

Germany wants economic coordination of the eurozone

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Concepts for the further reform of the eurozone were discussed during a meeting of the Eurogroup on 17 January. The talks were dominated by a dispute over the European Commission's proposal to increase the capacity of the European Financial Stability Facility (EFSF). Additional funds would have to be provided by countries which have a better budget situation, Germany in the first order. Germany agreed with the need to increase the facility's funding. However, precise solutions have to be adopted along with comprehensive eurozone reforms to be discussed during future summits.

In the opinion of the German government, the actions taken so far to rescue the euro have been makeshift solutions which do not guarantee the stability of the system as a whole. For this reason, Berlin intends to create a link between strengthening financial support as part of the EFSF and in-depth reforms of the entire eurozone. This scenario is confirmed by the increasingly intensified German-French co-operation for example on the harmonisation of the two countries' fiscal systems as well as by the improving the financial and economic situation in Germany. Detailed provisions of a possible agreement and the two countries' determination in reaching a compromise will decide whether this initiative has a chance for success.

Germany will give higher guarantees to the eurozone in exchange for reforms

The issue of increasing the funding of the EFSF, which was established last May as part of the plan of rescuing the most indebted eurozone members, was in the foreground of the talks. The idea of allocating more funds to this facility has been fostered by the European Commission (EC) and supported by those eurozone member states which have high debt rates. The EC's demands stem from the need to improve the reliability of the EFSF which must have sufficient assets to remain credible to the rating agencies. Financial institutions estimate that the eurozone this year will need 900 billion euros, while the EFSF in fact may grant guarantees worth 250 billion euros. If loans are given to more countries, for example Spain or Portugal, a shortage of funds within the facility may cause unrest on financial markets. The burden of additional guarantees will have to be taken mainly by the six countries which have a better budget situation: Germany, France, Holland, Austria, Finland and Luxembourg.

During the summit, Germany (as with the other five countries) agreed to increase the funds, however on the condition that the increase would be linked to eurozone reforms. The German government assumes that, although the financial markets are calm at the moment, they may become volatile again, if the situation in any of the countries gets worse.

Evolution of the German stance

The predominant belief in Germany until recently was that the crisis in the eurozone was an effect of the irresponsible economic policies of some member states. According to this diagnosis, creating a proper penalties system and the quick imposition of such penalties on the excessively indebted countries was a sufficient remedy to deal with such problems. When the financial markets slumped in 2010, Germany decided to grant consent to the establishment of the EFSF and to intensify the coordination of economic policy as part of the Task Force consisting of the eurozone's finance ministers chaired by the President of the European Council, Herman Van Rompuy.

Recently, however, the German government came to the conclusion that such a superficial reform may turn out to be an insufficient measure to prevent another crisis on a similar scale. Therefore, it is increasingly likely that the German stance will change and a decision to enhance co-operation within the eurozone will be made. The events calendar this year is favourable for implementing deeper reforms. Both the negotiations regarding the long-term financial perspective and the dependence of such countries as Greece or Ireland on the EFSF, where Germany is the largest contributor, provide strong arguments in the discussion about the reform of the eurozone.

Germany and France have been discussing this issue for many months at various levels. A compromise will be difficult to achieve due to difference of opinions on such issues as the degree of the state's engagement in the economy. Nevertheless, the two countries are now ready to intensify their economic coordination, especially in the fields of fiscal policy (a harmonisation of the tax systems) and labour market integration. Germany and France have already started talks about precise measures aimed at integrating their economic policies, an example of which can be the concept for adjusting the French fiscal system to the German one put forward by President Sarkozy last November. In the two countries' opinion, a similar initiative implemented across the EU would improve the financial situation of many countries and also liquidate tax competition, especially from the new member states and Ireland. Additionally, France had earlier considered introducing a 'budget brake' based on the German model to prevent the excessive growth of public debt.

According to the German press, one of the ideas considered is to use article 20 of the Treaty on European Union, which envisages the possibility of establishing reinforced co-operation between at least nine EU member states, provided that the opportunity to join such a group should be guaranteed to all member states of the European Union.

Conclusions

1. The German-French co-operation in reforming the eurozone in the immediate future may bring a comprehensive project containing solutions for deepening economic coordination on the basis of 'reinforced co-operation' in the EU. The details of this proposal may decide whether it receives support within the eurozone and in the European Union as a whole. It can be presumed that the countries which will join the initiative will have to observe much stricter economic rules, especially those regarding debt limits. The legal background of this

concept is beneficial from the German point of view because it uses the solutions already included in the regulations introduced under the Treaty of Lisbon.

2. If this proposal is accepted, the divide between the eurozone members and the rest will be deepened and the notion of a 'two-speed Europe' may become durably institutionalised. The countries which will remain outside the reinforced co-operation will have fewer opportunities for pushing through their stances in the EU. It seems that many (especially new) member states will not be interested in such elements of this proposal as the harmonisation of fiscal policy because they are at a different stage of development and high taxes could turn out to be too heavy financial burden for enterprises in those countries.

3. It is still uncertain how public opinion, and even some German parties, for example the CSU, will react to this proposal. Not long ago it was Germany which was very sceptical about enhancing economic integration, one example of which is its unwillingness to open its labour market to new member states. Over the past weeks, CSU has signalled its reluctance, to any idea of European economic government. Many countries could demand that Germany should impose restrictions on its export surpluses as part of the coordination, an effect the German elite would not be enthusiastic about.