Sharp conflicts in Europe over economic stimulus program

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The debate concerning a joint European stimulus package has led to sharp international tensions. In particular, German Chancellor Angela Merkel (Christian Democratic Union, CDU) has become the focus of criticism for her refusal to support a wide-ranging package of measures aimed at stimulating the economy.

The economic situation in Europe is worsening by the month. A joint forecast by ten European research institutes has projected a 0.4 percent decline in European GDP (gross domestic product) in 2009 and a substantial increase in unemployment. The researchers do not rule out a considerably worse economic decline.

Most European Union (EU) countries are already in recession. In Germany, where the GDP grew in the first quarter of 2008 at an annual rate of 5.7 percent, the figure for the second quarter slumped by 1.7 percent and by 2.1 percent in the third quarter. The Organisation for Economic Cooperation and Development (OECD) forecasts a rise in the number of unemployed in Germany over the next two years of around 700,000.

The German government is fully aware of this worsening situation. In the course of the parliamentary debate last week on the country's budget for 2009, Merkel told the assembled deputies that Germany, Europe and the industrial nations in general confront an "extraordinarily difficult path" and warned that the population would have to prepare for "hard times."

Unlike other European governments, however, which have made large sums available to stimulate their economies, the response thus far by the German government has been minimal. It consists of just €11 billion distributed over two years.

This amounts to a mere 3 percent of the €500 billion that the government freed up recently to rescue German banks. In addition to a small relaxation in auto taxes and a tax rebate for private craftsmen's bills, the government's economic stimulus includes more money for transport, for municipalities and for the renovation of buildings.

There has been considerable opposition in Berlin to the economic revival package of €200 billion put forward in Brussels last Wednesday by the president of the European Union Commission, José Manuel Barroso.

Prior to Barroso's announcement, French President Nicolas Sarkozy tried to persuade Chancellor Merkel to support a larger financial contribution from Germany as part of the EU stimulus package. Germany has a comparatively low budget deficit—considerably less than the stipulated EU limit of 3 percent of GDP. This cleared the way for additional expenditure from Germany, Sarkozy argued.

Merkel, however, sharply rebuffed the proposal. According to *Le Monde*, the chancellor "showed little generosity" at a French-German summit held November 24. At the end of the talks, Merkel told a joint press conference that each of the 27 EU member states had to make a financial contribution and said, "Germany, for example, has already made a large amount available."

The budget spokesman of the CDU/CSU (Christian Social Union) parliamentary group, Steffen Kampeter, was even more explicit. He backed the stance of the German government as follows: "We should not use German tax revenues to make every other country happy."

In the event, Merkel gave the green light for Barroso's economic stimulus package, but only as a recommendation. The implementation and financing is left to individual governments. She rejected any transfer of additional funds to Brussels, telling the *Frankfurter Allgemeine Sonntagszeitung*, "We will continue to make our contribution of 20 percent to the EU budget. We do not want to increase this contribution."

Merkel's stance has met with fierce criticism in the British, French, Italian and American press, and she is also coming under increasing pressure within Germany.

In its annual appraisal issued at the beginning of November, the German Council of Economic Advisers called for much larger sums to be invested in the economy. The committee, consisting of five renowned economic professors, issues an annual report on overall economic developments and has earned a reputation for recommending radical cost-cutting measures.

Last Sunday, *Der Spiegel* appeared with a banner headline "Fainthearted Angela" and a fierce attack on the chancellor. The magazine accused her of failing to provide any orientation and instead relying blindly on her finance minister, Peer Steinbrück (Social Democratic Party, SPD). Their economic revival program was "a mishmash of half-baked ideas, questionable subsidies and false labels," the magazine wrote.

Der Spiegel went on to compare Merkel's economic policy with that of Reich Chancellor Heinrich Brüning at the beginning of the 1930s, saying the latter had tried to counter the economic crisis of that period "with iron thrift—with devastating consequences."

The main criticism made by *Der Spiegel* is that Merkel's course will lead to international isolation. She and Steinbrück had "switched to a national course, fearful that German crisis money will be wasted in Europe." Instead of taking the initiative in Europe, she had allowed British Prime Minister Gordon Brown and French President Sarkozy to dominate. "Merkel has largely isolated Germany with her hesitation and the Germans are losing influence in world politics as a result," *Der Spiegel* complained.

Merkel also confronts opposition inside her own party. The small business association that is linked to the CDU and the allied Bavarianbased CSU has put forward demands for an immediate reduction of taxes in order to bail out medium-size enterprises, which have been hit by the lack of credit and the current economic decline. It was only with difficulty that Merkel was able to prevent an open rebellion in the CDU, which commenced its congress on Sunday evening in Stuttgart.

Over the weekend both Merkel and Steinbrück underlined their opposition to making additional finance available to deal with the rapidly worsening economic situation.

Steinbrück told *Der Spiegel*: "I do not consider it fair to give the impression we can finance our way out of the recession with state money." He added, "I think it is important not to senselessly burn money. Just because others have out-bid themselves with billions on a daily basis does not mean I have to follow suit." He went on to accuse the Council of Economic Advisers of changing "their position these days more often than I change my shirt."

In the *Frankfurter Allgemeine Sonntagszeitung*, Merkel expressed herself less aggressively, but with equal determination. On Monday she stressed to the CDU congress: "We are not prepared to participate in a ... senseless competition involving billions. In such times we also have a responsibility to the taxpayer."

Merkel's only concession was to review the agreed economic package at the beginning of January and consult on any further measures.

To reduce the stance adopted by Merkel and Steinbrück to faintheartedness, as *Der Spiegel* does, misses the point. Both politicians are seeking to defend the Stability and Growth Pact, which has formed the backbone of Germany's strategy in Europe since the beginning of the 1990s.

At that time, Chancellor Helmut Kohl (CDU) and his finance minister, Theo Waigel, insisted on rigid financial criteria for the introduction of the euro as the standard European currency. Such criteria limited new indebtedness of a country to a maximum of 3 percent and total debt to 60 percent of GDP. At the same time, the independence of the European Central Bank (EZB) was aimed at preventing governments with economic difficulties from pressuring the EZB to implement polices that could lead to inflation.

The Stability Pact thereby served a double purpose. First, it was designed to guarantee the stability of the euro and enable the euro to compete with the dollar. This, in turn, would strengthen the dominance of the German economy within Europe under conditions where the powerful German export industry would benefit from a stable currency.

Second, the rigid financial criteria in the Stability Pact provided the basis for a sustained offensive throughout Europe to cut wages, social security benefits and other public expenditure. Germany was particularly "successful" in this regard.

Wage levels and social security benefits were radically slashed through the Agenda policies introduced by the former SPD-Green government led by Gerhard Schröder. According to a recent study by the International Labour Organization (ILO), Germany occupies first place among industrial nations for the rate of its wage differentiation. In no other industrialized country has the gulf between high and low incomes increased so dramatically.

The German government sees the Stability Pact being endangered if it gives way to pressure and increases public expenditure. According to the *FAZ* newspaper: "If the chancellor is too generous, there is the danger that Germany might violate the Stability Pact and thereby deliver it a mortal blow. In so doing, the CDU would be burying its own child."

If, however, Germany continues to hold fast to the Stability Pact, it is threatened with increasing isolation in Europe—uniting its competitors against it. In addition, the threatened bankruptcy of a series of Eastern European countries heavily dependent on European support would have grave repercussions for the German economy, which has extensive economic interests in Eastern Europe.

It is this dilemma that accounts for the fierce exchanges over a European economic stimulus package. The impact of the economic and financial crisis has undermined the basis for Germany's previous European strategy. It is proving increasingly difficult to dominate the European Union by peaceful means. As a result, political conflicts between the European powers are intensifying.

As the six-month French chairmanship of the EU comes to an end, media commentaries are proliferating which refer to "increasing distrust" and "sharp conflicts" between Berlin and Paris. In Germany, France is accused of state protectionism because it has used state funds to invest in major enterprises and intervene in the auto industry. The Austrian magazine *Profile* writes: "Berlin suspects that Paris wants to further partition off its key industries, manipulate the EU economic system accordingly and increase its influence over the European Central Bank in order to lower the base interest rate and devalue the euro. This has palpably more benefits for French industry than for the existing export world champion, Germany."

In Paris, on the other hand, according to *Der Spiegel*, Merkel has become a target of anger within leading circles, which see her as someone who stubbornly blocks any initiative.

In the past, German chancellors were prepared to strike political compromises through financial concessions, but the current government insists more strongly on its own interests. Merkel and her economic and financial backers believe that Germany is better equipped to deal with the crisis than other European countries.

In her *Frankfurter Allgemeine Sonntagszeitung* interview, Merkel declared that "during the past few years, the German economy has re-established itself structurally and improved its competitiveness. Germany is strong and we have every opportunity of mastering the crisis well." Her deputy, Vice Chancellor Frank Walter Steinmeier (SPD), went so far in the Bundestag (parliament) budget debate as to describe the crisis as a "chance for a realignment."

The only common element in the policies proposed by Paris and Berlin is their determination to shift the burden of the economic crisis onto the backs of the working population. To this end they are resolved there should be no reduction in popular taxes or any mediation of the effects of the crisis on broad layers of the population by such measures as direct subsidies or price reductions.