

EURO NEUROSIS IN GERMANY

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14 ottobre 2011

Many of the current debates about the European Monetary Union show symptoms of neurosis. Obsessions, anxiety, and hysteria shine through in the ways in which the media, the wider public, but also a large number of politicians and experts comment on the political processes around the European Stabilization Mechanism (ESM).

The future of the euro, if not Europe is suddenly perceived as very uncertain. Principles of policymaking and standards of living are seen to be at stake in endless struggles about the distribution of losses and transfers. In populist North-South divides these conflicts are characterized, in the pejoratives of either side, as struggles between "reckless PIIGS" and "Sparnazis"(saving fascists). In other views it is a struggle between reckless bankers and helpless taxpayers, who are stripped of their money and democratic rights by governments that seem to be clueless about how to get financial markets and profligate spenders under control. Often the two perspectives mix, while the emphasis differs between the countries in the Eurozone.

The euro neurosis is, of course, not just a whim. It is rooted in uncertainties about national interests and domestic conflicts of interest in a world with transnational financial markets, and it may have serious consequences in terms of self-fulfilling prophecies. That risk is particularly great in the case of Germany, so let us take a closer look at the perceptions of the financial crisis in the largest economy among the EU member states.

In the first act of the Great Financial Crisis, the US subprime crisis, German banks were in the front row of misspeculating loss-takers. In the second act, when the crisis turned into panic following the collapse of Lehman Brothers, the German government reacted swiftly by recapitalizing various banks through Soffin, a special fund for financial market stabilization. At the EU level it acted with more restraint, when it came to stabilize the real economy through fiscal stimuli, even though German industries saw a 25% decline of exports in early 2009 and the German economy went into a 5% recession that year. However, automatic stabilizers in Germany and fiscal stimuli elsewhere (in particular in the US and China) made aggregate demand recover quickly. Unlike all previous recessions since OPEC I in 1973/84, the downturn of 2008/09 did not lead to a persistent increase of unemployment in the German labour market. This time, German industries did not have to fear the revaluation shocks that kept hitting them in the D-mark era. The euro clearly contributed to the stabilization of employment in Germany and saved a lot of tax money in that respect.

The third act of the crisis started with the revelations of Greek overindebtedness in late 2009 and early 2010. The markets began to bet on sovereign default. The German government helped to fuel the Greek debt crisis and fears of contagion among the other PIIGS by letting its representatives speculate about an exclusion of Greece from the Eurozone, haircuts and other drastic measures. The no-bail-out clause of the Maastricht treaty was invoked to the extent that the nervousity in the markets increased and a bail-out became ever more necessary and costly.

The political motivation for such risky talk was a round of state elections, beginning in heavyweight North Rhine-Westphalia, where the conservative-liberal coalition feared losing the majority in the Bundesrat, the second chamber of the Federal parliament. The majority was lost indeed, and since then the CDU/CSU-FDP government has been trapped in a credibility dilemma. While it is talking harshly about restrictions of transfers, debt control, sanctions and regulations to cater to its constituency, it is forced to act more softly at the EU level in order keep the monetary union working. While it is dragging its feet at the European level and pulling the breaks on "bigger bang" solutions in terms of lending of last resort, banking regulation and fiscal policy coordination, it loses support at home because this looks incompetent, ineffective and costly to one part of the constituency, and like an undefensible departure from national interests to the other.

The deeper reasons for this credibility dilemma may be found in an identity crisis of the "German business model". For a long time, the German economy has benefitted from the strong export orientation of its industries. Being an "export nation" has been seen as a recipe for sustainable growth and repeated recovery

from crises. It was the base of the postwar economic miracle and it bedded, after the breakdown of the Bretton Woods regime, for a leading role in the emerging European Union. More recently, it appears to have helped Germany to overcome the post-unification stagnation and, again, the deep recession of 2009. Yet it is increasingly evident that the success of German industries in the world markets, and in particular within the EU, comes at high risks. The chronic surpluses in the current account imply long-term net lending to other countries without necessarily enabling them to pay back. The spending boom in the PIIGS countries was, after all, strongly fuelled by an armada of German banks (and their Irish or other subsidiaries) that were looking for profitable investments of German surplus earnings. 25% return on equity was the "shareholder value demand" propagated by Germany's leading banker.

In a highly integrated economic area, such as the European internal market, the endogenous risks of excessive leverage, real divergence and customer default cannot be ignored forever. Moreover, in a currency union the bill is no longer picked up by workers who, as a consequence of revaluation and cost-cutting rationalization become unemployed and marginalized, but by wealth owners and other holders of foreign assets who remain more influential. The devaluation of foreign assets is no longer a matter of changes in the exchange rates, but of financial stability and political processes of redistribution of the losses. Some banks look too big to fail, some countries (like Greece) too small to save. But what if there is contagion, threatening Spain and Italy as well? If they fail to refinance themselves and to pay back, will not this mean the end of the German business model? And isn't it high time to transform from an "export nation" to a different mode of political and economic development?

These are questions that should be discussed in Germany. However, the debates there often go awry because of moral overtones that make people, including professional economists, believe that they know the exact answers. The Great Financial Crisis owes indeed a lot to moral hazard of borrowers and lenders, and this goes strongly against the morale of an "export nation" that was cultivated in German public discourse since the 1950s under the principles of subsidiarity and frugality. In the past the two principles have run under the slogans of "wage moderation" and "low inflation". At present they spell out as "no bail-out" and "fiscal consolidation", enacted in Germany by a "brake on public debt" (Schuldenbremse) and now forcefully exported to Spain and elsewhere.

The "no bail-out" clause has some moral force in German debates because the origins of the European Monetary Union are still commonly interpreted as a deal, where Germany traded her D-mark hegemony in for the acceptance of German unification. The integration of East Germany required (and still requires) huge transfers from the West, and in view of that transfer union it was presented as totally unsustainable, and unacceptable to German voters, to allow for any transfers to overindebted EMU member states. Moreover, after 15 years of strong wage moderation and some harsh labour market reforms (Hartz IV et alia), it is hard to make the public accept that German taxpayers should help to clean up the mess after the spending boom in the PIIGS countries. In the general opinion, the banks and their shareholders should pay, if the Greek cannot. A large fraction of German economists supports that morale and demands strict liability, based on a tradition of German Ordnungspolitik, often at the peril of forgetting about the interdependence of markets and the social costs of bank runs. Thus it is an easy game for populists who demand the outright rejection of the ESM or even the return to the D-mark in the shape of a hard-core "Northern" euro.

The present struggle over the distribution of the losses incurred in the Great Financial crisis exposes fundamental problems of control and legitimacy, not only in Germany, but in the whole Eurozone and beyond. Dealing with the crisis would require clear rules about lending of last resort by the ECB, insurance of last resort by the ESM and borrowing of last resort by coordinated member states (to allow banks and other intermediaries to transfer wealth over time) - all this combined, of course, with stricter banking regulation that reduces leverage and the transfer of risks. The piecemeal approach of European politics, the gradual muddling-through, is inadequate for the present situation, as it drives costs higher, inspires a lack of confidence and lets policymaking be driven by market sentiments. Stabilization policies are replaced by symbolic politics, such as the introduction of debt brakes that may be just as useless as the Maastricht criteria, when it comes to overindebtedness of the private sector (as in Spain and Ireland), or the introduction of financial transactions taxes that can be easily circumvented. If Germany could overcome her "export nation" neurosis, things might get easier. But it is difficult to change from a chronic net exporter and net lender position to a more balancing role merely by political decree. Structural change in the real economy takes more time, in Germany as much as in Greece and elsewhere. However, the monetary union is now at a stage when that finally must begin to happen.