

Germany is preparing a plan to comprehensively reform the eurozone

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German Chancellor Angela Merkel and her country's Ministry of Finance are shaping a plan for a comprehensive reform of the eurozone. Germany is determined to rescue the euro – even at a high price – on condition that profound changes are going to be conducted. Germany is working to introduce mechanisms for sanctions on excessive borrowing, namely the creation of a European Stabilisation Mechanism which would balance the financial situation in the eurozone, and to establish an 'economic government' aimed at coordination of the eurozone countries' economic policies. Germany is promoting this plan under the slogan 'A Union of Stability', and is proposing to amend the EU treaties during the coming year.

Mechanisms to restrict borrowing

Firstly, Germany is pushing for a further tightening of sanctions for running excessive levels of budget deficits and public debts. German politicians have welcomed the introduction of six economic management reforms within the EU (the so-called six-pack), which have facilitated the imposition of sanctions for excessive deficits and debt within the existing European treaties. Germany sees them as being helpful for the time being, but not sufficient in themselves. In the longer term, Germany will insist on a fully automatic system of penalties for breaching the Maastricht obligations, which impose a limitation on budget deficits of below 3% of GDP and a public debt level below 60% of GDP; breaching these limits should lead to administrative sanctions, with no possibility of veto. To reinforce the pressure to reduce debt, Germany would like to see the introduction of so-called 'budgetary brakes' to the other eurozone countries' constitutions, which would permit punishment for the national leaders of those states on the basis of national law if they allow excessive growth of debt. Angela Merkel has also proposed changes to the treaties which would allow countries not abiding by the Maastricht criteria to be brought before the European Court of Justice. Germany should also be expected to agree to the European Commission's proposal to limit the structural funds for those member countries that violate the Maastricht criteria, if the German *Bundesländer* do not oppose this idea.

The European Stability Mechanism – calming the financial markets

The second pillar of the solutions Germany has proposed concerns the stabilisation of financial markets, and the creation of restructuring procedures for those eurozone countries which are at risk of insolvency.

Germany will press for a clarification of procedures of functioning of European Stabilisation Mechanism (EMS: see Appendix), an institution, which is supposed to be analogous to the International Monetary Fund. The EMS will come into operation on 1 January 2013, and in June that year it will take over the existing interim funding obligations for the most indebted countries. The method of decision-making in the EMS will depend on an area of competence; the number of votes available to the member countries will depend on how much capital they have paid into the EMS. In key areas such as allocating financial aid, increasing capital, and changes to the system for dividing up the capital, decisions will be taken by consensus. In the areas of selecting the chairman, determining the EMS's working procedures, shortening the term of the EMS's managing director, deciding how the beneficiary countries will reduce their debt, and abolishing immunity for the EMS's major directors, the Council will take decisions by a qualified majority (80% of the votes); that is, a veto will need more than 20% of the votes. The distribution of the votes guarantees Germany (with 27.1% of the votes) and France (20.4%) the opportunity to veto proceedings. This means that even the entry of a large country such as Poland into the eurozone will not prevent the possibility that Germany could veto decisions taken by a qualified majority, because in this case they would retain about 25% of the votes, whereas France's share would fall below 20%.

Germany expects the EMS to take the opportunity to intervene in the budgetary policy of the countries it will supervise. From the German point of view, the main task of the new mechanism will be, if necessary, to bring about so-called internal devaluations in countries that become uncompetitive in comparison with other eurozone countries. This means that as such a country will be unable to devalue the currency (the euro) and thus regain competitiveness, these countries will be forced to reduce wages and limit their growth rates, and to balance their public finances through privatisation and improvement of their institutions efficiency. To allow such intrusion into individual national economies, increasing the competence of the EMS in the future cannot be ruled out. A request to determine the precise procedure for bankrupting a country, linked to the partial limit of such a country's sovereign rights with regard to its budget policy, was included in a letter sent on 4 October from Germany's Economy Minister Phillip Rösler to the secretary of the Ministry of Finance, Jörg Asmussen.

Still, there is great controversy as to whether the German method for resolving the situation in the eurozone countries in the form of drastic savings will be effective. They could have very high social costs in the form of rising unemployment, as exemplified by the economic situation in Greece; this in turn may prevent comprehensive reforms, and lead the eurozone economy into recession.

Coordinating economic governance within the eurozone is the maximum goal

In the longer term, Germany will seek to rebuild the entire architecture of economic governance in the eurozone by creating an 'economic government'. This could in consequence lead to a weakening of the role of the EC, which will probably become a

technical body for implementing the tasks set by the future 'economic government'. This idea has not yet been clearly worked out. The previous German plan, based on the belief that controlling debt and deficits in the eurozone countries would suffice, has failed. Germany now argues that the eurozone members must co-ordinate and take joint decisions on fundamental economic issues such as the shape of the social system, retirement age, and the scale of investment in research and innovation, and these issues would probably be dealt with by the 'economic government'.

Conclusions

- Germany wants to present a comprehensive proposal for reform by the end of October. For now, it is difficult to predict which elements of the German plan will be accepted. The scope of the changes to the treaties which they manage to push through next year will be crucial to Germany's plan. The prospects for reforming the eurozone also depend on many political and economic factors. The European Commission, some members of the eurozone, as well as the political opposition within Germany (some CSU and FDP parliamentary deputies) will oppose the creation of an 'economic government' as an institute which manages the eurozone's economies. The current German concept may, however, find support due to the growing crisis on financial markets and the deteriorating economic situation, which could force the plan's opponents to accept it in the face of recession, and in the absence of alternative solutions.

- The first stage of reforming the eurozone will be established by an intergovernmental agreement strengthening the powers of the eurozone group, which can later be integrated into the EU treaties. Recent calls by representatives of the German government demanding rapid changes in the treaties must be taken seriously, but if there are any problems with pushing through these modifications, Germany will propose an intergovernmental agreement as a transitional form. The proposed changes to the EU treaties will also seek to restrict the right of veto, as German politicians think that even after Lisbon, the current system is still preventing a comprehensive reform of the eurozone. This means reducing the political role of smaller countries, as exemplified by the situation in Slovakia, which despite huge public opposition was forced to finance part of the aid for Greece.

- The concept of an 'economic government' will mainly concern the 17 countries of the eurozone. Changes in this direction will sanction the division of the European Union into a 'two-speed Europe', because the most important economic legislative initiatives will be undertaken by the eurozone countries. An example of this may be the plans (disclosed by the German press) for amendments to the treaties drawn up by members of the CDU, whose suggestions included introducing a chamber of deputies from eurozone countries in the European Parliament.

Appendix

Participation of individual countries in the ESM's capital

Country	Capital (€bn)	Share
	190 025	
Germany	142 701	
France	125 396	
Italy	83 326	
Spain	40 019	
Netherlands	24 339	
Belgium	19 717	
Greece	19 484	
Austria	17 564	
Portugal	12 582	
Finland	11 145	
Ireland	5 768	
Slovakia	2 993	
Slovenia	1 753	
Luxembourg	1 373	
Cyprus	1 302	
Estonia	512	
Malta		