German hegemony: Unintended and unwanted

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Germany didn't intend to become Europe's current hegemon, writes Wolfgang Streeck. However, even now that it is, German chancellor Angela Merkel may yet go down in history as the person who liberated Europe from a common currency turned into a common nightmare.

Germany’s new European hegemony is a product of the European Monetary Union in combination with the crisis of 2008. It was not Germany, however, that had wanted the euro. Since the 1970s, its export industries had lived comfortably with repeated devaluations of the currencies of Germany’s European trading partners, in response to which much German manufacturing moved out of price-sensitive and into quality-competitive markets. It was above all France that sought a common European currency, to end the humiliation it felt at having to devalue the franc against the deutschmark and, after 1989, to bind united Germany firmly into a, hopefully French-led, united Europe. From its conception, the euro was a highly contradictory construction. France and other European countries, such as Italy, were tired of having to follow the hard-currency interest rate policy of the Bundesbank, which had de facto become the central bank of Europe. By replacing the Bundesbank with a European central bank, they expected to recapture some of the monetary sovereignty they felt they had lost to Germany. Clearly the idea was also to make monetary policy in Europe less obsessed with stability and more accommodating of political objectives like full employment. At the same time, Mitterand and his finance minister Jacques Delors, but also the Bank of Italy, hoped to gain political clout against national Communist parties and trade unions by foreclosing external devaluation and thereby forcing the Left to renounce its political-economic ambitions under the constraints of a harder, if not hard, currency.

In Germany the Bundesbank and the (overwhelmingly ordoliberal and anti-Keynesian) economics profession were squarely against monetary union, afraid that it would jeopardize the German “stability culture”. Even Helmut Kohl would have preferred currency union to be preceded by political union. His European partners, however, wanted the common currency, not in order to give up their sovereignty, but to restore it. Seeing German unification at risk, Kohl agreed to monetary union first, in the hope that political union would somehow come about later as a “spill-over“. When powerful forces
in his political camp hesitated about following him, he overcame their resistance by insisting that the common European monetary regime be designed in exact accordance with the German model, with the ECB as a giant replica of the Bundesbank.

The slogan with which the German government eventually sold the euro to the German electorate became: “The euro – as stable as the mark”. Germany’s partners signed the treaty in the end, presumably hoping to amend it later under the pressure of economic realities, if not on paper then in practice. It helped that the 1990s were a period when, issuing from the United States, fiscal consolidation was a common political objective for the countries of OECD capitalism, in the context of financialization and the transition to a neoliberal, non-Keynesian money regime. It was in the spirit of the era to commit to a ceiling on public debt of sixty per cent of GDP and to budget deficits that would never exceed three per cent; financial markets would have looked with suspicion upon any country refusing to fall into line.

Today it is Germany, together with countries like the Netherlands, Austria or Finland, which is reaping the benefits of the EMU. But it is important not to forget that this has only been so since the financial collapse of 2008. During the first years of EMU, Germany was “the sick man of Europe”, and monetary union had a lot to do with it (Scharpf 2011). The common interest rate set by the European Central Bank, which had to take into account the economies of all member countries, was too high for a low-inflation political economy like Germany. A possible solution might have been wage increases forced by aggressive trade unions. In a heavily industrialized, export-dependent country like Germany, however, this would have meant not just fewer exports but also, in a time of increasing capital mobility, a drain of jobs to foreign countries. This explains the, to many outside observers, mysterious wage moderation of German unions since the early 2000s. By comparison, the more inflationary economies of the Mediterranean enjoyed negative real interest rates, coupled with a dramatic fall in the cost of public borrowing – the latter on the assumption by capital markets, encouraged by the European Commission, that with a common currency there would also be some sort of common responsibility for the solvency of member states. The result was a boom in the South and stagnation, along with high unemployment and growing public debt, in Germany.

**Germany rising**

That situation was reversed in 2008, and contrary to popular neoliberal mythology this had little to do with the “Hartz reforms”. They made a dent in public spending, especially as regards unemployment insurance, and opened the door to an expansion of low-wage employment outside of the core sectors of German economic strength. What really mattered was that the German economy, traditionally driven by foreign demand and due to its perennial “over-industrialization”, was in a position after 2008 to serve global markets in the high-quality manufacturing sector. As a result, it suffered much less from the fiscal crisis and the breakdown of credit than more domestic demand-led EMU countries. Moreover, when it became clear that there would be no mutualization of the public debt of southern member states – which was of course exactly in line with the treaties, although this had been conveniently forgotten – countries with high debt had to pay much higher interest, raising the possibility of default of several EMU member states. This was the moment when Germany, unwillingly and unintentionally, became the new European hegemon.
Postwar Germany never had a desire to run Europe. German political leaders, regardless of party, agreed that as a European power Germany had a fundamental problem that required extremely delicate handling: it was too big to be loved and too small to be feared. The German national interest, therefore, had to be in becoming part of a larger European entity, one led not by Germany alone but in cooperation with others, in particular France. As long as Germany had secure access to foreign markets, for both the procurement of raw materials and the export of manufactured goods, it had no interest in international status. Under Kohl in particular, the integrity of the European cocoon in which Germany hoped to find a comfortable home became so important that Kohl, when there were frictions among his European partners, was always more than willing to provide the material means – that is, pay the bill – for a compromise that left European unity, or its appearance, intact.

But that is no longer possible, and it is this condition that Angela Merkel’s government must come to terms with. Almost seven years since the crisis began, there is no end in sight. Everybody in Europe and beyond looks to Germany for a solution, and often for one based on the Kohl model. Now, however, the problems have become too big for Germany to settle them out of its pocket. What may be new about Merkel, as compared to Kohl, is not that she was eager to become Europe’s leader. But the times are such that the German head of government, whether she likes it or not, has to step out of the shadows of the European backstage, if only because otherwise the front stage will remain empty. There the problems she faces are gigantic. In Europe, integration has become a political and economic disaster, with Germany now appearing big enough to be blamed for whatever goes wrong, but still being too small to make it right. At home meanwhile, the centrist consensus of German politics is about to collapse.

**Europe divided**

Concerning Germany in Europe, a few years of post-crisis monetary union have wiped out most if not all of the sympathies German postwar governments had worked so hard to earn among their neighbours. In the countries of the Mediterranean, in part also in France, Germany is now more hated than ever since the end of the war. Pictures of German leaders dressed in Wehrmacht uniforms and adorned with swastikas have become commonplace. The safest way to win elections is by styling them as campaigns against Germany and its chancellor, on the Right as well as on the Left. Whatever else the European Central Bank’s adoption of “quantitative easing” may or may not cause, it has produced a sense of triumph in southern Europe about Germany being defeated on the ECB’s Board. The hero of Italy is Mario Draghi, his firm neoliberal creed and his Goldman Sachs past notwithstanding, due to his having repeatedly outfoxed and humiliated “the Germans”. Nationalism is rampant in Europe now, and it is beginning to build even in what has long been the least nationalist European country, Germany. Foreign policy in southern Europe is increasingly about how to extract concessions from Germany – about how to rein in Germany in the interest of one’s own country, of “European solidarity”, and of humankind in general. Nobody can even guess how much time it will take, if at all, to heal the emotional devastation that the euro has caused in the relationship between Germany and countries like Italy or Greece.

It is an irony of history, and one that cannot have escaped the chancellor’s attention, that the EMU, which was supposed to cement European unity forever, is now about to drive
Europe apart. German policy is slowly beginning to realize that the conflict within and over the EMU is not just about a one-off “rescue” of the Greek state or the French (and German) banks. Rather than disappearing after some kind of skilful heroic surgery that gives way to renewed unity, it is inherent in the very structure of the EMU. EMU unites very different national societies with highly divergent economic institutions, practices and cultures reflected in different social contracts regulating the intersection between modern capitalism and social life. Important elements of these divergent political-economic orders are their respective monetary regimes. [1] In a stylized account, the countries of the Mediterranean in particular have developed a kind of capitalism in which growth is primarily driven by domestic demand, if necessary stimulated by inflation propelled by public deficits and strong trade unions benefiting from high employment security, especially in a typically large public sector. Inflation, in turn, makes it easier for the state to borrow as it devalues the accumulated debt. Corresponding to this is a highly regulated, often public or semi-public national banking system. All these together make it possible to more or less align the interests of workers and employers, in particular in domestically oriented small-firm industries. The price of social peace of this kind is declining international competitiveness, which must be compensated for by occasional devaluations of the national currency, at the expense of foreign exporters. This, of course, requires monetary sovereignty.

The northern European economies, above all Germany, work differently. They derive growth from successful competition in foreign markets, which makes them averse to inflation. This applies also to workers and trade unions, especially today, as rising costs can easily cause production to move abroad. Being able to devalue the national currency is not important for an economy of this sort. While Mediterranean countries, including to an extent France, were best served in the past by a soft currency, countries like Germany have historically adjusted to a hard-currency monetary policy. This makes them averse, not just to inflation but to debt as well, even though the interest they typically have to pay is low (also because their accumulated debt is low). That they can do without an accommodating monetary policy furthermore allows them to live without the risk of bubbles forming in asset markets. It also benefits their savers, of which there are many. [2]

A battle between two files

A unified monetary regime for the save-and-invest economies of northern Europe on the one hand, and the borrow-and-spend economies of southern Europe on the other, cannot serve both equally well. If one wants a common currency, one of the two political economies has to “reform” its social system of production and the social peace treaty founded upon it, so as to conform with the other. Right now, the treaties place the onus on Mediterranean countries, obliging them to “change” so that they become “competitive”, with Germany as their hard-currency taskmaster. As it turns out, their governments cannot or do not want to achieve this, certainly not at short notice. The result is a battle between two files within the EMU, one that is becoming nasty as it is not just about people’s material livelihood but also about their ways of life to which they are accustomed (as reflected in the negative clichés on both sides of the divide: the “lazy Greeks” versus the “cold Germans” who “live to work rather than work to live” and, in defending both the treaties and their own capitalist settlement, appear as merciless disciplinarians of their European neighbours). Southern European attempts to have the
The domestic politics of the EMU, then, is about alliances of member countries pulling the common monetary regime in different directions, towards either a southern or a northern version. While they cannot live with each other, neither do they want for the time being to live without each other: northern European exporting countries cherish fixed exchange rates whereas southern countries want low interest rates, in return for which they accept debt ceilings and deficit limits at the same time as hoping for leniency when required – since partner states are perhaps easier to placate than financial markets. Right now, Germany and its allies have the upper hand. In the longer run, however, neither side can afford losing the battle, as the loser will have to fundamentally rebuild the complex setting of interdependent institutions and understandings that is its political economy. The outcome of all of which cannot be certain and, even if all goes well, a long transition period will likely ensue, replete with political uncertainties and economic turbulence. For example, whereas the southern countries would have to accept a North-European labour market regime, the Germans would have to give up their – in the eyes of their partners: destructive and egoistic – habit of saving. [3]

As the debates on the future shape of the European monetary regime are taking place not just in technical but also in moral terms, it is important to note that none of the different ways of doing capitalism is necessarily morally superior to the others. The embedding of capitalism in society and the reconciliation of its logic with that of social life is always a messy affair involving improvisation and compromise, and less than fully satisfactory from both perspectives. This does not prevent partisans of each national model considering the other models morally deficient, while finding their own not just natural and rational but also conducive to the highest social values. Thus when Germans urge the Greeks to “reform” their political economy, and indeed themselves, so as to get rid of waste and corruption, they find the idea absurd that by demanding submission to the “laws of the market” they are in effect demanding the replacement of old-fashioned, socially-embedded corruption with the Goldman Sachs-type modern, financialized corruption endemic in contemporary capitalism.

There is no reason to believe that the bitter ideological and economic conflicts that are today dividing Europe along national lines, fuelling nationalist sentiments on all sides, will soon go away. Even if austerity does what it is supposed to do and restore southern European competitiveness under a hard currency, this will be at the cost of a decline of living standards in the debtor countries by an estimated twenty to thirty per cent as compared to the situation before 2008. The reason why countries are urged to accept this is, of course, the market-liberal promise of a subsequent catching-up, on a then supposedly solid economic basis. But a narrowing of income differentials by convergence in and through free markets, given the numerous forces of cumulative advantage operating in the latter, [4] is a chimera. Regional disparities, exacerbated by austerity, will have to be addressed politically within the EMU, on the model of nation-states like Italy and Germany. It is here that the Mezzogiorno and the Neue Länder (the former eastern European states), respectively, benefit from and depend on continuous support
from national governments to help them cope with the gap in regional living standards. In fact both Italy and Germany are transferring roughly four per cent of their domestic product every year to their backward regions, which however is barely enough to prevent inter-regional income gaps from increasing further (Streeck and Elsässer 2014).

Economic disparities among EMU member states will give rise to grinding conflicts both between and within them. Southern countries will demand “growth programmes”, a European “Marshall Plan”, regional policy support to help them build up a competitive infrastructure, and material “solidarity” in return for their adherence to the “single market” and European unity in general. Northern countries will be unable, for economic as well as political reasons, to provide more than only a small share of what will be required, not to mention asked for. [5] Still, in return they will demand control over how their money will be spent, if only to avoid being blamed by their domestic opposition for local waste, clientelism and corruption. Southern countries, for their part, will resist northern intrusions on their sovereignty while complaining about northern stinginess, whereas northern countries will find they have to pay too much at the same time as receiving too little in return in terms of control. Germany in particular, as the largest and, presumably, richest member country, will be perceived as politically imperialistic and economically egoistic, without being able to do much about it: its voters will not allow its government to support southern countries unconditionally while refusing to pay more than token money for a European regional policy in addition to what they are already paying for eastern Germany.

**Eroding support**

How long Merkel and her grand coalition, squeezed between their European partners and German voters, will be able to assuage both is an open question. The German export industries and associated trade unions have made the continuation of the EMU their uppermost priority and, with the help of the Euro-idealistic Left, have sacralized the euro in a quite extraordinary way, considering that it is no more than a currency. [6] Merkel, always attentive to her domestic power base, followed suit with her famous dictum, “If the euro fails, Europe fails”. Having committed itself to the euro in the name of high moral objectives, her government must now suffer the humiliation of searching for viable concessions that might be made in the hard international bargaining that has become an everyday European reality under the EMU.

The problem is that what used to be the “permissive consensus” among Germans in favour of European integration has faded away as integration has penetrated more deeply into the national political-economic fabric. Suddenly there is “euroscepticism” in Germany, hitherto the most unlikely site for it. The new political party Alternative for Germany (AfD) is threatening to eat away at the right of the CDU. If it is to be contained, the parties of the centre, including the SPD, must be wary of future concessions that other countries may demand on Europe. Up to now, transfer payments inside the EU and the EMU were often hidden in European regional or social funds. But the sums that the EMU will require, *nota bene* not just for the Greek “rescue” but also on a regular basis thereafter, are too enormous to be concealed in the same way. Several lawsuits before Germany’s constitutional court have done their share to politicize “Europe” and alarm the German public. For a while, the Merkel government seemed to look with secret approval upon the European Central Bank circumventing in a variety of imaginative ways the prohibition under the treaties on directly providing credit to member states. While the
Bundesbank complained, the government kept remarkably silent. But as the
distributional conflict among EMU member states becomes chronic, the costs of
monetary union for Germany, politically and economically, may soar to a point where they
can neither be hidden nor defended before a public that is itself increasingly suffering
from fiscal consolidation.

The sacralization of the euro notwithstanding, the German economy could in principle
adjust to a life without it. Restoring some sort of monetary sovereignty to the countries of
Europe, allowing the South (and the South-East waiting for entry) more breathing space,
may be better suited to balancing economic performance than the single currency.
Doubts about the sustainability of a one-size-fits-all monetary regime in Europe are
beginning to grow, even in Germany. After all, if the German conviction is valid that
under certain circumstances, a country’s economic health is best improved by austerity,
it matters that in practice austerity has worked its wonders only if accompanied by a
devaluation of the national currency (Blyth 2013). Today’s EMU is kept together almost
totally by fear and uncertainty over what would happen if it broke apart. Very soon this
may no longer suffice to justify to German voters the contributions required of them to
keep the EMU alive. Facing a surge of popular nationalism, German political elites may
find it advisable to abandon their ideological identification of the euro with “Europe” and
listen to the growing number of economists even in Germany[8] who are beginning to
think about an alternative, more flexible, less unitary European monetary regime. While
this may not be an ideal solution either, one needs to remember that ideal solutions are
not normally available in a capitalist economy with its manifold internal contradictions.
German exports may suffer for a while, but German taxpayers may benefit, together with
Germany’s reputation among its neighbours. Remembering Merkel’s rapid turn-around
on nuclear energy, one should not permanently rule out that, at some point, she might
want to go down in history as the person who liberated Europe from a common currency
turned into a common nightmare.

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Footnotes

1. On the following see, for example, Armingeon and Baccaro (2012), Blankart (2013), Hall (2012), Hancké (2013) and Höpner and Schäfer (2010).

2. Erst sparen, dann kaufen -- save first, buy later -- is a fitting if slightly exaggerated summary of traditional German economic attitudes as encouraged by German political-economic institutions (Mertens 2014).

3. The ECB's current programme of quantitative easing, officially aimed at raising the rate of inflation to two per cent, may be seen as part of a strategy to soften the euro, in the interest of Mediterranean member states. Indeed, its first effect is a rapid decline in the euro's external value. One is reminded of Enrico Letta, who served as Italian prime minister for a short time and, in an unguarded moment, was overheard speaking of the "damned euro" being too high for the Italian economy to recover. The problem is that a devaluation of the euro would benefit most an export-oriented country like Germany and fail to improve the position of weaker EMU members in relation to stronger ones. Moreover, in the longer term, it may set off a competitive devaluation battle at the global level. And while German exporters will not complain about a further improvement of their competitiveness, German savers will for a long time have to live with negative interest rates.

4. As impressively exposed by Piketty (2014).

5. Rough estimates, based on the national experience of Italy and Germany, indicate that the transfers needed within the EMU merely to prevent income gaps from widening vastly exceed the ability to pay even of Germany, France and the Netherlands combined. See Streeck and Elsässer (2014), available at www.mpifg.de/pu/mpifg_dp/dp14-17.pdf.

6. Perhaps this is a continuation of a habit developed by postwar Germans to confuse their collective identity with their money -- something that Jürgen Habermas once ironically referred to as D-Mark-Patriotismus.