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EUROPEAN REFORMS: OUTLINES OF A GERMAN RESPONSE TO MACRON

Berenberg Macro Flash

Progress for Europe. Whether or not Germany‘s SPD will join chancellor Angela Merkel for a new “grand coalition” in Berlin remains an open question. It looks likely but not certain ahead of an SPD party convention on 21 January as SPD left-wingers prefer to sharpen their party’s profile in opposition. But regardless of the SPD decision, the potential coalition deal which leaders of Merkel’s CDU/CSU and the SPD presented last Friday marks a significant step for Europe. As the more conservative parts of Merkel’s CDU/CSU including the Bavarian CSU have agreed to the deal, it does show how far Germany may – or may not – go to meet the proposals of French president Emmanuel Macron and others to reform Europe. On EU/euro issues, it is not the SPD but the more conservative segment of Merkel’s own CDU/CSU which constrains her room for manoeuvre.

Remarkably, CDU/CSU and SPD leaders present the pledge to strengthen European integration as their top priority, with Europe taking up the first three pages of their joint paper. As expected, Merkel apparently wants to make progress in Europe one of her signature achievements for her place in future history books. On this count, she is very much supported by SPD leader Martin Schulz, who headed the EU parliament until late 2016. To some extent, the paper can be seen as a first German response to Macron, as German FAS newspaper wrote on Sunday. Relative to the domestic content of the potential German coalition deal, which seems mediocre at best (expensive increases of pension entitlements, some small-scale reform reversals), the European content seems more forward-looking.

In the paper, the would-be “grand coalition” promises to raise investment in Europe, strengthen the role of the European parliament and increase the German contribution to the EU budget. While Germany would prefer all members of the EU27 to participate in EU reforms, the paper also emphasises that Germany and France should develop common positions on all major European and international issues and should be ready to proceed in areas in which other EU members may not (yet) be ready to follow.

As concrete measures, the paper proposes i.a. to

- allocate specific funds within future EU budgets to economic stabilisation, social convergence and the promotion of structural reforms in the Eurozone, which could turn into the nucleus for a future investment budget for the Eurozone;
- scale up the European EFSI investment programme;
- turn the European Stability Mechanism (ESM) into a European Monetary Fund (EMF);
- devise an EU framework for national minimum wage laws;
- combat corporate tax evasion so that profits are taxed where they arise;
- harmonise the way in which the basis for corporate taxes is calculated;
- strengthen security and defence co-operation;
- pass a substantial financial transactions tax.

These proposals are largely in line with our earlier assessment of the kind of reforms that Germany, France and their other EU partners could eventually agree on. Our view:

A **European Monetary Fund** is not exactly Macron’s preferred idea, as he commented over the weekend. However, Germany will likely get this wish granted. Whether or not a new facility to support countries hit by a non-systemic asymmetric shocks will be part of the EMF or fall under the EU budget remains an open question.

The EU will spend more on **investment** and provide privileged access to EU funds for countries that pursue **pro-growth reforms**. We also expect the EU – or subgroups of EU members willing to co-operate more closely – to establish new funds to support joint **defence** and other projects.

While the EU parliament may get a stronger role and the head of the Eurogroup of finance ministers may possibly even assume the extra title of Eurozone finance minister, decisions to spend large amounts of new money have to be approved by a qualified majority of member states, de facto giving the German parliament as well as France and Italy a veto.

The hurdles for the EU or a minimum group of 9 EU members to pass a genuine **financial transactions tax** remain high. As countries compete to attract some financial business from post-Brexit London, few countries may want to pursue this idea energetically in the end.

Germany and France will try to co-ordinate their reform ideas ahead of the EU summit on 22-23 March. For more on European reforms, see also Reforming Europe: which ideas make sense?

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