiums on government bonds, or that a default could weaken European banks. Nevertheless, France has supported the creation of a European Stability Mechanism (ESM), which renders the EFSF permanent.

Financial regulation. Early on in the crisis, France made the reform of financial supervision its priority. This explains why France negotiated the seat of commissioner in charge of the

internal market and financial services, which is now held by Michel Barnier. The French government has pushed for the creation of a supranational framework using European authorities, as proposed by Commissioner Barnier. As a result, the European Systemic Risk Board and three other European agencies have been created. Furthermore, the Commission announced it would propose a package on a new EU framework for crisis management in the financial sector during 2011.⁵⁵ France, alongside Germany, also backs a European financial transaction tax. The French government is also trying to push this proposal in the context of the G-20 presidency, which is at the top of President Sarkozy's 2011 economic agenda.

French advocacy of an enlarged conception of economic governance

In the current debate about the reform of European economic governance, France is also pushing for an enlarged concept of economic governance.

An emphasis on growth. Traditionally, France has placed the accent on growth rather than stability. Recently, it has advocated a more ambitious European industrial policy.⁵⁶ Jacques Delors has even recommended the creation of a European Energy Community.⁵⁷ At the Commission level, the Single Market Act, proposed by Commissioner Michel Barnier⁵⁸ to relaunch the European Single Market, is particularly focused on small business.⁵⁹ It is also explicitly linked to the Europe 2020 flagship initiatives on industrial policy and innovation. This illustrates a shift in the way the single market is understood.

More generally, there have been several proposals in France to increase resources for European projects. A recent report by the French Assemblée Nationale⁶⁰ advocates an investment strategy at the EU level.⁶¹ In the context of a constrained EU budget, it supports President Barroso's proposal of European borrowing for EU projects and calls for a 'grand emprunt européen', a proposal supported by the main political parties. Unlike the French government, the Socialist Party and Europe Ecologie also recommend an increase in the EU budget and the establishment of a European carbon tax. On the centre-right side, Alain Lamassoure advocates an increase of EU resources using national contributions to EU projects. Finally, several French economists have advocated the creation of Eurobonds, i.e. the pooling of government debt within the euro area, either to provide the resources for projects or to reduce borrowing costs faced by Member States.⁶²

French protectionism? The claim for fair trade

French opinion increasingly favours some kind of protection against what is perceived as 'unfair' competition from emerging economies.⁶³ In a recent Eurobarometer poll,⁶⁴ only 39% of people interviewed responded that they benefit from international trade, a low figure explained mainly by the belief that international trade creates unemployment and reduces the quality of products. Moreover, 60% of those interviewed were prepared to pay more for products or services from companies that respect the environment and 57% would pay more for products or services from companies that respect labour rights and apply high social standards.

As a result, many parties, including the centre-right Union for a Popular Movement (Union pour un Mouvement Populaire, UMP) and the Parti Socialiste, promote a new form of European protectionism. Sarkozy's advocacy of the *préférence communautaire*⁶⁵ played an important role in the 2007 presidential campaign. According to President Sarkozy, the EU should protect citizens⁶⁶ from the threats of globalisation. In this view, the EU should create a European industrial policy protecting European businesses and promoting its champions.⁶⁷ Similarly, French socialists denounce social and environmental dumping and argue for a *juste échange* (fair trade).⁶⁹ Concretely, this means establishing social and environmental taxes on imports from countries that do not respect social and environmental standards.

Conclusion: room for compromise?

Despite the absence of consensus on certain issues, the French view on economic governance is relatively consistent. It favours:

1. an increase in the degree of institutionalisation of macroeconomic policy coordination in the eurozone,
2. more comprehensive macroeconomic supervision,
3. a strengthened financial regulation at the EU and international level,
4. a growth-oriented economic strategy based on a European industrial policy, and

5. protection against perceived dumping from emerging economies.

The French government's priority in 2011 is the G-20 presidency. In that respect, it will need the European economic agenda to move forward. It will also seek the support of its European partners, especially Germany and the UK. It is therefore probable that France will seek compromise on the main issues with regard to European economic governance: reinforced economic policy coordination, convergence in competitiveness and advancement of the financial regulation agenda. In the medium term, the question of the European strategy will become more important and France is likely to support the Commission's flagship innovation and industrial policy initiatives. Alongside structural reforms, a compromise could also be sought around the definition of a European investment strategy, involving actions both at the EU and Member State level, which would add a second, growth-oriented pillar to the reform of European economic governance, and may help to reduce intra-European imbalances as well as to avoid a double-dip recession. However, as the 2012 presidential election approaches, French politicians are also more likely to move protectionism to the fore or take a tough stance with regard to the EU budget.

NOTES

- 1 I am very grateful to Fanny Brûlebois and Famke Krumbmüller for their excellent research assistance and to Nicolas Jabko for the discussions we have had on the subject.
- 2 For an analysis of the history of the concept of European economic government, see F. Layer, *La gouvernance économique de l'Europe* (Paris: L'Harmattan, 2006).
- 3 Eurogroup meetings are also attended by the Eurogroup president, the commissioner for economic and monetary affairs and the president of the European Central Bank.
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- 14 P. Artus et al., *Réformer le Pacte de stabilité et de croissance*, Rapport du Conseil d'analyse économique 52 (Paris, 2004).

- 15 J. Pisani-Ferry, A. Sapir and J. von Weizsäcker, 'A European Recovery Programme', Bruegel Policy Brief (November 2008).
- 16 A view especially represented by Alain Lamassoure—see for instance A. Lamassoure, 'L'autre crise de l'Europe : le budget commun', in T. Chopin and M. Foucher (eds.), *L'état de l'Union 2008. Rapport Schuman sur l'Europe* (Paris: Lignes de Repères, 2008), 39–43—Jacques Delors and the left-wing parties.
- 17 See Council Conclusions from the end of October 2010, where France, together with countries such as the UK and Italy, agreed not to increase the EU budget by more than 2.9%.
- 18 Y. Algan and P. Cahuc, *La Société de défiance* (Paris: Editions Rue d'Ulm, 2007), 20 and 67.
- 19 Ibid. 42–3.
- 20 For speeches by key people from the different parties, see 'Le référendum du 29 mai 2005 sur le projet de Constitution européenne', *Vie publique*, 9 May 2005, accessed at <http://www.vie-publique.fr/actualite/dossier/referendum-europe-29-mai-2005/referendum-du-29-mai-2005-projet-constitution-europeenne.html> on 13 November 2010.
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- 27** See Ipsos, 'Euro : monnaie unique, opinions plurielles', (2002), accessed at <http://www.ipsos.fr/Canalipsos/articles/1045.asp> on 13 November 2010.
- 28** Results for the French referendum on the ratification of the Maastricht Treaty in 1992: 51.04% yes, 48.96% no. For details consult the French Interior Ministry Web site: http://www.interieur.gouv.fr/sections/a_votre_service/resultats-elections/rf1992/000/000.html.
- 29** I. Ramonet, 'Survie', *Le Monde diplomatique* 474 (1993), 1.
- 30** Some academics argue that there is no link between the decrease in purchasing power and the establishment of the euro. De Silguy, former EU Commissioner for Economic and Financial Affairs, has stated, 'The idea that the decline in consumers' purchasing power is a result of the euro is a myth.' See 'De Silguy: "Decline in purchasing power is not the euro's fault"', *EurActiv*, 19 January 2009, accessed at <http://www.euractiv.com/en/euro/silguy-decline-purchasing-power-euro-fault/article-178590> on 13 November 2010.
- 31** '57% des Français accusent l'Euro', *Le Nouvel Observateur*, 23 June 2006, accessed at <http://tempsreel.nouvelobs.com/actualite/economie/20080128.OBS7639/57-des-francais-accusent-l-euro.html> on 14 November 2010.
- 32** See the French Senate report, 'L'évolution du pouvoir d'achat des ménages : mesure et perception', Service

des Études économiques et de la Prospective
Délégation pour la planification, December 2006,
accessed at
http://www.senat.fr/commission/planification/notes/evolution_pv_achat.pdf on 17 May 2011.

- 33** C. Lemonnier, 'L'Union monétaire, l'euro et l'opinion publique', *Bulletin de la Banque de France* 171 (2008), 74.
- 34** A criticism of the independence of the ECB by the French anti-globalist organisation Attac can be accessed at
<http://local.attac.org/paris15/documents/reflexion/CR8-6.html>.
- 35** On that point, see AFP, 'Sarkozy regrette la hausse des taux de la BCE', *Le Point*, 5 July 2008, accessed at
<http://www.lepoint.fr/actualites-politique/sarkozy-regrette-la-hausse-des-taux-de-la-bce/917/0/258236> on 17 May 2011.
- 36** Nicolas Dupont-Aignan is a French MP and a declared candidate for the 2012 presidential election. His positions on the euro and the ECB are presented on the web page 'Agonie de l'euro : les eurocrates au bord de la crise de nerfs !' accessed at
<http://blog.nicolasdupontaignan.fr/post/2010/05/18/Agonie-de-l-euro-%3A-les-eurocrates-au-bord-de-la-crise-de-nerf-!> on 14 November 2010.
- 37** Eurobarometer 72 / QA14.4, September 2009.

- 38** The German Marshall Fund of the United States, *Transatlantic Trends 2010* (2010), accessed at www.gmfus.org/trends/doc/2009_English_Key.pdf on 14 November 2010.
- 39** See Z. Brzezinski, *Le grand échiquier : l'Amérique et le reste du monde* (Paris: Bayard, 1997), 91–2 and M. Foucher, *La République européenne* (Paris: Belin, 2000).
- 40** Y. Bertoincini and T. Chopin, *Politique européenne : états, pouvoirs et citoyens de l'Union européenne* (Paris: Dalloz, 2010), 67.
- 41** J.-M. Lamy, 'Alchimiste à Bruxelles', *Le Nouvel Economiste*, 1 October 2010, accessed at <http://www.lenouveleconomiste.fr/la-fonction-de-commissaire-europeen/> on 17 May 2011.
- 42** See P. Canfin, *Le Contrat écologique pour l'Europe* (Paris: Les Petits Matins, 2009).
- 43** See The Spinelli Group, 'Manifesto', accessed at <http://www.spinelligroup.eu/manifesto/> on 17 May 2011. Sylvie Goulard and Daniel Cohn Bendit are among the founders of the group.
- 44** C. Lagarde and W. Schäuble, 'Gouvernement économique européen : papier Franco-Allemand', accessed at <http://www.economie.gouv.fr/actus/pdf/100721franco-allemand.pdf> on 14 November 2010.
- 45** See Assemblée Nationale, 'Audition de Mme Christine Lagarde du 19 May 2010', *Compte-rendu* 150, 6;

accessed at http://www.assemblee-nationale.fr/13/europe/c-rendus/c0150.asp#P5_228 on 14 November 2010. Furthermore, French UMP MPs address the question of sanctions in their proposal ‘Propositions en vue de l’établissement d’une gouvernance économique de l’Union européenne’, accessed at <http://www.deputes-ump.fr/>.

- 46** See the Conclusions of the European Council of 28–9 October 2010 at www.consilium.europa.eu.
- 47** This view is shared by most French political parties such as Parti Socialiste, Europe Ecologie, MoDem and UMP. Some economists argue instead for more decentralised surveillance, for instance, through an independent fiscal committee and constitutional rules—see for instance, J. Delpla, *Réduire la dette grâce à la Constitution : créer une règle budgétaire en France*, Fondation pour l’Innovation Politique (Paris, 2010)—a path partly followed by the French President, who agreed to a constitutional rule but not to an independent fiscal committee.
- 48** See T. Coutrot et al., ‘Manifeste des économistes atterrés’, *Le Monde*, 15 September 2010, and the column published by M. Aubry and S. Gabriel, President of the German SPD, ‘Pour une relance progressiste du projet européen’, *Le Monde*, 14 July 2010.
- 49** In March 2010, French Minister of Economic Affairs Christine Lagarde urged Germany to tackle its surplus and to boost domestic demand because otherwise it would endanger the competitiveness of its European partners. See the following articles in *Der Spiegel* and

Le Monde:

<http://www.spiegel.de/international/europe/0,1518,683567,00.html> and

http://www.lemonde.fr/economie/article/2010/03/15/zone-euro-christine-lagarde-s-en-prend-a-la-politique-economique-allemande_1319150_3234.html.

- 50** The French National Assembly endorsed the principle of a European semester. See Assemblée Nationale, 'Rapport d'information sur le gouvernement économique européen', Rapport d'information 2922, 27 October 2010, accessed at <http://www.assemblee-nationale.fr/13/europe/rap-info/i2922.asp> on 14 November 2010. The French UMP MPs addressed this principle in their report 'Propositions en vue de l'établissement d'une gouvernance économique de l'Union européenne', accessed at <http://www.deputes-ump.fr/> on 13 November 2010.
- 51** A. Lamassoure, 'Budgetary Crisis: How Can We Protect the Future of Europe?', European Issues. Policy Papers of the Robert Schuman Foundation 181, Fondation Robert Schuman (2010), accessed at http://www.robert-schuman.eu/print_qe.php?num=qe-181 on 13 November 2010.
- 52** France supported the German request for a modification of Article 136 of the Treaty on the Functioning of the European Union to create such a mechanism at the European Council of 28–9 October 2010. A concrete proposal was put forward by an influential French economist, Jean Pisani-Ferry. See F. Gianviti et al., 'A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal', Bruegel Blueprint Series, 9 November 2010.

- 53** S. Cossé and G. Klossa, 'Pour un Fonds monétaire européen', *Les Echos*, 27 February 2009, 15.
- 54** D. Gros and T. Mayer, *Towards a Euro(pean) Monetary Fund*, Centre for European Policy Studies, 17 May 2010.
- 55** For the European Commission's position on crisis management, see http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm.
- 56** Présidence de la République française, 'Vision du Président de la République pour l'Europe', accessed at <http://www.elysee.fr/president/les-dossiers/europe/la-vision-du-president-de-la-republique-pour.9580.html> on 7 November 2010.
- 57** J. Delors, 'A Call for a European Energy Community', foreword in S. Andoura, L. Hancher and M. Van Der Woude, 'Towards a European Energy Community: a Policy Proposal', *Notre Europe Studies & Research* 76 (2010).
- 58** On 27 October 2010, the European Commission presented the Single Market Act. The press release and the act are available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1390&format=HTML&aged=1&language=EN&guiLanguage=en>; accessed on 13 November 2010.
- 59** Part 1 of the Single Market Act is entitled 'Strong, Sustainable and Equitable Growth for Business'.

- 60** Assemblée nationale, 'Rapport d'information sur le gouvernement économique européen' (see n. 52 above).
- 61** On the same subject, see the European Parliament, 'Report on the Financial, Economic and Social Crisis: Recommendations Concerning Measures and Initiatives to be Taken', draft final report, 17 March 2011, accessed at <http://www.europarl.europa.eu/activities/committees/draftReportsCom.do?language=EN&body=CRIS> on 17 May 2011. The rapporteur was a French socialist MEP, Pervenche Berès. See also J.-F. Jamet and G. Klossa, 'A Europe that Dares, in the Interest of Europeans' (Paris: EuropaNova, May 2010), available at <http://www.jf-jamet.eu/upload/europe-that-dares-jamet-klossa.pdf>.
- 62** See for instance J. Delpla and J. von Weizsäcker, 'The Blue Bond Proposal', Bruegel Policy Brief, May 2010.
- 63** Although most French economists reject protectionism, Maurice Allais, a French Nobel Prize laureate in economics, explicitly advocated it. See M. Allais, *La Mondialisation : La destruction des emplois et de la croissance : l'évidence empirique* (Paris: Clément Juglar, 1999).
- 64** Eurobarometer, 'International Trade', Special Eurobarometer 357, November 2010.
- 65** For a better understanding of Sarkozy's view on the 'préférence communautaire', see http://archives.u-m-p.org/propositions/?id=05_preference_communautaire.

See also ‘Nicolas Sarkozy plaide pour une préférence communautaire agricole renouvelée’, accessed at <http://www.euractiv.fr/priorites-de-lue-elections/article/nicolas-sarkozy-plaide-pour-une-preference-communautaire-agricole-renouvelee-000775> on 13 November 2010.

- 66** In his inaugural speech, Sarkozy said, ‘Je me battrai pour une Europe qui protège’ (I will fight for a Europe that protects). Discours d’investiture, Paris, 16 May 2007, available at http://www.elysee.fr/president/mediatheque/videos/2007/mai/discours-d-investiture-du-president-de-la.4734.html?search=discours+investiture&xtmc=discours_investiture&xcr=.
- 67** Présidence de la République française, ‘Vision du Président de la République pour l’Europe’, accessed at <http://www.elysee.fr/president/les-dossiers/europe/la-vision-du-president-de-la-republique-pour.9580.html> on 7 November 2010.

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EU economic governance: the German view

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Summary

When the financial and economic crisis in the EU became a general debt crisis in some of its Member States, they disagreed both on how to react in the short run and on how to reform the rules of the monetary union to stabilise the euro in the long run. The German government played a crucial role in both discussions: First, it prevented the impulsive granting of financial aid to the ailing countries and insisted on the involvement of the International Monetary Fund (IMF). Second, after the European Financial Stability Facility (EFSF) was established, it called for far-reaching reforms of the Stability and Growth Pact to prevent another crisis. Last, it cut a strange deal with France to amend the European treaties. France was rewarded with only a modest strengthening of the pact. The behaviour of the German government in the crisis was striking in at least three aspects. Its political style was unusually rude, and it was considered by some other Member States to be impertinent and obstinate. Although it clearly asked for a far-reaching reform of the stability pact, it avoided an explicit position on economic governance in a more general sense, and it clearly dismissed any notion of *gouvernement économique*. It demanded an amendment of the European treaties without specifying why it was needed. This behaviour can be explained primarily by domestic pressure. First, the German public knew well enough that Germany would become the main paymaster for any

European assistance. Second, and most important, the aid measures were rightly considered as a breach of the central principles of the monetary union on which Germany had insisted when the euro was created. Particularly, the no-bailout clause was breached, and the independence of the European Central Bank endangered. These developments implied a legal probability: the German Constitutional Court, which had set limits to European integration on several occasions, could annul any aid decision as a breach of the Treaty.² This explained the call for a Treaty change.

Differing terminology and different conceptions

When the heads of state from the euro area agreed on emergency assistance for Greece in March 2010, they agreed at the same time that the ‘economic governance of the European Union’³ had to be improved. Their common understanding was that the institutional framework of the currency union should be amended to prevent an event like the Greek crisis from recurring. The creation of the task force led by the President of the European Council, Herman Van Rompuy, was the logical consequence. However, the heads of state disagreed from the beginning on what should be improved.

The discord was apparent even in the text of the heads of states’ conclusions. The neutral wording of ‘economic governance’ in the English version differed considerably from the French version, which asked for the reinforcement of a *gouvernement économique*,⁴ and from the German version, which referred to the need for more *wirtschaftspolitische Steuerung*.⁵ From a German perspective, the three terms do not have anything like the same meaning. And it seems clear

what *gouvernement économique* means: a concept of French interventionism which has to be rejected. In contrast, the English and the German versions seem more to conceal than to explain what they mean. These technocratic phrases lack content and are neither translatable (the English version) nor used (the German version).

The differences are more than merely semantic. They document the far-reaching disagreement between Germany and France in fundamental questions of economic and monetary policy, including the role of the state. Before assessing the underlying conceptual differences, we need to explain the political (or even historical) background of the differences in wording. They reflect two different debates, even if these debates are clearly linked. The first followed the decision to establish a currency union in the early 1990s, and referred to the potential influence of politics on the central bank. The second debate arose in the financial and economic crisis, and refers more generally to the reform of the institutional framework of the euro area.

The starting point of the first debate was that France could not accept the idea of an independent central bank with no political constraints. In the wake of the Maastricht Treaty, the idea of *gouvernement économique* was to establish a political counterpart to the European Central Bank (ECB) in order to politically determine (or at least influence) monetary policy. France principally disagreed with the institutional model of the ECB established by the Treaty since it followed the model of the Bundesbank. The dissent was based on a differing understanding of what a central bank should do.

The German interpretation was (and is) that the ECB's only objective should be to maintain price stability, and the central

bank should pursue this objective without political interference. From the French perspective, it is up to democratically elected politicians (representing the *volonté générale*) to execute every policy, including monetary policy. An independent authority like the ECB, obligated only by abstract rules, is incompatible with this idea. Consequently, the French concept does not allow for a one-dimensional approach to monetary policy. It calls for a central bank which not only tries to maintain price stability but also pursues objectives such as boosting economic growth. If there were a trade-off between the two objectives, it would be up to the political actors to weigh in favour of one or the other.

Since France could not prevent the establishment of an independent central bank under the Treaty, the government in Paris always called for a *gouvernement économique* in order to contain the ECB.⁶ The idea was to establish a powerful institution at the eurozone level which represented the political will of Member States and could weaken the position of the ECB. The launch of the eurogroup (consisting of the Finance Ministers of the eurozone) did not really meet the French requirements.

France has maintained this first concept of *gouvernement économique* to date. Since its point of reference was monetary policy, it applied to the eurozone rather than to the EU as a whole. French calls for *gouvernement économique* gained momentum again when the financial crisis erupted. President Nicolas Sarkozy, who presided over the Council of the EU at the peak of the crisis in the second half of 2008, further promoted the idea by convening an extra summit of the heads of state of the eurozone in Paris in October 2008.⁷ He argued that this unprecedented meeting was necessary given the political challenge created by the crisis. At the

same time, however, he called for making this special type of eurozone meeting a permanent fixture. This proposal not only divided the EU into important (euro) and unimportant (non-euro) countries, it also aimed at destroying (or at least marginalising) the eurogroup. Sarkozy's idea obviously was that the heads of state would have more power to restrict the ECB than the eurogroup.

Although his suggestion about the eurozone meetings failed at first,⁸ Sarkozy continued to put pressure on the ECB. He claimed victory in May 2010 when the European Council decided to establish a European rescue mechanism for ailing euro states. The decision included the commitment of the ECB to purchase government securities henceforth. At his press conference afterwards, Sarkozy proclaimed that he had achieved a *véritable gouvernement économique* for the eurozone. What he meant was that the independence of the ECB had been broken at last.⁹

Even if France still sticks to this narrow interpretation of *gouvernement économique*, the term is currently being used somewhat differently, particularly in the English and German versions. In its alternative meaning, 'economic governance' comprises more or less the whole legal and institutional framework which is considered necessary to prevent financial or economic crisis. The somewhat cloudy term 'economic governance' was introduced by the European Commission issuing its first of several communications in May 2010.¹⁰ All communications, (non-)papers and reports issued by different European institutions used the same term. The different translations reflect the different interpretations of what should be reformed. France still aims at a *gouvernement économique* in the first sense, whereas Germany aims at something else.

When assessing the German position, one has to distinguish between its conceptual basis and the political pragmatism that its leading representatives observed in the crisis. Over the past two years, German policy withdrew considerably from what may be called the German model of monetary union. However, the attitude of the federal government—which was criticised several times by other Member States—can only be understood in the context of its background. We present this model in section two. In section three, we discuss the perception of the crisis in the German public before assessing the role of German policy in the reform discussion in section four. In section five, we focus on the German effort to redirect the discussion on economic governance towards a new—institutional—meaning. Section six concludes this paper.

The German conception of monetary union: a rules-based approach

Ordnungspolitik is a German invention, and it seems impossible to translate the term.¹¹ However, the concept considerably influenced the institutional framework of the EU, particularly its competition rules; and the model of a ‘social market economy’, which is based on the political philosophy of Ordoliberalism from the Freiburg School, found its way into the Lisbon Treaty.¹² In a nutshell, *Ordnungspolitik* is a rules-based approach to politics. It defines abstract rules as an institutional framework for economic activity, applicable ‘to an unknown and indeterminable number of persons and instances’.¹³ In the ordoliberal view, the rules should primarily define those actions which are prohibited rather than prescribe any specific conduct. To put it generally, the state should set only the legal framework within which private

actors can proceed as freely as possible. At the same time, the rules should constrain political interference.

The institutional framework of the European monetary union was clearly devised on ordoliberal ideas. This can be explained by the explicit German reluctance about a monetary union at the beginning of the 1990s. The Bundesbank claimed that a monetary union could not be achieved without establishing a political union. The German citizens, still traumatised by the experience of German hyperinflation in the 1920s, did not like the idea of giving the Deutschmark and the Bundesbank away. A majority of German economists warned against establishing a monetary union.¹⁴ Given this resistance, it was obvious from the beginning that Germany would only accept the euro if monetary rules were designed on the German model.

In a nutshell, these rules are based on three central principles:

1. The central bank is obliged to exclusively pursue the objective of price stability, free of political interference. As Otmar Issing, the former chief economist of the ECB, put it, the monetary union should be 'as non-political as possible'.¹⁵
2. The monetary union implies only the centralisation of monetary policy; fiscal policies remain at the national level. Therefore, a system of fiscal rules is needed at the EU level to confine public expenditure in the Member States and to ensure solid public finances. The Stability and Growth Pact is based on this rationale.
3. To exclude moral hazard in fiscal policies and to further safeguard the principle of sound public finances, no

single Member State (or the Union as a whole) need assume liability for the public debt of another state. This rule is laid down in the no-bailout clause of the Treaty.

In the current discussion, the latter principle gained particular relevance. This results from a change of attitude towards the EU within Germany in recent years. An earlier willingness to contribute the majority of the EU budget declined, and a slogan reflecting this became increasingly popular: Germany must not continue to be the paymaster of Europe. Whether these complaints are justified is moot. But, given their existence, any German politician must avoid expanding the country's financial contribution to 'Europe'.

The perception of the crisis among the German public

In the first decade of monetary union, the German public still looked at the common currency with mistrust. Even if the notion that the euro turned out to be a 'Teuro'¹⁶ was not really justified, it remained quite popular. However, German confidence in the stability of the euro rose after the ECB seemed to obtain independence from political interference and the inflation rate did not spike. When it turned out in 2004 that Greece had faked its deficit figures in the years leading up to its accession to the eurozone in 2001, this was noticed indignantly in Germany, but without attracting much interest.

The Greek case was not the only breach of the rules. The second case gained much more attention in Germany because it involved the German government. In November 2003, the German and French ministers of finance,

supported by Italy, refused to accept the Commission's proposal to open deficit procedures against their countries. This was a clear violation of the rules and of the stability pact. Since the Commission could not obtain an unambiguous ruling from the European Court of Justice in the case, it gave in and launched a proposal to change the rules. The Council agreed happily, and thus the rules were softened considerably in 2005.

The reaction in Germany was ambiguous. The government was criticised for having broken (and then amended) the 'German' rules of the pact,¹⁷ but German Finance Minister Hans Eichel could claim that he had averted further damage to the German taxpayer by avoiding the deficit procedure. Even if this was a dubious claim, Eichel succeeded to a certain extent: there was, at least at first glance, no money at stake. One could argue that the breach of the pact could destabilise the euro, but this conjecture was too obscure to really take hold.

The current German debate on economic governance cannot be understood without taking into account a further element which is not directly linked with the economic issues. The enactment of the Maastricht Treaty not only initiated a discussion on monetary union, it also kicked off a more general debate on the legal limits of European integration and on the future of the nation state. For many Germans, the enhancement of EU competencies in the Treaty went too far. The German Constitutional Court set clear legal limits to further integration in two important rulings. In its judgment on the Maastricht Treaty of 1993, it not only stated that German membership in the EU must not threaten the legal structure of Germany as a federal state, which also meant that the EU could not be transformed into a federation; it also defined the

conditions under which Germany could convey national competencies in monetary policy to the EU. It defined the monetary union as a 'community in stability' and explicitly mentioned provisions of the Treaty which were to secure the stability of the euro: among others, it listed Article 124 of the Treaty on the Functioning of the European Union (TFEU; formerly Article 102 of the Treaty establishing the European Community, TEC), which excludes the privileged access of Member States to financial institutions, and Article 125 of the TFEU (formerly Article 103 of the TEC) which constitutes the no-bailout clause.

In its judgment on the Lisbon Treaty of 2009, the Court restricted the transfer of national competencies to the EU level even further. It expressed its intention to act as a guardian of the principle of conferral and of the subsidiarity principle. Following the ruling, every extension of political action at the EU level which is legitimised only by some 'undetermined authorisation' in the Treaty will be treated by the Court as if it requires an amendment. To put it more simply: every EU action which is not clearly covered by the Treaty requires a change of the Treaty.

Before the outbreak of the euro crisis, the German attitude towards monetary union was thus influenced by a strong feeling that German financial support for 'Europe' should not increase uncertainty about the stability of the euro, the perception that the rules of the stability pact had already been softened and the intention of the Court to constrain EU action. All these elements have to be considered when assessing the German position in the crisis.

As it became evident in early 2010 that Greece would get into considerable financial trouble and possibly need help,

crisis management seemed to follow a pattern: most Member States and the Commission were eager to help; only Berlin held back. It was clear to the federal government that Germany would have to carry the major financial burden. From February 2010 Chancellor Angela Merkel tried to impede or at least delay financial assistance for Greece. At first she argued that it was too early to decide on anything since Greece had not asked for help. Then she claimed that the conditions for granting credit had to be fixed before any credit would be granted. Then she enforced the involvement of the IMF.

It is hard to tell whether the crisis deteriorated because of her reluctance or whether it was mitigated by her insistence on high standards to be fulfilled by Greece. At any rate, the late decision to grant loans failed to calm the markets. On the very day that heads of state and government endorsed financial assistance, the situation grew even more acute. Consequently, the EU states concluded that a general rescue mechanism was necessary to safeguard countries such as Portugal, Spain and Ireland from Greece's fate.

Merkel stressed afterwards that the IMF would not have been involved either in the assistance for Greece or in the general crisis mechanism had she not been so relentless. It was obvious, however, that her attitude was based more on domestic policy motives than on concern about an economically sound solution. Elements of the German press had led a harsh campaign against financial assistance for the 'sloppy' Greeks. Some backbenchers in the German Bundestag had urged the government in Athens to sell all the uninhabited Greek islands before asking for help. Economists and lawyers had warned against a possible breach of the no-bailout clause.¹⁸ Merkel thus explained to

her European partners that a German contribution to financial assistance would be conceivable only as an ‘ultima ratio’ – in case the ‘financial stability of the eurozone as a whole’ were in danger. One might add that her waiting for the ‘ultima ratio’ case was also influenced by the election in Nordrhein-Westfalen, which took place on the weekend of the ‘crisis summit’ of 9 May 2010.

The German public responded as expected to the assistance for Greece and the rescue mechanism. Harsh criticism prevailed, and it referred both to the amount of money which Germany had to contribute and to the obvious breach of the rules. The ECB got particular attention since its president, Jean-Claude Trichet, had agreed in Brussels to the ECB’s future purchase of government bonds.¹⁹ This not only meant a de facto increase of money supply (implying further inflationary risks) but also a breach of Article 124 TFEU. Additionally, since Trichet had agreed on the new ECB policy when he met the heads of state and government, the suspicion grew that the ECB had also lost its independence from political interference.²⁰

The general notion in Germany at that point was that the whole of the ‘German’ institutional model for monetary union had been jettisoned. Not only had the stability pact finally been invalidated, the no-bailout clause had been destroyed as well, and even the independence of the ECB had been challenged. Monetary union with a stable currency had been transformed into a transfer union. And Germany had to pay the bill.²¹ It did not take long until the first economists and lawyers announced an appeal against the EU decisions. They claimed that the decisions breached Art. 124 and 125 TFEU, and they referred to the Constitutional Court’s Maastricht ruling that Germany would

have to leave the eurozone if the stability of the euro could not be secured.²²

The German position in the current reform discussion

Against this background, it came as no surprise that the German government asked, from the beginning, for far-reaching reforms of the institutional framework. In his 'Key Proposals to Strengthen the Euro Area' of 19 May 2010, Finance Minister Wolfgang Schäuble argued that the Commission's proposals of a week earlier did not go far enough.²³ Even then, he had stressed that 'all of the measures will need a solid legal basis . . . If our goal is to create a strong and lasting framework for Monetary Union, we must also take the possibility of amendments to the Treaty into consideration'.

Like the Commission in its first communication on economic governance,²⁴ Germany called for reforms in three areas: the strengthening of the stability pact; better economic policy coordination (including a 'competitiveness review') and the development of a 'crisis resolution framework'. Whereas Schäuble's suggestions were elaborated in detail in the first area, they were vague in the other two. The Minister seemed clear on how to improve the stability pact: better budgetary surveillance at an early stage; embedding the principles of the pact more firmly in national budgetary planning, as Germany did when introducing a constitutional limit to state borrowing; suspending EU funds designated for deficit countries; faster procedures; and suspending voting rights in the Council.

The German debate on the issue of competitiveness concentrated on the alleged harm that 'Europe' could cause

to Germany by undermining the export industry and intruding into collective bargaining rights. This anxiety was exaggerated. It was politically clear from the beginning that any common surveillance of economic policies would concentrate on countries with current account deficits and not on Germany. Moreover, the discussion was steered in the wrong direction. Nobody in German politics seemed to consider whether the whole construction of ‘competitiveness surveillance’ made any sense. It did not. In a market economy, the only way to level ‘macroeconomic imbalances’ is by flexible prices and wages. Using political tools to restore balance would be conceivable only in a completely state-directed economy, and even then it would probably fail.

The issue of how to establish a functioning ‘crisis mechanism’ was not discussed much at first. Everyone figured that such a mechanism required a Treaty amendment, and the members of the task force agreed to first find a common understanding of the topics which did not require a Treaty change. The public discussion in Germany thus concentrated on tightening the rules of the pact and on ‘competitiveness surveillance’. To some observers, the latter constituted, in a way, the *Wirtschaftsregierung* they always wanted to prevent.

But generally, a kind of consensus emerged in the political and academic discussion in Germany during the summer. Most people agreed that Member States’ economic policies should be coordinated more thoroughly without creating any new European competencies, that the control of national fiscal policies should be strengthened along the lines of the Schäuble paper mentioned above and that provisions should be taken to exclude moral hazard in the

future and to avoid a permanent transfer union. Everybody dismissed the idea of *gouvernement économique* in the French sense.²⁵

Schäuble came out with another paper in September with specific proposals on how automatic sanctions and accelerated deficit procedures should be enforced.²⁶ His requirement that the sanctions had to be as ‘automatic’ as possible corresponded to the ‘old’ German philosophy that any decision in the monetary union should follow abstract rules—that is, it should be as non-political as possible. It had been generally acknowledged that the stability pact had failed primarily because of the heavy influence which the Member States could exert on deficit procedures. Since it was up to them to decide every step of the procedures, the enforcement of the rules always depended completely on political discretion in the Council. There, no Member State really has an incentive to enforce sanctions against another state since it could be a potential deficit country in the future. It thus turned out that fiscal sinners decided upon sinners. As a result, the Council has never imposed fines upon a Member State, even though there have been grounds for it to do so on more than one occasion.

Unlike France, Schäuble supported the Commission’s approach: removing as many discretionary elements as possible from the procedures and introducing a kind of automatism. Under this system, the Commission would trigger the procedure and decide upon sanctions as soon as the public deficit or public debt in a country became too high, as measured by objective criteria. Following the Commission’s proposal, the Council would be able to stop the sanctions only by qualified majority.

To a large extent, the Commission's proposals on economic governance of 29 September²⁷ conformed to the German requests at that stage.²⁸ The federal government thus generally welcomed them, particularly the suggestion for rules-based procedures. However, Merkel again emphasised her insistence on an amendment of the Treaty. Her main concern was the possibility of suspending voting rights and, again, the establishment of some 'crisis mechanism' which she did not describe in more detail. She mentioned only that it should ensure that private investors be included when it came to restructuring the debt of a bankrupt Member State. At the same time, the Chancellor rigorously dismissed the idea of extending the EFSF, which expires in 2013.

At the beginning of October 2010, days before the last meeting of the task force, the German position was thus unambiguous. The federal government generally supported the whole of the Commission's proposals on strengthening the pact and also on the future establishment of a 'competitiveness procedure', but wanted to go further. It particularly asked for more ambitious rules for the stability pact. It was obvious, though, that France would not agree to any further measures to establish a truly rules-based enforcement of the pact. The French government had always claimed that decisions on sanctions could not be taken by a bureaucratic body like the Commission, but had to be politically legitimised, falling, therefore, to the Council. The old German–French conflict over 'rules-based' or 'political' governance arose again.

Angela Merkel and Nicolas Sarkozy resolved it by cutting a surprising deal. In a bilateral agreement signed at Deauville, they came up with acceptable conclusions for the task force, which had its final meeting on the same day in

Luxembourg.²⁹ Germany refrained from its request to sanction high deficit states automatically. In return, France supported the German call for an amendment of the Treaty to allow for establishing the suspension of voting rights and including a well-defined ‘crisis mechanism’.

The closing report of the task force was clearly based on the Deauville declaration, even if several representatives of smaller countries protested against this bilateral approach of the German–French ‘directorate’.³⁰ The task force suggested a sanction mechanism much ‘less automatic’ than that proposed by the Commission. And it added a further element which will weaken the strengthening of the pact: sanctions can be imposed only after a delay of six months.³¹

As a result of the Deauville declaration, the discussion on economic governance at the following European Council was not between the usual antagonists, that is, Germany and France, but between those two and the rest of the EU, particularly the smaller Member States. It resulted in a not too surprising log-rolling agreement. In the run-up to the meeting, it had already become apparent that the proposal to suspend voting rights would be refused by most heads of state and government. Therefore, there was no risk for Sarkozy in agreeing to the German request. He knew that Merkel would not be able to get it through. On the other hand, nobody disputed Merkel’s general demand that a ‘crisis mechanism’ should be permanently established. The only argument was over whether a Treaty amendment was necessary. Jean-Claude Juncker, President of the eurogroup, who had already criticised the Deauville agreement, teased Merkel about making a fuss ‘trying to enforce something which everybody agrees on anyway’.

At the end of the day, the Chancellor won approval on the amendment, but only for legally safeguarding the permanent ‘crisis mechanism’, that is, the continuation of the EFSF.³² Originally, Germany had insisted that the EFSF close down in 2013.³³ What she had given away was more or less everything the German government had struggled for earlier. Automatic sanctions were no longer envisaged, and nobody seemed to remember that Germany had asked months earlier for sanctions such as banishing high-deficit countries from the eurozone. In other words, the only thing Merkel had achieved was getting approval for legally fixing an instrument which she had resolutely dismissed not too long before. The agreement was thus heavily criticised by the German public.³⁴

But are the Council compromise and the task force report not still based, to some degree, on German ideas? The answer depends on the perspective. When taking the status quo as a starting point, one has to admit that the reforms envisioned for the pact will strengthen it somewhat—if they are adopted and applied. When compared with the Commission proposals, however, the Council decisions on fiscal supervision are much ‘less German’ than they could be. The proposals on a ‘competitiveness procedure’ are definitively inspired by French constructivism. As to the crisis mechanism, it is hard to judge since the heads of state and government refrained from defining the functioning of the mechanism. The argument can still be made that the threats of moral hazard and a continuing transfer union persist.

At the end of the Council meeting, it became clear that Merkel’s strategy had never been primarily aimed at economic objectives. Her paramount goal was the

amendment of the Treaty, for one clear purpose: to make sure that the German Constitutional Court would not interfere in future cases of financial assistance to other Member States. It seems that she succeeded in this respect. But it is not clear that this success contributes to the stability of the euro.

Merkel's *Wirtschaftsregierung*: an institutional redefinition

When assessing the German position on economic governance, one should also take into account that Merkel tried to redefine the term *Wirtschaftsregierung* during the crisis. She thus created a new (institutional) meaning of the term. The Chancellor had originally rejected the French notion of *gouvernement économique*. In the crisis, however, she increasingly recognised the French argument that it should be up to the Member States to take the crucial decisions on crisis management. Unlike Sarkozy, though, she did not intend to thwart the ECB. Rather, she was worried about attempts of the European Commission to gain further political influence by suggesting additional 'European' measures to deal with the crisis.³⁵ Both the Commission's proposals and several calls of ailing Member States for a European solution to the crisis seemed to suggest that wealthy Member States such as Germany would have to pay the bill. Merkel thus intended to get involved in any measure of crisis management as directly as possible.

She used a kind of semantic ploy when claiming the need of a *Wirtschaftsregierung* for the EU.³⁶ She only specified who, in her view, should constitute such a *Wirtschaftsregierung*:

the heads of state and governments of the 27 Member States. The Chancellor did not indicate, however, what exactly the *Wirtschaftsregierung* should do. Admittedly, this institutional definition allowed for both repelling the ambitions of the Commission and avoiding a *gouvernement économique* in the French sense. By involving all 27 Member States, Merkel hoped to lessen political pressure on the ECB.

In the course of the crisis, she stuck more and more to this institutional understanding of *Wirtschaftsregierung*. At the end of the European Council in October 2010 she declared in Brussels that ‘as of now, the Council works as a *Wirtschaftsregierung*’.³⁷ This statement was not aimed at the ECB; rather it implied that Member States are the key players when it comes to reforming the institutional framework of the euro area. It thus was addressed to the Commission and the European Parliament. They should, in Merkel’s view, refrain from calling for too many competencies and acknowledge the leading role of the Member States. A few days after the European Council met, she added to this argument by requiring a ‘better interplay of the European institutions’ and a new ‘Union method’ to replace the conventional Community method. She left no doubt that the European Council should have the leading role among the institutions.³⁸

Merkel’s institutional argument was no accident. The reform of economic governance in the eurozone is not only a matter of substance, but also of competencies. Right from the beginning of the debate in spring 2010, the Member States and the Commission competed for leadership in this discussion. When the Van Rompuy task force met for the first time in May, the Commission had already launched its

first communication. And when the task force concluded its work in October 2010, the legislative proposals of the Commission already lay on the table.

At an early stage, the question of who launched the proposals seemed irrelevant because both sides appeared to focus on the same issues. However, the situation changed when the Member States devised their common strategy in October 2010. Even if she then gave up some core German positions on economic governance, Merkel was quite successful from an institutional perspective. After the European Council, she could pretend that the Member States (and Germany in particular) had taken over leadership and that the Council decision constituted more or less the end of the story on economic governance. This was in line with Merkel's promoting of a new 'Union method'.

In a way, the Euro-Plus Pact adopted in March 2011³⁹ reflects this new method. Merkel had vehemently promoted a 'pact for competitiveness' whose objective was to enhance the competitiveness of those countries which suffer most from the public debt crisis. At first, her proposals caused resentment among the states concerned since they clearly interfered in national sovereignty, for instance by demanding an increased retirement age. Since the adopted version of the pact consists only of promises rather than commitments, it could be agreed upon easily. Since it is based on intergovernmental cooperation and does not involve Community institutions such as the Commission and the Parliament, it constitutes a *Wirtschaftsregierung* in the institutional sense. Additionally, the new European stability mechanism, to be introduced in 2013, will not become a Community instrument but will also be based on intergovernmental principles.

However, the ‘old’ Community method persists and is still to be applied. This is especially true for the legislative package on economic governance. It is based on the Commission’s proposals and is to be discussed by the European Parliament and the Council (of Ministers). It remains to be seen if the new structure of economic governance in the euro area also changes the institutional interplay.

Conclusion

Obviously, there is no such thing as the German position on economic governance. However, the ordoliberal model of a rules-based framework for the monetary union, with an independent central bank, clear-cut rules for supervising national fiscal policies and the prohibition of financial transfers can be considered as a widely accepted blueprint for the euro area. The initial framework of the monetary union largely matched this model. This contributed significantly to the acceptance of the common currency which had been unpopular in Germany in the beginning. This model was strongly challenged by the crisis. It can be argued that all three elements mentioned—an independent central bank, a strong stability pact and no bailout—had been damaged, if not destroyed, by the measures taken to rescue the ailing Member States in May 2010.

The German government did not stick to those principles dogmatically. But to a certain extent, it was constrained by them, for at least two reasons. First, the German public, encouraged by the tabloids, called for the observance of the rules and objected to the idea that Germany should pay the bill. Second, the Federal Court set clear limits to active crisis management and to enhancing European competencies.

This explains the hesitant and inconsistent action of the government at times. Rushed by the crisis events, it was still anxious to maintain as much of the German 'model' as possible. In the end, however, it could only secure a measure of legal certainty. Most of the battered principles of a rules-based monetary union have not been restored.

Notes

- 1 This version was completed in April 2011. A previous version had been finalised in November 2010. Meanwhile, the European Council has decided upon a far-reaching package on economic governance. This version takes account of the most significant parts of the package.
- 2 Unless specified otherwise, the term ‘Treaty’ refers to the Treaty on the Functioning of the European Union, formerly the EC Treaty. Current rules on the currency union were already specified in the EC Treaty.
- 3 ‘Statement by the Heads of State of the Euro Area’, 25 March 2010, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf on 20 August 2010.
- 4 ‘Déclaration des Chefs d’Etat et de Gouvernement de la Zone Euro’, 25 Mars 2010, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/fr/ec/113564.pdf on 20 August 2010.
- 5 ‘Erklärung der Staats- und Regierungschefs der Mitgliedstaaten des Euro-Währungsgebiets’, 25 March 2010, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/de/ec/113566.pdf on 20 August 2010.
- 6 Interestingly enough, it was Jean-Claude Trichet, then a high official in the French Ministry for Economic and Financial affairs and today President of the ECB, who conceived the idea of *gouvernement économique* in the wake of the Maastricht Treaty.

- 7 'Berlin plant Bürgschaften und Kapitalspritzen', *Frankfurter Allgemeine Zeitung*, 13 October 2008, 1.
- 8 The Euro-Plus Pact, which was agreed upon in the European Council in March 2011, implies that the heads of state of the euro area are to meet once a year in order to discuss matters of economic policy. These meetings will not become the classical eurozone meetings, however, since a couple of non-euro states have joined the 'pact' and will take part.
- 9 W. Mussler, 'Das Endspiel um den Euro', *Frankfurter Allgemeine Sonntagszeitung*, 9 May 2010, 35.
- 10 The Commission changed the wording at the last minute. Whereas the original text of the communication (COM(2010)250 final) prepared by the Commission's services was on 'Reinforcing economic policy coordination', the press release used the wording 'economic governance', which has been used since. See 'Reinforcing Economic Policy Coordination', accessed at [http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com\(2010\)250_final.pdf](http://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com(2010)250_final.pdf), and 'Mastering Economic Interdependence: Commission Proposes Reinforced Economic Governance in the EU', accessed at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/561>, both on 4 November 2010.
- 11 However, its affinity to constitutional economics was recognised internationally at a rather early stage. See V. Vanberg, "Ordnungstheorie" as Constitutional Economics: The German Conception of a "Social Market Economy", *ORDO* 39 (1988), 17–31.

- 12 Treaty on European Union, new version, Art. 3(3). The term 'social market economy' was introduced into the Treaty on European Union (formerly Article 2, now Article 3) by the Lisbon Treaty.
- 13 F. A. Hayek, *Law, Legislation, and Liberty*, Vol. 1, *Rules and Order* (Chicago: University of Chicago Press, 1973), 50.
- 14 See 'Die EG-Währungsunion führt zur Zerreißprobe, Manifest von 60 deutschsprachigen Ökonomen', *Frankfurter Allgemeine Zeitung*, 11 June 1992, 15.
- 15 W. Mussler, 'So unpolitisch wie möglich', *Frankfurter Allgemeine Zeitung*, 29 September 2010, 11.
- 16 The neologism *Teuro* is a play on the word *teuer* (expensive).
- 17 H. Göbel, 'Die Schuldenunion', *Frankfurter Allgemeine Zeitung*, 22 March 2005, 1.
- 18 See 'Ökonomen sehen Gefahr für Euro-Stabilität', *Frankfurter Allgemeine Zeitung*, 11 February 2010, 9.
- 19 See H. Steltzner, 'Der Euro als Weichwährung', *Frankfurter Allgemeine Zeitung*, 10 May 2010, 1 and H. W. Sinn, 'Wir stürzen uns in ein unkalkulierbares Abenteuer', *Süddeutsche Zeitung*, 14 May 2010, 18.
- 20 G. Braunberger, 'Die Amerikanisierung der Geldpolitik', *Frankfurter Allgemeine Zeitung*, 11 May 2010, 13.
- 21 H. Steltzner, 'Im Dienst der Politik', *Frankfurter Allgemeine Zeitung*, 14 May 2010.

- 22** ‘Verfassungsbeschwerde gegen den “Euro-Rettungsschirm”’, Az. 2 BvR 1219/10, 18 August 2010. For further information, please see the press release of the complainants, accessed at <http://www.europolis-online.org/index.php?id=10> on 1 June 2011.
- 23** ‘Key Proposals to Strengthen the Euro Area’, Non-Paper, Federal Ministry of Finance, 19 May 2010.
- 24** Statement by the Heads of State of the Euro Area’, 25 March 2010, see n. 3 above.
- 25** For an instructive survey, see ‘Ist eine europäische Wirtschaftsregierung eine sinnvolle Option?’, *Ifo-Schnelldienst* 69(14), 3–19. The text contains statements by several German officials and economists, the tenor of which is quite similar. See also R. Caesar, ‘Braucht Europa eine Wirtschaftsregierung?’, accessed at <http://wirtschaftlichefreiheit.de/wordpress/?p=4541>, on 8 November 2010.
- 26** “Automatic” Sanctions and Accelerated Procedure for Future Fiscal Surveillance in the EU’, Non-Paper, Federal Ministry of Finance, 23 September 2010, Berlin.
- 27** ‘A New EU Economic Governance: A Comprehensive Commission Package of Proposals’, 29 September 2010, accessed at http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-09-eu_economic_governance_proposals_en.htm on 1 November 2010.
- 28** The proposals are not discussed in detail here. For an explanatory assessment, see W. Mussler, ‘Wie die

Währungsunion reformiert werden soll', *Frankfurter Allgemeine Zeitung*, 30 September 2010, 12.

- 29** 'Franco-German Declaration', 18 October 2010, accessed at http://www.elysee.fr/president/root/bank_objects/Franco-german_declaration.pdf on 1 November 2010. The wording in the German and the French versions remained different.
- 30** W. Mussler, 'Stabilitätspakt à la Deauville', *Frankfurter Allgemeine Zeitung*, 20 October 2010, 13.
- 31** 'Strengthening Economic Governance in the EU', Report of the Task Force to the European Council, 21 October 2010, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/117236.pdf on 1 November 2010.
- 32** See the conclusions of the European Council of 29 October 2010, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/117496.pdf on 6 November 2010.
- 33** W. Schäuble, 'Die Rettungsschirme laufen aus – das haben wir klar vereinbart', *Frankfurter Allgemeine Zeitung*, 24 July 2010, 16.
- 34** See, for instance, H. Steltzner, 'Von der Währungs – in die Transferunion', *Frankfurter Allgemeine Zeitung*, 30 October 2010, 1.
- 35** For example, the Commission launched a 'European Recovery Plan' at an early stage of the crisis, in November 2008. It suggested more deficit spending at

the national level as well as the premature exploiting of EU funds. See 'The Commission Launches a Major Recovery Plan for Growth and Jobs, to Boost Demand and Restore Confidence in the European Economy', accessed at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1771&format=HTML&aged=0&language=EN&guiLanguage=de>, on 6 November 2010.

- 36** See H. Kafsack and W. Mussler, 'Wundertüte Wirtschaftsregierung', *Frankfurter Allgemeine Zeitung*, 3 March 2010, 11.
- 37** 'Merkel: "Rat arbeitet als Wirtschaftsregierung"', accessed at <http://www.faz.net/s/Rub99C3EECA60D84C08AD6B3E60C4EA807F/Doc~E1AC7BFCC122C41E9B72B3A457A9BAD93~ATpl~Ecommon~Scontent.html> on 6 November 2010.
- 38** 'Rede von Bundeskanzlerin Merkel anlässlich der Eröffnung des 61. akademischen Jahres des Europakollegs Brügge', accessed at http://www.bundeskanzlerin.de/nn_683608/Content/DE/Rede/2010/11/2010-11-02-merkel-bruegge.html on 6 November 2010.
- 39** Conclusions of the European Council on 24–5 March, 2011, accessed at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf on 4 April 2011.

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A Unique European Economic Governance Model

Stefaan De Corte

The papers by Jean-François Jamet and Werner Mussler provide us with a good insight into the different mindsets of French and German policymakers. When trying to envisage how the current European economic governance framework will work in the future, it is important to take into consideration both the French preference for government intervention and the German belief in a rules-based approach.

In the first part of this contribution, we give an overview of what has been decided so far and what is still being negotiated. The main sources of information are official EU communications, decisions and regulations (both agreed and proposed). In the second part we provide fresh food for thought on some elementary questions.

The development of an EU economic governance framework

The rationale behind the establishment of a more thorough European economic governance model dates back to 2007, when the housing crisis spread throughout the US. With root causes much earlier than 2007, the problems took hold, infecting the US and consequently the European banking sector. This meltdown in the financial sector quickly became an economic crisis and in 2008 started to disrupt the entire

economy. The public deficits and debts of all EU Member States increased, and doubt was cast over the solvency of not only European banks, but also some European States. This obliged the IMF, the EU and the World Bank to grant financial assistance to non-eurozone European Union Member States: Hungary (2008 and 2010), Latvia (2009) and Romania (2009). Later, aid was given by the EU and the IMF to eurozone EU Member States Greece (2010), Ireland (2010) and Portugal (in 2011).

As early as 1989, it was stated in the Delors report that ‘With full freedom of capital movements and integrated financial markets incompatible national policies would quickly translate into exchange rate tensions and put an increasing and undue burden on monetary policy In particular, uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community’.¹ That financial support has had to be granted to some eurozone Member States to keep them from defaulting on their debts, whilst many others withstood the crisis without there being any doubt about their solvency, made clear that there exist significant macro-economic imbalances within the Economic and Monetary Union (EMU). One could therefore conclude that the economic pillar of the EMU remained underdeveloped.

The above analysis and conclusion have led the European institutions (the European Commission, the European Council and the European Parliament) to establish an improved European economic governance model.

Apart from the European Stability Mechanism (ESM), new financial sector regulations and supervisory bodies, none of

which will be discussed here, one can distinguish two major building blocks of the EU's economic governance model: policy coordination, and policy surveillance and enforcement.

Policy coordination

In terms of *economic policy coordination*, the main instruments are the Europe 2020 Strategy and the Integrated Guidelines for Economic and Employment policies. The European Council has approved five headline targets in the context of the Europe 2020 Strategy. Based on Commission recommendations, the Integrated Guidelines have been approved by the Council and politically endorsed by the European Council. In addition to these two instruments, most of the EU Member States have also subscribed to the Euro Plus Pact. This is an intergovernmental agreement on policy priorities which will be consistent with the other existing instruments.

The main instrument related to *fiscal (budgetary) policy coordination* is, apart from the legal framework that is the Stability and Growth Pact, the first Integrated Guideline, which states the following: in particular, Member States should achieve a consolidation of well beyond the benchmark of 0.5% of gross domestic product (GDP) per year in structural terms until medium-term budgetary objectives have been reached. This target has been repeated several times in European Council conclusions.

The main innovation with regards to *economic and fiscal policy coordination* did not require any new regulations, directives or decisions. Council conclusions approved the Commission's proposal to synchronise the *ex ante*

assessment of fiscal policies (the budgetary policies described in the national Stability and Convergence Programmes (SCPs)) and structural policies (for example, the labour market reforms described in the National Reform Programmes (NRPs)). In EU jargon, this synchronisation is known as the 'European Semester'. Over the first half of each year, *ex ante* discussions will take place on the structural and fiscal policies of each Member State, in order to coordinate more precisely economic policies within the European Union. The European Semester has the following elements:

1. In the month of January, aiming for alignment with the Europe 2020 Strategy and the Integrated Guidelines, the European Commission will put forward priority actions in the form of an Annual Growth Survey. Based on Council conclusions and further to this Growth Survey, the European Council will then endorse priorities for fiscal and structural policies.
2. Based on the relevant legal texts, and keeping in mind their medium-term budgetary objectives and the European Council conclusions, Member States will elaborate or review their SCPs. They will also elaborate or review their NRPs based on the Europe 2020 Strategy and the Integrated Guidelines, at the same time keeping in mind their commitments within the Euro Plus Pact and the EU-level guidance of the European Council.
3. Both the Stability and Convergence Programmes and the National Reform Programmes are to be reviewed individually by the European Commission. Based on this assessment, the Council will issue country-

specific guidance with regards to structural and fiscal policies. These country-specific recommendations will be endorsed by the European Council. It is then up to the governments and parliaments of Member States to decide whether or not the guidance of the Commission and/or the Council is to be taken into account in their NRPs and/or during the elaboration of their national budgets.

Policy surveillance and enforcement²

The above conclusions about the need for increased economic policy coordination and the fact that the enforcement mechanism within existing fiscal policy coordination had never been applied make clear that more stringent surveillance and more automatic enforcement mechanisms are necessary. The remainder of this section provides a short overview of what has been and what will be put in place on a European level.

One can distinguish three different types of surveillance and enforcement mechanisms, each with its own specificities: structural policies, macroeconomic imbalances, and fiscal policies.

When it comes to the coordination of structural policies, which are translated into the National Reform Programmes, the Commission and the (European) Council can issue country-specific recommendations and agree on a set of priority actions. The Commission can also issue a warning when recommendations are not acted on within a given time frame. However, enforcement only exists in the form of peer pressure within the (European) Council or between Member States.

The pressure to coordinate structural policies increases when macro-economic imbalances arise.³ The performance of Member States with regards to an agreed set of indicators together with economic judgment by the Commission paves the way for in-depth reviews which will provide the basis for policy recommendations, issued by the Council upon a recommendation by the Commission. The Council can also, based on a Commission recommendation, declare a Member State to be in a position of excessive imbalance, which obliges that Member State to come up with a Corrective Action Plan. When the actions taken or planned to be taken are considered to be insufficient, fines of up to 0.1% of GDP can be imposed on euro-area Member States. The decision to impose a fine will be considered adopted by the Council unless it decides by qualified majority to reject the proposal from the Commission (this procedure is known as ‘reversed qualified majority voting’).

In terms of fiscal policy coordination, the first step is increasing transparency in national public accounts by bringing them into line with agreed EU standards. The second step is the application of the newly adopted rules. First, this implies bringing national fiscal policies into line with the stricter rules governing both the progress towards medium-term budgetary objectives—to meet the 3% deficit criterion—and sufficiently reducing the ratio of government debt to gross domestic product (GDP). Second, the new rules envisage providing both the preventive and the corrective arms of the SGP with more enforcement mechanisms.

In the preventive arm, in the event of persistent or particularly significant deviations from prudent fiscal policymaking, the Commission can draft a recommendation to a Member State, to be adopted by the Council. For euro-area Member States,

this recommendation will be backed by an interest-bearing deposit.

In the corrective arm, if the Council decides, in line with the Treaty, that an excessive deficit exists in a Member State, a non-interest-bearing deposit will be imposed by the Council upon proposal by the Commission (reversed qualified majority voting will apply). If the Council decides that a Member State has not taken effective action in response to Council recommendations, the Council, upon proposal by the Commission (again, the reversed qualified majority procedure will apply), will impose a fine.

EU economic governance: more than just German and French views

The first part of this chapter showed that what the European institutions are putting in place is neither the French nor the German view on economic governance, but a *unique European economic governance model*. It is true that the European Council has taken on a more significant role in giving guidance and endorsing recommendations, the ultimate example of this being the intergovernmental Euro Plus Pact. But a more rules-based approach is also being introduced, with the European Council often voting by reversed qualified majority. Even so, the European Commission has its own important role to play in the analysis and strengthening of publicly available country-specific reports and in the formulation of recommendations for the (European) Council.

One could argue that ‘markets will do the job’ and force the European authorities to execute structural reforms that

increase productivity, lower the balance of payment deficits and so on. In this view, these reforms would ultimately lead to lower public deficits and thus to lower debt levels. The incentive for the authorities to coordinate policies should thus be lower interest rates instead of the rules-based approach that leads to fines. However, it should be borne in mind that the authorities do not like to be dictated by markets, preferring instead to establish an administrative system that obliges them to 'stick to the rules'. To the extent that the regulations, and thus the fines, will be applied in the future, we will indeed have a more 'repressive' administrative system in place to ensure that governments put in place coordinated and sustainable economic policies.

When we reflect on structural reforms and what needs to be done to build a sustainable future, we should not forget that we live in democratic countries. *The political economy of the reforms ahead* is therefore the biggest challenge: not only to get policies approved in national parliaments, but also to get them accepted by the citizens of these countries. Political leadership and endurance within the European Council to resist protests and populism will be decisive for whether or not Europe will manage to remain the prosperous continent it is today.

In the same context we can speak of the *sovereignty of the Member States*. We must remember that we have a directly elected European Parliament which has approved most of the regulations that underlie the new governance model. Moreover, elected members of the Council have approved all of the regulations, the Commissioners have all been heard and the entire Commission been approved by the same Members of the European Parliament. It is true that if there are excessive macroeconomic imbalances, the Member

State involved will have to come up with a Corrective Action Plan. And it is also true that the actions described in the plan will not be easy to implement. But it is equally true that all reforms included in the plan will have to be approved by the national parliaments. If a country ignores some or all recommendations but still manages to improve its imbalances, it is possible that the head of state will be singled out in the (European) Council for not implementing the agreed policies but that the country will not be fined.

Has progress been made in the attempts to *create a genuine EMU*? If one reads the regulations and sees the timeline and milestones of the European Semester, it becomes clear that a comprehensive framework is being developed which could provide a significant impetus to achieving a truly economic union. But when the need is urgent, one is quick to adopt new methods. What if markets are calm and local resistance is strong? As with the Stability and Growth Pact, the effectiveness of the system in enabling real coordination of economic policies will be put to the test when the first fines are imposed. This will be a crucial moment, since Member States will only take the requirement to coordinate economic policies seriously if they know the new system will have consequences. One should therefore not forget the reasons for setting up the new system: without better coordination of national economic policies, one cannot aspire to create a single currency area. Using the same logic, policymakers and citizens should not forget the benefits of stable exchange rates and low inflation that the euro currency union brings.

And of course, *institutions are made up of people*. Therefore, a lot depends on how the institutions behave. With the current European Semester and its regulations in place, one cannot predict how the balance of power between the European

Commission, the Council and the Parliament will evolve. Will the European Commission stay strong enough to issue far-reaching country-specific recommendations that are also a signal to the markets and thus have the potential to raise interest rates on sovereign debt? Will the dynamics within the Council become different from what they were in the past, when large Member States could force the Council to deviate from the strict application of the rules? How will ministers behave if national politics come into play? Will the European Parliament use its leverage to increase the transparency of the procedure and interrogate European leaders when there is an issue, even if there are no cameras to record the often technical debates?

In terms of economic governance, some will say that the Integrated Guidelines and the Europe 2020 strategy are too much about describing the actions a Member State should take, and not enough about defining what Member States are not allowed to do. From this perspective, the EU should focus on, amongst other things, reducing red tape and barriers to trade, instead of describing what type of pension reform each Member State should undertake. Of course, it is important that the EU institutions use their own competences to the full. But surely, the financial, economic and sovereign debt crisis within the EU has shown that it is not enough to speak only about what governments should not do if distorting economic divergences are to be avoided.

We could conclude that better economic and fiscal policy coordination should lead to *a more competitive and prosperous Europe*. Indeed, it is clear that if the EU reaches the targets it set for itself for 2020—75% employment, 3% investment in R&D and school dropout rates below 10%, to name just a few—Europe will be or become more competitive

and prosperous. However, the EU is not closed off from the rest of the world. Factors such as global competition for capital, human and natural resources, along with revolutions and other types of unexpected events, will have an impact on the European economy. The resilience of the EU and its economy in the face of such factors will be decisive for the competitiveness of the European economy. Coping with the current crisis is providing useful insights into how the unfolding of unforeseen events can be faced in the future.

As a final remark we could ask: *‘Will this new European economic governance model be enough to avoid distorting economic divergences?’* We can reflect on this in terms of both policies and the governance framework. Of course, we often hear that ‘Europe is already doing enough’. However, looking at the demographic challenges Europe faces, including issues with movement within and immigration to the Schengen zone, one can easily see that there is great opportunity to develop a coherent strategy at European level, if only to avoid harmful imbalances. In terms of governance, we could reflect on game-changing proposals such as Eurobonds or more modest changes such as investment bonds. Both of these proposals will require time to bring into alignment the French and German views, let alone those of the remaining 25 Member States, the European Commission and the European Parliament.

The European Institutions are formulating a unique governance model to obtain more coordinated economic policies, all for the sake of creating a genuine Economic and Monetary Union. Both the French preference for political leadership and the German preference for clear rules and procedures will be needed to get the EMU working effectively again for the benefit of its citizens.

Notes

- 1 Committee for the Study of Economic and Monetary Union, 'Report on Economic and Monetary Union in the European Community' (1989), 40.
- 2 The main sources for this chapter are the regulations and directives proposed by the European Commission and currently being negotiated between the Council, the European Commission and the European Parliament. Final agreement is expected in September 2011.
- 3 Although the exact indicators still have to be decided upon, potential indicators would be a strong decrease in export market sales or a decrease in the current account balance/GDP ratio.

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