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Remarks on the Role of Germany in the Current Eurozone Financial Crisis

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1. Germany has been blamed on two counts. First, for its huge trade (and current acount) surplus accumulated over the first decade of the common currency. Second, for its attitude at different stages of the crisis and its policy towards various proposals on how to keep the crisis under control and avoid further contagion.

1.1. Concerning the first issue, the German trade surplus vis-á-vis the other Eurozone countries has been growing steadily. In 2008 it reached 56.5 per cent of Germany's total trade surplus and in the crisis year of 2009 it jumped to 62.9 per cent (in the first ten months of 2010 it dropped to about 55 per cent). In contrast, the Eurozone countries represent only slightly more than 40 per cent of total German exports and less than 40 per cent of imports.

Germany's huge trade (and current account) surplus is the result of several factors. First, the German economy is more competitive than the other Eurozone economies. In this context, it is futile to blame Germany for being more competitive, since without Germany the EU would have lost an even greater share of global competition over the last decade. A more appropriate question is why other Eurozone countries could not cope with Germany?

Second, the birth failures of the EMU should be mentioned. From the common currency's initial introduction, it was obvious that countries at different levels of economic development, technological standing and production structure (let alone largely differing social attitudes and mentality) would not be able to perform at the same level of competitiveness under the umbrella of the common currency. Even though year-to-year differences have not caused major troubles, a decade-long accumulation from the competitiveness gap could not remain hidden. Though the global financial crisis brought this problem to the surface, the competitiveness gap would also have appeared without the crisis. A fortunate (or unfortunate?) overlapping of accumulated problems and the global crisis has occurred. The qualification depends on what will happen in the Eurozone in the coming weeks and months.

In addition, intra-German transfers (about 800 bn Euros before the introduction of the common currency, as much as 8 years of EU financial framework spending)[1] have resulted in a widespread (mainly erroneous) view in Germany, largely shared by politicians and (misguided) public opinion, that such transfers are, by their nature, both inefficient and economically and socially harmful. No doubt this view has been reinforced by similar experiences in some net beneficiary countries, particularly Greece (but not necessarily in the new member countries).

Third, the financial crisis broke out at a moment when all countries, not least Germany, had initiated a budget consolidation period to „manage the costs of crisis management". Widening deficits due to bailing-out other Eurozone countries is hardly acceptable in the eyes of public opinion. Moreover, such issues immediately become part of the domestic political debate driven by short-sighted and short-lived party politicians, without any consideration for their

[1] Even today, annual transfers from the German central budget amount to approximately 60 bn Euros, half the EU's annual common budget.

responsibility toward their own country or European integration more generally.

Fourth, the accumulation of a huge German surplus lacked any kind of early-warning-system that, in an optimistic scenario, could have influenced politicians, banks (including German ones) and the media.

1.2. The second issue is comprised of different chapters. However, each stage of the „Eurozone drama" can be described by two constant elements. On the one hand, unavoidable decisions were either delayed or, once the lesson of the Greek crisis had been learned, taken without delay but also without a strategic medium-term plan. Second, in each case Germany (and, in the background other surplus countries as well) tried to link rescue steps with harsh conditionalities that others could successfully „soften" or water down. Germany's role (reluctance) in postponing the treatment of the Greek crisis increased the bailout cost from 25 bn to 110 bn Euros. Lessons on the cost of delaying decisions in the face of international financial market demands (be their origin speculative or just the nature of globalized financial markets) seem to have been learnt. Still, the second lesson is missing. Namely, the volatility (and „eagerness") of the international financial markets does not allow and even less does it accept piecemeal approaches, a „success story" of the tradition of decision-making over half a century of European integration. The main loser of such an approach, as long as it is interested in keeping the common currency alive, will definitely be Germany.

2. While Germany has had to assume the lion's share of bailing-out costs, this country has been the main beneficiary of the common currency in the last decade. This is well-reflected in export and trade balance statistics. The common currency deprived less developed member countries of the Eurozone from continuing their previous economic policy pattern of repeatedly devaluing their national currencies once they perceived any loss of competitiveness vis-á-vis Germany. At the price of higher inflation this strategy was able to create more or less balanced production and foreign trade, with continuous inflow of foreign capital because cost (exchange rate) advantages could be made use of. This instrument has not been available for member countries of the Eurozone over the last decade. In addition, mainly due to the growing indebtedness caused by financing intra-German transfers, when introducing the Euro, Germany switched to a policy of wage-restraint. Though officially never confirmed, Germany was looking for additional competitiveness in the first decade of the Euro. Moreover, rapidly growing private borrowing at low interest rates (sometimes below the official inflation rate) in less competitive Eurozone countries (PIGs) contributed as well to the profit-making activities of several German banks. For instance, in Spain, German banks also bear the responsibility of having financed the huge housing market bubble. Finally, even the problems of the Euro, reflected among other things, in its relative undervaluation against the US dollar (and all currencies linked to the USD), have benefitted German exporters and all those linked to the export economy (business and the labour market alike).

3. The repeated request/suggestion/demand of some Eurozone member (and other) countries that Germany should reduce its current account and trade surplus by taking fundamental measures in order to artificially stimulate domestic demand are largely misplaced. First, Germany, like several other countries, is confronted with a rapidly growing public debt that, also considering the future credibility of the euro and the stability of all Eurozone member countries, has to be kept under control and, in a few years, brought back to the Maastricht level (60 per cent of GDP instead of the current 80 percent). Even if Germany were ready to give up its stability-oriented economic policy (disregarding its domestic and European consequences), an artificial stimulation of domestic demand would not automatically help less competitive Eurozone member countries. On the one hand, owners of additional money (mainly private households) would not necessarily take the decision of spending the available surplus. But, as happened in Japan 10 to 15 years ago, they could turn to the bank to deposit their personal savings. Public debt would be rapidly increasing, similar to private savings, with practically no impact on domestic demand. But even if the enhanced purchasing power were spent on goods and services, who could guarantee such purchases would benefit potential exports from the Eurozone countries. Based on international competition, it is highly probable such money would be spent on goods coming from China, the new member countries, Turkey, etc., but not from the uncompetitive Eurozone members. As a result,

Germany's current account surplus could be reduced, but not its dominant surplus position vis-á-vis the Eurozone countries. In addition, growing investment demand from the business sector would be covered by low-cost imports and, in consequence, would further strengthen global and EU-related German competitiveness. Moreover, artificial demand stimulation in Germany would likely raise doubts about the stability of the Euro, leading to a weaker Euro and repeated speculation against the common currency. However, it would immediately contribute to an even larger German trade surplus based on lower exchange rates automatically stimulating exports (and making imports less competitive).

4. In the last months (initiated by a US think tank study in April 2010), Germany's possible abandonment of the Eurozone has also been raised (a special type of „self bail-out"). Before addressing the future of the Eurozone and the availability of instruments, including those that, at the moment, seem to be „impossible", the option of leaving the Eurozone and reintroducing a strong German mark has to be dealt with. The consequences, both domestic and external, would be catastrophic.

4.1. On the domestic side, a new German currency would appreciate dramatically against all other currencies of the former Eurozone countries. In addition, Germany would become the European magnet of international capital, including flight capital arriving from weaker European countries experiencing huge losses of their (newly introduced) national currency. It would be very difficult to keep such capital inflow under control. Huge sterilization costs and the threat of high(er) inflation could hardly be avoided. But first of all, Germany's cost-based competitiveness would be seriously undermined with unforeseeable consequences for growth, production and employment.

4.2. The imminent external consequence would be the cessation of European integration or, not unlikely, even the dissolution of the results already achieved by the integration process. Most, less competitive, EU member countries would resort to the devaluation of their currencies and start a period of competitive devaluations. Certainly German citizens would gain in tourism. But if potential host countries were confronted with economic and social hardship, the overall economic, social and human climate would not necessarily be friendly toward a boost in tourism. In addition, German banks represented in other EU (Eurozone) member countries would face serious problems that, together with the exposure of other banks, could easily lead to a dramatic banking crisis across all of Europe. Large pension and insurance fund bank deposits would be eroded, resulting in huge saving losses for a large share of EU citizens. However, a further implication not explored until now has to be added. European integration in general and the Euro in particular would cease to be a (potential) pillar of China's multipolar efforts. The bankruptcy of „project Europe" would leave no alternative for China than a strong bilateral relationship with the United States, thus leading to Europe's irrelevance in global strategic, political, economic and institutional affairs.

5. Thus, the future of the Euro must be considered seriously against this threatening scenario. In this light, several steps that, starting from a short-sighted perspective, seem to be both necessary but at the same time impossible, have to be considered. Placing the entire crisis management process in a new context, it highlights the urgency of decision-making and presses politicians, media and public opinion to overcome „insurmountable barriers". The success of this exercise, however, requires two-way solidarity. Everybody must recognize that one-way solidarity has ended (or has its clear limits for financial, institutional and public opinion reasons). Even if the net balance will not be equilibrated, both sides are required to make their contribution. This, however, can hardly happen without a signficant historic jump towards fiscal (and partly political) union.

Piecemeal approaches do not work. The Greek crisis, followed by the Irish, Portuguese and the looming Spanish, Italian and Belgian etc. crises, clearly illustrate this point. Piecemeal efforts are largely incapable of appeasing financial markets and dispelling doubts about the sustainability of the common currency (and European integration more generally). Measures taken to-date, however bold compared to traditional EU practice or to what would have been considered possible even a few months ago, are simply not adequate. In part, they are not expected to be introduced before 2013, a period too distant in time and likely to test the patience of the international financial markets. Even already agreed measures are now potentially hostage to an institutionally empty or questionable framework, with several (potential or very real) loopholes. It is certainly positive that, as of January 2011, the European Financial Stability Facility (EFSF) has started working and new rules have become part of the game. Moreover, the „European semester" is necessary, even if its efficiency is far from convincing. But these factors do not represent the big jump needed in order to deter speculation around the Euro (and some member countries). The „big jump" should consist of two intertwined elements.

5.1. First, under the current circumstances, the Eurozone is badly in need of time. This time can be bought for a period of 18 to 24 months (until the Greek drama automatically reappears). This period should be used to construct a solid and reliable Euro framework, including the strict control of member country deficit cutting policies, zero tolerance in the enforcement of the enhanced rules of the Stability and Growth Pact, more fiscal coordination, and implementation of the internal market in all areas still outside the „four freedoms". An indispensable and key element of the first period should be the implementation of the mechanism of issuing joint (Eurozone-wide) bonds. This would increase the German deficit and require additional financing from Germany in the amount of 11 to 14 bn Euros annually (depending on the refinancing need of the German budget and business). However any further bailing-out would cost Germany (and German banks in the respective region) much higher sums, without any prospect for calming markets and putting an end to speculation against the Euro. At the same time, Germany is right to co-control the budgets of other (weaker) Eurozone countries and to prevent any (mis)use of obtaining cheaper credits from using the money for loosening fiscal discipline and financing additional consumption. Instead the savings as a difference between current high spreads and much lower spreads expected from common Eurobond issuances must only be used either to finance structural reforms accepted and supported at the level of the Eurozone (or even as part of the European Economic Governance), or to directly repay outstanding debt.

5.2. Second and necessarily linked to the „buying time" approach, the nascent failures of the common currency can only be remedied if the EU establishes a fiscal union, including clear rules for fiscal transfers. In fact, such transfers already occur today, but either on a small scale (the annual amount of the financial framework is equivalent to the Greek bail-out package, or half of the – at least in economic terms highly inefficient - intra-German transfer), or as a result of ad-hoc decisions. No doubt such an unprecedented jump seems unlikely at the moment. However, as compared to other alternatives, let alone the disappearance of the common currency and the potential fragmentation of European integration, this still seems the smaller price to pay. These costs would be rapidly compensated by a qualitatively new stage of European itnegration with a clear positive impact on Europe's standing in the global political and economic arena.

However, Europe's potential to recognize its enlightened self-interest, its awareness of the dramatic impact of global developments and, as a result, its interest in and readiness to undertake this jump remain uncertain. At least on the surface, its politicians and the broader public seem unprepared (much less than European business). Maybe, after more than a century, Nietzsche is, unfortunately, once again right: "The time was ripe for Europe, but Europa was not ripe for the time". („Die Zeit war reif für Europa, aber Europa war nicht reif für die Zeit".)

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