

Tensions are rising between Germany and France over the eurozone crisis. Dominic White explains

# A RECIPE FOR DYNAMITE

Alfred Nobel, the inventor of dynamite, established his prizes after reading his own obituary in a newspaper. The article, titled 'The merchant of death is dead', was mistakenly written in response to his brother's passing. But the soul-searching that followed convinced Nobel that he should leave a more positive legacy.

For those of us with a dry sense of humour, this adds to the sense of irony surrounding the EU's receipt of this year's Nobel Peace Prize. Despite frequent reports of the euro's demise in recent years, a similar moment of self-reflection and change of heart has so far escaped European politicians. We should perhaps just be thankful that the EU didn't also receive the prize for economic sciences.

Notwithstanding Greece's fiscal fiasco and Spain's banking fudge, the growing divergence between France and Germany is currently the biggest threat to the legacy of European politicians. And if next year sees the US fall off the fiscal cliff and China experience a hard landing, then France is an accident waiting to happen.

Since World War II, the wedge between the two countries driving Europe's integration has seldom appeared wider. And the adjustment taking place in the eurozone's 'periphery' is acting as the hammer to this wedge. The fact is the demand adjustment in the south of Europe is hurting the French economy far more than its neighbour across the Rhine. Italy and Spain serve as the destination for 16% of French exports against just 10% of Germany's.

Improving competitiveness is likely to have a similarly uneven impact. As labour costs continue to fall, companies in Spain, Portugal and Italy could increasingly find they are able to undercut their French competitors; German firms, by contrast, should remain more insulated due to lower labour costs and differing areas of product specialisation. In effect, the peripheral adjustment is exerting yet another 'asymmetric shock' on the eurozone, but this time it is France and Germany that are growing apart.

It is difficult to escape the sense that the political economies of these two countries are becoming increasingly polarised. Germany's current account surplus remains stuck at 6% of GDP (thanks in part to stronger trade links with emerging markets), while France's deficit

is now the largest in the eurozone. More significant, the gap between the two countries' unemployment rates is at its widest since the Elysée Treaty was signed in 1963.

Compounding this, France and Germany have always had competing visions for the future of Europe. Germany's preference is for a confederal structure, with the euro club of countries bound by strict rules that limit their ability to act as truly sovereign states. France's strong national identity doesn't sit well with this; it envisages a federal Europe, which emphasises shared institutions and centralised powers.

Some might argue that growing tensions could ultimately prove positive for European 'solidarity'. It is often said that the history of EU integration is best understood as a Franco-German compromise – and crises can act as the trigger for forging this compromise.

Yet it is also true that in the past, European integration has always been consistent with both France and Germany pursuing their national interests. The EU's precursor – the European Coal and Steel Community – was established in the early 1950s to reassure France against the growing Soviet threat and weaken Germany's monopoly of the raw materials required to build an army; Germany gained from the relaxation of restrictions on its economy. The embryonic European Defence Community, by contrast, was doomed by French politicians' belief that NATO better served the country's interests.

It remains unclear how French and German national interests might become realigned. A more overt financial crisis in the eurozone, a deeper French downturn or a 'hard landing' in China could all serve as a timely reminder that Europe remains economically and politically more important to Germany than any other region. But while the crisis is far from over, it remains too soon to write the euro's obituary. European politicians have already stumbled upon the recipe for dynamite. Like Alfred Nobel, it is now down to them to ensure that their legacy is constructive, rather than destructive. ♦

## FACTS AND FIGURES

**6.9%**

**THE GERMAN UNEMPLOYMENT RATE**  
(SOURCE: DATASTREAM)

**9.7%**

**THE FRENCH UNEMPLOYMENT RATE**  
(SOURCE: DATASTREAM)

**0.0%**

**FORECAST THIRD QUARTER GDP GROWTH IN GERMANY FOR THE THIRD QUARTER OF 2012**  
(SOURCE: CONSENSUS ECONOMICS)

**-0.2%**

**FORECAST THIRD QUARTER GDP GROWTH IN FRANCE FOR THE THIRD QUARTER OF 2012**  
(SOURCE: CONSENSUS ECONOMICS)

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