



## Is Macron becoming isolated in Europe?

by Charles Grant

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**Macron thinks the EU is not viable without radical reform. His priority is to reshape the eurozone, but Germany is blocking his bolder ideas. He risks isolation in Europe, which could weaken him at home.**

In a series of speeches during his first year as French president, Emmanuel Macron has not only sought to define grand concepts like ‘European sovereignty’ and ‘a Europe which protects’, but also proposed dozens of specific initiatives, ranging from an innovation agency, to a carbon tax, to an intervention force. He has taken a special interest in the eurozone, which he believes is unsustainable in the long term without much more federal governance. Macron has had a clear plan for achieving that goal. First, reform the French economy, to regain credibility with Berlin; during the presidency of François Hollande, France’s weakness made the Franco-German relationship unbalanced. Then, persuade Germany and the other key members to build a stronger eurozone.

The first part of the plan has worked quite well. Macron has carried out a major reform of France’s labour markets, and also tackled training, unemployment insurance and some parts of the education system. He has cut taxes on companies, investment income, wealth and employment, in an effort to boost investment. He is currently busy with railway reform and has many other ideas in the pipeline.

The problem is with the second part of the plan. Macron wants to strengthen the banking union by beefing up the European Stability Mechanism (ESM), the EU’s under-powered bail-out fund, and making it a backstop for the Single Resolution Fund for banks. He supports the European Commission’s plans for a pan-European scheme for insuring bank deposits. He wants a eurozone budget – distinct from the EU budget – of “several percentage points” of GDP (his officials would be happy with 1 per cent). In the longer term he wants a European finance minister, with decision-making powers, responsible to a eurozone parliamentary body.

But reforms in France have not made the Germans willing to dance to Macron’s tune. Last year, the feeling among some top officials in Berlin was that they needed to give Macron something, to strengthen his position vis-à-vis France’s eurosceptics. This year the mood is different. As one Berlin official put it,

“Why should we pay a price for reform in France? France is reforming because France needs to reform.” There are four reasons why Germany is resisting Macron’s plans for the euro.

First, Germany’s financial establishment continues to believe that the eurozone is doing fine. Germany and many other members have grown rapidly in recent years. German officials say that if other countries experience problems they should do their ‘homework’, comply with budgetary rules and implement structural reform – like Spain has done. They see no systemic weakness in eurozone governance.

Second, even if Angela Merkel wanted to cede to some of Macron’s requests, she is too weak to deliver much. Only 364 members of the Bundestag voted for her to be Chancellor, just nine more than the 355 required for a majority. A small rebellion in her own ranks would bring defeat. Both her allies in the Christian Social Union and the increasingly powerful right wing of her own Christian Democratic Union (led by health minister Jens Spahn) are virulently opposed to risk-sharing within the eurozone.

Third, a group of eight northern EU countries, led by the Netherlands, is working to strengthen Germany’s spine in its dealings with France. This ‘new Hanseatic league’ shares Berlin’s analysis of the eurozone and would block Macron’s more radical ideas if Germany went soft.

Fourth, Italy’s new government, dominated by the eurosceptic League and Five Star Movement, is hostile to Germany, eurozone budget rules and structural reform. This makes politicians in Germany and its allies extremely wary of any scheme that could entail transfers to the south.

Despite all this, officials in Paris and Berlin are concocting a modest agenda for reform that EU leaders can endorse at their summit on 28<sup>th</sup> and 29<sup>th</sup> June. France is confident that Germany will agree to the ESM becoming a backstop to the Single Resolution Fund. Could the ESM evolve into a European Monetary Fund (EMF), as some Germans – including Merkel in her recent interview with the *Frankfurter Allgemeine Zeitung* (FAZ) – have suggested? Though not opposed to an EMF per se, the French are wary of the German idea that it should be purely inter-governmental and take on some of the Commission’s tasks of supervising economies and bail-outs. France will not agree to the automatic restructuring of sovereign debt if the ESM/EMF lends, as some Germans desire, lest that spook the markets (Merkel has suggested giving the EMF the authority to impose restructuring).

France wants a bigger ESM/EMF, and one that can more easily grant ‘precautionary’ lines of credit – to a country that is not yet in dire straits – than can the ESM today. German officials could accept both ideas, but emphasise that the ESM treaty would need amending. They add that credit lines would come with conditions attached.

Germany shows no signs of agreeing to pan-European bank deposit insurance. Like its allies in the Dutch-led grouping, it sees this as a southern European scheme to grab northerners’ savings.

Macron is personally committed to a eurozone budget, in addition to a bigger ESM. The point of the ESM is to lend to a country when it loses access to bond markets. The budget, by contrast, would encourage eurozone convergence and investment, and help to stabilise member-states suffering asymmetric shocks (those affecting just one country). It would be spent on things like training and R&D. The French want all countries to pay into the budget in normal times; countries in recession, and therefore in need of help from the budget, would be excused contributions; and bond issues would make up the shortfalls. When

problem countries returned to growth they would repay the budget. The ESM would raise the money and the Commission would decide on disbursement.

Germany can live with the idea of a budget to boost investment, but not the stabilisation function, and not bond issues that could resemble the dreaded 'eurobonds' (involving the mutualisation of sovereign debts) Even for the investment function, Germany doesn't see why the eurozone rather than the whole EU should run the budget. It doesn't like the idea of the eurozone becoming a political actor in its own right, to the exclusion of non-euro countries.

The Commission recently published plans for a €30 billion 'European Investment Stabilisation Function' within the broader EU budget, designed to help eurozone countries overcome asymmetric shocks. The Germans don't like that purpose, while the French complain that the Commission proposal is too small (just 0.25 per cent of eurozone GDP). The Commission plan would make money conditional on compliance with the rules of the stability and growth pact, and the macro-economic imbalances procedure, to reassure Germany that the budget would not create moral hazard. French officials would attach a similar conditionality to their budget. But the Germans still oppose any kind of budget for tackling asymmetric shocks, even with conditionality attached.

The new Hanseatic league shares Germany's hostility to Macron's budget. But Italian officials have backed the French and one may guess that their new political masters would like loans from the budget, if not the conditionality attached. Spain has been more focused on the banking union but its new Socialist government will probably be sympathetic to Macron's thinking.

A German official cautions that a eurozone budget would never get through the German parliament. "We'll talk about improving the ESM at 19 and the EU budget at 27 – the latter could have a subdivision for the eurozone," he said, adding that "if there is a case for a bigger EU budget [to help the eurozone] we will look at it." Merkel told the FAZ that it remained unclear whether a eurozone investment budget should be managed inside or outside the EU budget, and that it could be "in the low tens of billions". That is unlikely to satisfy Macron. One French official responded to her interview by saying "on EMU, it certainly goes in the right direction but it is insufficient – we do want to go beyond this."

There has been a lot of irritability between Paris and Berlin in recent months. The Germans think Macron is too obsessed with the euro, compared with other problems, like the need to make the European economy more innovative, and migration. The French have been frustrated with Merkel's inability – before the FAZ interview – to respond to Macron. In Sophie Pedder's excellent new biography, Macron tells the author:

"Germany is faced with a real choice: whether it wants a European model with a German hegemony which isn't durable, because it rests in part on courageous reforms that Germany did a dozen years ago, and in part on the imbalances in the eurozone. Or whether Germany wants to participate with France in a new European leadership which rebalances Europe, with more solidarity and also a project of stronger convergence."

Macron told Pedder that if the imbalances continue, "Europe will fracture." He believes that Germany's budgetary and current account surpluses are imbalances that risk destabilising the eurozone. So in May, when Merkel awarded him the Charlemagne prize in Aachen (pictured), he criticised Germany's

“perpetual fetishism for budgetary and current account surpluses, because they are always made at the expense of others”. That went down really badly in Berlin, where the surpluses are seen as signs of national success that others should emulate. One Berlin official responded:

“The Macron team is annoying, trying to bully Germany with these public declarations about Merkel being weaker – it is counter-productive and doesn’t build confidence. It would be better if he talked to us about working on common ideas. In any case a lot of Macron’s initiatives are old French ideas and very much about the French rather than the European interest.”

It is true that Macron’s plans for a plethora of new institutions, or for a core group to lead the way on eurozone integration, or for quasi-protectionist limits to foreign investment, are very French. But he is also prepared to cede powers to EU institutions, which is less traditionally French.

Merkel’s *FAZ* interview conceded little of substance on the eurozone, though its polite tone helped to improve the climate between Berlin and Paris. But the needling has continued, notably on how to deal with Donald Trump’s protectionism. Some Germans partly blame France for his imposition of steel and aluminium tariffs on the EU, saying that France’s tough stance in this dispute may have prevented a compromise. Yet some of the French blame the Germans for the tariffs: by being so willing to compromise, Germany displayed weakness, thereby encouraging Trump – who in their view respects strength – to take a hard line.

France and Germany will of course come together at the European Council at the end of June, which must tackle not only the euro but also Trump and trade, Brexit, sanctions on Russia, how to handle the new Italian government and reform of asylum rules. Paris and Berlin know that they are condemned to find ways of working together, however much they may annoy each other. The fiasco of the Quebec G-7 summit, after which Trump withdrew from the joint communiqué, has created feelings of solidarity between Paris and Berlin.

French officials are trying to put a positive gloss on relations with Berlin, emphasising that they have worked together on reforming the posted workers directive, that they want to tax US tech giants, that they will collaborate on artificial intelligence and that they agree on a new EU defence fund.

On defence, Merkel is moving in ways that please the French. She told the *FAZ* that she would support Macron’s ‘European Intervention Initiative’, an avant-garde defence grouping that Germany had previously opposed. His rationale for this scheme is that the EU’s permanent structured co-operation – an alternative club backed by Germany – is unlikely to achieve a great deal, since with 25 members the results are likely to be lowest common denominator. Macron wants a more select grouping that can move quickly, outside EU structures, and be open to British participation. Belgium, Estonia, Italy, the Netherlands, Spain and the UK want to join.

But the European Intervention Initiative is unlikely to be enough for Macron to show that he is winning in Europe. His entourage believes that if he is perceived as failing in the EU, and notably on eurozone reform, getting re-elected will be difficult – partly because he made such a big deal of his European agenda when running for the presidency.

In the medium-term, failure would be a poor performance in next May's European elections – either the National Rally (formerly the National Front) winning more votes than Macron's République en Marche, or the eurosceptics becoming the largest bloc in the European Parliament. Concerns about these elections explain some of the steel in the French stance on Brexit: voters must see that leaving the EU carries clear and negative consequences, lest they be tempted to vote for Frexit.

Such concerns influence the ambitious plans that Macron retains for reshaping Europe's political landscape. His advisers talk of Macron "disrupting" European politics in the way he disrupted France's party system. They believe that the current structure of pan-EU political parties – involving the centre-right European Peoples Party (EPP), the Party of European Socialists, and so on – is unsustainable and should be shaken up. République en Marche has not yet affiliated with the liberals or any other group in the European Parliament.

Macron, like Merkel and many other European leaders, dislikes the *Spitzenkandidaten* system, whereby the candidate of the party with the most MEPs automatically becomes Commission president (Jean-Claude Juncker was the first president chosen in this way). Even though the European parties are likely to appoint lead candidates, Macron's advisers believe that this system may not work after the elections. They talk of MEPs peeling off the existing parties to join a new Macronist group that is committed to EU reform. They suggest that Macron may appeal directly to voters in other member-states, over the heads of their leaders.

That would not go down well with Merkel or many other EU leaders, especially those in the EPP, which wants to maintain its stranglehold over the top EU jobs. One German official says that such an approach would make the heads of government unwilling to support Macron's plans for reform. But Europe is going to have to get used to the restless ambition of Emmanuel Macron.

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