

Macron and Merkel: how far will the relationship go

President Macron, remained tightlipped on the Eurozone yesterday but he's made it clear he wants to renew the French-German axis. The big question is will Germany agree?



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What did President Macron propose?

Yesterday (26 September), President Macron presented his vision for Europe's priorities for the coming years at Sorbonne University. While Macron did not want to interfere in the German election campaign, the timing of the presentation seems to have been deliberately chosen. His speech is now likely to leave some marks on the coalition negotiations in Berlin.

Macron's proposals encompassed several themes but the overarching theme resonated with his Presidential campaign pledge. A more protective Europe with an integrated core. It was also an attempt to give Europe a vision, heart and feeling. In his almost two-hour long speech, Macron presented a long laundry list of new, old and just recycled ideas and policy proposals. Here is an overview:

1. Defence: Macron proposed a secret service academy, a military exchange programme and a

European Court for terrorist acts.

2. European civil protection against natural disasters.
3. Immigration crisis: Macron proposed a reform of migration policies with more uniformity across countries, more protection of EU borders and a biological ID for migrants. He also wants to refund development aid towards origin countries, through a European “stamp duty” aligned on the UK system rather than a Tobin tax. This is an attempt to revive the almost buried Financial Transaction Tax in Europe.
4. Energy transition: Macron wants a floor for the carbon price, investments in transnational energy networks and a carbon tax at EU borders for heavy polluting countries.
5. Agriculture: Macron wants to reform the Common Agricultural Policy to better protect farmers against price fluctuations and European consumers against bad practices.
6. Digital revolution: Macron wants a European Innovation Agency to facilitate the emergence of European giants, notably in artificial intelligence while regulating at the European level digital companies which pay no taxes where they create value.
7. Institutions: He proposed various measures, notably the reduction of the EU Commission to 15 commissioners, having a part of the EU Parliament elected directly from transnational electoral lists (first the 73 British seats, then up to 50% of the seats).

Given Macron's very brief proposals on the Eurozone, the German reaction to Macron's speech should be positive

Financial market participants and Eurozone experts were hanging on every word Macron had to say on the Eurozone and given that the speech had initially been framed as a Eurozone integration speech. However, we learnt very little that we didn't already know. Macron reiterated the proposal for a Eurozone budget, but he did not comment on the size or the timetable for such a measure.

It seems as if in the end, Macron tried not to touch upon the touchiest issues in Germany, probably to keep Germany as a friend and not alienate his first pro-European vision ally, but also to avoid affecting the upcoming coalition negotiations in Berlin.

What to expect from Berlin?

Given Macron's very brief proposals on the Eurozone, the German reaction to Macron's speech should be positive. In fact, many ideas have already been circulating for a while now. Germany itself even proposed some.

In the coming weeks and months, the elephant in the room is of course further integration of the Eurozone. Let's not forget that the current eu(ro)phoria in financial markets is to a large extent based upon hopes for further Eurozone integration on the back of a renewed French-German axis. The big question is whether the stance of the new German government regarding the Eurozone will change.

In our view, all of this could mean there won't be far-reaching reforms of the Eurozone with the new government.

The longer we think about the implications of a possible “Jamaica coalition” in Germany for the future of the Eurozone, the clearer it gets that the next German government will clearly not be in the visionary driving seat. This role has been given to Mr Macron. The FDP could be a welcome excuse or scapegoat for Angela Merkel to hammer on practical and political feasibility of any further reforms.

Permanent transfers, even a small unconditional Eurozone budget look like a no-go for the next German government (and would probably always have been a problem with any new Merkel-led German government). Even the idea of a rainy day fund looks unlikely. Instead, the focus could again shift on the well-known paradigm of conditional solidarity; or in short “money for reforms”. In this regards, a fiscal capacity which offers investments or funding if a country has delivered on structural reforms could be a compromise between France and Germany. As regards the institutional front, the idea of a European Monetary Funds, a beefed-up ESM, which focuses on fiscal surveillance and takes full responsibility of future bailout programmes could find support with Angela Merkel. But don't forget that the FDP has pleaded for a (partly) unwinding of the ESM, while the Greens have often criticised the lack of democratic control of the ESM.

In our view, all of this could mean there won't be far-reaching reforms of the Eurozone with the new government. The fact that any new government will have the AfD and probably also more slow-reformers in its ranks adds to our scepticism. In fact, far-reaching reforms might not even be necessary.

Obviously, starting a monetary union from scratch would look much different than the current set-up but with some additional tweaks and only little changes like a conditional fiscal capacity, a finalised banking union, an upgraded ESM or a “Special Commissioner of Economics and Finance” (or Eurozone finance minister), the monetary union could also become more sustainable. Even though any sub-optimal set-up (as close as it might get to optimal) will always leave a residual risk of break-up or exit, it reduces economic stability and investment prospects.

Good start of (a long) debate

Macron's long-awaited speech was a first attempt to surf the current wave of eu(ro)phoria and to rebuild a new positive European narrative and vision. As regards the Eurozone, however, Macron remained remarkably tight-lipped. In our view, Macron has signalled that keeping Germany as an ally is one of his main goals. A smart move as putting Germany in “opposition mode” from the beginning could be a hit beyond repair.

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