



A New Union of Creditors and Debtors

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For half a century, the EU has been a political project underpinned by solidarity and confidence. Rich northern countries were willing to show a remarkable level of solidarity with their less well-off southern neighbours in a combination of perceived self-interest and trust in them. Peripheral countries that had emerged from authoritarian regimes used their EU membership to consolidate their democracies and promote economic growth. This, in turn, gave rise to large and stable markets for the core-countries' exports. It was a win-win situation. Northern solidarity paid off because the countries in the south generally behaved as expected. It was an EU dominated by a balanced Franco-German axis. There was no hegemonic power, but a division of labour in which France's strategic vision and Germany's economic power were compatible and facilitated progress towards deeper integration.



However, the **Euro Zone (EZ) debt crisis** has dramatically changed the nature of European integration. The combination of poor financial regulation and an incomplete design of the euro have led EMU to the brink of collapse, forcing the EZ to move forwards decisively in order to avoid catastrophe. However, the institutional changes that the EZ has been implementing since 2010 to convince the markets that the euro is an irreversible project do not have the same underlying logic as in previous steps towards integration. Northern creditor countries, led by Germany, have increased their bargaining power *vis a vis* southern countries, creating a new decision-making process in Europe in which creditors set the rules and debtors have little option but to follow what the north dictates. They have become 'decision takers'. In fact, the 'community method' has been weakened and a new asymmetric intergovernmentalism has emerged, in which a hegemonic Germany sets the direction, timing, speed and scope of reforms with little or no counterweights.

This can be seen in the negotiations on the Germany-sponsored Fiscal Compact (which constitutionalises the German debt brake and reduces the scope for fiscal discretion), the banking union (in which limited supervision has prevailed over a common resolution regime or a common insurance deposit guarantee system, essentially reflecting German interests), the ESFS/ESM (which is arguably too small and too inflexible, again reflecting Germany's goal of providing only the minimum level of solidarity required to avoid a EZ collapse) and the **'six pack' and 'two pack' negotiations**, in which, for instance, Germany has dictated that the macroeconomic imbalances procedure will not be symmetric (ie, large current account deficits are considered to be 'more dangerous' than large current account surpluses).

Similarly, Germany has so far kept the negotiating agenda free of alternative proposals which would have satisfied the preferences of the Mediterranean countries (France included), such as a partial mutualisation of debt (in the form of Eurobonds or a Redemption Fund), a larger EU budget to deal with asymmetric shocks, a comprehensive growth programme at the EZ level and a strategy to deal with legacy assets in the financial system.



Finally, the ECB's reluctance to intervene on a continuous basis in the debt markets to reduce financing costs for the EZ's periphery (at least until September 2012 when it launched its **OMT programme**) has forced these countries to adopt austerity measures and implement structural reforms in order to be able to raise money in the international markets. In fact, the EZ has never witnessed a process of coordinated fiscal adjustment and structural reforms as intense as the one that is currently taking place in southern Europe since the beginning of the crisis in 2010. And the process is likely to continue and deepen as austerity and reforms are the bargaining chip used by Germany to accept some sort of a transfer union in the long run.

In sum, the old Franco-German axis has been replaced by a Berlin-Frankfurt axis, which is Germanising the south's economies through austerity and structural reforms and, at the same time, is creating a new governance framework for the EZ, which is essentially an extension of the German view of capitalism.

The problem, however, is that such a strategy could well backfire if citizens across Europe (and especially in the southern countries) reject this new model of Europe by voting for anti-European parties in their national elections. The results of both Grillo and Berlusconi in the recent Italian elections are a good indication of the risk involved in trying to build Europe against the preferences of a majority of its citizenry.