

Economic Governance in the Eurozone and the EU: Drawing lessons from the crisis

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Session 3: The politics of crisis management: common institutions and national policies

“The role of Germany redefined?”

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1. Europe’s unwilling anchor

- German reunification, EU enlargement and the current crisis have recreated a situation that European integration and monetary union sought to overcome. Germany is once again Europe’s central country, the indispensable nation, the only member state with an effective veto power - especially in economic policy issues.
- Chancellor Angela Merkel has become the de facto president of Europe and the eurozone. In the crisis markets increasingly ignore those who officially speak for the currency area and focus on her.
- But Merkel is unable to provide leadership. This is the result of her difficult domestic situation, historic unease in Germany to take up such a role and a persistent alienation of the country from the EU. This creates tensions with the EU partners and within Germany that will intensify, especially if the crisis persists.

2. The end of EMU as Germans thought they had designed it

- The government of Helmut Kohl had used all its leverage to force through a monetary union according to German design. The initial Economic and Monetary Union was founded on a federal monetary policy, a rules based fiscal policy in national responsibility, no bailouts of other members, independence of the ECB with a mandate to focus on price stability and the interdiction of monetizing public debt.

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- In an astonishing show of inconsistency of national positions chancellor Gerhard Schröder emasculated the stability and growth (SGP) pact. While Schröder's action may be understandable from a domestic point of view it sent the fatal message to all euro members that EMU rules must not really be adhered to. Merkel's decision to rebuild the SGP's credibility, abide to its rules and work closely with the Commission for enforcement did not fundamentally change this.
- In Germany however the founding principles of EMU continued to be seen as the assurance Germany had rightfully obtained for the sacrifice of abandoning the D-Mark. It thus came as a shock to many Germans when they felt that over the weekend of May 7 to 9 those principles had been thrown over board. EMU according to German stability culture had ended, many feel, and nobody knows according to what rules the new EMU will operate. This causes an emotional divorce of many Germans and a relevant part of the press from the euro.

3. The collapse of Merkel's status quo illusion

- The Greek and the ensuing Euro crisis shattered Merkel's and many of her fellow German's illusions about the EU's future and the country's place in the EU. With German unity achieved, the internal market and the Euro in place, Poland and the other central European neighbors part of the Union and the Lisbon treaty in force the chancellor considered her country had reached its strategic goals in Europe. Her priority was to protect this status quo favorable to Germany.
- Contrary to all her predecessors Merkel abstained from defining any goal or vision for the EU and Germany's place in it. In a speech at Berlin's Humboldt University the chancellor claimed a year ago that integration had reached an optimum level with the Lisbon treaty. She categorically rejected calls for any further transfer of competencies to the EU level and sought to contain the European institution's powers at the current level. In parallel the emergence of the G20 gave her new opportunities to act as a national leader independently of the EU.
- In this context Merkel failed to develop any positive narrative about the EU, the Euro and the benefits Germany derives from being part of both. A sense of German purpose within the EU would have prevented euro-indifference and euro-skepticism from becoming today's main stream attitude. Additionally such a narrative would have provided a useful starting point for Merkel in convincing the public that a once in life time crisis called for exceptional measures by Germany to safeguard the euro.

4. German walls against too much Europe: Subsidiarity and Karlsruhe

- After reunification the feeling was that Germany was paying too much in relation to its diminished GDP per capita. Additionally there was the sentiment that the commission and poorer EU member states systematically teamed up to

extract money from more affluent countries by legislating and distributing money in areas where there was no clear legal basis. Kohl and his successor Gerhard Schröder chose a defensive approach to counter this. They sought to fight off all Brussels “competence imperialism” by making the subsidiarity principle the yardstick of all EU action. Schröder joined the “1-%-club” of like minded net payers to keep the evolution of the EU budget and their contribution to it under tight control.

- Germany’s constitutional court has dramatically limited the government’s room of maneuver in the EU. In the so called Maastricht ruling the Karlsruhe judges conditioned Germany’s participation and its continued membership on the perpetual validity of the stability criteria as laid out by the treaty. Implicitly this could indicate that Germany would have to leave a monetary union in which those principles were no longer abided by. Last year’s ruling on the Lisbon treaty defines reserves of sovereignty where the government cannot transfer competencies from the national to the European level. Additionally it imposes a much tighter scrutiny of the parliament’s lower house (Bundestag) on crucial EU legislation than previously. In these cases (e.g. future enlargements, treaty changes, Greek and euro rescue packages) the government now needs the explicit assent of the Bundestag in the form of a German law. Also the court explicitly dismisses that European law systematically breaks national law. With its ruling the Karlsruhe court de facto erects itself as a European constitutional court and the Bundestag as a European parliament.

5. The Greek/Euro crisis and European leadership Merkel style

- Seen from the outside the German government’s behavior appeared erratic and destructive. In the context of the legal constraints, a crucial regional election and an openly hostile public opinion to any rescue for Greece Merkel’s behavior appears more rational. It is troubling however that the chancellor needed something close to a systemic euro crisis in May to be able to credibly demonstrate to Bundestag, the public and the constitutional judges in a future court case that helping Greece and providing a protective umbrella for other troubled euro countries was an ultimate ratio step to safeguard the stability of the currency. She felt she would not have been able to make that case convincingly in February or end of March.
- The market’s pressure and the perceived threat of the eurozone’s implosion helped Merkel drive home her point of the need of serious consolidation and comprehensive welfare state reforms in countries like Spain, Portugal, Italy and France that had so far refused them.

6. Angst of an economic government for the eurozone

- German governments have always been ill at ease with the French concept of an economic government for the eurozone. Their worry is that France would use the tool to undermine the ECB’s independence and to introduce state planning into an economic order strongly inspired by ordoliberalism. On top

of this Merkel fears she would be permanently in the defensive because within the 16 euro members France and the “Club Med” countries would dominate numerically. The French ambiguity on the content, powers and limits of an economic government has helped keep the German resistance against the idea alive.

- These worries have prevented Germany from seeing the advantages of an economic government in a renovated EMU. It could become an efficient instrument to force individual countries to abide by the rules of the SGP and to impose sanctions. It could be an instrument to avert macroeconomic imbalances such as the past housing bubbles in Spain and Ireland. It could be used by the government to overcome public resistance against developing the German service sector further and open up protected public services. Meetings on the level of the eurozone’s heads of state and government are a useful tool to advance far reaching reforms of the welfare state (pension and health system, labor market) that the finance ministers are unable to deal with by themselves.

7. Dissidence within Europe and the emergence of a German Le Pen

- The sense of alienation from the EU, the Euro and its institutions has dramatically increased with the Greek/euro crisis. The public criticism of Bundesbank president Axel Weber with regard to the ECB’s decision to buy state bonds on the secondary market is the most striking example. The tense relationship Merkel has with José Manuel Barroso and the European Commission is another one. There is a risk this may lay the political foundations for German political agenda of questioning EMU, a reappraisal of its current membership and a split of the currency zone.
- Public reception of the Greek/euro crisis in Germany was a catastrophe. Over months mass circulation daily “Bild” ran xenophobic front page stories with lazy Greeks that hard working Germans had to bail out by handing over billions of Euros that otherwise would have paid tax cuts. “Once again we are the fools of Europe” was the half a page front page headline after the 750 billion Euro package. Merkel, her government and parliamentarians think this may have created the momentum for a talented euro-hostile demagogue. In the present climate a charismatic German anti euro campaigner similar to Jean-Marie Le Pen or Geert Wilders could easily score 15 or more percent in an election. Within the established parties there will be strong temptation to play the anti-EU-card in the next elections.

8. Getting Germany out of the corner

- Germany, the rest of the EU and particularly euro members have a mutual interest that this development be reversed rapidly. Germany reaps more political and economic benefits from the EU and the Euro than any other country. At the same time Germany’s partners must be anxious not to see Germany settle into a permanent dissident mood. EMU with an angry anchor country is likely to become dysfunctional, EMU without Germany is unviable and does not make any sense. This is especially true for France which sees

EMU not only as an economic project but also at a geostrategic arrangement to counter Germany's increased weight after reunification.

- Merkel and other politicians will have to develop a narrative about Europe with a double aim. They must make the case that being in the EU and the eurozone is not a sacrifice to please others but German political and economic self interest. Additionally they should set a goal or a vision for Germany within the EU that can serve as a political motivation force.
- After the perceived destruction of EMU as Germans knew it Merkel needs to be able to walk away from the negotiations about the renovated EMU with a visible reassurance for her domestic public. Nominating Weber for the succession of Jean-Claude Trichet as ECB president would be such a symbol of reassurance.

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