

No. 188

## Populist Blackmail and the EU\*

When it comes to justifying violation of European rules on sovereign debt or liquidating banks, one argument is very much in vogue just now: That you have to make an exception once in a while to avoid fuelling populist criticism of the euro and EU.

This is how France extended mitigating circumstances in the run-up to the presidential elections, even though it had been flouting the European agreement on reducing public debt for years. Deadlines were constantly pushed back and penalties postponed, for fear of providing grist for the National Front's far-right mills.

Spain had already profited from similar arguments prior to its last elections. And the latest approval for government assistance in a bailout of Italian banks was essentially aimed at depriving the anti-Europe Lega Nord and Five Star Movement of fresh ammunition against Brussels. The fact that this could damage the credibility of recently introduced European Banking Union rules was swept under the carpet.

The idea that states should be rewarded with transfers for complying with European agreements, rather than sanctioned for transgression, has become common currency in the European Parliament. It's little different from rewarding those who manage to refrain from shoplifting rather than punishing theft.

The European Commission has just published a reflection paper on the future of the European monetary union, devoid of any calls for structural reform, such as more flexibility in the labour market, cutting excessive public spending or eliminating barriers to market entry. Instead, the paper is rich in ideas for new hedging instruments and financing mechanisms for the benefit of southern Europe.

If it was fear of populists which guided the paper's authors in the Commission, they aren't alone. The European Central Bank is shying away from normalizing its monetary policy. Since it finds it increasingly difficult to underpin its decision not to exit quantitative easing with economic data, political uncertainties are repeatedly raised as a justification. In other words, the ECB is pursuing its risky negative interest rate policy combined with extensive bond purchases for longer than necessary based on hopes that favourable refinancing conditions will help moderate parties in southern Europe to remain in power.

Such politically motivated decisions see Europe bowing to populist blackmail and give southern Europeans all the more reason to vote for populist parties. Even if Italian voters clearly recognize that

the 5 Star Movement's economic policy agenda is economic nonsense, it may still pay off to support the party from an Italian perspective. More votes for euroskeptics becomes the best way to force concessions, soften rules, and ultimately extract transfers from northern Europe. Similarly, it's rational for northern European voters, in turn, to vote for populists who oppose this trend.

Giving in to populist extortion is not a strategy to ensure the survival of the euro or the EU. Firstly, it damages the credibility of painstakingly improved regulations in fiscal oversight and the banking union. Against this backdrop, it's impossible for potential net contributor countries to implement further steps towards shared risks.

Secondly, this behaviour undermines the principle that aid is dependent on reform and reduced autonomy. And thirdly, bids to curb populism in southern Europe boost the EU's critics in northern Europe. The support for the European project allegedly preserved in the south is eroded in the north.

What can Europe do to resist such populist blackmail? In the short term, interpretation of euro zone regulations shouldn't be influenced by election strategies. To ensure this, decisions over the stability pact should be handed over to independent institutions.

In addition, there needs to be an orderly path for euro-zone countries to declare insolvency and exit the single currency that does not trigger systemic crisis. It is precisely this systemic risk that is currently allowing populist parties to blackmail Brussels with so little opposition.

Ultimately, radical populists can only be stopped if voters realize their demands are a threat to peace and prosperity. European institutions giving up on enforcing European law is not the answer.

\* Published in German under the title "Populistische Erpressung", *Handelsblatt*, 17 July 2017, p. 48.