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France and Germany look set to fudge it yet again

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By Wolfgang Münchau

Angela Merkel and Nicolas Sarkozy are as far apart as they ever were. But with five days to go until the next summit, their political standoff is part of the usual pre-summit poker game. The German chancellor and the French president always reach some agreement in the end. My main concern is they will again fudge it.

Contrary to what is being reported, Ms Merkel is not proposing a fiscal union. She is proposing an austerity club, a stability pact on steroids. The goal is to enforce life-long austerity, with balanced budget rules enshrined in every national constitution. She also proposes automatic sanctions with a judicially administered regime of compliance. She rejects eurobonds on the grounds that they reduce pressure on fiscal discipline.

Mr Sarkozy's proposal could not be more different. He has said that he is not prepared to cede any sovereignty to the centre. He wants to retain the inter-governmental approach that has so abysmally failed in the past. He opposes any attempts to strengthen the European Commission, or to involve the European Court of Justice in adjudicating on breaches of the rules. While rejecting Ms Merkel's obsession with austerity, he is not interested in a genuine fiscal union either. He is open to a eurozone bond and to the European Central Bank having the role of lender-of-last resort. I would surmise that this is because France would stand to benefit from both.

Mario Draghi, meanwhile, insists politicians deliver their part of the bargain before he does. The ECB's president has so far resisted pressure on him to provide an unlimited backstop to the system, either by backing the European bail-out fund or through a direct guarantee of long-term bond market prices.

Can the positions of the three main players be reconciled? Of course they can. Unfortunately, reconciliation will not solve the problem. What the eurozone needs most urgently is a strategy to address the immediate financial crisis. This will have to involve the ECB in the short run, and a eurobond in the long run. They also need to reconsider the disastrous strategy of private sector participation. The second priority is to avert the looming credit crunch and depression. Third, to be done concurrently, is a reform of the system of governance. The issue here is not that ever elusive "single telephone number", but a system capable of handling all aspects of economic policy, including crisis management.

It will have to address the various imbalances that have given risen to the current situation. A priority would have to be a stronger, and properly supervised, European banking sector. And

yes, there needs to be fiscal co-ordination. But fiscal policy has not really been the main motor of this crisis, except in Greece.

As of today, I find it hard to see how the European Council is going to deliver such a package. The debate in Brussels is about how to reconcile *Austerität* and *souverainisme*. What is needed is not to reconcile these propositions, but to reject them. Andrew Duff, a member of the European Parliament, last week provided a very useful guide to the distance the eurozone is from where it would have to be if it were a proper fiscal union. He drew up a list of all the changes in the European Treaties that would need to be amended to achieve that. It includes changes to 23 articles and five protocols. This is the stuff the European Council should discuss, not another silly stability pact.

Of course, a fiscal union is not a quick fix. On the contrary, it may take 10 years, or even longer. The EU would once again have to set up a convention to make a proposal for a treaty change, to be followed by an inter-governmental conference. Some states would hold referendums with uncertain outcomes. There is no way the EU can agree on a fiscal union on Friday, and implement it on Monday. But it would be a big step if the European Council made a clear commitment for a multi-step, multiyear process.

European leaders understand the technical, and legal issues well. I am also certain that most understand that the eurozone faces an existential threat. But I doubt they have ever understood the economic and financial dynamics behind the crisis. Their narrative, which reduces the crisis to a failure of fiscal discipline, is probably the underlying reason why all their crisis resolution efforts have failed so far.

With five days to go, the world is waiting for a big political signal. What I fear is a fudge, consisting of a multi-annual fiscal retrenchment, no eurobond, at most a temporary debt redemption instrument. The ECB will provide liquidity measures to stabilise the financial sector, and it will also provide a backstop for the bond markets. But I find it hard to see how Mr Draghi can agree an unlimited guarantee in the absence of a political union and a eurobond. A strengthened stability pact is not a fiscal union.

The way the negotiations are going now, I can see a compromise, but no solution.

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