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Germany: Merkel's growing problems with pushing through the fiscal compact

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The political events of recent weeks have brought about new threats to the ratification of the fiscal compact in Germany and other EU countries. Firstly, with the victory of the socialist François Hollande, who has openly criticised the new treaty, in France's presidential election held on 6 May, there is the risk that all the opponents of the treaty will join forces and a strenuous renegotiation will have to be held. Secondly, in Germany itself increasingly vehement protests against the ratification of the fiscal compact are appearing. Even if the treaty is ratified, certain of its provisions will be taken to the Federal Constitutional Court of Germany. This treaty championed by Germany is being criticised for having too large emphasis on savings without taking into account growth-stimulating instruments and for transferring the sovereign rights of parliament to shape and oversee the budget to the EU level. The victories of the Social Democrats in the state election in North-Rhine Westphalia and of the Socialists in France, who display similar views on the necessity of the "improvement" of the fiscal compact, will place Angela Merkel in a position where she will be forced to reopen the negotiation of the treaty. Therefore at least a delay in the ratification of the treaty in Germany must be expected as must be the fact that it will be supplemented with another agreement introducing new growth-stimulating measures. The largest contention between France and Germany will probably arise about the way of financing these new instruments and the resulting compromise may be to fund them at the expense of a part of EU funds which have until now been earmarked for cohesion policy.

The EU's game over the fiscal compact

François Hollande's victory in France is a major threat to the implementation of the fiscal consolidation plans in the euro zone advocated by Angela Merkel. François Hollande has based his campaign on criticising the solutions offered by the fiscal compact and announced it will be renegotiated. The aim of this would be to increase funds for investments and to curtail debts by introducing the tax on financial transactions and eurobonds as well as by transferring unused funds from the cohesion policy to the EU budget. The French president would like to boost economic growth by employing such instruments as bonds which support investments and by extending the scope of activities of the European Investment Bank. His stance is endorsed by an increasing number of EU politicians, including President of the European Parliament Martin Schulz and heads of states from the Southern part of the euro zone who argue that up to now drastic austerity measures adopted in Spain or Greece have not yielded the expected results. The European Central Bank and the International Monetary Fund have also criticised the lack of growth-stimulating measures in the treaty. The press also speculates that the European Commission is considering proposing new programmes aimed at easing the strain on the budgets of the most heavily indebted countries and providing support for small and medium-sized businesses which are experiencing more and more difficulty in access to loans.

There are mixed signals coming from Germany in response to this criticism. On the one hand, Merkel in her letter to Hollande has rejected the idea that the treaty will be renegotiated. On the other hand, a proposal has come from those close to her to include a provision in the treaty about fostering growth but without substantial changes being made to the fiscal compact. Angela Merkel, faced with a much larger possibility of Germany being isolated in its demands for further consolidation of budgets after changes in the governments in Italy, Spain and probably soon in the Netherlands, is determined to maintain close German-French co-operation. However, Merkel is aware that the lack of concessions on her part may lead to a stronger opposition to her concept of combating crisis. For this reason she announced already at the end of April the possibility of introducing a growth pact. The German chancellor hinted that it would be possible to use funds from the cohesion policy and from the European Investment Bank to undertake measures intended to improve the economic situation.

The growing problems on the German internal scene

The ruling coalition in Germany is still faced with the challenge of ratifying two agreements which are crucial to the implementation of the current rescue plans for the euro zone. Firstly, in order to make the European Stability Mechanism (ESM) operational from July this year Germany has to ratify the treaty that establishes it by mid-June. The ESM will support the most heavily indebted countries of the euro zone and will enable the European Central Bank to limit the scale of issuing more money to stabilise financial markets. Due to protracted negotiations regarding the establishment of the ESM, the European Central Bank has been forced to grant loans to commercial banks and to buy up bonds of the most heavily indebted countries. Secondly, the ruling coalition has to ratify the fiscal compact which will introduce new budget constraints by the end of 2012 at the latest. This compact will also grant the euro zone countries involved in it access to capital from the ESM. The fiscal compact is paramount key element of the German strategy of crisis management and is set to persuade voters in Germany that the assistance provided to other euro zone countries will not be unconditional but dependent on the reduction of their debts. The ratification of both agreements requires a two thirds majority in both the Bundestag and the Bundesrat, which means that the ruling coalition has to win support of at least the SPD in both chambers of parliament.

So far the ruling coalition has expected that the ratification of the fiscal pact and the treaty establishing the ESM will be held during one vote on 25 May. However, the victory of the Social Democrats in North-Rhine Westphalia has strengthened their position which makes the support for the fiscal compact dependent on the introduction of amendments they are demanding. Their demands are essentially not much different from Hollande's proposals. The SPD is calling for such instruments as measures supporting the young unemployed, the issuing of bonds for investments in infrastructure and green technologies and an increase in the capital of the European Investment Bank. These measures look set to be financed from unused funds from the cohesion policy and from the tax on financial transactions. It cannot be ruled out that the SPD will press for the introduction of eurobonds, which, however, Angela Merkel is firmly opposed to. The SPD's aim is to discredit Merkel's current strategy for combating the crisis and to show that it is possible to get out of the crisis by shifting focuses to a larger extent from painful savings to growth-stimulating investments. This could be a great asset for the Social Democrats in the federal election in Germany held next year.

In practice, the current situation can mean that in June Germany will succeed in ratifying only the treaty establishing the ESM while the negotiations about the adoption of the fiscal pact will be put off until autumn; this has been already announced by certain SPD and Green Party politicians. The increasingly assertive attitude held by the FDP – the CDU/CSU’s coalition partner in the government – is also a problem since within the FDP the faction that is critical of the present methods of rescuing the euro zone is gaining more and more ground. This approach can be illustrated by a recent statement made by Frank Schaffler, the financial expert of this faction of the FDP, who has not endorsed the candidature of Finance Minister Wolfgang Schauble for the head of the euro group because he deemed Schauble responsible for having introduced Germany into the “community of debts”.

Cases of litigation which representatives of the SPD, CSU, the Left Party and the Mehr Demokratie association intend to submit to the Federal Constitutional Court of Germany may also be an additional problem for Chancellor Merkel. They argue that the fiscal compact excessively limits the constitutional competences of the Bundestag regarding its right to supervise the budget. They are all referring to the verdict issued by the Federal Constitutional Court in the case of assistance provided to Greece. In this case the court opposed any further transfer of even partial budget rights of the Bundestag without amending the constitution. Similar doubts are being expressed – not only by the opposition but also by many representatives of the ruling coalition – over the ESM due to the fact that this will enable Germany's substantial funds to be allocated without the appropriate supervision of the Bundestag. Under the ESM control over German funds will be exercised only by a representative delegated by the federal government, probably of the rank of finance minister or deputy finance minister.

The forecast for Germany’s measures

It seems a foregone conclusion that Angela Merkel will be forced to make concessions on the euro zone stage. A fund of a sort will have to be established to promote economic growth. The ruling coalition will however seek measures to grant the fund a more symbolic meaning and to make sure it does not call for mobilising considerable financial resources. From the perspective of the interests of the entire EU, it would not be beneficial if Germany, under pressure from other partners, agreed to establish a fund intended to boost growth and which would draw on the financial resources from the cohesion policy. In such a situation support for the new instrument "Connecting Europe" would not be excluded. This instrument is intended to provide assistance for investments in infrastructure and energy in the EU without allocating funds for particular countries though Germany has initially opposed this. The foreign minister, Guido Westerwelle indicated in his 11 May speech in the Bundestag that the way of disbursing funds under the cohesion policy should be reconsidered and that more funds should be channelled to boost employment and competitiveness. This could mean that Germany will try to shift the weight of the debate over the support for the countries from the southern part of the eurozone from the fiscal compact to the negotiations about the Multiannual Financial Framework 2014 – 2020.

On Germany's internal political scene Angela Merkel may also be forced to make concessions with regard to the demands made by the SPD and the Green Party as these parties are for the first time in several years able to effectively block the government's plans. Disputes over this issue between the coalition and the opposition will however depend on the situation on the financial markets, in the euro zone and on the position held by François Hollande. If it turns out that uncertainty regarding the fate of the euro zone or the risk of Greece withdrawing from the monetary union increase, the opposition may be forced to accept the fiscal compact unconditionally.