Franz-Josef Meiers

# Germany's Role in the Euro Crisis

## Berlin's Quest for a More Perfect Monetary Union

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# Preface

This book is a study of Germany's role in the euro crisis since 2009. It shows how the German economic model of ordoliberalism has shaped the perception of German decision makers and their response to the gathering storm within the currency union over the last 6 years. The peculiar concept of postwar Germany's stability culture has become the compass for German decision makers to pave their way through the brush of the crisis. West Germany's postwar economic success ("Wirtschaftswunder") under the ordoliberal economic doctrine made the maintenance of order in a social market economy and price stability enforced by an independent central bank and fiscal probity the Alpha and Omega of German economic policy. But the ordoliberal concept developed to meet the postwar challenges of the German economy lays open some structural limits and deficiencies of Germany's preferred strategy of expansionary fiscal contraction and internal devaluation, the distressed euro member countries where asked to adopt to reach the promised land.

For many observers, the euro crisis revealed another uncomfortable reality: Berlin's primacy. Germany as the continent's biggest economy has emerged from the crisis as the Union's undisputed economic and political powerhouse. Germany's preeminent role in the euro crisis management is again the subject of often deep and bitter contention in and outside of Europe. This book explicitly rejects the realist/pessimistic assessment that the Berlin Republic today behaves in a nineteenth and twentieth century fashion where it shows no qualms to pull the levers of power to push the European institutions and partners into preferred German interests and policy outcomes even if it meant a worsening of an already dire economic situation in the euro area's misery belt and a weakening of European institution. Reviving the German question in a new form not only reinforces old stereotypes, prejudices, and misconceptions about the role of Germany within the context of the euro-Atlantic institutions, but also leads to highly dubious and misleading conclusions that the Berlin Republic is drifting away from the "long road west" and that the German

Überpower can only be balanced by countervailing coalitions. These unfounded fears actually conceal the real challenges the Berlin Republic faces in putting the currency union on a lasting and stable foundation. I hope that my analysis will provide some useful insights of the paradoxes of German power for policy decision makers, experts in international organizations and think tanks, and students in and outside of Europe. The book has been written with the aim to provide a better understanding of the sources of German conduct and to draw appropriate conclusions for Germany's indispensable role within its principal institutional context.

Special mention must be made of the superb proofreading of Ms. Jane Ralph, B.A., M.A., Chartered Librarian at the Library of Political Science of the University Erlangen-Nürnberg. She has greatly improved the readability of my sometimes teutonic English. I am most grateful to the University Erlangen-Nürnberg which provided me an extremely stimulating academic environment that allowed me to write this book. I am deeply indebted to the Financial Times of its very informative coverage of and balanced commentaries, particularly of Martin Wolf, of the euro crisis. I also want to thank my editor Dr. Johannes Glaeser and his assistant Judith Kripp who have been supportive, competent, and patient in shepherding my manuscript through the labyrinth of the editorial process. Lastly, I recognize gratefully two anonymous reviewers for their highly valuable advice to make my analysis more concise. Any remaining errors and omissions are, of course, my own.

This book is dedicated to my wonderful wife Gisela and our two delightful children Friederike and Jean-Pascal.

Erlangen, Germany Franz-Josef Meiers

# Contents

**1 Introduction: Europe's Powerhouse** . . . . . . . . . . . . . . . . . . . . . . . . 1
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 6

**2 "Made in Germany": Categorical Imperatives of Ordoliberalism** . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 11
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 15

**3 Teetering at the Edge of the Precipice: Merkel's Politics of Small Steps, 2009–2013** . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 17
3.1 Advice of the Swabian Housewife: Do Your Homework! . . . . . . . 18
3.2 Merkel's Tough Love: Solidity in Return for Solidarity . . . . . . . . 23
3.3 Merkel's Acquiescence to Draghi's Bazooka . . . . . . . . . . . . . . . . 35
3.4 The Banking Union: Merkel's "New Union Method" . . . . . . . . . . 44
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 51

**4 Germany's Ordoliberal Lodestar and the Shifting Euro Crisis, 2014 –** . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 63
4.1 Nein, Nein, Nein to Fiscal Leniency . . . . . . . . . . . . . . . . . . . . . 63
4.2 In Defense of the Maginot Line of Monetary Stability . . . . . . . . . 74
4.3 Message in the Bottle: Athenians, Pay Your Debt! . . . . . . . . . . . . 86
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 104

**5 Germany's Role in the Euro Crisis Management** . . . . . . . . . . . . . . . 111
5.1 The Grapes of Wrath . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 111
5.2 Stress-Testing the Leadership of Europe's Powerhouse . . . . . . . . . 118
5.3 Germany's Changing European Vocation . . . . . . . . . . . . . . . . . . 125
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 128

**6 "Merkelism" and the "New Normal"** . . . . . . . . . . . . . . . . . . . . . . . 139
References . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 145

# Chapter 1
# Introduction: Europe's Powerhouse

*What is good for Germany is also good for Europe.*
Angela Merkel, September 11, 2014

*Whatever is good for the eurozone economy is good for Germany.*
Benoît Cœuré, January 16, 2015

*When faith meets evidence, evidence doesn't stand a chance.*
Mario Draghi, quoting Paul Krugman, January 15, 2015

*There is nothing He (God) does not wish to be investigated and understood by reason.*
Tertullian, quoted by Commissario Guido Brunetti in Donna Leon, By Its Cover, London: William Heinemann 2014, p. 151

Five years after the start of the crisis, there is a consensus that with the pledge of Mario Draghi, the head of the European Central Bank (ECB) "to do whatever it takes", the immediate threat of a breakup of the European Monetary Union (EMU) has receded. Not a single member, even Greece the worst pupil in the euro class, has been forced out. A sense of cautious optimism has returned to the euro area. Better than expected economic data and declining sovereign bond yields in crisis-hit countries of the eurozone since late 2013, have revived confidence that the nascent recovery is gaining momentum. The European Commission, the European Central Bank (ECB), the International Monetary Fund (IMF), and the Organization for Economic Cooperation and Development (OECD) foresee the annual real GDP increases by up to 1.2 % in 2014, compared with a decline of 0.4 % last year. Growth in 2015 and 2016 is seen at 1.5 % and close to 2 % respectively.[1] The eurozone governments reduced their budget deficits for 2013 to 3 % of Gross Domestic Product (GDP), in line with their target for the first time since 2008.[2] The eurozone is no longer under siege in financial markets. Borrowing costs for the economies of the euro misery belt—Portugal, Ireland, Italy, Greece and Spain

[1] European Commission (2014, pp. 1, 7), European Central Bank (2014a), International Monetary Fund (2014, p. 26), Organization for Economic Cooperation and Development (2014), Eurostat (2014a).

[2] Eurostat (2014b).



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(PIIGS)—have fallen to levels since the debt crisis erupted in early 2010. The high demand for eurozone periphery debt reflected rising confidence in the creditworthiness of euro area economies. Ireland, Spain and Portugal have exited their bailout programs and can now finance themselves in the bond markets. This leaves Greece and Cyprus as the only Eurozone countries now under assistance.

In a major change from his first year in office, French President François Hollande began to embrace the "German path" of fiscal austerity and business-friendly structural reforms.[3] He announced a "responsibility pact", that signalled a need to go "faster, further and deeper" by reducing labor costs, tackling onerous labor regulation, and cutting government spending by at least 50 billion euros between 2015 and 2017. "We need to produce more, and better. Action is therefore needed on supply. Yes, supply! This is not contradictory with demand. Supply even creates demand."[4] The new Italian Prime Minister Matteo Renzi also pledged an economic reform package including a 10 billion euros tax cut for low earners and a 10 % cut in labor costs paid by the private sector to boost stagnant growth and to stimulate depressed levels of private consumption. Most of the tax cuts, he pledged, would be funded by public spending cuts, higher taxes on capital income and increased VAT revenues.[5]

The German government in particular, feels vindicated that the medicine of rigorous and painful austerity—deep spending cuts and rising taxes, i.e. value-added tax, property taxes, business taxes—and a strengthening of competitiveness through wage cuts, sweeping reforms of the social security system and more flexible labour markets were essential to address the root cause of the sovereign debt crisis—fiscal profligacy—and to lay the foundation for steady and sustainable growth.[6] Chancellor Merkel praised Ireland and Spain as examples of how crisis countries could turn the corner from recession to recovery. "The successes of Ireland and Spain are just two examples what resolute action of individual countries and joint European backing could produce together." Hence, the principle that solidarity and individual responsibility belong together had turned out to be right.[7] "Efforts which were so painful, and for such a long time, are producing now some positive outcomes," declared Mario Draghi.[8] The eurozone crisis, though temporarily stabilized, is far from over. The shoots of recovery are still "very green", as Mario Draghi put it. When asked if the Eurozone's financial and economic crisis was over, he gave a guarded response. It was "premature to declare

[3] Frankenberger (2014), Evans-Pritchard (2014), Krugman (2014), Münchau (2014).

[4] Ouverture de la conférence de presse du président de la République au Palais de l'Élysée le 14 janvier 2014, Élysée, Paris, January 14, 2015. http://www.elysee.fr/declarations/article/ouverture-de-la-conference-de-presse-du-president-de-la-republique-au-palais-de-l-elysee-le-14-janvier-201/.

[5] Dinmore (2014), Yardley and Pianigiani (2014), Dinmore and Sanderson (2014).

[6] Schäuble (2013, 2015), Peel et al. (2013).

[7] Deutscher Bundestag (2013, p. 240), Deutscher Bundestag (2015, p. 8882).

[8] European Central Bank (2014b).

any victory". The region's gradual recovery was "still weak, still fragile, still uneven", "meaning that there are several risks."[9]

For many observers, the euro crisis revealed another uncomfortable reality: Berlin's primacy. Germany as the continent's biggest economy has emerged from the crisis as the Union's undisputed economic and political powerhouse. The perception of Berlin as the emerging capital of the European Union has raised three interrelated accusations. Firstly, Berlin's economics critics like Lawrence Summers, Paul Krugman, Martin Wolf or Joseph Stiglitz repeatedly warned that a fixation on debt and deficits would lead to a disturbing "Japanese" future of "secular stagnation" characterized by a prolonged period of slow growth, chronically weak demand, and high joblessness.[10] Imposing austerity programs on countries in the middle of a deep recession would be a fundamentally flawed response which like medieval blood-letting would effectively be a "suicide pact" for these economies, Stiglitz observed. Germany's deficit target fetishism would not only unnecessarily prolong and exacerbate the downturn; it would also undermine the long-run growth prospects, Krugman added.[11] Against the better judgment of the IMF, the OECD and informed economic opinion, Berlin refuses to recognize that the adjustment within the Eurozone has to be symmetrical. As Christine Lagarde, then French Finance Minister, said in May 2010: "It takes two to tango."[12] Instead, Germany's attitude is beggar-your-neighbour, protecting its own well-being at the expense of other countries' imbalances. This selfish behaviour also contributed to the "persistent shortage of demand" of the depressed world economy.[13]

Secondly, Berlin's political critics see Germany, like Japan in the late 1980s, as an unstoppable "juggernaut" or "hyperpuissance" using its unabated economic and monetary might to assert its role of a heartless, self-righteous, Calvinist austerity task-master who is prepared to risk a bitter conflict with its closest partners, notably France.[14] Chancellor Merkel has emerged as a particular lightening rod. She is perceived as the exclusive decision maker in Europe at the expense of Germany's EU partners being downgraded to decision takers. Her unrelenting determination to force upon the European partners the German Diktat of strict fiscal austerity has transmogrified the Eurozone into "an economic prison", with Germany as "the jailer" and the German inspired and enforced monetary stability rules as "the bars".[15] With the rising stature of the EU's pre-eminent member, the "benign

[9] European Central Bank (2013a, b, 2014c, d), World Economic Forum (2014).

[10] Summers (2012, 2013a, b, c, 2014, pp. 27–38), Krugman (2013a), Wolf (2013a, b), Lew (2013), Roubini (2012).

[11] Moore (2012), Krugman (2011, 2012a, b), Briancon (2012).

[12] Lagarde (2010). See also Wolf (2014, pp. 339, 341).

[13] Krugman (2013b, c), Tilford (2010, 2012), Wolf (2010a, b, 2012), Monti (2013).

[14] Kundnani (2011, pp. 39–43), Kundnani (2014, pp. 6, 96, 99, 102–105, 108, 110–114), Evans-Pritchard (2012), Moravcsik (2012, p. 60), Feldstein (1997).

[15] Chaffin (2013), Douthat (2013), Moore (2013). See also Kundnani (2012), Vinocur (2012), Soros (2012), Traynor (2011).

hegemon" has yielded to the temptation of an "imperial power" determined to take control of Europe for the third time in less than 100 years.

Third, a "Germany unbound"[16] marks a tectonic shift from the "reflexive"[17] commitment of a "Europeanized Germany"[18] to a "Germanized Europe"[19] in which the socialising effects of cooperation and multilateral action within the institutional structures of the Euro-Atlantic community have been superseded by a "go-it-alone", power-conscious and power-capable foreign policy[20] that is only looking for Germany's national interest and shows no interest in Europe anymore.[21] Is the stubborn insistence on rigid fiscal adjustment another ominous sign of the Berlin Republic moving away from the "long road west"?[22]

Both Ulrich Beck and Hans Kundnani argue that behind the mask of the problem-solving "Merkel method" where decisions "appear to be borne at the back of her [Merkel's] brain"[23] hides an adroit calculation and execution of power. The European integration project conceived largely to constrain German power, actually served to increase it,[24] as the unraveling of euro crisis since 2009 vividly demonstrates. In Beck's view, Chancellor Merkel has seized the euro crisis as "her occasione, 'the propitious moment'" "to restructure power relations in Europe." The "key lever" of "the new German power in Europe" is its "economic power", not, as in former times, force as the ultima ratio." The "Merkiavelli method" rests on the art of "deliberate hesitation. . .as a means of coercion". The policy of procrastination leaves the debtor euro-states no choice but to succumb to the demands of "the strongest and wealthiest economy in the EU" and "to satisfy the

[16] Szabo (2004a, pp. 115–116, 151).

[17] Katzenstein (1997, p. 19), Anderson and Goodman (1993, pp. 55, 60–62).

[18] Bulmer and Paterson (1996, p. 17). See also Anderson (1997, pp. 80–107), Anderson (1999), Bulmer (1997, pp. 49–79).

[19] Harnisch and Schieder (2006, pp. 95–108), Crawford (2007, pp. 15, 19, 34, 42–43, 53, 104, 106, 113, 115, 120, 123–124, 140, 175, 176, 186), Paterson (2010, pp. 41–52), Paterson (2011, pp. 72–74), Bulmer and Paterson (2010, pp. 1051–1073), Morisse-Schilbach (2011, pp. 28–41).

[20] The Kohl government's decision in late December 1991 to grant diplomatic recognition to Croatia and Slovenia, Chancellor Schröder's public clash with U.S. President George W. Bush over U.S. policy in Iraq and the Merkel government's abstention from the NATO's military intervention in Libya in spring 2011 are cited as examples of a more assertive unilateral foreign policy of the Berlin Republic. Binder (1992), Horsley (1992, pp. 239–240), Libal (1997, pp. 100, 105, 106, 162, 163, 164), Maull (2003, p. 17), Maull (2011, pp. 93–117), Szabo (2004a, pp. 77, 116, 151, 152).

[21] Vinocur (2010a, b, 2011), Tooze (2010), Stephens (2010, 2011), Cohen (2011), Errera (2012), Heilbrunn (2012).

[22] Winkler (2007).

[23] The Economist (2006).

[24] The Swiss journalist René Fritz Alleman concluded some 60 years ago that Chancellor Adenauer played the European game because he better understood than most Germans that Germany would not only regain its unrestricted equal status but also a leading role even if the outline of Europe had been designed by French architekts in French hegemonic style. Alleman (1956, p. 174). See also Simms (2013).

conditions of Germany's stability policies". Merkel's siren call is: "better a German euro than no euro at all." The "truths" of the Protestant work ethic are applied to the crisis-ridden Europe: "Suffering purifies." Attempts to enmesh the Berlin Republic into an ever deeper web of European integration actually produced a "German Europe". The European Union since the Maastricht treaty has developed into a "hierarchical dependency (hegemony)" instead of "equal participation (reciprocity)" with Germany as the would-be "good hegemon" at the top and Merkel as "the uncrowned queen of Europe."[25] Kundnani argues that the driving force of German behaviour in the euro crisis is a return to classical German great power politics, a lust for an "assertive, nationalistic, adversarial, zero-sum, semi-hegemony" that reflects the geo-economic pre-eminence of the Berlin Republic in Europe. The emergence of German "hegemony" has turned "the network structure" within the EU into a "hub-and-spoke relational structure." The "geo-economic power uses economic means in a way that seems more Clausewitzian than Kantian." The "new German nationalism" which increasingly questions the foreign-policy parameters of the Federal Republic, namely Westbindung, raises doubts whether the geo-economic power remains "committed to the West". In other words, "German history is not yet at an end."[26]

The "Merkiavelli method" poses the central question of concern: does the Berlin Republic today behave in a nineteenth and twentieth century fashion where it shows no qualms to pull the levers of power to push the European institutions and partners into preferred German interests and policy outcomes even if it means a worsening of an already dire economic situation in the euro area's misery belt and a weakening of European institutions? Has the "German question re-emerged in geo-economic form" as Kundnani argues. "Is the danger in Europe now of a geo-economic version of the conflicts within Europe between 1871 and 1945"? In short: "Has history returned to Europe"?[27]

The book's main argument is that the different responses to the euro crisis can best be explained by different conceptions of self, historical memory, and institutional practices. The euro crisis is like a strong beam of light. The light gets filtered by national lenses that create distinctive national responses. The lens through which German decision makers have perceived the euro crisis is the culture of stability. It is the economic concept of 'Ordoliberalismus' which gives German attitudes to economic policy special characteristics. West Germany's post-war economic success ("Wirtschaftswunder") under the ordoliberal economic doctrine, made the maintenance of order in a social market economy and price stability enforced by an independent central bank the Alpha and Omega of German economic policy. This specific German economic concept has shaped, to a high degree, the

[25] Beck (2013, pp. 46, 47, 49, 50, 51, 52, 54, 59, 61, 64).

[26] Kundnani (2014, pp. 92, 103, 104, 108, 112, 114).

[27] Kundnani (2014, pp. 108, 110, 111, 112). See also Feldstein (1997, pp. 69, 72), Szabo (2004a, pp. 149–153), Szabo (2004b, pp. 50–52).

perception and response of German decision makers to the gathering storm in the euro area.[28]

The book proceeds as follows: I begin with a brief review of the central tenets of the economic concept of ordoliberalism. The second part deals with the Merkel government's euro crisis management since late 2009. Four phases can be identified: a laissez-faire policy from late 2009 until March 2010, to be followed by a reactive step-by-step engagement marked by Berlin's insistence of a quid pro quo of solidity in return for solidarity, Merkel's acquiescence to the ECB's OMT program and the German design of a more perfect monetary union. The third part deals with the shift of the euro crisis in 2014 from the acute to the chronic, from the periphery to the centre with Berlin still stubbornly saying Nein to a policy of fiscal and monetary easing and debt forgiveness in response to persistent stagnation of the euro area economy, particularly in France and Italy, the rising deflationary pressure as a result of prolonged weakness of aggregate demand within the currency zone, and the re-emergence of the Greek debt crisis which brought back the spectre of the country's default. The forth part will evaluate Germany's role in the euro crisis management. First, does Germany's policy prescription of expansionary fiscal contraction and internal devaluation successfully address the root causes of the euro crisis? Second, does Germany as Europe's undisputed economic and political powerhouse extend its sway over its European partners by forcing them to surrender to the German Diktat of fiscal Disziplin and economic efficiency? Lastly, does the euro crisis signify a fundamental change from Germany's traditional European vocation to "Germanized" Europe"? I end with the central political challenges "Merkelism"[29] faces in the near future to resolve the euro crisis and to put the monetary union on a sound and sustainable footing.

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[28] Katzenstein (2003, pp. 732, 733), Wolf (2014, p. 54).

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