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The Role of France and Germany in the Euro Area Reform

Dimitra TSIGKOU
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December 2020
Working Paper #113/2020

ELIAMEP | Working Paper # 113/2020

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HELLENIC FOUNDATION FOR EUROPEAN & FOREIGN POLICY (ELIAMEP)
49 Vasilissis Sofias Ave., 10676, Athens, Greece
Tel.: +30 210 7257 110 | Fax: +30 210 7257 114 | www.eliamep.gr | eliamep@eliamep.gr

Dimitra TSIGKOU
Junior Research Fellow of the A. G. Leventis Foundation Research Chair, ELIAMEP

With the support of the "A.G. Leventis Foundation Research Chair"

About the author

Dimitra Tsigkou is a Ph.D. candidate in the Department of Political Science and Public Administration of the National and Kapodistrian University of Athens. Her Ph.D. Thesis topic is "The Role of Germany and France in the Euro Area Reform: A Comparative Political Economy Approach." She holds an MSc in European Studies from the Athens University of Business and Economics and a BA in Political Science and Public Administration at the National and Kapodistrian University of Athens. Ms. Tsigkou has served as an associate expert at the PM Office of Strategic Planning (November 2011 – July 2012). She has been a Junior Research Fellow of the A. G. Leventis Foundation Research Chair Fellow at ELIAMEP (December 2019 – September 2020) and has extensive experience in research programmes regarding the European Sovereign Debt Crisis and the European Economic Governance reform.

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Introduction

The bilateral cooperation between France and Germany has often been viewed as the "engine" of European integration. From the beginning of the European integration process, the Franco-German initiatives have played a pivotal role in overcoming stalemates in negotiations and identifying solutions to common challenges. The joint initiatives between the two most potent European economies have profoundly influenced the economic integration of Europe. A typical, recent example is the historic decision to create a new recovery instrument, the Next Generation EU, as a response to the severe economic crisis caused by the Covid-19 pandemic. This instrument foresees, among others, common EU borrowing from the financial markets with the aim of providing transfers and loans to the European economies. Coming to this decision, however, was by no means an easy process, considering the complex and intense discussions among the EU member states. Despite the efforts of the President of the European Commission and the President of the European Council, the negotiation effectively began only after the Franco-German axis was reactivated. In a surprising common initiative, the German Chancellor Angela Merkel and the French President Emmanuel Macron unveiled their joint proposal for the creation of a European Recovery Fund that would be funded by common EU borrowing from the markets with a view to channeling grants to the countries that have been hit hardest by the pandemic. As a result, this groundbreaking Franco-German initiative gave new impetus to European economic integration. Still, the convergence of the German and French negotiating positions should not be taken for granted. So far, whether we are referring to the creation of the European and Monetary Union (EMU) itself or its reform effort that began in 2012, the French and the German governments have primarily sought to promote their distinct aspirations and preferences. For instance, all these years, the German government has adamantly opposed any initiative involving debt mutualization and transfers between Eurozone member states while promoting fiscal discipline and drastic economic reforms**.** In contrast, the French government has always favored greater flexibility and has been more inclined to set up common fiscal transfers at the EU level (Mourlon-Druol, 2017).

This divergence of perspectives was also echoed in the joint Franco-German Meseberg declaration, adopted in June 2018. In this context, the two member states agreed on an extensive catalog of reforms for the continued integration of Europe, including the creation of a Eurozone budget. However, according to the Declaration, this budget would not constitute an autonomous tool, foreseeing the euro area's macroeconomic stabilization. Instead, it should be directly linked to the next Multiannual Financial Framework – MFF (2021-2027). This would unavoidably lead to a reduction of its resources, aiming to promote the competitiveness and convergence of the eurozone economies. Furthermore, the possibility of establishing a European Unemployment Stabilization Fund was also mentioned, nevertheless, without, again, foreseeing any fiscal transfers.

Against this backdrop, it becomes evident that Germany's recent deviation from its traditional negotiating positions was immensely affected by the catastrophic economic consequences of the pandemic. However, this deviation is likely to be a temporary one. Both the French and German

governments have persistently held diverging interpretations regarding the strengthening of the euro area, which are embedded in their deeply-seated economic philosophies.

In view of the forthcoming debate on the future of Europe and the vital need to further reinforce the EMU, it is essential to examine the two member states' negotiating positions during the central debates in the course of the European economic integration process; that is, the establishment of the EMU and the discussion on its reform. Drawing on insights from the comparative political economy literature, I will explore how the institutional features of different varieties of capitalism led these member states to adopt divergent growth strategies while participating in the same monetary union. In this respect, we will be able to decode the various proposals that these two member states put forward regarding the Eurozone reform effort, taking into consideration their attempt to preserve their comparative institutional advantage and, ultimately, promote their own "vision" on the deepening of the EMU. The original contribution of this working paper is that it presents and codifies the proposals submitted by the European Commission as well as the political views expressed by France and Germany as regards the deepening of Europe's Economic and Monetary Union.

Toward the establishment of the EMU: Explanations

The Economic and Monetary Union (EMU) was established under the Treaty on European Union (TEU). It constitutes a hybrid monetary union characterized by its lopsided architecture that combines a robust monetary union with an insufficiently developed economic union. More specifically, on the one hand, the responsibility of conducting monetary policy has been transferred to the EU level (i.e., to the European Central Bank (ECB), which operates under a specific institutional framework that provides for moderate and low inflation rates, close to 2%. On the other hand, fiscal policy remains under the authority of national governments, abiding by the restrictions of the Stability and Growth Pact (SGP). At the same time, as argued by the theory of Optimal Currency Areas (Mundell 1961, McKinnon 1963, Kenen, 1969, De Grauwe 2013), the EMU does not meet the essential criteria to form an effective and integrated monetary union between countries, as it lacks the necessary adjustment tools, such as labour mobility or central fiscal stabilizers which would support the euro area economies in the event of asymmetric economic turmoil.

According to the theory of Neo-Functionalism/Supranationalism, the transition from the single market to the EMU was due to spillover effects, which can be perceived as either functional, political, or "cultivated". More specifically, the functional spillover concept argues that modern economies consist of interdependent parts, and thus, no sector could be isolated from the other. Consequently, it is suggested that when member states integrate one (functional) sector of their economy, the interdependence between the different sectors will inevitably lead to the further integration of the other related sectors through a functional spillover. In essence, this implies that the integration of one sector would only be effective if other functionally related sectors are integrated as well. In addition to this logic, the neofunctionalists introduced the idea of the political spillover, shifting attention to the political pressures exercised by interest groups that operate in an integrated sector

of the economy to support the further integration of other sectors as well (Haas 1968, Lindberg 1963, Bache and Stephen 2006). In that respect, once the liberalization of the single market took place, the swift transition to the next stage, that is, the EMU, was the logical aftereffect that would enable the member states to reap the full benefits of this liberalization. On the other hand, since there was no consensus among economists regarding the need for further monetary integration as a vehicle for reaping the benefits of the single market, the establishment of the EMU could be seen as a "cultivated spillover". In other words, it is argued that the European Commission created the right conditions and exerted the necessary pressures so that member states could transition from the environment of the single market to that of the EMU, intending to foster the European integration process (Haas 1961, 1964; Bache and George 2006).

The theory of Liberal Intergovernmentalism advocates a different perspective by arguing that the most significant choices in favour of the integration of Europe reflected national governments' preferences and not the preferences of supranational institutions. Therefore, this framework focuses on the member states' national preferences as it stresses that the negotiations between the governments of the two most potent European economies, those of France and Germany, were essential for the establishment and the eventual structure of the EMU (Moravcsik 1998). In that sense, it also suggests that the EMU could be seen as a vehicle through which governments could pursue necessary, albeit unpopular economic policies, without incurring any political costs.

The most prevalent narrative regarding the reasons that urged governments to establish EMU, emphasizes political motives, which also explains why little consideration was given to the provision of the relevant institutions and tools for the smooth functioning of the EMU (De Grauwe 2013). More specifically, the French political elites, through the participation of their country in the EMU, intended to alleviate the significant pressure under which the relatively weak French franc was from the strong German mark while also regaining greater control over the formation of the European economic policies. Moreover, according to this perspective, French elites sought to secure the attachment of the reunified Germany in the chariot of European integration (Baun 1996, Dyson and Featherstone 2000, Marsh 2011). Correspondingly, the political elites in Germany, and Chancellor Helmut Kohl, in particular, aspired to effectively demonstrate that, even after its reunification, Germany would be committed to the objectives of the European integration process. Thus, Chancellor Kohl wanted to reassure his European partners, who were apprehensive about the resurgence of nationalism in Germany, while safeguarding the long-term peace on the European continent (Baun 1996, Szász 1999).

Although these viewpoints are, with hindsight, historically confirmed, the theorists of comparative political economy insist that the deeper motives behind the establishment of the EMU lie in the politico-economic benefits that the respective governments pursued through their participation in it (Iversen et al. 2016). This perspective is in line with the theory of Liberal Intergovernmentalism, as, according to Moravcsik (2012), Germany's primary incentive for creating the single currency, contrary to common belief, was neither to promote reunification nor to implement an idealistic federal plan for the European Political Union. Instead, it was the reinforcement of its own economic prosperity through open markets, competitive exchange rates, and anti-inflationary monetary policy (Moravcsik 2012, p. 55).

Of course, this does not mean that political negotiation did not play its part. For example, the design of the ECB , which was based on the German Central Bank (Bundesbank) doctrine of price stability and independence, was undoubtedly the price that the French government had to pay in order to persuade Germany to abandon its strong currency (Szász 1999, Marsh 2011). Nonetheless, the creation of the single currency has mainly been the result of a compromise between the national political and economic interests of the two strongest European economies. This can be traced to the fact that long before the reunification prospect was added to the German political agenda, in the 1970s and 1980s, its governments were concerned with the competitive devaluations and exchange rate volatility that threatened Germany's vital export sector (Brunnermeier et al. 2016). As a result, following the collapse of Bretton Woods, the Bundesbank pursued a low inflation policy averting an increase in real interest rates and the appreciation of exchange rates (Flanagan et al. 1985, Hall and Franzese 1998, Iversen 1999, Soskice and Iversen 2000, Soskice 2007). France, on the other hand, sought to attach its economy to a system that, through external constraints, would impose domestic fiscal restraint and monetary policy discipline by keeping inflation, and consequently, real interest rates low while boosting investments at the same time (Iversen et al. 2016).

The Comparative Political Economy Perspective

In light of this, it becomes evident that in order to grasp the complex rationale that forged, and still does, the member states' negotiating preferences and aspirations, it is crucial to look into the specific features of these states' political economy by drawing on the insights from the Comparative Capitalism (CC) literature, and, therefore, by analyzing their models of capitalism and growth. From this standpoint, the most influential approach within CC scholarship is the Varieties of Capitalism (VoC) theory, formulated by Hall and Soskice (2001), who accentuated the institutional variations across states as a response against the widespread belief that globalization would lead to the gradual convergence of advanced capitalist economies. Instead, the VoC model contends that disparities among advanced capitalist economies not only do not fade away but may be amplified due to the different comparative institutional advantages that various socioeconomic models may hold (Tsigkou 2020).

Following an actor-centered approach, VoC tries to assess how interactions among interest-seeking agents [primarily, industrial firms] shape the economic and political environment of action (Scharpf, 1997). National Political Economies (NPEs), Hall and Soskice claim, should be compared according to the ways that industrial firms resolve potential coordination problems along five areas (i.e., industrial relations, vocational training and education, corporate governance, inter-firm relations, and coordination problems with their own employees) as the latter have a direct impact on a country's economic performance. As a result, two dominant ideal types of NPEs can be discerned in VoC, the Liberal Market Economies (LMEs) and the Coordinated Market Economies (CMEs). Within the LMEs, an arm's length relationship exists between the state and economic actors operating within a competitive environment (Chang, Steinberg, & Torres, 2020, p. 3). On the contrary, more extensive relationships between governments and economic actors occur within the CMEs, fostering a more cooperative economic environment. These two types of economies are considered resilient due to

the emergence of institutional complementarities that result in different comparative advantages in areas like innovation systems, industrial structures, international competitiveness, political regimes, social policies, and reactions to globalization. The UK and the US are typical LMEs, while Germany, Belgium, Austria, and the Netherlands are presented as the typical CME countries.

Nevertheless, recognizing that all economies cannot fit within this dualistic distinction, Hall and Soskice also alluded to an intermediate type of capitalism, the so-called "Mediterranean", to describe economies that share characteristics of both LMEs and CMEs. This hybrid type of capitalism [referred to in Hall's and Gingerich's (2004; 2009) work as Mixed Market Economies] lacks the functional consistency and the institutional com-plementarities that characterize LMEs and CMEs. Instead, it is defined by frequent state interventionism as the latter endeavors to counterbalance the country's economic deficiencies by providing subsidies and implementing state protectionism policies. Italy, Spain, Greece, Portugal, as well as France, constitute some such examples.

Furthermore, recent political economy analyses associated with the VoC theory (Hancké 2013a, 2013b; Johnston 2012, 2016; Johnston et al., 2014, Baccaro and Pontusson 2016; Hall 2012, 2014; Iversen et al. 2016; Iversen and Soskice 2012) have contended that countries with different varieties of capitalism tend to operate different growth. Hence, these economies tend to adopt various approaches, contingent on how the organization of their political economy encourages the production of certain types of goods and restricts or expands the number of instruments available for managing the economy Hall (2017, pp.4). The Coordinated Market Economies (CMEs) of the North, and especially Germany, are pursuing sustainable growth through the expansion of exports as the institutional infrastructure of these economies enables them to espouse an export-led growth model. The characteristic institutional infrastructure of the CMEs underpins high levels of coordination between producer groups. It thus facilitates coordinated wage bargaining and cooperation in vocational training programs, resulting in high levels of skills and incremental technological innovation that, consequently, enhance medium- or high-technology production (Hall and Soskice 2001). Additionally, these economies tend to implement restrained fiscal policies as, according to modern macroeconomics, public sector deficits translate into a deteriorating external balance in the medium term, undermining the country's competitive advantage (Hancké 2013a; Iversen et al. 2016; Johnston 2012). Nevertheless, although these macroeconomic restraints favor the export sector, at the same time, they adversely affect domestic demand (Johnston and Regan 2018). In this regard, the traditional (German) export growth model mainly relies on manufacturing and safeguards the high competitiveness of its companies in the international markets through the tacit support of employers and trade unions to hold down unit labor costs (Iversen et al. 2016).

On the contrary, the Mediterranean Market Economies (MMEs) of Southern Europe, which often include France (Hall and Soskice 2001, Hall 2017), tend to secure their growth by stimulating domestic demand. Therefore, growth is demand-led as it is consumption which is the major contributor to GDP growth.[1] Domestic demand-led growth models do not fully accommodate classic varieties of capitalism typologies. Their common denominator, however, is that their economic viability relies on wage-led and/or credit-led growth, as well as the electoral coalitions these sectors

[1] In this case, we analyze the MMEs, as France is usually included in this type of capitalism. However, this approach to economic growth is also typical for the LMEs (Iversen and Soskice 2012).

are inclined to promote. This suggests that, instead of trade, their economic vitality relies on the increasing domestic demand for non-tradable sectors (e.g., public sector, construction, services etc.), underpinned by wage increases and low-interest rates.

Consequently, fiscal policies are designed to stimulate domestic demand and wage coordination or wage restraint initiatives are bound to fail (Johnston and Regan 2018, Hall, 2017). Moreover, in these economies, collective bargaining institutions are fragmented, hampering any efforts to provide income policies, such as those adopted by the export-oriented growth models of northwestern Europe (Johnston 2016). Recent literature also indicates that the relationship between business and the state is regularly dependent on clientelistic relations developed with specific firms (Evans 2015, Featherstone 2011, Hassel 2014).

Therefore, it becomes evident that, through its participation in the common currency, the export-led German economy aimed at eradicating the continuous devaluations of the Mediterranean economies of the South, and in particular of France, which adversely affected its exports. In contrast, the demand-led economies of the South, including France, sought to maintain stable and low inflation levels, ensuring low-interest rates and, consequently, high levels of domestic investment (Iversen et al. 2016). The table below demonstrates the fundamental negotiating positions of the two strongest EU economies, which reflect the ideas discussed thus far.

Elements of the EMU	Germany	France	European Commission	Outcome
ECB autonomy, mandate, and voting procedure	Prefers autonomous central bank, except for multilateral exchange –rate policy, firm anti-inflationary mandate, and simple majority decision making.	Favors political control, particularly over exchange rates, balanced mandate, and decisions by simple majority.	French position, plus even stronger Commission role.	German position prevails.
Location of the ECB and name of the currency	Frankfurt; Euro.	Paris, maybe Brussels; ECU.	Brussels.	Frankfurt; Euro.
Domestic budgetary controls with sanctions	Yes, by simple majority.	No.	No.	Yes, decision by QMV.
Financial Transfers	No bail-outs, no financial transfers.	No financial transfers.	Fiscal federalism: large, permanent financial transfers.	No bail-outs or federalism, but temporary increase in structural funds.

Source: The table is based on Moravcsik, A., .1998. The Choice for Europe: Social Purpose and State Power from Messina to Maastricht. Ithaka, New York: Cornell University Press, pp.384.

The European sovereign debt crisis and the debate on Eurozone Reform

The first decade of the EMU was considered successful, with the average inflation hovering at 2,2% and the trade in goods within the Eurozone rising from 26% of GDP in 1998 to 33% of GDP in 2008. Furthermore, Foreign Direct Investment (FDI), as a share of Eurozone total GDP, also increased from 35% to 45% between 1999 and 2006 (European Central Bank 2008, pp. 89-93). At the same time, the financial integration progressed further as cross-border interbank loans increased (Lane 2008).

According to the CC perspective, the introduction of the single European currency facilitated the (smooth) operation of a dual growth model, as most Eurozone economies grew relatively rapidly. On the one hand, the export-led economies of the North (and particularly Germany) benefited from the non-accommodating monetary policy that the independent European Central Bank conducted, while, at the same time, secured their growth through the expansion of exports as their neighboring markets could no longer perform any competitive devaluations. On the other hand, the (domestic) consumption-oriented economies of Southern Europe[2] saw their economic growth rates rising faster than their export-oriented Northern neighbors. These economies profited from the lower interest rates and enhanced access to foreign borrowing (Hall 2012, 2014, Iversen and Soskice 2013, Fuller 2017).

However, in a monetary union where the member states have lost the exchange rate tool which was previously used to offset the effects of inflation on competitiveness, and monetary policy is centrally implemented, it was inevitable that macroeconomic imbalances would occur (Johnston et al. 2014, Regan 2015, Johnston and Regan 2016, Hall 2017, Höpner and Lutter 2018). More specifically, under the EMU, countries such as Germany, where the manufacturing sector is coordinated through robust producer coalitions, have been able to hold down the inflation rates through aggressive wage dumping, and, have thus, attained more competitive real exchange rates (Baccaro and Benassi 2017). As a result, the Eurozone's Coordinated Economies managed to continuously run current account surpluses (and the corresponding capital account deficits) at the expense of their Southern Eurozone trading counterparts. Therefore, this fact eventually permitted the export-oriented growth model to reap the economic benefits that stemmed from establishing the EMU to the detriment of the domestic-growth models in southern Europe (Johnston and Regan 2018).

The high growth rates recorded during the first decade of the EMU covered the sharp disparities and differences between its member states in terms of the competitiveness and productivity of its economies. The global financial crisis of 2008, which evolved into the Eurozone sovereign debt crisis in 2010, was crucial for revealing the institutional shortcomings of EMU's architecture. These weaknesses, among others, included the SGP's inadequate rules, the absence of a euro-area fiscal watchdog and robust supranational institutions for banking supervision, the lack of the proper

[2] With the notable exception of Italy, where growth had been stagnant for more than a decade. Portuguese growth was also stagnant after the first few years.

mechanisms to foster structural adjustment as well as a crisis-resolution mechanism and a lender of last resort (Begg 2011, Darvas 2012, Pisany - Ferry 2014, Enderlein 2015, Baldwin and Gros 2015). The need to respond to the crisis led to the implementation of several institutional reforms as well as to the establishment of new policy instruments (e.g., the European Stability Mechanism, the Treaty on Stability, Coordination and Governance in the Eurozone, the Six-Pack, the Two-Pack, the European Semester, etc.) that made the EMU more resilient. Nevertheless, EMU's institutional architecture remained incomplete. Recognizing the pressing need for reform, the European institutions, particularly the European Commission, launched a dialogue intending to address the institutional weaknesses and shortcomings of the EMU (European Commission 2012).

The foremost theories of macroeconomic analysis, in their attempt to explain the Eurozone debt crisis, identify its causes either in the existence of external shocks ¬– in the present case, the global financial crisis (Feldstein 2011, Krugman 2013)– or in the various endogenous developments such their asynchronous economic cycles (Landmann 2009, Feldstein, 2011, De Grauwe, 2013). However, even if we can, on the basis of the above, discern the shortcomings and imbalances that were created, we cannot explain the "how" and the "why" (Kuokštis 2015).

The CC scholarship suggests that the actual causes of the crisis were rooted in the institutional asymmetries of the different varieties of capitalism linked together into a single monetary union. Those asymmetries urged governments to pursue different growth strategies with a view to safeguarding the comparative advantages that their economies had developed. And consequently, these strategies shaped their preferences regarding the debate on the Eurozone reform.

During this debate, which started in 2012, various groundbreaking proposals were presented, which, inter alia, included the establishment of a European Monetary Fund (EMF), the creation of a dedicated Euro Area budget financed through European taxes, the appointment of a European Minister of Economy and Finance, and more. However, the most appropriate time to examine these (divergent) preferences is 2017, as the then election of the French President Macron gave new impetus to the dialogue between the governments of Germany and France while, the European Commission also tabled its policy package on the Deepening of the EMU (European Commission 2017b).

More specifically, the government of Germany, on the one hand, having set the protection of the export sector as its main priority, opposed any reform that could undermine the euro area's fiscal discipline doctrine. In that sense, it invoked "moral hazard" and "free-riding" arguments while it stressed the need to reinforce the member states' responsibility as a prerequisite for any further progress regarding the deepening of the EMU. It disagreed with the Banking Union's completion without prior implementation of risk reduction measures, and it strongly opposed fiscal transfers between the euro area member states, especially without the adoption of the appropriate structural reforms for the convergence of the EMU economies.

The government of France, on the other hand, has been a strong proponent of greater solidarity and flexibility within the Eurozone, supporting further fiscal and economic integration of the EMU. More specifically, President Macron put at the epicenter of his election strategy the substantial deepening of the Eurozone, proposing, among other things, the creation of an autonomous eurozone budget

that could perform a macroeconomic stabilization function. According to the French President, this budget should be worth "several percentage points of the Eurozone's GDP"[3] and would be placed under the strong political guidance of a common minister while being subject to strict parliamentary control at the European level.

Against this backdrop, the following tables aim to present and codify the proposals submitted by the European Commission as well as the political views expressed by France and Germany as regards the Deepening of Europe's Economic and Monetary Union. The first column is based on the European Commission's, Completing Europe's Economic and Monetary Union- policy package, unveiled on 6 December 2017. The second column is based on President's Macron Sorbonne Speech delivered on 26 September 2017 and the interview that the French Minister of Finance, Bruno Le Maire, gave to Handelsblatt during his visit to Berlin in November 2017. The third column is based on Germany's Ministry of Finance: Non-paper for paving the way towards a Stability Union presented on 9 October 2017.[4]

[3] See more at https://euobserver.com/economic/138841

[4] The attempted codification follows the content of the primary sources. As a result, there is no absolute coherence between the three different columns.

The future role of the European Stability Mechanism (ESM)

European Commission (EC)

Proposal for a Council Regulation on the establishment of the EMF under Art.352 TFEU.

Establishment of a new EMF built on the ESM as a robust crisis management body anchored firmly within the Union legal framework.

EMF's Functions/Features:

- Succeeding the ESM, it will continue to provide financial stability support to M-S in need, to raise funds by issuing capital market instruments, and to engage in money market transactions.
- It will have more direct involvement in the management of financial assistance programs alongside the EC.
- It will provide the backstop for the Single Resolution Fund (SRF) by acting as a last resort lender.
- It should have the possibility to develop new financial instruments, which could be particularly useful in supporting a possible stabilization function in the future (see below).

Decision-making procedure:

- Preservation of Unanimity voting for all major decisions with financial impact.
- Introduction of **Reinforced qualified majority** (85% of the votes) proposed for specific decisions on stability support, disbursements, and the backstop deployment.

Overall Lending Capacity: €500 bn
Timeframe for the adoption of the proposal: mid-2019

France

President Macron made no real mention of the EMF or the Banking Union's completion in his Sorbonne speech, delivered in September 2017.

Nonetheless, the French Finance Minister, Bruno Le Maire, during his visit to Berlin in November 2017, laid out a four-stage proposal for a fiscal union, suggesting that the strengthening of the ESM should be the second stage following the completion of the banking and the capital markets union, and tax harmonization.

Minister Le Maire supported the strengthening of the ESM beyond its present capacities so that it could become a safety net, rather than develop into an EMF. He was also willing to discuss the possibility of an EMF.

Germany

Core Principle: *fiscal responsibilities and control must always stay together to avoid moral hazard*.

Argues for an intergovernmental solution that may eventually be transposed into EU law on the condition that a Treaty change is agreed.

New ESM Mandates:

Crisis prevention and monitoring of country risks:

- More effective and timely identification of potential stability risks for the EA M-S. The affected countries themselves should reduce risks.
- The ESM would monitor M-S compliance with the Fiscal Compact and, over time, could be given a stronger, neutral role in the monitoring of the SGP.

Establishment of a predictable debt restructuring mechanism to avoid ad hoc solutions
The following elements should be incorporated into the legal text of the ESM Treaty:

- the automatic extension of the maturities of sovereign bonds if an ESM program is granted.
- the obligation to carry out comprehensive debt restructuring on the condition that this ensures debt sustainability.
- to prevent holdouts, an amendment of the collective action clauses that were introduced, moving to "single-limb aggregation" (i.e., a requirement for only one vote on the debt restructuring of all the bonds involved without additional votes on the individual bond series.

Germany:

- Would consider a more significant role for the ESM in bank restructuring on the condition that substantial risk reduction is achieved, including a different regulatory treatment for sovereign bonds held by banks. Mandate the ESM with a backstop function in the form of a credit line for the SRF would require an amendment to the ESM treaty.
- Opposed more ambitious plans for the ESM, such as creating a brand-new fiscal capacity as a transfer mechanism for the Eurozone.

Budgetary Instruments

Initiative	European Commission (EC)	France	Germany
Incentivize Structural Reforms / Fostering convergence	**Guiding Principle:** *Offer support to national structural reforms and foster a high degree of convergence in full synergy with the EU finances***.** **Proposed Instruments:** Establishment of a **reform delivery** tool to support reform commitment packages agreed with M-S as part of the European Semester process. -Provision of **technical support** at the request of M-S. Set-up a **dedicated convergence facility** for M-S on their way to joining the euroEMF's **Suggestions for the period 2018-2020:** • **Implement targeted changes to the Common Provisions Regulation governing the European Structural and Investment Funds** (ESIF) in order to give M-S the possibility to use part of the performance reserve of these Funds to support the implementation of reforms identified through the European Semester. This will take place during a pilot phase. • **Boost technical support** available for all M-S. By 2020, the capacity of the Structural Reform Support Program (SRSP) should be doubled to **€300 million** • **Develop a dedicated workstream for non-euro M-S** on their way to joining the EA. The technical support will be offered upon their request covering all policies that can help achieve a high degree of convergence. It will also be fully funded through the SRSP. **Period Post-2020** • **Establishment of the new reform delivery tool** that could operate as follows: The M-S themselves would propose the reforms in their National Reform Programs based on the challenges identified in the European Semester process. A structured dialogue between the EC and the M-S would follow to conclude a reform commitment package covering several reforms to be implemented over a three-year period. M-S would provide a detailed set of measures, milestones for implementation, and a calendar for completion and would report on the progress made together with their National Reform Program in the European Semester. Criteria would be drawn up for assessing progress at the different milestones. This assessment would provide the basis of the evaluation for financial support. • **Proposal to set up a dedicated convergence facility** as part of the follow-up to the SRSP in order to support M-S in their concrete preparation for smooth participation in the EA.	Implementation of essential reforms is a precondition for a potential EA budget.	**Core Principle:** *EZ needs better instruments to foster the implementation of structural reforms.* **Main guidelines:** • Another new and intergovernmental fiscal capacity is not necessary. • Better link future Euro members´ contributions to the EU budget with structural reforms in the EA, based on the EC's country-specific recommendations (CSRs). • This approach could prepare a nucleus for a Eurozone budget. Once established, it should be evolved further, based on solid financing and its own revenues.

Initiative	European Commission (EC)	France	Germany
Provide common fiscal backstop for the Banking Union	***Creating a backstop for the SRF will ensure that funding is available to facilitate the orderly resolution of distressed banks in the event that the SRF does not have the resources.*** ***EC's Proposal*:** The future EMF should provide a credit line or guarantees to the SRF by acting as a last resort lender and ultimately protecting taxpayers in the unlikely event that the SRF does not have the resources to facilitate the orderly resolution of a distressed bank. Any contributions from the EMF to the SRF would be recouped from the banking sector. To be operational in the event of a crisis, the backstop should be: • Of an adequate size to be able to fulfill its role. • Activated swiftly. • Fiscally neutral so that industry repays any potential disbursements from the fund and the use of public resources is limited. **Timeframe:** • Swift agreement by mid-2018. • Operationalization by 2019.	President Macron made no real mention of the EMF or the Banking Union's completion in his Sorbonne speech, delivered in September 2017. Nonetheless, the French Finance Minister, Bruno Le Maire, during his visit to Berlin in November 2017, laid out a four-stage proposal for fiscal union, suggesting that the completion of banking and capital markets union and tax harmonization should be the first stage. He also mentioned that he would envisage a stronger ESM as a safety net - presumably beyond its present capacities.	***Focus on risk reduction instead of risk-sharing.*** The ESM should have a backstop role in order to finance a credit line for the SRF, opening up the possibility to eliminate the instrument of direct bank recapitalization. Germany opposed more ambitious scenarios and plans for the ESM regarding its possible role as an additional backstop for the European Deposit Insurance Scheme.

Initiative	European Commission (EC)	France	Germany
Provision of a Stabilization Function	**Key Principles:** *A dedicated vehicle, managed by the EC, could bring together different funding sources at the European level in an efficient way to provide the stabilization function responding in asymmetric shocks.* ***Guiding principles***: The stabilization instrument should: • Minimize moral hazard and not lead to permanent transfers. • Be strictly conditional on clear criteria and continuous sound policies, particularly those leading to more convergence within the EA. • Be developed within the EU legal framework. • Be open and transparent vis-à-vis all M-S • Not duplicate the role of the ESM – the future EMF – as a crisis management tool. **Key features:** To be effective, the stabilization function should be: • Distinct from and complementary to existing instruments in the EU public finances toolbox. • Neutral over the medium-term and not lead to permanent transfers between M-S. • Contribute to sound fiscal policy and minimize moral hazard. • Economically meaningful in the steady-state. • Timely and effective. • Include a budget support/grant component**.** **EC's Envision:** Based on the logic of a European Investment Protection Scheme, provision of a stabilization function which would bring together different sources of funding at the EU level to maintain national investment levels in the event of large asymmetric shocks. Such a function would complement the stabilization role of national budgets, i.e., M-S should first use their national automatic stabilizers and discretionary fiscal policy in line with the SGP. The stabilization function is intended for the EA M-S and will be open to all who wish to participate. **Eligibility Criteria:** M-S that comply with the EU surveillance framework during the period preceding the large asymmetric shock. **Triggering Mechanism:** Triggering should be activated automatically and rapidly based on pre-defined parameters, e.g., based on a large temporary negative deviation from unemployment or investment trend **Financing Options:** -The EU budget and the EMF could provide loans guaranteed by the EU budget. -The EU budget could provide limited, annually budgeted grant support. -An insurance mechanism based on voluntary contributions from M-S could complement this support function. **Timeframe:** The EC will table a proposal for the period post-2020 in May 2018 as part of its proposals for the next Multiannual Financial Framework.	Minister Le Maire referred to the creation of a budgetary capacity as the third stage of his proposal for the fiscal union. The budgetary capacity would: • Fund investment in new technologies. • Build up a buffer against cyclical shocks.	**Core Principle:** *EZ needs credible stabilization functions to deal with global or domestic shocks* ***Proposals***: • Better use of the national automatic stabilizers to absorb shocks. • Further development of the fiscal rules so as the debt rule is at least on an equal footing with the deficit rule. This means that as long as the national debt is on a declining path, national deficits could be treated flexibly. • Creation of a more flexible single market to would be able to absorb asymmetric shocks better. • Support reforms to increase resilience through effective policy coordination and in the future through a well redesigned EU-budget**.** A macroeconomic stabilization function, e.g., through a new fiscal capacity or unemployment insurance, is economically unnecessary for a stable monetary union. A new stabilization function in the form of a new Euro debt capacity repeats the past's national mistakes.

Financial Instruments & Euro Area Budget			
Initiatives	European Commission (EC)	France	Germany
Financial Instruments	***Additional ability for the EMF to develop new financial instruments.*** The range of financial instruments currently available for the ESM should also be available for the EMF. In the future, the EMF could also be conferred with new financial instruments to support policy initiatives, for instance, related to the establishment of a stabilization function. The EMF may raise funds by issuing financial instruments or entering into agreements or arrangements, financial or otherwise, with its Members, financial institutions, or other third parties.		***Create real stability through reforms, not through financial engineering.*** Debt mutualization can have undesirable repercussions, raising fundamental legal issues and, therefore, putting the stability of the whole Euro area at risk. Stability needs to be achieved through reforms and not through complex and expensive financial engineering (e.g., creation of European Safe Bonds, Sovereign Bond Backed Securities, Eurobonds, etc.)
Euro Area Budget		President Macron supported the creation of a dedicated EA budget, which would be financed through European taxes, for instance, in the digital or environmental area, and through a percentage of its members' corporate tax, once harmonized. [5] Minister Le Maire referred to the creation of a budgetary capacity as the third stage of his proposal for the fiscal union. The budgetary capacity would: • Fund investment in new technologies. • Build up a buffer against cyclical shocks.	

[5] Macron wanted eurozone countries to set up a budget worth "several points of the euro zone's GDP," shortly after the Euro Summit of 15 December, where discussions over a future eurozone budget took place, Macron played down the importance of the size of such a budget. He said the important thing would be first to define the aims of a eurozone budget and the size would then follow from that.

European Minister of Economy and Finance

European Commission (EC)

EC'S Communication on a European Minister of Economy and Finance

Establishment of a European Minister of Economy and Finance to promote more coherence, efficiency, transparency, and democratic accountability of economic policy-making in the EU.

Roles

A European Minister of Economy and Finance could serve as:

- Vice-President of the EC.
- Chair of the Eurogroup.
- Oversee the work of the new EMF.
- Be accountable to the European Parliament.

Possible functions:

- Pursuing the general interest of the EU and EA economy by acting as a key interlocutor vis-à-vis EU institutions and bodies, M-S, and the general public. The Minister would also naturally assume the function of the external representation of the euro.
- Strengthening policy coordination and overseeing economic, fiscal, and financial rules.
- Pronouncing on the adequate fiscal policy for the EA in support of the monetary policy of the European Central Bank.
- Overseeing the use of EU and EA budgetary instruments, including instruments supporting reforms, macroeconomic stabilization, and convergence.

Timeline for the creation of the position within the existing Treaties:

- The function of the Minister as Vice-President of the Commission could be established as part of the appointment of the next Commission as of November 2019.
- The Eurogroup could agree to elect the Minister as its President for two consecutive mandates, thus agreeing on an alignment of its mandate with the mandate of the EC.

France

Establishment of a common Minister:

- With strong political leadership.
- Responsible for the coordination of economic policies and the EA budget.
- Under strict parliamentary control at the European level.

For the time being, there is no indication as to who should fulfill the role.

Minister Le Maire referred to the creation of a eurozone finance minister as the fourth and final stage of his proposal for the fiscal union.

Germany

Core Principle: *Fiscal responsibilities and fiscal control are inextricably linked.*

Creation of an EU Finance Minister requires Treaty change

Table 5. European Minister of Economy and Finance

Following a series of bilateral negotiations, the governments of France and Germany finally adopted in June 2018 the Meseberg joint Declaration,[6] intending to enhance the continued European integration. More specifically, in the field of strengthening the EMU, the Declaration included the ambitious idea of creating a budget for the euro area. However, President Macron's high expectations were not realized. According to the Declaration's text, the creation of the Eurozone budget would not be autonomous as it should be linked to the Multiannual Financial Framework 2021-2027, which also implies that it would be limited in size. This budget was proposed for convergence and investment purposes and not for the macroeconomic stabilization of the euro area economies. In case of severe economic crises, the possibility to create, as part of the budget, a European Unemployment Stabilization Fund was also discussed, which however would have to be fiscally neutral in the medium-term.

Additionally, the Meseberg Declaration contained plans for reinforcing the European banking sector and further strengthening the institutional framework of the European Stability Mechanism (ESM). More specifically, regarding the Banking Union, it was proposed that the ESM should be the backstop to the Single Resolution Fund (SRF), with a size close to but not bigger than the size of the SRF, provided in the form of a credit line. Its operationalization should be contingent on the (significant) risk reduction in the member states' banking systems, relating mostly to non-performing loans. Regarding the European Insurance Deposit Scheme (EDIS), there was no other commitment than a reference to the roadmap that has already been agreed upon since 2016.[7] Conversely, the proposals concerning the ESM's enhancement were more concrete, foreseeing a short time horizon of implementation. More particularly, these included the ESM's possibility to provide precautionary financial assistance (and for stabilization purposes) while having an enhanced role in designing and monitoring the relevant programmes as well as its incorporation into the EU law.

As it was expected, the Franco-German initiative gave new impetus to the debate on the Eurozone reform. In line with the Meseberg Declaration, the Eurozone Summit of 14 December 2018 decided that the ESM should be the backstop to the Single Resolution Fund and endorsed the term sheet on the ESM reform.[8] Also, in the context of the MFF, it approved the creation of a Budgetary Instrument for Convergence and Competitiveness for the euro area, without mentioning the possibility of financing a European Unemployment Fund.[9] The Summits of June and December 2019 recognized the technical progress made in implementing the above decisions and noted the continuation of processes on the common deposit guarantee system, without, however, adopting a decision for further reforms.

Against this backdrop, it becomes apparent that both the proposals of the Franco-German Declaration and the Summit decisions that followed appear to reflect a plan of limited ambitions. The

[6] See more at https://www.diplomatie.gouv.fr/en/country-files/germany/events/article/europe-franco-german-declaration-19-06-18

[7] See more at https://www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/

[8] See more at https://www.consilium.europa.eu/en/press/press-releases/2018/12/14/statement-of-the-euro-summit-14-december-2018/

[9] Eventually, the proposal for a Regulation of the European Parliament and the Council on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area was withdrawn, reflecting the MFF's (2021-2027) revised objectives see more at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2020:408:FIN

proposals that seem to be moving forward involve the least possible fiscal consequences for the creditor countries and the fewest possible changes in the powers of European institutions limiting thus the transfer of national sovereignty to the supranational level (Katsikas forthcoming). The severe economic crisis caused by the Covid-19 pandemic has complicated things further as all initiatives regarding the strengthening of the Eurozone have come to a halt.

Conclusions

The negotiations between the governments of France and Germany strongly influenced the course of the European integration process, whether we are referring to the very creation of the European and Monetary Union (EMU) itself or its reform. More specifically, the debate on the reform of the European economic governance started in 2012 as a response to the sovereign debt crisis that erupted in 2010. Following the initiative of the European institutions, the discussion revolved around ambitious ideas and radical proposals that aimed to gradually transform EMU, into a genuine economic and monetary union. In that regard, a significant number of academics, European officials and experts, think tanks, as well as most European governments, submitted their ideas on the issue. Most of these proposals were groundbreaking, foreseeing the development of an autonomous fiscal capacity for the EMU, the establishment of a euro area Treasury, as well as the possibility of common debt issuance.

This debate underwent many stages; however, the election of Emanuel Macron as President of the French Republic in May 2017 gave new impetus to the whole discussion. The French President put the reform of the Eurozone at the epicenter of his electoral and political agenda, promoting radical reforms such as the creation of an autonomous Eurozone Budget, which would be financed by European taxes and would be led by a European Finance Minister subject to strict parliamentary scrutiny at the European level. At the same time, President Macron's proposals re-launched the negotiations between the Franco-German axis, which however, despite the progress that has been made, remains divided given the two states' views about the functioning of the EMU. These divergent perspectives stem from their different aspirations (the deeper political and economic incentives of the political elites of France and Germany) that are causally related to the models of capitalism/growth models that characterize their national political economies.

What follows is that Germany, as a Coordinated Market Economy, which has adopted the export-led growth model, aims at a Eurozone that will ensure strict enforcement of fiscal discipline rules and promote the implementation of bold structural reforms and debt sustainability policies without envisaging any fiscal transfers between its member states. The French economy, on the other hand, bears many similarities with the southern Mediterranean Market Economies, which base their growth model on stimulating domestic demand. As a result, French governments seek to create a more flexible and socially inclusive Eurozone reinforced with the appropriate tools so as to be able to stabilize their economies in case of an asymmetric economic shock.

Against this backdrop, the whole debate on Eurozone reform has underscored, once again, the differing perceptions within the EMU, demonstrating the ongoing confrontation between the member states seeking the transformation of the EMU into a genuine fiscal union, and those strongly opposed to the (further) federalization of Europe. As a result, the one side advocates more solidarity, burden-sharing, and risk-sharing, while the other puts forward arguments of moral hazard and "free-riding" on the part of "fiscally unruly" economies.

This division was also verified throughout the negotiations on the EU's response to the economic impact due to the Covid-19 pandemic. Despite the historic decision that was reached, allowing the European Commission to borrow from the financial markets on behalf of the EU, it is evident that these differentiating perspectives lie in the heart of the European integration process. However, EMU viability depends on the understanding and fruitful articulation of these two different perspectives, so that the motto of the EU 'unity in diversity' becomes a guiding principle for creative and inclusive policy-making (Tsigkou 2020).

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