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Budget crisis threatens EU

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Basic priniciples of economic union at risk

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LONDON -- Days after the proposed European Union constitution was shattered by French and Dutch voters, two other pillars of Europe's economic union are teetering this week on the edge of collapse.

As leaders of all 25 EU member states gather in Brussels today for a two-day summit, they appear unable to come close to any agreement on a long-term budget for the federation. The most basic questions of the economic union are falling into deep and fundamental debate, with little agreement over any aspect of the EU's future direction or the way out of its current economic malaise.

At the same time, yesterday saw new challenges to the viability and independence of another EU institution, the European Central Bank.

With ECB leaders and leading central bankers wary of making cuts to the long-standing European prime interest rate of 2.0 per cent, the bank has come under severe pressure from countries facing fiscal and productivity crises, including Germany and France, to cut rates to stimulate the economy.

It now appears that this political pressure could pose a direct threat to the autonomy of the central bank.

A growing number of commentators suggest the euro currency itself could become a victim of the deep budgetary and economic discrepancies between member nations. Yesterday, Jean-Claude Juncker, the Prime Minister of Luxembourg who holds the rotating EU presidency until the end of the month, suggested strongly that the bank's monetary policy might come under direct political control.

"I see no reason why it shouldn't take the advice of ministers," he said. "Ministers of finance in the euro zone are gradually moving towards making the same kind of statement, which will end up being imposed on the monetary authority."

While such a move would face heavy resistance and would threaten the viability of the euro, it would follow a number of major political incursions into Europe's supposedly sacrosanct fiscal policies.

At the heart of the budgetary dispute is the failure to adhere to the fundamental requirement for EU membership, that all nations limit their budget deficits to 3 per cent of GDP. This rule has been flouted for years by major nations including Germany, France and Italy, while smaller countries like Ireland and the Netherlands have undergone painful restraints in order to continue to meet the requirement.

There was no sign yesterday of any resolution to that dispute. And another fundamental dispute -- between Britain and France over the generous subsidies received by French farmers and the equally generous cash rebate received each year by Britain as a condition for its EU membership -- appears poised to hold the entire budget in limbo.

British Prime Minister Tony Blair and French President Jacques Chirac failed to find even minor points of agreement after meeting this week, with Mr. Chirac demanding Britain abandon or deeply reduce its rebate, and Mr. Blair insisting it not be touched, and should continue to expand as a proportion of the EU budget, at least until Europe eliminates agricultural subsidies.

The rebate was negotiated by then-prime minister Margaret Thatcher in 1984 as a condition for Britain's entry into the EU. Her argument was that Britain, whose agricultural sector is efficient and draws few EU subsidies, would be paying for a service it does not receive. However, a number of European nations today, including Germany, the Netherlands and Sweden, pay more into the EU budget than they receive in services. They feel Britain's special treatment is unfair, although they acknowledge the expansion of the EU to include impoverished Eastern nations -- 10 new members last year and Bulgaria and Romania in 2007 -- means that all the larger nations should be paying more into the budget than they receive, in order to bring the poor nations up to Western European economic standards.

However, there was no agreement on a formula for members' fees, and it appeared yesterday that the Anglo-French impasse was the main sticking point.

Mr. Juncker yesterday offered a compromise proposal, in which Britain's rebate would be frozen at current levels beginning in 2007, and then gradually scaled down after 2013. At the same time, the expensive farm subsidies offered through the EU's Common Agricultural Policy would be scaled down at a similar rate.

Europe in crisis

Prospects look gloomy as leaders of the European Union's 25 member states meet in Brussels today to hammer out a long-term budget deal. The budget is just the latest flashpoint in the EU's push toward greater integration.

Political uncertainty

Referendums in France and the Netherlands saw voters overwhelmingly reject the new EU constitution, with other countries considering holding off on planned referendums as a results.

Monetary policy spat

ECB president Jean-Claude Trichet is under pressure to cut rates - which have stood at 2 per cent for the past two years - as a way of spurring growth in stagnant euro zone countries.

Economic downturn

Growth in the 12 countries that use the euro is expected to slow to 1.6 per cent or less this year from 2.0 per cent in 2004. Italy is in recession after two quarters of shrinking output, while in Germany domestic demand remains weak.

Budget showdown

France and Britain remain at odds over Britain's annual rebate, worth 5.1 billion euros this year, and EU farm subsidies that mainly benefit France. There is also disagreement over how much major contributors should pay into EU coffers.
