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Europe Under Merkel's Third Term

Now that Angela Merkel has won an impressive victory in the German election, it is tempting, if not a duty, for economists to propose a rational, coherent package of EU initiatives and reforms which would significantly improve the performance of the EU economy. After all, the grand coalition with the SPD, which is likely to come about after much kicking and screaming, would command some 80% of the seats in the Bundestag and a two-thirds majority in the Bundesrat (i.e. the German Parliament and Senate respectively). Indeed, the CDU-CSU is only five seats away from an absolute majority in the lower house (311 as against 316). Such a comfortable majority would seem to suggest a genuine mandate for "leadership" in Europe, without having to look back all the time at what objections might erupt from domestic politics. Conversely, it can also be interpreted as giving Germany fewer political or social reasons for dragging its feet on some important single market issues, such as the opening of certain services sectors or proper implementation of sensitive EU directives.

Given the Union's ongoing macroeconomic problems – albeit much less urgent for Germany – and the only slightly reduced fragility of many European banks (including German ones), tackling the weaknesses of the eurozone as well as the triptych of the "banking union" must assume priority. Firming up the eurozone would appear to be politically acceptable, because Germans still support the euro and have begun to forget about the Deutschmark.[1] In the eurozone, a win-win strategy consists of Germany boosting domestic investment in infrastructure and presumably in education, too (where Germany spends less than the OECD average share of GDP). This would likely increase its own economic growth, in turn raising demand for imports from struggling eurozone countries. It is quite possible that a slight increase in German inflation above the eurozone average might result as well, which would also be helpful in reducing macroeconomic imbalances, which had got out of hand in the first decade of the euro.

The benefit of such an approach would be that the reduction of imbalances would no longer necessitate a harsh "Southern slump", but instead would result from the combination of improved competitiveness and market performance in the crisis-stricken countries (due to the imposed reforms that have already been undertaken) as well as higher demand for these countries' exports. In addition, Germany might top up recent initiatives to address youth employment and consider other ideas to induce a return of FDI to the eurozone periphery now that reforms have transformed and/or will further improve the potential of their markets. The insistence on deep reforms of markets and market institutions is best accompanied by simultaneous access to private and public funding and/or other incentives, not only for economic reasons but also for political ones, such as pre-empting eurosceptic parties from gaining ground (e.g. in the EP elections of 2014).

As to the banking union (a cute marketing label for the common governance of the "single market for banking services"), German politics, and certainly the CDU-CSU, has a problem, even with its robust majority. Merkel supporters are firmly opposed to Eurobonds or even a European Debt Redemption Fund, an idea from the German Council of Economic Experts, to deal with the problem of sovereign debt, and they remain equally opposed to a mutualisation of liability risks via a European deposit guarantee system. There is also German op-

1 See F. Roth, L. Jonung, F. Nowak-Lehmann: Crisis and public support for the euro, VOXEU, 5 November 2012, available at www.voxeu.org/article/crisis-and-public-support-euro; D. Gros: Have Germans lost their trust in Europe?, CEPS Commentary, 20 September 2013, available at www.ceps.eu/book/have-germans-lost-their-trust-europe.

position to an EU-wide bank resolution mechanism, without which there simply cannot be a banking union. Indeed, the proper banking union is a triptych: a single supervisory mechanism combined with a credible resolution mechanism, backed up by an EU-wide deposit guarantee system (the great virtues of which were proven in the US during the crisis).

Moreover, the underlying supervisory rules have been considerably tightened recently (though arguably not enough). Germany was no exception during the crisis: some of its commercial/mortgage banks and its *Landesbanken* proved weak, and intervention activities were hasty and fairly drastic. It is here where Germany is incoherent and risks frustrating sound EU solutions which would inspire great confidence in financial markets, even though the banking union might never have to employ its most extreme mechanisms, precisely because the triptych has to be regarded as a whole. Firm German leadership would also make it much harder for other EU countries to oppose the banking union on purely political grounds. Given that Chancellor Merkel has repeatedly argued for "more Europe" (including suggestions of turning the Council into an EU Senate and strengthening the European Parliament in the longer run), it would seem that German resistance is based less on a general fear of more EU centralisation than on the sentiments of ordinary folks mistrusting (EU) authorities when it comes to their savings and pensions.

It is far less easy to generalise on Germany's near-term stance with regard to the EU internal market and the common EU policies inextricably linked with it. This is the hard core of European integration and still the main reason current member states (including the UK) are highly unlikely to exit the EU and why others are still queuing up to get in. The Union's single market has steadily progressed, even when there have been no conspicuous programmes or spectacular initiatives.[2] Less noticeable nowadays, given that political leaders and the press spend most of their time on eurozone issues and the banking union, a number of major regulatory and investment decisions have been made which could lead to a much better exploitation of the single market by dynamic market players. In this vast domain, Germany is much more like other EU countries, all of whom love the internal market in general but are erratic and not always forthcoming when it comes to the many specific dossiers. A much firmer German stance forcefully backing the deepening of the single market in the remaining difficult issues would greatly facilitate EU decision-making whilst supporting economic growth in the medium run. Imagine an EU single market in gas and electricity, in freight rail (with its huge potential), or in eComms (where the Digital Agenda is growing ever more complex and progress is selective, whilst the sector loses out to the US and Asia). Imagine these network markets finally getting truly independent EU agencies (the lack of which being one reason why the single market has not yet been achieved). Imagine Germany firmly and publicly supporting the European Commission, insisting that European air traffic controls (with huge financial and environmental savings) must be implemented in earnest, now. Imagine Germany not merely wishing that others reform services but taking the lead in Europe in this domain. And with regard to an issue that is too rarely discussed, imagine the incredible distortions in the German energy market for the sake of renewables, now magnified by the *Energiewende*, no longer being regarded as a national issue, if it is ever was.

Finally, Germany under Merkel is unlikely to join the superficial and selective (if not self-serving) debate on returning EU powers to the Member States that was initiated by the UK political leadership and weakly (and unconvincingly) followed by the Dutch government led by Mark Rutte. On the contrary, Chancellor Merkel may well carefully advocate selected transfers of powers to the EU centre, perhaps in a mix of intergovernmentalism and truly EU Treaty-based powers. Merkel stands for stability and predictability in Germany – that is why she won – and this also applies to Europe during Merkel's third term.

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2 See J. Pelkmans: The European Single Market – How Far from Completion?, in: Intereconomics, Vol. 46, No. 2, March/April, 2011 for a survey on progress during the last few decades.