

Fault lines emerge across Euroland

by William Engdahl

The failure of the Feb. 26 European Union summit in Petersburg, Germany, to agree on an EU budget reform proposal, part of the far-reaching "Agenda 2000" negotiations among the 15 EU member-states, exposes more than a dispute over members' payments into the EU budget. It reveals deep fault lines within the artificial supranational structure of the European Monetary Union (EMU), with its new euro single currency.

Significant is the degree of bitterness between the two core members of Euroland, France and Germany, which has emerged over a proposal by the German government of Chancellor Gerhard Schröder (Social Democrat) for a major reform of the Common Agriculture Program (CAP). French President Jacques Chirac made an extraordinarily blunt critique of the German government's chairmanship of the Petersburg summit, telling media, "I have never seen such bad preparations for a summit, so little attempt to sound out the other governments."

Under EU rules, each of the 15 governments assumes a six-month rotating presidency of the EU Council, the highest authority in the Union. On Jan. 1, it was the turn of the Schröder government to take over the presidency until July 1. The EU Council president has significant powers to set the discussion agenda.

Confirming how serious the cleavages are which erupted into the open at the summit, after the talks broke down in utter failure, Schröder told reporters, "There could be difficulties on financial markets if heads of governments do not succeed in putting a financial agreement together," a reference to the recent fall in the euro, as well as to nervous stock markets across Europe.

The summit talks breakdown stems from a divergence between France and Germany. The German government is politically committed to reduce its 24 billion deutschemark (roughly \$15 billion) annual contribution to the EU budget. It was a major election pledge of Schröder's Social Democrats, whose members rarely include the conservative farm bloc. But, Germany's demand to cut its over-size contribution to the EU budget, the largest of any EU state by far, was made well before Schröder's election victory in October 1998 over Christian Democratic Chancellor Helmut Kohl.

For its part, the French government is determined to defend the interests of France's most powerful political lobby—agriculture. To date, France is refusing to even consider a German "co-financing" plan that would limit future CAP spending. At present, the spending for the CAP agricultural portion of the EU annual budget makes up fully 50% of all EU spending, which this year totals DM 100 billion. This large agriculture subsidy, as some EU states argue, comes despite the fact that today only 6% of the EU population is engaged in farming.

Germany is proposing what it calls "co-financing" as a solution to the rising farm budget. The present total EU farm budget would be frozen at today's level for the next seven years. To do that, while bringing the farm-dependent economies of Poland and Hungary into the EU, requires severe cuts in current crop payments to EU farmers, according to Bonn's proposal. But, the German plan would allow a member government to "co-finance" or supplement payments to its farmers out of its own national budget. That plan has Paris hopping mad, as France has traditionally been the largest recipient of CAP funds. Germany, so the argument goes, as the largest contributor to the EU budget, has, in effect, been financing the French agriculture sector.

New EU members

Behind the farm reform issue is a deeper split within Euroland involving the imminent membership of Poland, Hungary, and the Czech Republic. In Poland, more than 25% of the population is engaged in farming. In Germany, only 2%. The German insistence on CAP reform is tied to the fact that with the eastern European states, which are large agriculture producers, set to become EU members, they, too, would be entitled to receive significant new cash transfers from the EU Cohesion Fund, much as have Spain and Portugal, as well as from the CAP.

In the 11 states in the EMU, including France and Germany, the sharp economic downturn is beginning, while they are also in the self-imposed straitjacket of the Maastricht Treaty's ceiling on national budget deficits, which can be no more than 3% of Gross Domestic Product. The 3% deficit ceiling is regarded as vital to the euro, a sign to investors that governments will not permit fiscal "recklessness." Holding to that 3% deficit provision is regarded as essential, especially now, in order to retain the confidence of international financial market investors in the euro markets.

Since the 11 nations started the new currency experiment on Jan. 4, the euro has already begun to weaken significantly. Within the first two months, the euro has already fallen 8% against the dollar, quite opposite to what confident Euroland governments and bankers were expecting. The collapse of especially German exports, as the world economic depression spreads from Asia, Russia, and Ibero-America, is the chief reason.

The fault lines around the Agenda 2000 proposal run along a north-south divide, with France being backed by Spain, Portugal, Italy, and Greece. Germany is backed by Austria and the Scandinavian members, the United Kingdom, and Holland, all of which claim that they are net contributors into the CAP, and are demanding a ceiling on farm costs. Former EU Commission President Jacques Delors calls this split the “greatest problem threatening the EU.” Chirac and the French charge that the Schröder government, currently EU Council president, is violating the fundamental basis of the 1960s Franco-German accord, in which French President Charles de Gaulle and German Chancellor Konrad Adenauer agreed that in any dispute, Paris and Bonn would give in to the demand of the other if the issue were one of vital national interest. The heart of the fight is that between Paris and Bonn over CAP reform, the French say, and a break with four decades of EU policy is at stake.

The de Gaulle-Adenauer agreement

When the six governments of what became the European Economic Commission met in 1958 to sign the Treaty of Rome and create the Common Market, the heart of the EEC was an agreement between de Gaulle and Adenauer. Under that pact, France in effect agreed to unhindered German industrial growth and exports—which French policy had tried desperately to block after World War II, for fear of German rearmament. In return for allowing free trade in German machine tools and high-precision engineering equipment within the Common Market, France got Germany’s support for the EEC to funnel the bulk of member contributions, via the CAP, to the benefit of French agriculture. Last year, France got the largest chunk of the CAP budget, some DM 18 billion.

One consequence of the flow of CAP monies into French agriculture has been to make France today the world’s second-largest food exporter, after the United States. Much of that food goes to Germany, in return for French purchases of German engineering goods.

Over the past four decades, an informal system of conflict resolution evolved around this Franco-German core, under which, if either Paris or Bonn held any issue to be one of its “vital national interest,” the other party was obligated to respect that. All issues were resolved first in bilateral French-German government negotiations; then a common policy concord of the two largest states in what is now the European Union, would, with rare exception, become European Union policy.

Not this time. After the failed Petersburg talks, French officials accused the Schröder government of “not understanding European realities” and the nature of the Franco-German relationship. The French charge that Schröder is pushing German national interest in cutting the budget for the CAP, without prior consensus from Paris. One European

diplomat remarked, “What is new is that France finds itself in the dock, with the Germans wanting their money back.” France is threatening to use its veto to block the German proposal on Agenda 2000. In early March, Chirac pledged to French farmers that he will remain firm in opposing the German demands. Germany has called for a final decision on Agenda 2000 by the time of the next EU summit on March 24.

More fissures

But the split over CAP finances is far from the only one emerging in the new “one-size-fits-all” European Monetary Union. At the last Group of Seven meeting at the end of February, France suddenly distanced itself from earlier support for a German call for a system of currency bands among the euro, the dollar, and the yen, proposed by German Finance Minister Oskar Lafontaine. According to informed European banking circles, France has begun to fear a fixing of the euro which might benefit German exports at the expense of French exports.

Further strains in the Franco-German core of Euroland emerged as well in recent weeks when German Environmental Affairs Minister Jürgen Trittin, a member of the radical Green party, unilaterally declared that he would stop reprocessing all spent fuel from German nuclear power plants. For years, German reactor fuel has been reprocessed at the French facility at La Hague, a major support facility for the immense French nuclear power industry. Trittin declared the halt without consulting France. Only through the last-minute intervention by Schröder to delay the decision, was a major rift between the two countries averted.

There are indications that British Prime Minister Tony Blair is trying to take advantage of this rift. Blair told the British Parliament on Feb. 25 that he supports British entry into the euro. Blair’s support for the German position on Agenda 2000 has added further suspicion to French fears of a German go-it-alone policy on farm reform.

While this battle is likely to end in some compromise between France and Germany on the CAP reform, the new north-south fault line across Euroland will in no way be eliminated. With the euro now trading at 1.08 to the dollar, a drop of 8% in just two months, the danger is that nervous financial markets might soon conclude—as anyone could have told them—that the most radical monetary experiment since 1945, has been a failure. That creating a single supranational currency and central bank for 11 nations, involving a surrender of basic national monetary and economic sovereignty on the part of member-states with no parallel political structure to counter the independent European Central Bank, is likely to rip apart from its internal contradictions and lack of a common, sound economic foundation. Were investors to conclude that, the euro could rapidly turn into a millstone around the neck of Europe.