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Stability or instability

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Europe's stability pact meets national sovereignty

MENTION the words “national sovereignty” in Brussels and you are likely to get a pitying look. For those building the Europe of the 21st century, the idea of “sovereignty” has a distinctly passé, 19th-century ring to it. Europhiles admit that nation-states still exert a certain atavistic hold over the imaginations of ordinary Europeans. But the reality, according to Brussels orthodoxy, is that in the modern world European countries must “pool sovereignty” to get things done. The point was put well by Gerhard Schröder, the German chancellor, in a speech in the Netherlands in 1999, just after the birth of the single currency. “The introduction of the euro”, declared the chancellor, “is probably the most important integrating step since the beginning of the unification process. This will require us to bury some erroneous ideas of national sovereignty.”

National control of interest rates came to an end with the arrival of the single currency. But the countries adopting the euro also approved rules limiting their sovereign control over decisions on taxing and spending. Unless a euro member is in a severe recession, it is not meant to run a budget deficit of more than 3% of GDP. Any country that breaches this ceiling for three years in a row is subject to sanctions, and ultimately to fines that can run to billions of euros. These strict rules, known as the “stability and growth pact”, were adopted at the insistence above all of the Germans, who wanted an absolute assurance that countries with a long history of fiscal incontinence would not damage the euro-area economy.

Hoist with one's own petard

By a nice irony, however, a sustained period of low growth has meant that Germany itself is now unable to keep below the 3% mark. The latest forecasts from the European Commission suggest that Germany will breach it for the third year running in 2004. The result is that the commission may soon propose mandatory budget cuts in Germany, as a last step before the imposition of fines.

Faced with this prospect, Mr Schröder seems to be having some difficulty ridding himself of those “erroneous ideas of national sovereignty”. The idea that the German government may lose control of its national budget and be put under supervision by Brussels is, it seems, too humiliating to contemplate. The Germans are now employing a collection of legalistic, political and economic arguments to avoid accepting the rules that they themselves wrote.

Fortunately for Germany, they have allies in this fight. The French are even farther down the slippery slope to fines than their friends on the other side of the Rhine. The commission has proposed that, in 2004, France should cut its structural deficit by a further 1% of GDP. France is refusing to do as much. This week European finance ministers bravely postponed a vote on this awkward issue until the end of the month. But by then the commission may also be proposing to act against Germany, under the same treaty provision, known to *cognoscenti* as Article 104 (9). This article, as a senior commission official puts it, “is the very last step before financial sanctions”.

The French have made themselves vulnerable by ignoring previous commission recommendations. The Germans say that, by contrast, they have followed all suggestions previously made under the less onerous Article 104 (7): they have just been unlucky with the economy. So they argue that the commission should invoke Article 104 (7) once again, rather than moving to tougher measures under Article 104 (9). Commission officials are not impressed. “It's like when you are playing a game with your kids,” says one. “If they begin to lose they want to start all over again.” More substantively, the commission points out that the Schröder government is proposing to cut taxes next year, so it can hardly argue that it is doing everything in its power to curb its deficit.

If the commission forces a head-on confrontation with France and Germany later this month, however, it is the French and Germans who will probably win. Sanctions or demands for mandatory budget cuts need to be approved by member governments, and the big two have enough support among their fellows to block them. But any such “victory” would, in effect, kill the stability pact.

France, which never liked the pact in the first place, would not lose much sleep over that. But for Germany it would be a momentous step. Less than a year ago Hans Eichel, the German finance minister, pledged “my complete and undivided support for the stability and growth pact, despite the problems Germany is having with its public budgets.” Mr Eichel argued then that the pact was vital to the economic and political stability of Europe. This week, in marked contrast, he was saying that countries that “co-operate” by trying to cut their deficits should not be subject to sanctions.

Others, however, still believe that rules are rules. On October 29th, in his farewell address before stepping down as president of the European Central Bank, Wim Duisenberg called the stability pact “a contract with every single citizen of the euro area” and one of the two pillars supporting the stability of the single currency (the other being the bank). He gave warning that several countries seemed to be on the brink of breaking the pact's rules. In that case, he concluded, "the pact will unravel, the contract with the people will be broken."

The difficulty for Mr Schröder and Mr Eichel is that keeping to the terms of this contract could cause a political crisis in Germany. When hard-hit developing countries submit to the supervision of the International Monetary Fund, their citizens rarely react kindly. Why should it be any different if the orders come from Brussels, not Washington? It is easy to call national sovereignty an "erroneous idea" in a flowery speech. It is rather harder to see that lesson applied in practice—and at home.