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Don't judge Germany's negotiation outcome yet^(*)

Sebastian Dullien^(**)

Germany's aim in the negotiations on the reform of the governance structure of European Monetary Union and the Stability and Growth Pact (SGP) was threefold: First, the German government wanted a tightening of the budgetary rules of the SGP, preferably with tougher fines and automatic sanctions. Second, in order to make the no-bail-out-clause credible again, Berlin was pushing for a crisis resolution mechanism which – as an *ultima ratio* – contains the possibility of an orderly sovereign default. Third, Germany wanted to prevent the EU Commission or the partners to apply pressure on it to reduce its large current account surpluses.

This position can best be understood in the context of the German monetary tradition, its constitution and its current economic policy debate. Already in the 1990s, when the Stability and Growth Pact was originally negotiated, Germany wanted to have strict rules for dealing with excessive deficits in order to calm the public and prevent the impression that the euro was built on macroeconomic foundation less sound than those of the Bundesbank. The reason for this is not only the public's attachment to the former national symbol, the German mark, but has also constitutional reasons. The constitutional court has ruled that property rights guaranteed in the German constitution need to be protected in EMU which they interpreted was only possible with strict budgetary rules. The German ministry of finance at the moment holds the position that the rescue packages for Greece and the set-up of the European Financial Stability Facility (EFSF) has been an ad-hoc construction and that a permanent liquidity fund would conflict with the German constitution were it not supported by other measures strengthening the no-bail-out principle.

The current state of the SGP reform leaves Germany with little success so far. The SGP has not been significantly tightened as the council still needs to vote before sanctions come into effect. However, whether in the end Germany can be seen as the loser in the negotiations can only be judged after the other elements of governance reform have been decided on. If in fact the compromise on the SGP reform leads to France moving towards the German position on the temporary suspension of voting rights for violators of the SGP and a crisis resolution mechanism, the overall budgetary framework actually might be strengthened. It is also open so far in how far German current account surpluses will become an issue targeted by the new governance framework. In the Commission proposal, in principle, countries with large current account surpluses could also be fined if they do not cooperate in reducing them. In the coming months, Germany will try to do everything to make sure these rules will be applied in an asymmetric way, applying pressure on current account deficit countries, but less on current account surplus countries.

Moreover, from an economic point of view, the automatic sanctions in the EU Commission's SGP proposal might not have been very helpful to prevent debt crisis in the future anyway. We should not forget that even stricter rules would probably not have prevented the current debt crisis. The Greek government just cooked the books. This probably would have happened also if fines had in principle been applied more quickly. Spain and Ireland had seemingly sound government finances

(*) The opinions expressed herein are strictly personal and do not necessarily reflect the position of ISPI.

(**) Sebastian Dullien is professor of International Economics at HTW Berlin, University of Applied Sciences.

with surpluses prior to the financial crisis of 2008/9. Applying monetary fines to them now would only have added insult to injury, but would neither have prevented the large deficits caused by the strong increase of unemployment nor prevented the Irish government from inserting large amounts of money into the struggling banking system. Thus, in the end, for the working of EMU, the fines in the SGP are secondary to the macroeconomic coordination framework. And a well-working EMU should in the end also be in Germany's vital interest.

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ISPI
Palazzo Clerici
Via Clerici, 5
I - 20121 Milano
www.ispionline.it

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