Confrontation over French budget

Italy moves to compliance after banking setback

by David Marsh

Mon 27 Oct 2014

Confrontation is in the air as Europe's policy-making preoccupations veer between banking soundness and budget deficits, after Sunday's bittersweet banking assessments by the European Banking Authority and the European Central Bank.

The analysis provides both good and bad news about the health of European banks. Attention is shifting to the politically still more fraught issue of French and Italian budget shortfalls. The European Commission must decide on Wednesday whether Paris and Rome are violating EU rules on fiscal stability.

Italy will be far more diplomatic over the issue, especially on account of defensiveness in Rome over nine Italian banks failing to pass the ECB's comprehensive review, a greater concentration of weakness than expected. French banks, by contrast, like German ones, were given a generally clean bill of health.

President François Hollande has shown no sign during 30 months in office that he is prepared to submit to European Commission strictures on French budget sovereignty, despite constant failure to rein in budget deficits to 3% of GDP.

Hollande is in direct lineage to his former mentor, the late President François Mitterrand, a principal architect of economic and monetary union, who never accepted that one of the main conditions would be that France would give up economic sovereignty. In particular, Mitterrand was congenitally opposed to an independent European Central Bank – a recurring nightmare that has haunted all of his successors.

'I am not hostile to the Central Bank, but to certain of its modes of operation. The Bundesbank is completely beyond the control of governments. Our central bank [the Banque de France] is independent, but it is the government that decides the economic and monetary policy,' said Mitterrand in 1989, several months before the fall of the Berlin Wall. 'It is dangerous that the [European] Central Bank, in the absence of a political authority, should have sovereign power. The European Monetary System [the forerunner of EMU] is already a German zone. But the Federal Republic of Germany does not have authority over our economies. With the [European] Central Bank, it would have it.'

Underlying the nagging doubts behind Mitterrand's predictions, last week's EU summit in Brussels saw soundings on a compromise between José Manuel Barroso, the outgoing commission president, and French and Italian leaders. Matteo Renzi, the Italian prime minister, showed himself far more ready to reach an understanding than Hollande.

French ministers have proclaimed that the government has no plans to adjust the 2015 budget sent to Brussels last week. Not for the first time, Paris – after missing the 3% budget deficit target for the third time – is sidestepping the fiscal rules by pretending they do not exist. 'We decide the budget,' said Manuel Valls, the prime minister. 'That's not the way it happens. France should be respected. It's a big country.'

The Paris government defends the overshooting as justified by low growth and low inflation. It points to €50bn of spending cuts in the next three years as evidence that France is doing enough. Germany and other supporters of fiscal orthodoxy say that France's lack of thorough reform is one of the reasons for Europe's poor growth prospects.

Economic polarisation in the EU is thus resulting in more strains among member states showing variable economic performance. Britain has been told to pay an extra €2.1bn to the EU budget within weeks because of its relative prosperity.

To compensate for its economy performing better than other EU countries since 1995, the UK will have to make a top-up payment on 1 December, a surcharge that David Cameron, the UK prime minister, is threatening not to pay. France, meanwhile, will receive a €1bn rebate.