Europe Turns against France

Jacob Funk Kirkegaard and Nicolas Véron discuss France's confrontation with the European Union over the French failure to meet its commitments on fiscal consolidation.

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Steve Weisman: A new confrontation is emerging in Europe between France and Germany over the merits of fiscal consolidation five years after the downturn in Europe began. This is Steve Weisman with the Peterson Institute for International Economics with Nicolas Véron and Jacob Kirkegaard to talk about this new confrontation. Nicolas, first, give us more details.

Nicolas Véron: Basically, the French government has not been doing the sort of fiscal consolidation they should have done under the rules that were approved unanimously by euro area member states. They have been given a free pass in the past, but now they are asking for another free pass. And basically the reaction of both Germany and the European Commission seems to be, at this time, it doesn't wash. If we give you a free pass now, we really undermine the credibility of our whole system.

Steve Weisman: Is France in danger being punished or sanctioned in some way?

Nicolas Véron: Yes, it is. And because the view in Brussels and Berlin at this point is that if now the sanctions that are written into agreement that France signed up for are not triggered, then it becomes really totally not credible piece of paper.

Steve Weisman: Jacob, Germany is leading the way on this. Why are the Germans so concerned?

Jacob Kirkegaard: I think there are several reasons. First of all, the Germans tend to have a somewhat legalistic approach to a lot of EU rule-making and they really believe that the rules are in place to be kept and adhered to. One of the things that they always fear is this issue of moral hazard—that on the one hand, if you give, as Nicolas said, France two years to do a fiscal consolidation and then you don't do it in Paris, then if you do it again, you make a mockery of the rules.

I think the other issue at play here is that it isn't just Germany. Clearly, Germany is speaking out the most. But the reality is that all the smaller member states of the EU, especially those who may have been sanctioned before under these rules, are very keen on making sure that large countries can also be sanctioned—that there is a difference made between a small and large economies.

So in some ways, Germany has the votes to this. They have the support of the majority of European member states.

Steve Weisman: But Jacob, Europe is still--except for Germany--struggling to recover from a recession going on for years. Isn't there some doubt whether this is a wise policy in terms of helping Europe recover?

Jacob Kirkegaard: Well, there's no doubt that if you adopt a strict interpretation, and having additional fiscal consolidation at this very moment, may seem counter-intuitive. But I think the counter-argument is that Europe spent several years putting together an institutional response, a change of the rules, in response to the crisis.

And now, we're at the first time at which these rules are actually being tested. So if it turns out that you can actually just not adhere to these rules, then Europe has essentially wasted the five years since the crisis began. And the credibility of the entire overhaul of European fiscal surveillance rules has been wasted.

Steve Weisman: Jacob just said it was counterintuitive. But is it counter-productive? What's the argument that France is making, Nicolas?

Nicolas Véron: I think you really have two logics here, as Jacob has explained. There is a logic which states the rules are stupid. Let's ditch them first and do the right thing, which at this point is not doing austerity, and discuss what new framework would make sense. And Germany is making an argument which may be more holistic, which is to say the credibility of our institutions come first. So you have to first abide by the rules and trust is there and then we can discuss how to amend them.

So you can see it in a way as an issue of sequencing. And I think frankly there are merits on both sides. But I have some sympathy with the German argument. I think at this point if you don't apply the sanctions, you're really making a statement that this whole set of rules is just a pure smokescreen, and I don't think that's good for Europe.

So my view is that the quantum of fiscal adjustments that we're talking about for France is not making as much of the macroeconomic effect as to trust implications of ditching the rules altogether. And therefore, at this very point, I think the French government basically played the whole game very poorly. They should have seen it coming. They should have prevented this confrontation for the sake of the credibility of the EU framework. And frankly finding themselves in this situation at this point is pretty embarrassing.

Steve Weisman: Is it too late to have a compromised solution?

Nicolas Véron: I think it's not too late to have a compromised solution. But I think the compromised solution will be an embarrassment for France.

Steve Weisman: Jacob, what would it look like?

Jacob Kirkegaard: I think the classical one is what most people, myself included, will be hoping for is kind of an Italian solution--meaning that the French government does what the Italian government under Prime Minister [Matteo] Renzi is doing right now, which is essentially breaching some of the same fiscal rules that France is in danger of breaching, but at the same time seemingly at least being much more serious about implementing potentially far-reaching labor market reforms.

So that you have a quid pro quo that you are being given forgiveness for breaching the fiscal rules, but at the same time, you're making it up for it by structural reforms. The real problem therefore in a political sense for France is that they have nothing to show. They have no meaningful structural reforms. And they are still breaching the fiscal rules.

Steve Weisman: Gentlemen, thank you very much.