

The Telegraph

## Germany faces an uncertain future as the eurozone's magic money tree



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11 JUNE 2017 • 7:28PM

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German chancellor Angela Merkel. Her compatriots are wary of subsidising the rest of Europe CREDIT: AFP

The EU has had a good few weeks, starting with the election of Emmanuel Macron as President of France, backed up by a series of strong economic figures from just about everywhere in Europe, and culminating in the Remainers' Revenge last Thursday in the UK.

Given the UK's profound political uncertainty, it is now even possible that Brexit will not happen at all. Yet the EU is facing a potentially bigger challenge.

[Last week](#), I berated Germany for being partly responsible for the eurozone's huge current account surplus and urged a relaxation of German fiscal policy. Such a

relaxation would indeed contribute something to improving European economic performance and stabilising the euro. But on its own, it will not be enough.

Leaders such as President Macron who want to ensure the euro's survival support the construction of a fiscal union, which would ultimately involve the pooling of spending, taxing and borrowing. This is a much bigger deal than mere monetary union. Indeed, it is potentially much bigger than any integration yet attempted.



Leaders such as Emmanuel Macron support a fiscal union

Forming the monetary union simply meant that member countries used the same currency. Forming a fiscal union means that they will share the same bank account. I fully understand why most German citizens are wary of this. Interestingly, from a reading of most of the economics literature, you would not think that they had much to be concerned about.

In the imaginary unions discussed there, different parts undergo different shocks from time to time, and therefore alternate with regard to which part of the union helps out which. One of the defects in the design of the single currency was precisely that the system did not have this characteristic. Monetary union without fiscal union meant that there was no natural economic mechanism for the relief of less fortunate members on those occasions when the economic dice rolled against them.

By contrast, within existing fiscal unions such temporary transfers occur all the time. But often this sharing of alternating ups and downs is not fiscal unions' most important feature and it is not what German voters should be most worried about.

In most existing fiscal unions, as well as economic fluctuations that affect different parts differently, there tends to be a persistent discrepancy in the level of prosperity of different parts, and sometimes even in their growth rate, with the result that there is a one-way flow of fiscal transfers that persists over decades, and possibly over centuries.

For instance, the Office for National Statistics announced last month that [London effectively subsidises](#) just about all of the rest of the UK, while England subsidises Scotland. These features of our Union are not here today and gone tomorrow. They are deep-rooted in the nature and structure of the Union.



Scotland is subsidised by the rest of the UK, but is strangely where the strongest call for independence is CREDIT: PA

What is more, by and large, they are accepted by British citizens without demur. Interestingly, in the United Kingdom it is not the part of the Union that is a net contributor, namely England, that wants to leave the Union, but rather the part that is a net recipient of fiscal flows, namely Scotland. (Mind you, after Thursday's election results, it seems that is a receding prospect.)

As far as I know, there is no movement in favour of independence for London, or even for a revised settlement to end London's subsidy to the rest of the country, however that could be achieved. The reason is that there is so much that we have in common that binds us together, most importantly, a long history of shared endeavours, and shared sacrifices, producing shared success (and some failures) in peace and war.

Other unions face similar issues, but not always with the same results. In Italy, it is not that the north and the south alternate with each other as suppliers and takers of



funds. Rather, there is a one-way flow from north to south. What is more, it has been this way pretty much all the time since Italian unification in the 1860s.

But many Italian citizens are not happy with this situation. In marked contrast to the UK, the movement in favour of breaking up the country is in the part of the country that is a net provider of funds, namely the north. What German citizens need to be worried about with regard to fiscal union is that their country will be asked to play Milan, while just about the whole of southern Europe takes on the role of Naples.

The role of permanent provider is not one that Germany is going to take on lightly. It is, of course, precisely what West Germany did in relation to East Germany, when the country reunited in 1990 after its separation in the decades after the Second World War. This flow of funds from west to east may not last for ever but it is still continuing. It is grudgingly accepted by the German taxpayer, but still resented.

And Italy is not south Germany. Over the last few weeks of election campaigning, we have seen how democratic politics naturally produces an escalation of demands on the public purse as politicians, and voters, seem to believe in the magic money tree that will produce the goodies that they want.

Within the eurozone, if its leaders press on to fiscal union, Germany will be asked to become the magic money tree in relation to most of the rest of the union. I am increasingly of the view that the whole integrationist project of the European Union is a form of fantasy, dreamed up by the European elites. Huge steps, such as monetary union, are taken without thought of the consequences.

When these consequences become apparent, the approach has been to disguise them from European electorates, and/or to pretend that they are not there at all. The whole philosophy is dominated by the casual assumption that, whatever the current difficulties, it will all be all right on the night. But it won't. Fiscal union is the shoal on which the EU will founder.

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