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Budget for the Eurozone: Germany's Approach Gains the Upper Hand

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The decisions of the December summit of eurozone countries to set up a budget for the monetary union are in line with Germany's expectations. The new financial pool is indeed deepening integration, but its small size and lack of autonomous character do not violate their economic interests and the existing EU integration structure. The outcome is also acceptable to EU Member States outside the euro area because it lowers the risk of differentiated integration.

The question of a budget for the euro area was introduced to the European debate by French President Emmanuel Macron. In a speech at the Sorbonne in September 2017, he proposed to create a separate financial pool for the needs of monetary union countries. France was in favour of separating this budget from the EU-wide multiannual financial framework (MFF) and strengthen it politically by a new European minister of finance. The budget was also supposed to have its own sources of financing and a scale of spending allowing stabilisation of the economic situation and crisis prevention—at least a few percent of the GDP of the Member States.

The eurozone states at the summit in December last year accepted Macron's idea, but at the same time cut back on it significantly. The budget will not be autonomous and will be included in the MFF, which means, at least for now, ending the discussion about a new finance minister. Anchoring it in the EU also underlines the opening of the budget to non-eurozone countries (conditional on being linked to the euro through the exchange rate mechanism, ERM II). The summit decisions do not mention the ambitious stabilisation function. With presumably €25–30 billion, the budget will be small and will have the limited objective to support competitiveness and convergence. The details will be determined by June 2019.

The final outcome of the negotiations was certainly influenced by the opposition of the Netherlands and the so-called “Hanseatic group” reluctant to support the idea of a shared budget. However, Germany's many months of persuasion were more important, as they convinced France to limit its ambitions and gradually—as the Meseberg declaration of June 2018 showed and the joint plan for a eurobudget of November 2018—achieved the intended effect.

Germany's Interests. The fundamental doubt about the French proposals—a large, autonomous budget of the euro area—stemmed from the fear that it would change the reaction to economic crises. In Germany, the view prevails that in the event of a downturn, market reforms need to be undertaken first and foremost. Thanks to them, the economy will be “cleaned up” of ineffective enterprises and interest rates will be lowered, which in turn facilitates taking up new investments and returning the economy to the path of growth. A eurobudget of several hundred billion euros aimed at supporting demand in crisis-stricken economies could jeopardise this logic as the pressure for reforms is weakened.

Another reservation is related to financial discipline in the euro area. A budget large enough to perform a stabilising function could relieve national budgets and allow governments to show better data than the reality about the state of their public finances. This could lead to a relaxation of fiscal discipline towards overly indebted countries (in particular Greece and Italy). Such an effect would be met with a very negative reception by the German public.

Critics of the eurozone budget idea also focus on the issue of costs. The new MFF (2021–2027) will mean a higher burden for Germany due to the increase in contributions after Brexit (about €4 billion annually more for Germany) and new expenditure targets, e.g., for migration policy. Germany is cautious about creating another financial pool in part because of its own fiscal goals: for several years, it has been determined to reduce public debt to below 60% of GDP, in line with the Stability and Growth Pact. Although Germany does not have far to go—in 2017 it recorded 64.1%—the room for manoeuvre is still limited.

Germany's doubts about the budget also concerned its political consequences. The French postulate for a eurozone finance minister was treated with distrust because it would mean the creation of a strong, supranational authority, violating the current division of competences between nation-states, the Commission and Parliament. An additional consequence of the institutionalisation of the budget would be the risk of the permanent diversification of integration into the euro area and other countries. This could complicate relations within the EU and provoke an increase in Eurosceptic attitudes in non-euro Member States.

A Compromise with Flaws. Generally, the decisions of the December summit favourable for Germany are not devoid of dilemmas. The most important of them is of a political nature and concerns the situation in France. The limited budget weakens Macron's position at a sensitive period in the election campaign to the European Parliament and amid the protests by the "yellow vests." Modest achievements at the European level deviating from the ambitions announced at the Sorbonne may induce Macron to buy social support with higher expenditures. This in turn means loosening discipline in public finances, which pushes France towards an alliance with the indebted countries of the south of Europe. This is a very unfavourable scenario for Germany, signifying a serious weakening of cooperation with France to reform the EU.

The lack of a large budget for the euro area may also help increase the tensions in the European Commission's relations with the Member States around adherence to fiscal discipline. Countries recording high public debt will—in the absence of the EU stabilisation fund and a downturn—fight for every fraction of a percent of the expenditure space. An example of this is the current dispute with the Italian government, which demanded the possibility of increasing Italy's budget deficit to 2.4% to fulfil election promises. France, in turn, plans to increase its deficit to 3.2%. The European Commission, demanding compliance with fiscal discipline, will be an easy target for Eurosceptics in these disputes.

However, there are voices criticising even the limited budget idea for the eurozone. According to them, its very existence threatens the principle of the fiscal autonomy of Member States and raises the risk that financial transfers will gradually increase in the union. The pressure won't ease: expansion of the budget is still on the agenda of France and the Southern European Member States. Critics also have formulated an allegation that the eurobudget is incoherent with the existing EU financial structure. Its goals—supporting "competitiveness and convergence" as mentioned in the December decision—are difficult to consider as specific to the euro area. Indeed, these are EU-wide objectives that have so far been pursued through EU-wide structural funds. In this situation, the eurozone budget seems to have fairly weak justification.

Conclusions. Each of the parties negotiating the eurozone budget for the last two years is trying to present the compromise as a success. From France's point of view, the political decision to create it gives hope for increasing its role in the future. In turn, Germany and other countries favouring cautious steps towards deepening integration point to the small size of the budget, its anchoring in the EU, and its limited goals of strengthening competitiveness and convergence. From the latter group's perspective, the risk of moving away from reacting to crises through structural reforms and prudent fiscal policies has been clearly reduced. At the same time, it is an undeniable deepening of cooperation, which neutralises accusations of reforms in the EU being inhibited.

Prudent progress in the work on the common eurobudget is acceptable to countries that are not part of the eurozone, including Poland. The financial platform of the monetary union is unlikely to become in the near future an instrument of political division of integration and a distribution channel for structural expenditures competitive with current funds. It also does not look like an instrument for forcing countries outside the zone to quickly adopt the single currency. Any country wishing to use the eurobudget will be able to do so if it participates in ERM II (for now, this only applies to Denmark). This is a signal that deepening integration in the euro area does not necessarily lead to differentiation at the EU level but at the same time encourages tighter ties with the monetary union.