What Economic Policy for the Euro Area after the Financial Crisis? The Path Towards a New Franco-German Compromise

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The financial and economic crisis has posed the most serious challenge to the European Monetary Union (EMU) since it was created over eleven years ago. Throughout the crisis, the Euro Area has proven a safe haven for its participating countries as it sheltered them from currency turbulences and severe speculation. It constitutes a core of stability in the single market. The attractiveness of the euro has consequently risen in the eyes of those member states which are not (yet) part of it, notably in Central and Eastern Europe, and which were on average more strongly hit by the crisis than the EMU members. But at the start of 2010, important challenges for the Euro Area persist.

Firstly, economic recovery cannot be assumed to be guaranteed. Exit strategies need to be carefully coordinated: Interest rate increases, budgetary adjustment, a withdrawal of government guarantees for the financial sector and a reduction of state interventionism have to be orchestrated in such a way that they do not cause domestic demand slumps and weigh on corporate activities through higher interest rates. In particular Germany and France as the largest Euro Area economies should ensure a confidential exchange with the ECB, fellow member states, the European Commission and the EU-Presidency.

Economic recovery could furthermore be hampered by an insufficient allocation of funds to companies if a spill-back of corporate insolvencies into the banking sector put new strains on Europe's banks and further increased prudence in the financial system. This could cause short-term re-financing problems which could provoke insolvencies. Companies could also reduce R&D investment which would negatively impact the competitiveness of the EU.

Secondly, the economic divergence in the EMU has been aggravated as the crisis has hit less competitive economies harder than the strong performers. This nurtures economic and political tensions[1] and the political and economic setting for the ECB to act in becomes

1. See for instance: Sebastian Dullien/Daniela Schwarzer: "A Question of Survival? Curbing regional divergences in the Eurozone", in: *Review of Economic Conditions in Italy*, no. 1/2006.

more complex. Policy divergence with regard to external competitiveness is also manifest between Germany and France (see below).

Thirdly, the deterioration of fiscal positions threatens the sustainability of public finances in a large number of member states. It also risks undermining the framework of fiscal surveillance as some governments did not commit themselves to correct these developments once the exceptional circumstances of the crisis have ceased to exist, and the functioning of surveillance depends on Ecofin's implementation of it. In particular a clear commitment of the largest EMU members Germany and France, but also Italy and Spain, will be decisive to the survival of the Pact and the perspective for sound public finances in this crucial phase.

Furthermore, the Euro Area may face its first case of a sovereign default. As there are neither a precedence nor clear rules in EU law of how to cope with such a situation,[2] political leadership of the larger member states in coordination with the ECB would be needed in order to define rescue measures, help reinstall market confidence and maintain the credibility of the Euro.

Strategic Decisions with a Long-Term Impact

The year 2010 could turn out to be crucial for the EU's future economic governance set-up. Firstly, *fiscal and economic policy co-ordination* may be strengthened. The crisis has revealed the inability to prevent developments that undermine macro-economic stability and to stop national policies which are in contradiction to the legal obligation to treat economic policy is a "matter of common interest" in the EU (article 121 TFEU).

Past experience[3] has shown how difficult it is to make Member States change policies. For some years, the European Commission and the Member States have become less motivated to push for national policy change. But the case of Greece illustrates how crucial an effective monitoring of national policies is and some governments, in particular the German one, see a need to improve surveillance. As a transfer of sovereignty in the field of economic or fiscal policy to the EU-level is unlikely, improvements can only be achieved by implementing economic policy coordination more rigorously. This requires governments to accept being criticized by their peers, which is particularly salient for Germany and France, a pro-active European Commission, a strong Euro Group chair and an impactful Ecofin Presidency.

In order to counterbalance strong national views on European problems, the trans-European element in the economic policy debate should be strengthened. The European Parliament should be involved as much as possible and despite its limited competencies in this field. The monetary dialogue of the EP Committee for Monetary and Financial Affairs

2. The No-Bail-out-Clause in Article 125 TFEU excludes an obligation for the EMU members to bail-out another member state, but this does not mean that there will be no financial assistance in the case of a solvency crisis. The instruments currently applied to the cases of Hungary, Rumania and Latvia are not eligible as the Balance of Payment Loans according to Art. 143 TFEU can only be granted to non-EMU-member states.

3. For instance with the recommendations to Ireland under the framework of the Broad Economic Policy Guidelines (BEPG) in 2001 which caused a huge national uproar as Ireland was asked to pursue more restrictive fiscal policies for macro-economic reasons – in times when it actually ran a budgetary surplus.

with the ECB President should be maintained, the informal exchange with the Euro Group President should be strengthened. The new EP Committee dealing with the Economic and Financial crisis should be fostered and dialogue between MEPs and national Parliamentarians could be strengthened in order to intensify the European economic policy debate.

The debate on the future of policy coordination should also focus on contents: surveillance may have to be expanded to include further variables to grasp economic divergence resulting from discrepancies in the development of competitiveness better. The inclusion of private debt, external balances and other indicators of the relative competitive position of a Member State could lead to a more encompassing framework of macro-economic surveillance. As it will be difficult to find a Member State consensus on this matter, a Franco-German dialogue could prove useful in preparation of European debates.

Secondly, negotiations on the new *strategy for growth and competitiveness tagged "EU 2020"* and on *the future EU budget* could prepare important reforms – if the governments agree to revise policies which are no longer suitable for to the inner-European and the global situation. The EU's new growth strategy has to ensure a return to sustainable growth and employment, a decisive improvement of the EU's competitiveness, the guarantee of the long-term sustainability of public finances and social systems and more convergence within the Euro Area. These aspects should be discussed together with the future of the EU budget. As negotiations will be difficult and risk to lead to only a minimal consensus, Germany and France, possibly with a small group of other Member States including the UK, should pre-agree a set of possible reforms, before submitting them to the other for further debate.

Thirdly, *EU financial market supervision* needs to be improved in order to reinstall confidence, enable better crisis prevention and management and to improve financial market integration. The current legislative procedure was launched with a Council decision of December 2nd 2009 that has watered down the European Commission's initial proposal. Conflict between the European Parliament and the Council in the co-decision procedure is possible and there may hence be a need on the side of the member governments to revise their position. German and French politicians potentially have a mediating role to play here, both in the Council and in the European Parliament.[4]

The Political Landscape in the EMU in the Current Crisis

The way the EMU manages its adaptation to the economic and financial shock in the next two years will decide over its medium-term performance in a world economy characterised by shifting power relationships as emerging markets such as China recover from the crisis at a quicker pace than Europe or the US. The EU's adjustment to the crisis will have to be managed in a complex political context.

The *governments*' willingness to accept structural reforms, budgetary adaptations and cooperation within the EU is rather low. Moreover, most governments have shown little

4. In the Council, Germany and Spain backed the British position which was reluctant to accept a strong European Financial Supervision. If the Council decision of Dec 2nd has to be revised, Germany and France could attempt to find a joint position and, based on this, forge an overall compromise in the Ecofin. In the Parliament, all four "Rapporteurs" in the ECON-Committee are either French or German, and could attempt to influence the national debate on EU Financial Supervision. For an analysis of the Parliament's role, see: Daniela Schwarzer: Financial Market Supervision: Now comes the European Parliament's hour, December 3rd, 2009, Eurozonewatch, http://www.euro-area.org/blog/?p=238

interest for joint EU approaches to crisis management. Meanwhile, measures to complete the single market (e.g. in the financial and services sector) are less likely to be taken, there is rather the risk of rising state interventionism and protectionism undermining previous achievements. Domestic developments such as rising unemployment (in the cases of some Member States rates of up to 15 to 20%, 10 % on average for the EU, are expected for 2010) could make certain governments less cooperative and more protectionist as the political and social effects of the financial and economic instabilities develop.

The *European Commission* has lost authority due to its problems in leading the crisis management, not being able to convince the Member States of more coordinated action. Furthermore, some commentators held it responsible for insufficiencies in financial market surveillance, in particular due to its focus on deregulation in the last five years. It is a major challenge for the new Commission to re-establish its authority in particular in applying fiscal and economic policy surveillance and in order to help shape their further development, on the future European growth strategy and on the EU budget.

The *European Central Bank*, on the contrary, has strengthened its position and credibility due to its swift reaction to the crisis. But it will have to prove its standing in managing the exit strategy: both the Euro and the ECB would lose credibility if the problematic effects of badly co-ordinated exit strategies were blamed on the ECB.

The acting *Trio-Presidency* (Spain, Belgium, Hungary) is unlikely to assume effective leadership on EMU issues. Out of the three, only Spain and Belgium are members of the European Monetary Union. Spain is in a difficult situation both with regard to its economic outlook, its public finances and soaring unemployment rates. Belgium on the other hand, does not have a particularly strong political role in the EMU.

In this overall political context, other large EMU member states, in particular *Germany and France*, have the responsibility and the opportunity to bring forward the debate in the Euro Group, the Ecofin and the European Council on the most pressing and the strategic issues listed above. The European Council will be a particularly important forum for Germany and France as its role is likely to be strengthened: Its first permanent President will make the leadership and steering role of the European Council more efficient and may speed up its ability to act. In his first major move, Herman van Rompuy summoned an informal European Council for February 11th, 2010 to discuss economic issues ahead of the regular Spring Council. The Heads of State and Government hence became more involved in European economic governance debates. A second Euro Area summit,[5] as the one of October 2008 held under the French EU Presidency is yet not on the horizon. But this option should be considered for instance as a part of the Spring Summit, as the Euro Area does have specific coordination needs which have to be dealt with.

The Political Impact and Economic Weight of Germany and France

In this political landscape, there is ample scope for a joint leadership by France and Germany in the shaping of policy responses and in the strategic debate on the future of the governance structures of the European Monetary Union. Germany's and France's traditional divergence over economic policy issues has in the past allowed for fruitful compromise and played a shaping role in the Maastricht negotiations. Since then, either France or Germany

5. The Heads of State and Government of the EMU together with the British Prime Minister.

initiated decisions on EMU governance and the traditional Franco-German cleavage over economic and fiscal policy issues as well as institutional questions shaped the outcome[6] and it seems unlikely that important reforms can be triggered without Germany and France.

A Franco-German compromise over the direction and depth of the adjustment of its governance mechanisms seems crucial, given the opposed views that persist in many ways on "the right" economic and fiscal policy, the need and nature of policy co-ordination and supervision or the importance of politics in governing the Euro Area internally and externally. As the two shapers of the economic set-up of the EMU and their political levy as the two largest Member States of the Union, Germany and France together can exert a strong influence on these matters. Their approach of course has to be open to impulses from the other Member States. But the expectancy of many smaller Member States is indeed that the two large ones should overcome their differences to get going.

The political influence of Germany and France is backed by their joint economic weight in the Euro Area. Both countries represent nearly half of the currency union's GDP (Germany contributes 27% to the EMU's GDP, France 20%).[7] From an economic point of view, coherent, sustainable and transparent approaches to fiscal and economic policies in both countries would mean that half of the Euro Area's economy is steered reliably. If both countries head for sustainable recovery, benefitting from each other due to the close economic ties, this can have important economic effects on the Euro Area and the EU as a whole.

Problems to Overcome: the Costs of Disagreeing

The obstacles that have to be overcome by Germany and France should not be underestimated. For instance, French and German positions on the EMU's institutional architecture have to be examined carefully. France traditionally argues for a stronger "gouvernance économique" which Germany interprets as a political counter-weight to the ECB which it refuses as much as any attempt to weaken politically the exchange rate of the Euro. The French quest has hence been countered by categorical refusal from the German side, while France has not even spelled out what this would mean. On the German side, doubts exist with regard to the question in how far France is ready to respect for example the EU's fiscal rules. Meanwhile, under the impression of the problems with Greece, the German position tends to shift towards a more decided application of economic and fiscal policy coordination mechanisms in order to be able to survey and influence national policies more strongly.

Furthermore, both countries have distinct growth models, the French one being centered on domestic demand, the German one focusing predominantly on export competitiveness.[8] From a French point of view, economic policy in Germany since the start of EMU has been non-cooperative, even aggressive[9] as it has concentrated on a reduction of unit labour

6. For instance when establishing the Euro Group and developing it over the years, in the establishment and shaping of the Stability and Growth Pact, the introduction of additional co-ordination mechanisms, and the first Euro Area summit on French initiative in 2008.

7. The German share in the EU's GDP is 19%, France's share amounts to 14%. All GDP data has been taken from: International Monetary Fund, *World Economic Outlook Database*, October 2009.

8. See the contribution by Jean-Francois Jamet in this volume.

9. For an excellent summary and evaluation of this argument see Patrick Artus: « La politique économique de l'Allemagne est-elle un problème pour les autres pays européens ? », *Natixis Flash*, 8th December 2009, no. 538.

costs, fiscal competition (in particular corporate taxation), too little engagement against the strong euro and too little budgetary stimulus during the recent recessions. From the German point of view, France has not done enough to improve its competitive position, neither in terms of wage restraint, not in terms of research and development expenditure. In turn, French (and other Europeans commentators) point out that Germany's economic policy strategy can only work because the other EU or EMU member states are not following it. If they did, they would collectively face a slump in domestic demand and no Member State would reap a medium-term benefit.[10]

If Germany and France do not pursue more coherent policy approaches in the future, there could be long-term consequences for the Euro Area. Interest rates will almost certainly be higher than they would be otherwise. France could use tax cuts to strengthen the economy's supply side, which in the worst case could fuel a race of competitive real devaluations. Furthermore, the risk of sovereign default within the Euro Area could rise.[11] These developments would come at a high cost for those Member States with severe fiscal problems.

But even if this negative scenario does not materialize, a lack of Franco-German coordination is likely to inhibit growth. An incoherent economic policy mix could for example prevent counter-cyclical policies from working the way they should.[12] Given that the German and the French economy together make up nearly half of EMU's GDP, more coherence would hence be beneficial to the currency union as a whole.

The management of the crisis will shape the future of economic governance in the EU decisively, in particular because policy issues and questions of coordination, hence the governance architecture of the EMU, are closely interlinked. Germany and France, as two countries who face this situation against the backdrop of different growth models and in some ways diverging policy preferences, have a specific role to play. If they assume this role in recognition of the close interdependencies which exist in the EMU and which the current crisis has underlined, they can importantly contribute to improving EMU governance for the future. It is positive that public disputes over EMU issues between Paris and Berlin have ceased. The recent intensification of bilateral exchange on EU and EMU economic governance is definitely a step in the right direction. This dialogue should be intensified and extended from the Finance Ministries to the Chancellery and the Elysée – with the double objective of improving ongoing co-ordination, for example by systematically preparing Eurogroup meetings together, and discussing the long-term reform issues listed above.

In addition, a new Franco-German Council of Economic and Political Advisors could inform debates on the top governmental level and strengthen working relationships between both administrations. Researchers and policy advisors should meet regularly for working sessions, based on reports commissioned to the Council by the two governments or initiated by members of the Council. Its mission should be to contribute to joint views of economic and financial developments in the EU and the EMU and to evaluate national policies with regard to their impact on the other country's economy and the whole Euro Area.

10. *Ibid.*, p. 4.

11. See the analysis by Wolfgang Münchau: Divided we fall, *Financial Times*, October 6, 2009. http://www.eurointelligence.com/article.581+M5fde5956294.0.html#

12. Philippe Aghion/Elie Cohen/Jean Pisani-Ferry: "Politique économique et croissance en Europe"; Documentation française, 2006, available online: http://www.cae.gouv.fr/IMG/pdf/059.pdf.

Both the intensified governmental dialogue in a European perspective and the new Council should seek to ensure a more developed understanding of the other country's situation as well as a common view on shared problems, and it should seek to limit divergence in national policy responses. This is a prerequisite for Germany and France to assume their responsibilities: to shape future governance of the Euro Area and to bring a strong European perspective into the evolving global governance in the field of economics and finance.

What Economic Policy for the Euro Area after the Financial Crisis? The Path Towards a New Franco-German Compromise

Jean-François JAMET[1]

The economic and financial crisis has shown the utility of the Euro and of coordination tools existing between the Member States of the Economic and Monetary Union, but it has also underlined the limits of an economic governance that is still suffering from diverging national economic policies[2]. At a time when Europe is only very slowly overcoming the crisis, the issue for the Euro Area is to define a coherent post-crisis economic strategy and to find the political means necessary to reach this objective. This particularly concerns defining the methods to return to balanced public finances and the means to increase potential growth in the years to come.

In this context, Franco-German relations are essential for several reasons. Firstly, France and Germany, which are the two largest economies in the Euro Area, have traditionally had a determining role in the political initiatives that led to the deepening of European economic integration. But beyond the observation of the leverage effect of Franco-German initiatives, the ability of France and Germany to agree on a common policy during crisis resolution is decisive due to the growing divergence of the respective economic strategies that characterised the decade preceding the crisis[3]. This divergence prevented the Euro Area from acquiring a coherent policy mix and thus cost it additional growth[4].

1. The views expressed are those of the author and not necessarily those of the institutions to which he is affiliated.

2. On this point, see J.-F. Jamet and F. Lirzin, L'Europe à l'épreuve de la récession, *Questions d'Europe* – Policy papers of the Robert Schuman Foundation, no. 130, 2nd March 2009.

3. See J.-F. Jamet, Les économies française et allemande: un destin lié, des stratégies à rapprocher, *Questions d'Europe* – Policy papers of the Robert Schuman Foundation, no. 149, 16th November 2009.

4. On this point it is useful to refer to P. Aghion, E. Cohen and J. Pisani-Ferry, *Politique économique et croissance en Europe*, *Rapport du Conseil d'analyse économique*, La Documentation française, 2006. The authors show in particular that macro-economic policies are less counter-cyclical in Europe than in the United States and that this affects European growth.

The necessary definition of a Franco-German economic strategy would benefit the entire Euro Area. Franco-German initiatives, however, will only reach their full potential if they are accepted and shared by the European partners of the two countries. For France and Germany this means aligning their viewpoints and building common initiatives while ensuring that their vision can be shared by their partners.

In the text that follows we will try to explore the path towards a new Franco-German compromise. In the same way that a compromise was necessary between the two countries to create the Euro, a new political agreement is necessary today to give overall coherence to the economic policy of the Euro Area in the post-crisis period. What content and what format should be given to this agreement?

Post-Crisis Issues in the Euro Area

Although the worst seems to have been avoided, i.e. the scenario of prolonged depression, similar to that of the 1930s, there are numerous post-crisis issues for Euro Area Member States: facing up to rapidly growing unemployment, returning to balanced public finances, finding the path to growth that is high enough to reach these first two objectives more easily, managing risks weighing down on economic balances that are both international (i.e. the evolution of exchange rates) and internal (i.e. ageing and the restructuring of industry), and finally, adapting to the scarcity of natural resources on a worldwide scale.

The task is not an easy one. The unemployment rate has continued to rise in the Euro Area since the beginning of the crisis: it should reach 10.5% in 2010 (as opposed to 7.5% in 2007) and even 19.4% in Spain and 13.5% in Ireland. The state of public finances in the Euro Area has also considerably deteriorated due to recovery plans but also to the increase in social expenditure and the decrease in tax revenue that mechanically stemmed from the crisis. According to the European Commission's forecasts, the public debt of Member States will represent 88.5% of GDP in the Euro Area in 2011 (as opposed to 66% in 2007). Here again, certain countries will see their public debt skyrocket: it has quadrupled in Ireland, for example, where it increased from 25.1% of GDP in 2007 to 87.3% of GDP in 2011; worse again, it should reach 134% of GDP in Greece in 2011. This situation obviously raises the issue of the future of the Stability and Growth Pact. It also raises the issue of the appropriateness of maintaining the same criteria as in the past for the admission of new States to the Euro Area.

Facing up to social and budgetary difficulties is not easy in the context of relatively low growth expected over the coming years: potential growth should be around 1% between 2010 and 2015 as opposed to 2.5% in the United States. In addition to the demographic factor (growth of the active population is slowing down tremendously), this is explained by the lack of innovation and investment in Europe, which results in productivity gains that are too limited, particularly in the services sector[5]. Pressure on the prices of commodities in a world facing a shortage of natural resources will, in addition, add to this already bleak picture.

Paradoxically, despite this modest upturn, there is a risk of international tensions in relation to several issues, notably exchange rates which are seen as a strategic variable by

5. On this point see P. Artus, "Pourquoi la croissance potentielle est-elle aussi faible dans la zone euro?", *Flash Économie – Natexis*, no. 394, 4th September 2009.

many countries, in particular China and the United States[6]. The depreciation of the euro, caused by slower recvovery in the Euro Area and by the fears generated by sovereign debt, is for now the greatest support to European growth after stimuli packages. In that context, the exchange rate policies of the EU's main trading partners will be key. China is for now maintaining a close to stable peg to the dollar and certain countries such as Switzerland and Japan have already mentioned the possibility of implementing a depreciation policy for their currency. The consequences of this latent trade war could well be negative for world trade including European exports.

Last but not least, the search for a common strategy in Europe is made more difficult by certain differences that emerged before the crisis. France and Germany thus went in opposite directions despite the interdependence of their economies: French growth was supported by household consumption (even though contribution to growth of the balance of trade has been negative since 2002) whereas German growth was a result of the growing role of its external trade (growth of the German economy has not been linked to consumption since the beginning of the years 2000 and has adopted the fluctuations of the balance of trade). It is however difficult to say whether one of these models was more effective than the other as both countries experienced relatively modest and similar average annual growth between 2000 and 2008 (1.5% in Germany, 1.9% in France). On the other hand, it is clear that Germany was hit hard by the decrease in international trade linked to the crisis: its GDP dropped by 5% in 2009, as opposed to a 2.2% decrease in France.

The divergence in growth engines on both sides of the Rhine is for the most part the result of diverging economic policy choices: support for demand in France and reduction of labour costs in Germany. These two strategies are incoherent, however, for the Franco-German entity. The slowdown in German consumption penalised French exports, whereas the steady consumption rate in France stimulated German exports. Between 1998 and 2008, French imports of German products increased by 51% whereas French exports towards Germany only increased by 22%. The good performance of German external trade was also largely due to the improvement of its balance of trade with France, where the industry share of GDP dropped significantly (from 17.1% in 1996 to 14.1% in 2005) contrary to what happened in Germany. The divergence between the French and German economic strategies also considerably changed the structure of the economies of the two countries, creating different political incentives. Whereas the share of exports in GDP remained relatively stable in France between 1997 and 2008 (approximately 26%), it skyrocketed in Germany, where it increased from 27.5% to 47.2%.

This vicious circle of Franco-German differences seems to have continued at the beginning of the crisis: the problems were numerous (with regard to support for the car industry, on the initial size and timing of the recovery plans, on the transparency to be given to the financial health of banks, on the energy policy with the "divorce" between Siemens and Areva). Luckily this was interrupted by the need for economic and political pragmatism in addressing the crisis, which led to an agreement on recovery policies as well as the definition of a shared Franco-German agenda in the field of financial regulation within the framework of the G20 and the European Union. However,

6. It is noteworthy that this inflation, which will be stimulated by restored confidence of economic players, even though the amount of currency in circulation increased considerably during the crisis (due to monetary and budgetary recovery policies), could take several forms: an increase in consumer prices, but also and perhaps mainly, an increase in the price of assets and commodities.

divergences reappeared during the "Greek" crisis, with Germany being more reluctant to a bail-out.

The course of the crisis highlighted a well-known fact: France and Germany have difficulties in agreeing in the field of economics because of a different heritage and economic structures that have had tended to differ recently. But when they do agree, the leverage effect is considerable, as was shown by the very history of European integration and that of the Economic and Monetary Union. How then can we then use this leverage effect to define a joint post-crisis policy?

The Need for a New Franco-German Compromise

Observers of Franco-German relations have recently and with reason insisted on German "emancipation[7]" but we should not see in this the impossibility of bringing the views of both countries closer together. It is true that Germany means to promote its well-understood interests in the European concert, which is legitimate. Moreover, France is not acting differently. On several occasions in the past, there have been diverging views between France and Germany, especially in the economic field. And yet compromise was found, for example when the EEC was created with the simultaneous creation of the Common Agricultural Policy, or when the Euro was created with the independence of the European Central Bank and the priority given to the goal of inflation. Both countries managed to overcome their differences on aspects that in the end appear as being relatively minor with regard to what the integration of the two countries could bring. In addition, the financial crisis has brought the Franco-German tandem back to the forefront of the European scene. During the crisis, the French President and the German Chancellor discovered the possibility of sharing European leadership once they spoke with a single voice, as was the case in the field of financial regulation. On the contrary, they could see during the "Greek" crisis how damaging and costly their disagreement and their failure to act could be.

First of all, on the method, much progress is necessary. This should ensure that the conditions for real Franco-German coordination are present at the highest level. The first goal is to create continuous high-level dialogue between the two executives. On this point, the Élysée Treaty laid the essential foundations, with the role played by the Franco-German Economic and Financial Council, the Franco-German Council of Ministers as well as the Secretaries-General for Franco-German Cooperation. It is nevertheless necessary to ensure that the respective decisions systematically receive prior consultation in order to avoid a situation where both countries openly oppose each other concerning an initiative of the other (as was the case, for example, with the Union for the Mediterranean, or – more recently – on the regulation of short selling). The creation of a joint Ministry has been envisaged. More precisely, we could see the creation of a Minister of State position for Franco-German relations which, in the French case, would be attached to a Ministry in charge of European Affairs, or even directly to the Prime Minister. In France, this Minister of State position would be held by a German figure, chosen in agreement with the German Chancellor. A similar structure would be created in Germany. The Ministers of State appointed in this

7. See for example C. Chatignoux, "Merkel-Sarkozy, quel projet?", *Les Échos*, 9th November 2009.

way would consequently benefit from the possibility of attending the Councils of Ministers and of ensuring the daily work of informing and coordinating between the two governments. They would also have the role of organising joint initiatives and monitoring their implementation. To accompany this work, it would be a good idea to bring together the economic and social expertise of both countries, for example by creating a Franco-German economic and social council where economists and social partners from both countries could exchange their viewpoints and draw up joint proposals.

The second objective is to play in a realistic manner on the well-understood interests of both countries and to take account of their respective economic cultures. Although it is useless for the French to argue on the possibility of using inflation during the post-crisis stage in order to limit the share of public debt in GDP, given the ECB mandate and the risk of receiving no response from the German side, it is more interesting to discuss the advantages of the appointment of a German figure as the head of the ECB in 2011, for example as part of the reinforcement of the role of Eurogroup and its dialogue with the ECB.

As regards the content, Franco-German compromise should be ambitious and set a road-map for the years to come. The state of progress of these objectives should then be examined and be the subject of joint communication at each Franco-German Council of Ministers. The agreement would be based on the following elements:

– A commitment by France with regard to returning to a balanced budget. In order to ensure the credibility of this commitment, France could adopt constitutional rules comparable to those recently adopted in Germany, which prohibit public deficit from exceeding 0.35% of GDP, excluding economic trends, from 2016 for central government and from 2020 for the Lander[8]. In addition, France and Germany should discuss the best way to return to a balance knowing that a combination of a decrease in expenditure and an increase in levies will be necessary. In particular, the coordination of timing in the adoption of necessary tax measures would be welcome.

– The joint and systematic preparation of Euro Group meetings with a view to bringing the guiding principles of the economic policy and the political communication of both countries closer together, especially concerning the articulation of budgetary and monetary policies or even the exchange-rate policy. This will avoid diverging macro-economic strategies and the creation of European imbalances similar to those observed at worldwide level. In the long term, this alignment should target the implementation of a joint external economic representation at the IMF, the World Bank or even the G20, which could then be extended to the entire Euro Area;

– A Franco-German proposal with a view to reforming governance of the Euro Area. This proposal could be based on the following foundations: supervision of private debt; internalisation of the budget rule in the legislation of Member States (through the adoption of a binding directive concerning deficits in periods at the height of the economic cycle and the rules of good governance as regards budget preparation)[9]; the adoption of common positions on international economic imbalances, which are then jointly defended at international level and discussed with the ECB in order to draw conclusions and act accordingly, if need be, with regard to monetary policy;

8. A similar rule applicable to the French case was proposed by J. Delpla: "Une règle budgétaire comme condition du grand emprunt", *Les Échos*, 29th October 2009.

9. See the article by S. Collignon in this book.

– The definition of a joint programme for structural reforms. France and Germany should give themselves seven main objectives: increasing the amount of investment in the economy (by increasing in particular the amount of investment expenditure in public expenditure so as to increase, for example, the finance available to higher level education and research), improving the employability of the labour force (by improving, for example, the efficiency of in-service training and back-to-work assistance, but also by encouraging the employment of women, young people and seniors), preserving the viability of health-care and pension systems, improving the regulatory and competitive environment of companies (for example in the area of access to finance), bringing French and German tax systems closer together (for example the rate of VAT and corporation tax), adopting joint investment and energy supply objectives and finally, defining shared industrial priorities (for example in the financing of environmental innovation). These priorities should then become joint projects, drawing especially on the proposals of the aforementioned Franco-German Economic and Social Council.

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The Euro Area should be equipped with a crisis resolution strategy, given the importance of the challenges that it will have to face, and for this it needs a Franco-German agreement. It is not a question of creating an executive board of the two main economies of the Euro Area, but rather of limiting the extremely negative impact of the divergent views and policies between both countries that in the past played a driving role to the benefit of all their partners. In order to have real scope, a Franco-German agreement must be both ambitious and realistic. This first of all implies the strengthening of institutions that coordinate economic policies between both countries, in order to find the path to essential convergence. Then, this cooperation must be given very solid content, through joint initiatives both internally and for the Euro Area in its entirety. The conditions for a revival of European economic integration would then be met.