TOWARDS A MORE RESILIENT EUROPEAN MONETARY UNION

THE PARTIALLY ORDOLIBERAL-INSPIRED RESPONSE TO THE CRISIS IN THE EUROZONE REVISITED

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1. Germans - allegedly “bad Europeans”

Many people especially in crisis-afflicted countries have been extremely dissatisfied with the state of European Union (EU) and especially the European Monetary Union (EMU) for the last years. Who is to be blamed? For many observers particularly outside of Germany and some other Northern European countries (including e.g. Finland and the Netherlands) with a similar financial “stability culture” as in the Federal Republic the answer appears to be obvious that foremost Germany with the largest Western European economy has to be seen as the scapegoat as the following quotation by a leading op-ed commentator and US Keynesian economist in his piece “Being bad Europeans” demonstrates:

“Why is Europe in such dire straits? The conventional wisdom among European policy makers is that we’re looking at the price of irresponsibility: Some governments have failed to behave with the prudence a shared currency requires, choosing instead to pander to misguided to misguided voters and cling to failed economic doctrines. And if you ask me (and a number of other economists who have looked hard at the issue), this analysis is essentially right, except for one thing: They’ve got the identity of the bad actors wrong. For the bad behavior at the core of Europe’s slow-motion disaster isn’t coming from Greece or Italy, or France. It’s coming from Germany. … In other words, to the extent that there’s anything like a competitiveness problem in Europe, it’s overwhelmingly caused by Germany’s beggar-thy-neighbor policies, which are in effect exporting deflation to its neighbors. … Yet European policy makers seem determined to blame the wrong countries and the wrong policies for their plights” (Krugman 2014).
For such critics who are not denying that the government of the small Greek economy had behaved irresponsibly prior to the end of 2009, when huge national problems became visible, the current crisis in the Eurozone (EZ) has been foremost a crisis of Germany’s “behaviour” in EMU. To grasp this view, one has to bear in mind that European integration since the early 1950s has been based, above all, on the idea “that the only way of taming post-World War II Germany was to link it as closely as possible to its European partners through the intermediary of international institutions” (Morisse-Schilbach 2010: 27). Obviously, the focus is here on the Federal Republic of Germany (FRG, or West Germany, and after unification in 1990, Germany).

According to at least a number of observers of current German economic policy at the EU level there was a structural break in the way how Germany approaches EU economic and financial issues especially since the financial crisis (cf. Funk 2015). Contrary to that, however, it may be argued that as opposed to policy practices of different governments (cf. Funk 2010, pp. 87-96) the basic academic foundations of German economic policies have, in spite of several theoretical amendments at least in principle hardly changed today compared to the initial phase of the post world-war II (west-) German Social Market Economy. There had been a passing turnaround to integrate Keynesian ideas for roughly a dozen years since the second half of the 1960s, but its remainders are limited to very special situations today only.

It is true, however, that former FRG’s financial generosity in (European) economic policy has not only been criticized for long within Germany. It had to change anyway as a result of mounting problems in public finance, the urgent need to fight persistently high unemployment and ongoing low growth due to the necessity to cope with the challenge of German unification and ongoing structural changes such as globalization, further European integration as well as, above all, the future challenge of population ageing. Having chosen this trajectory of adjustment, however, this had effects in terms of international finance due to persistently rising German current account surpluses particularly after the euro had been established. Indeed, the main international finance
issue facing Germany has been its trade surplus prior to German unification and nowadays again, as this has and is likely to further strain the Federal Republic’s relations with the European countries and the United States, amongst others (cf. Konrad 2014).

Quite a few foreign politicians and experts, as above, have urged Germany to do more to boost its domestic demand and curb its exports. However, such calls have usually fallen on deaf ears in Germany, as the German economy differs structurally from many other members of the EU due to the leading role of the manufacturing industry which, amongst other longer-term causes such as relatively high German propensities to save or not to absorb and for low inflation (cf. Schneider 2014), explains Germany’s strong propensity to export and for open markets. Moreover, calls to reduce exports or to increase further German imports are often interpreted in Germany as attempts to reduce unfairly the competitiveness of strong German businesses based on fair market competition and related to Germany’s comparative advantages rather than created artificially with protectionist measures by German politics or in order to pursue beggar-thy-neighbor policies. The next sections discuss the main pillars of the FRG’s economic model including a short description of the not only initially but also nowadays very limited role of Keynesian demand management ideas in Germany. Then the chapter demonstrates briefly Germany’s recently regained strengths after having been often regarded as the ‘sick man of Europe’ until the early 2000s. Afterwards we highlight the historical emergence of an “incomplete monetary union” (Ashoka 2014). Finally, we shall describe and evaluate the adjustment efforts until now and further needs to improve the architecture in the EZ before concluding with the main lessons to be drawn from a foremost ordoliberal inspired institutional economics perspective.

THE ESSENCE OF THE FRG’S HUGELY ORDOLIBERAL-INSPIRED ECONOMIC MODEL
At least in terms of its total economic strength, Germany has certainly been the most populated and most powerful EU member state since its reunification in 1990. This may explain why its economic order has been an influential factor also for other nations particularly in the EU. The economy of the FRG was founded on the principles of the “social market economy” (SME). It has become the German Federal Republic’s economic order after it initially was the economic programme of the Christian Democratic and Social Parties (CDU/CSU) in the first post World War II election. The establishment of the SME’s main principles contributed to a very fast growing social and economic development after World War II in the FRG. In several coalitions with the Free Democrats (FDP) until 1966 the CDU/CSU more or less successfully promoted and defended its main features: a delegation of tasks according to which (cf. Funk 2000: 20-21)

1. the central bank should be independent, i.e. primarily responsible for keeping inflation down, but not responsible for employment;
2. representatives of employees and employers should have a basic right of freedom in collective bargaining.
3. the state should be limited; it has to be “limited” to ensure (a) keeping public expenditure at an efficient, rather low level (primacy of budgetary discipline which also supports price stability and to prevent the crowding out of private investment); (b) refraining from discretionary intervention in response to lobbying by sectoral interests; (c) implementing privatisation wherever reasonable and (d) favouring of market-friendly supply-side measures in order to promote economic growth and employment in contrast to discretionary demand-side interventions that are regarded as counterproductive most of the time; (e) ensuring stability also implies rejection of the idea of ex ante macroeconomic policy coordination.
4. the state has to be “strong” particularly to create the right conditions for effective competition to decrease inefficiency and unwanted distributional effects of ongoing market power based on artificial entry and exit barriers.

This set of principles which became popularly known with the slogan “as much market as possible, as much state as necessary” was based foremost on the “ordoliberal” paradigm that has had a renaissance in practice within Germany during the 2000s
effectively when employment-friendly reforms – greater efficiency of job-search and better incentives to take up a job (cf. OECD 2012, pp.43) – were implemented successfully especially since 2003: “Rarely have economic reforms in a mature democracy been so successful in such a short time. With determined cuts in unemployment, health and pension benefits, with lower taxes, wage restraint and less rigid labour laws, Germany has turned itself from the sick man of Europe into a continental engine of growth. Reaping the rewards, Germany has created 1.1 m extra jobs since late 2003. We can attribute at least a third of this gain to the structural changes” (Schmieding 2007). Later on after the financial crisis spread to the FRG visibly to everybody in September 2008 and 2009, the concept came to the forefront again. Due to the fact that the financial and economic shocks that the crisis created also on many other countries that afterwards recovered comparatively worse than Germany, the ordoliberal paradigm regained some strength as an alternative to the damaged “Casino capitalism” (Sinn 2011) within the United States and even spread at least into academic debates in Anglo-Saxon countries (cf. e.g. Siems and Schnyder 2013). Until then it has been largely neglected in academic debates.

Nevertheless, the paradigm remains very controversial among certain authors (Blyth 2013: 135-143). However, also in the FRG when Bonn was capital, in practice and in contrast to the ordoliberal paradigm the relevant actors have accepted usually only the first and the second of these pillars of the ordoliberal SME while the need for labour market and product market flexibility had been neglected to such an extent that Germany became known as particularly inflexible and the “sick man of Europe” until the early 2000s (cf. Funk 2010: 90-96).

This set of principles was initially actively compiled foremost by Walter Eucken particularly during the 1940s. He was the leading economics professor among a group of founders of this school of thought with a strict focus on the incentives resulting from the economic order in contrast to business cycle management (ordo = Latin for order). His concepts became part of current institutional economics (cf. Richter 1999, p. 150).
From a German modern mainstream economics perspective, only based on such an institutional economics approach it is possible to come up with sustainable solutions for national politicians of the member states and the EU itself, which are in line with a modern SME. The following triangle sketches the three alternatives of a pure free market order, an interventionist states as well as the ordoliberal strong state. The implementation of the ordoliberal-inspired SME in contrast to an economic order with a minimal state or an interventionist state in the FRG has to be seen a “radical innovation of the economic order” (Scholtyseck 2012, 102). The ordoliberal-inspired solution is regarded by its adherents as clearly superior to its alternatives if it can be implemented.

This is because the pure free market order with a minimal or ‘nightwatchman’ state only (responsibilities limited foremost to the provision of courts, police and defense) can lead to distortions within markets that can result in exploitation of citizens due to emerging and not only temporary concentration processes and market power while the interventionist state obviously disregards the negative social welfare problems of discretionary state actions as explained above. In contrast, the strong state characteristic for an ordoliberal inspired SME is expected to make certain efforts in economic policy, to be vigorous and non-partisan, and to control the economic process without partially pre-determining its results arbitrarily in favour of individual interests.

This sound background, amongst other issues, explains why many German academics as well as particularly German chancellor Angela Merkel (since 2005) have made important elements of the ordoliberal-inspired concept of the SME a hegemonial poject especially in the EU but also world-wide by basing large parts of the own domestic and supra-national policy proposals on these principle and by advertising the advantages of this concept compared to competing approaches (cf. Nonhoff 2012). In its most recent report also the majority of the independent German Council of Economic Experts (GCEE) or ‘wise men’, an influential official advisory council to the government, regard this concept as the foundation for its domestic and foreign economic policy-related proposals: “The therapy considered appropriate by the Sachverständigenrat is based on the principles of the social market economy, ensuring the efficiency of economic processes and changing distributional results via the tax and transfer system, in line
with the societal consensus" (CGEE 2014: No. 6).

Source: own compilation.

Diagram 1: The respective roles of the state in different ideal typical economic orders

However, it becomes also immediately obvious that the “devil is in the details” since interpreting the concept is often controversial among its adherents in several respects: Firstly, the majority of the advisory council regards the current economic policy of the government already as too interventionist: “Overall, it would be advisable for economic policy to display more confidence in market processes. The reform requirements are considerable in view of the challenges. Despite the current attenuated economic outlook, the economic environment is still sufficiently favourable for implementing future-oriented reforms” (CGEE 2014: No. 6). Indeed, already in its previous annual report the CGEE warned “against a backward-looking economic policy” stating, above all, that current policies including exemptions to the formerly legislated new retirement age of 67 and decreasing the flexibility in the labour market means that recent structural reform efforts that have proved causal for German success become diluted or reversed in some cases (cf. Funk 2014: 323). Secondly, the Keynesian-dominated minority statement within the annual report makes clear that even among principal academic adherents to the SME concept several issues remain controversial: while four of the experts regard it as inevitable to ensure first of all the efficiency of all market processes and to ensure redistribution according to needs via the tax and transfer system, one
member of the council disagrees and states that governmental regulations of market processes and redistributional efforts by the government are not automatically damaging and do not necessarily imply a worsening growth prospects. “Empirically, only in extreme cases negative growth effects are visible”, according to the minority view in the council (cf. CGEE 2014: No. 80).

<table>
<thead>
<tr>
<th>Goal</th>
<th>Main instrument to be used and main policy actor</th>
<th>Ancillary responsibility (examples in brackets)</th>
</tr>
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<tr>
<td>Price stability</td>
<td>Monetary policy <em>(Independent Central Bank)</em></td>
<td><em>Government</em> (e.g. VAT); Partners in (collective) bargaining on the labour market (bargained wages)</td>
</tr>
<tr>
<td>Employment</td>
<td>Wage policy <em>(partners in autonomous collective bargaining that decide upon nominal wages)</em></td>
<td><em>Central bank</em> (inflation and thus real wages); <em>government</em> (e.g. additional wage cost, taxes, regulations)</td>
</tr>
<tr>
<td>Economic growth</td>
<td>Public Finance and general framework conditions <em>(government)</em></td>
<td><em>Central bank</em> (e.g. inflation), Free collective bargaining partners (nominal wages, regulations)</td>
</tr>
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Please note: The current account is not regarded as a goal but rather as the result of trying to achieve the other partly conflicting goals.


Table 1: Modern Ordoliberal assignment of instruments, actors and goals

The traditional ordoliberal assignment of economic policies (based on their relative ability to achieve certain economic goals in the long run) to the relevant economic actors can be described as in table 1 for the FRG.

Certain ancillary responsibilities do exist, however, because the longer-term effects usually differ from the short-term ones. For example, if a large share of the autonomous wage setters in an economy bargain wage increases much higher than productivity growth, they do not fulfill their ancillary responsibility according to this framework.
because as a result the central bank that sticks to its inflation goal will have to increase nominal interest rates which usually result in lower employment and higher unemployment (alternatively: it has to give up its inflation goal to keep the current employment level).

PASSING KEYNESIANISM IN THE FEDERAL REPUBLIC– LESSONS LEARNED

While the traditional SME governance model consisted of a set of general guidelines for economic policy rather than precise goals and instructions for policy this changed during the 1960s when Keynesian thinking gained between the mid-1960s and the end of the 1970s considerable influence also in Germany (cf. Nützenadel 2012). In spite of the fact that this influence actually lasted only few years, the goals included in the German economic “Law on Stability and Growth” of 1967 still often serve as a means to structure economic policy debates in Germany even if the law has hardly been applied in practice after the 1970s. The law was passed after the first cyclical economic crisis had occurred during 1966/67 in West Germany and was meant to start a shift to Keynesian demand side strategy. Indeed, the law for promoting stability and growth gave the government the obligation to smooth out the business cycle.

A high level of employment (measured in practice often by low unemployment) as well as price stability, steady economic growth and a “sound” balance in foreign trade (foreign economic equilibrium of imports and exports in the medium and longer term) are the four principal economic policy objectives of the government, the so-called “magic rectangle”. Additionally and amongst certain other issues (e.g. ecological goals), as a rule it has also been considered the government’s task to ensure an equitable distribution of income and wealth – a “magic polygon”.

Harmony of achieving two goals simultaneously can be normally observed in reality with respect to employment and growth because rising economic growth and increasing employment often go hand in hand during the business cycle (and vice versa). However, the “magic rectangle” is called magic due to the short-term target conflicts
arising in this context. For example, according to the traditional Keynesian trade-off/target conflict-view, it was assumed that economic policy could choose between a combination of lower unemployment plus higher inflation, on the one hand, or vice versa on the other. Empirically however, such a choice proved wrong due to the dynamics of the wage bargaining process. As a rule, in the longer term expansionary monetary and fiscal policies will only affect the price level, but not employment, as was wrongly assumed by many Keynesian economists during the 1960s as a simplifying assumption. Empirical evidence based on the theoretical criticisms against this approach demonstrated, however, that employees will build inflation forecasts into their expectations and, therefore, the price level and the cost of labour will – everything else the same – rise at a similar rate at least in the longer term in competitive labour markets. Thus there is no longer a trade-off between inflation and unemployment. In other words, more inflation is no longer-term solution to fight structural unemployment resulting from institutional inefficiencies caused by rigid labour and product markets. An often existing short-term trade off between inflation and unemployment should thus reasonably not be used by economic policy, because non-cyclical unemployment problems cannot be resolved lastingly with counter-cyclical demand management while at the same time negative side-effects such as rising public debt and inflationary problems can hardly be avoided. In other words, the key message is that Keynesian demand management cannot lastingly address classical unemployment that results from low profitability of firms.

The lesson learned especially but certainly not only among ordoliberal-inspired German mainstream economists with respect to the assignment problem which was discussed above was simple: “the assignment problem can be solved in such a way that each policy area concentrates on what it can achieve in the long run. This implies also that an international coordination of macro policies is not necessary. If each economy keeps its ‘house in order’, i.e. if all areas follow well defined rules, there is not reason to ask foreign monetary or fiscal policy for help in order to achieve the domestic targets” (Scheide 2003: 42).
Perhaps more than in many other nations and very likely related also to the ordoliberal heritage, saying that many German economists (as well as politicians today) are “anti-Keynesian” is true in the sense that the use of discretionary policy is regarded as counter-productive during a normal business cycle (cf. Kronberger Kreis 2013, p. 13). In Germany, nowadays “the use by government officials of discretionary countercyclical actions and interventions to prevent or mitigate recessions or to speed up recoveries” (Taylor 2011) – probably the essence of the Keynesian approach for many economists – is understood as very risky due to the unwanted side-effects and problems of abuse by politicians. In other words, in contrast to countries such as the United States or Britain, usually mainstream economists as well as governmental authorities in Germany limit Keynesian economic policy today, above all, to very specific situations only: “Government investment for the purpose of stimulating the economy is meaningful only – and on a limited scale – in times of extraordinary crisis” (Deutsche Bundesbank 1999: 15). This caution is also based on a missing trust in public discretionary actions due to moral hazard risks as “studies in political economy show that government investment decisions are often driven by political rather than economic criteria, which might dampen the associated growth effects” (Deutsche Bundesbank 1999: 21). While usually criticising employment-hampering micro-incentives in a conducive macroeconomic environment, in the last decades such a moment for discretionary fiscal policy was only seen among mainstream economists in Germany during the extreme situation of 2009 after a large negative demand shock due to the financial crisis originating in the United States had hit the then previously prospering German economy (cf. Funk 2012: 22-23). Survey results among German economists with respect to the question “Considering your scientific attitude and orientation, which school of thought do you prefer?” (multiple answers were possible) suggest that while neoclassical economics (42%) is jointly with institutional economics/public choice (37%) predominant in Germany, traditional ordoliberalism has lost its previous dominance during the post-war decades. Nevertheless, among roughly a fourth of respondents (24%) this specifically German version of economic thinking “is somewhat less popular, but still clearly preferred to other school of thought, such as Keynesianism” with just 12% (Frey, Humbert & Schneider 2009, 4 and 21). Moreover, at least parts of institutional economics/public
choice has be understood as a successor or a modernised version of ordoliberal thinking (cf. e.g. Leschke 2011), that is they can be seen as ordoliberals in a wider sense in contrast to the traditional ones in a narrow sense.

THE UNEXPECTED GERMAN SUCCESS STORY IN SPITE OF THE FINANCIAL CRISIS AND THE PERSISTING PROBLEMS IN THE EUROZONE

As opposed to many other countries and in spite of the largest fall of real GDP in the country since World War II (minus 5.1 per cent of real gross domestic product, GDP), the German economy proved particularly resistant against recent crisis pressures. Obviously, above all the supply-side reforms during the last decade combined with more traditional elements of its SME are responsible for Germany’s hardly interrupted labour market boom while much of the euro area’s periphery fell back into recession accompanied by strongly rising unemployment. The CGEE particularly emphasised in its 2011 annual report the “remarkable … almost continuous rise in employment since the middle of the past decade and … the fact that the situation is actually better than before the crisis.” (CGEE 2011: 19). The path of enduringly rising structural unemployment was broken for the first time within decades in spite of the bad cyclical developments around Germany (cf. Funk 2012, p. 853). The stable labour market and its further recovery after the financial crisis is based on an interaction of several factors. The most important components included – apart from certain direct fiscal policy measures (car scrapping subsidies) – a large amount of labour and thus skills hoarding and the use of short-time work. In spite of the fact that these instruments have been used traditionally especially since the 1970s in western Germany for labour market adjustment purposes, the wide use particularly in 2010 was unseen in the last decades. The approach worked well because its use was based on expectations by employers of a short recession only that proved to be true. Many of the most affected companies correctly anticipated to have a fundamentally appropriate structure of their products to meet the future demand in global markets as well as within Europe and Germany. Last but not least, the increased flexibility of the strategically restructured German labour market (cf. Funk 2014: 318-321) also contributed considerably to the success, due to
the elevated profitability of production prior to the 2008/2009 downswing and the accompanying decreased uncertainty for successful entrepreneurship in Germany. One may summarise that the employment successes in the last years was possible via a mix of more external flexibility (as a result of labour market reforms) and more firm-specific internal flexibility in the course of crisis management and despite of increased consolidation efforts since late 2009 already (cf. Funk 2014a: 318-319).

Especially these factors can explain the resilience of the labour market in spite of the fact that Germany had been heavily affected initially, above all, by the steep decline in international trade due to the great financial crisis which decreased especially German exports in the core area of the German production model, i.e. machinery and automobile manufacturing. However, the previous upswing between 2005 and 2008, combined with the accompanying wage moderation and increased flexibility as well as the resulting high profits in these sectors before the breakdown of demand allowed for this rather unique German way of adjustment. As the positive labour market developments continued despite of the emergence of a crisis in the euro area, the lesson learned in Germany has been that controversial structural reforms especially since 2003 finally pay off by shortening crisis situations and strengthening the economy while simultaneously making efforts to reduce the still very high level of debt compared to the FRG’s history (cf. Funk 2014: 319). Despite of considerable warnings prior to the implementation of these measures, unacceptable negative side-effects on income inequality can also not be detected: While it is true that income inequality has risen compared to the nineties as a result, above all, of a higher employment of low-qualified, female and older workers, inequality has not increased any further in the last decade in spite of the considerable structural reforms of the welfare state and the labour market (cf. CGEE 2014: No. 9). More generally, all this may explain why a majority in Germany thinks that at least some of these basic lessons of the German experience (which is mirrored in quite a few other countries that implemented employment-friendly reforms as well) of having successfully pursued supply-side orientated measures should serve as a guidelines for national reform efforts in the crisis countries of the Euro area. Against this background the following quote may well be understandable: “Rather than
doing too little too late to help, many Germans think they have already done too much too soon” (Kundnani 2012).

THE GENESIS OF AN INCOMPLETE MONETARY UNION

The EZ was expected initially to help overcome the low growth and high unemployment of the 1980s (‘eurosclerosis’). In other words, the euro was envisioned with a clear function well before German unification. Therefore it should not be regarded as the ‘price’ the FRG had to pay for the political acceptance in other parts of Western Europe (cf. Hampe 2013). Rather there are economic as well as political factors that have to be borne in mind in order to explain why an ‘incomplete’ monetary union emerged, that is: 

With the adoption of the euro at the beginning of 1999, EMU countries surrendered monetary sovereignty, but have remained without a reliable backstop in case of emergencies due to national liquidity problems (cf. Mody 2014). Let us look at economic issues first and then discuss the political backcloth of EMU.

From an economic perspective, the EMU aimed at resolving the trilemma of currency policy among the member states of the EU by abolishing nominal exchange rate changes. Neither the Bretton-Woods system of adjustable fixed exchange rates nor the flexible exchange rates after 1973 nor the European Monetary System (EMS) after 1979 led to convincing results. In principle, an internal market with highly intensive free trade and capital controls can function well even if it is segmented, so long as nominal exchange rates are relatively stable. In order to ensure such stability, the renunciation of nationally autonomous economic policy is needed because regularly such national economic policies lead to differing interest and inflation rates that would require changes to nominal exchange rates (Hampe 2013).

The EMS was initiated by the then German Chancellor Helmut Schmidt and French President Valéry Giscard d’Estaing in spring 1978 in order to achieve more stable exchange rates, at least in the European common market, and stronger economic growth. The exchange rate mechanism (ERM) aimed at improving trade relations
among the member states, since the constant changes in floating member state currencies were regarded as harmful to international trade within the European Economic Union, while the participating currencies were to float jointly against the currencies of third countries. According to the European Council of December 1978, the ERM was designed to contribute to more growth while simultaneously maintaining price-level stability; it was also expected to help reduce unemployment and to enhance European integration. One of its pillars was an improved convergence of economic policy. Participants initially included eight member states while southern European countries and the United Kingdom entered later.

Despite of these efforts, the system remained fragile as ongoing differences in inflation prevented the desired stability of exchange rates. The gain in convergence was probably much smaller than previously expected by the proponents of the EMS. Between 1979 and 1987, the number of realignments needed amounted to 14. Overall the Deutschmark appreciated against Spain and Italy by 105 per cent, while against the UK and France the appreciation amounted to 65 and 45 per cent respectively. In 1983 France changed course to a ‘franc fort’ policy in support of increased price stability. That meant that France accepted the Deutschmark as the anchor of the system, and thus the policy of the Bundesbank. In political terms this subordination was already seen as hardly acceptable from the French Government’s point of view. Even worse, fundamental differences in macroeconomic policy after German unification produced currency imbalances that in 1992 led to the exit of Italy and the United Kingdom from the ERM. As a result, the level of permitted fluctuations in exchange rates had to be increased from +/-2.25 per cent to +/-15 per cent. Effectively, this meant almost a return to flexible spot rates. To sum up, the fundamental solution to the problem the ERM was supposed to address could hardly be achieved with fixed but adjustable exchange rates.

More generally, the analysis of exchange rate regimes shows that it is impossible to achieve all the goals regarded as beneficial for a country at once. This problem is called an ‘impossible trinity’ (Reinert 2012: 274) and it reveals a fundamental trilemma. The term trilemma “describes a situation in which someone faces a choice among three
options, each of which comes with some inevitable problems” (Mankiw 2011: 712). The international finance trilemma stems from the fact that it is impossible for a nation to have fixed nominal exchange rates with other countries, free capital flows, and an independent monetary policy at the same time, even if achieving those national economic policy goals simultaneously would be beneficial (Mankiw 2011: 712). Firstly, fixed nominal exchange rates with other countries allows business and households to plan for the future in an easier way, while fluctuating exchange rates caused, for example, by speculation can be a source of broader economic volatility and problems. Secondly, free capital mobility ensures better, from a microeconomic perspective, the movement of capital to its most profitable uses and can generally be regarded as welfare-enhancing for societies as a whole. Thirdly, independent national monetary policy is regarded as nationally useful, because decreasing nominal interest rates can help to stabilize an economy in a recession in the short-term, while raising them can help to deal with a situation of overheating.

The existence of a trilemma implies that it is impossible to have it all at once. A country can choose only two of these goals at once while giving up the remaining one. In other words, firstly, “if you pick two of these goals, the inexorable logic of economics forces you to forego the third” (Mankiw 2011: 712); a second important implication is that there is no obvious best way of dealing with this impossible trinity, and “economists should be cautious when recommending exchange-rate policy, because it is far from obvious what is best” (Mankiw 2011: 713).

One option is to allow free flows of capital and to conduct an independent monetary policy; the United States exemplifies this choice, which implies a floating nominal exchange rate to equilibrate the foreign currency exchange market. A second option chosen, for example, by China, is to restrict the in- and outflow of capital, so that domestic forces decide upon the national interest rate; this allows government both to fix the nominal interest rate and to conduct an independent monetary policy. The third option is the one taken, for example, by the member states of the eurozone: they have eliminated all nominal exchange rate movements within the European monetary union,
while capital is free to move at the same time. This has, however, implied all member states relinquishing control over national monetary policy. The US economist N. Gregory Mankiw (2011: 713) thus notes wisely that “Americans shouldn’t be too harsh when other nations facing the trilemma reach conclusions different from ours. In this area of economic policy, as well as many others, there is room for reasonable nations to disagree”.

From a European point of view and in retrospect, however, the conclusions reached among EMU member states have proved untenable, as the persisting deep crisis in the eurozone, in general, and the introduction of (temporary) restrictions on capital movements in the case of the rescue package for Cyprus have demonstrated recently.

The political backcloth of the genesis of the current EMU can highlight why the euro was installed without a fully-fledged political union while economists remained divided on the issue. As mentioned at the start of this section, the oft-heard hypothesis that unification was the primary factor in Germany’s willingness to relinquish the leading European currency, the Deutschmark, in favour of a common currency is contradicted by the timing, and conspiracy theories that suggest that giving up the DM was the price of unification appear dubious. As a matter of fact, “the willingness of the German government to give up the stable Deutschmark in favour of a European currency existed prior to unification, even if the concrete act indeed meant a significant German concession to France during the process of German unification” (Lutsch/Schumann 2010: 118). In other words, the situation may nonetheless have suited other member states of the European Community quite well as a way of ending the established dominance of both the Deutschmark and the German central bank, the Bundesbank.

In order to demonstrate its political loyalty to the West, the federal government bid farewell to the so-called coronation theory, by which a joint currency should be established only at the end of a process of integration towards a real political union. In the latter case one would have to share (to some extent at least) fiscal sovereignty prior to giving up national monetary sovereignty. Although this change of course was very
controversial among economists due to its potential economic risks, the FRG’s government argued repeatedly after Germany has become geo-strategically and economically the dominant central power in Europe the primary purpose of the EMU apart from efficiency gains was to make a future European war impossible and uneconomic (Lutsch and Schumann 2010: 117, and James 2012: 1). Therefore, the government agreed to a fixed date for the implementation of the single currency based on concrete stability criteria and common institutional rules. By adopting this course of action, the government hoped to demonstrate that the unified Germany would be a ‘European Germany’ and would pursue political integration on the path to political union. However, this was regarded only as acceptable among the German government if central principles of the German monetary policy were accepted as pillars of the common currency policy which, in the final analysis, have been taken into account. At the request of the Federal Constitutional Court, a new Article in the German constitution states since then that the EU should become “committed to democratic, social, and federal principles, to the rule of law, and to the principle of subsidiarity’ and that it should guarantee “a level of protection of basic rights essentially comparable to that afforded by this Basic Law” (cf. Birckenbach 2011: 328). However, the fact that apart from Germany no big country wanted federalism at that time demonstrates a conflict regarding the final goal of the EU and an increase political union at which the FRG aimed at. The result was a specific balance between elements of a supranational fusion of the nation state and a merely merely intergovernmental political coordination in the Maastricht treaty which became the future legal basis of the EU (Lutsch and Schumann 2010: 117). During the bargaining process, however, the FRG’s government could not enforce all elements it regarded as necessary for ensuring a sustainable and stable single currency in the EU partly because it needed room to manoeuvre for concessions in favour of German unification. As a result, the currency was regarded as incomplete and potentially fragile especially among quite a few leading ordoliberals in Germany.

At the same time, it was assumed amongst parts of leading economists including the also ordoliberal-inspired first chief economist of the European Central Bank, Professor Otmar Issing, that “for the time being EMU can proceed perfectly well without a political
union on the form that we understand today” (Issing 2006, 2). The latter view led also to promises of Chancellor Kohl at the start of the euro that the FRG will not be liable for the debt of other member states as excessive indebtedness of any participating state is excluded from the outset due to stability criteria and a pact to avoid fiscal spending with potential negative spillovers onto other nations. With the benefit of hindsight, however, such forecasts proved much too positive as the euro’s architecture and the enforcement of mechanisms to protect it have been too weak to avoid the present situation of – despite of recent improvements – a still fragile and incomplete EZ without a fully reliable safety net.

Initially, however, the adoption of the euro appeared to work rather well: In January 1999, the currencies of the different member states were linked irrevocably to the euro. After three years of operating as a shadow currency, on 1 January 2002 the new currency finally took the shape of coins and notes, with €1 equal to Deutschmark 1.95583. Beyond the advantage that there was no longer any nominal exchange rate volatility among member states, the economic advantages of the euro were seen particularly in an ongoing reduction in transaction and information costs, and in expected gains in economic growth. Furthermore, there were potential gains due to the euro’s use as international reserve currency with a larger capital market and, all else being equal, lower average interest rates. And the E(M)U and its political representatives, as a unified player, became a more powerful actor in the globalized world.

Obviously, however, adopting the euro meant renouncing national monetary, interest rate, and exchange rate policies. Since then adjustment burdens in the case of economic imbalances is instead on public fiscal and structural policies as well as wage and welfare state policies in the different countries. The question was how to achieve the necessary discipline and microeconomic flexibility of production factors at national level (Hampe 2013: 336-7). Countries’ room for manoeuvre was affected by the general framework conditions set foremost by the stability and growth pact as well as by the no-bailout clause and productivity growth developments which set the leeway for the...
distribution of real production and depend foremost on the quality of national economic policies. The latter, in turn, decide upon the capacity of production factors to adjust to new situations, and on investment in skills and human capital, in particular. All in all, therefore, with the adoption of the euro the rules of the game changed considerably and it was initially unclear how well countries coped with this challenge.

ARE GERMANS REALLY BAD EUROPEANS?

Is it really fair to make Germany to the “scapegoat” (Gros 2013) as is sometimes done especially by some leading economists (as Paul Krugman, mentioned above) or economic policy commentators outside of the FRG? The hypothesis appears to imply that German governments acted consciously (more than the average of other EU nations) at the expense of other EMU member states. However, such statements appear far-fetched when we take into account both Germany’s record in terms of economic growth (cf. Hampe 2013) and its persistently high and apparently ever rising unemployment prior to 2008 (details in Funk 2012: 9-10). Although it is true that Germany changed jointly with France the “rules of the game” to their short-term favour, the lesson is that prior to the financial crisis and the crisis in the euro area the incentives set for many member states proved insufficient to reach the goals set in terms of structural (un)employment performance and desirable sustainable consolidation as well as economic growth. Therefore,

It is also questionable whether Germany really had pursued a ‘beggar-thy-neighbour’ policy while addressing its domestic problems. Moreover, it is unclear whether reflating the German economy would, indeed, contribute lastingly to a better success of the countries currently in crisis. Finally, one has to ask whether fighting deflation is always a good idea, as Keynesians usually argue, or whether positive effects of deflation may outweigh its potential negative side-effects.

Alongside Ireland (+105% increase of real gross domestic product, GDP, between 1995 and 2009), selected southern member states showed particularly strong economic
growth: Greece: +55.6%, Spain: +50.2%, Portugal: +29.5%, and France +27.4% in the same period with respective increases of the price levels between 25 and 67%). Simultaneously and contrary to the oft-repeated claim that it benefited particularly from entering the euro, Germany as the largest EMU country exhibited an inferior economic growth performance (real GDP increased by 16.2% overall only between 1995 and 2009). Italy performed especially badly (respective figures of 11.4% real GDP increase and of 44% price level increase), with a worse economic growth performance than Germany and, at the same time, a price level increase almost as high as in Ireland (+44%) and Portugal (+48%), that is in countries which had a considerably better growth record simultaneously, while Germany experienced the lowest price level increase at 12% between 1995 and 2009.

After reunification and the break-up of the EMS, real currency appreciation had had disastrous effects for the German economy, which according to some economists “had to be squeezed for 15 years to restore competitiveness” (Artus 2010: 7). In line with the pillars of the ordoliberal-focused SME and the iron triangle, the FRG therefore insisted as far as possible on rather strict fiscal requirements for entry into the EMU and during its operation. It asked in particular for adherence to a stability and growth pact (SGP) adopted by the European Council in 1997, and was adamant that “no bailout” should be allowed if countries experienced fiscal distress due to disregarding the fiscal straitjacket, which was implemented to ensure medium- and longer-term stability (Buti and Sapir 2008: 254). Many critics nowadays assert that the failure of the the SGP and later of the “bail out”-clause was easily foreseeable, but this is not necessarily true.

At the start of EMU, the approach was lauded even by academics in Britain (e.g. Artis 2002: 155). If understood and enforced correctly, the rationale behind the approach that sound fiscal consolidation contributes directly to credible stabilisation of the macro-economy seemed to make sense: As understood by the ordoliberal-inspired economists and the German Central Bank, “only budgets which are on average over the cycle balanced in surplus provide scope for the steadying influence of the automatic stabilisers and at the same time reduce long term debt levels” (Weber 2005: 3).
However, even the 3 per cent criterion of a maximum annual debt increase, which became part of the Maastricht treaty, was hedged later on with discretionary qualifications, and what actually happened differed considerably from what had been planned (for details, see Buti and Sapir 2008: 244-57). Nevertheless, the SGP aimed at enduring stability-orientated fiscal and financial policy, and contained the obligation to achieve a balanced budget at least in the medium term. An early warning system was provided by the duty to submit annual stability and convergence programmes, which would be followed up with recommendations from the Council. Sanctions threatened in the case of excessive budget deficits. In 2005, however, after Germany and France in particular had repeatedly failed to keep to the rules, the pact was reformed. According to critics, the new pact lost its ‘bite’ and was weakened because additional factors were given consideration and the deficit procedure was prolonged (Hampe 2013b: 335-6).

Beyond budgetary and financial stability at the macroeconomic level, which was addressed by an independent central bank as well as stability-guided fiscal policy the EU’s Lisbon strategy was meant to make the EU ‘the most competitive and dynamic knowledge-based economy in the world’ by 2009-10 (Papadimitriou 2012: 1). The latter strategy tried - without meaningful success, unfortunately – to improve microeconomic flexibility by giving incentives to implement structural reforms at the national level (cf. details Funk 2015). At least wake-up calls by academics were readily available prior to the outbreak of the current problems that clearly predicted that the targets for growth and employment were unrealistic without a meaningful push in terms of structural reform efforts (Pissarides 2006). In other words, with a weak governance mechanism, based on the open method of coordination (which relied heavily on voluntarism and peer pressure for its implementation), the incentives set for national reforms largely failed.

Also simplistic Keynesian recommendations leave a lot of questions open because it remains hardly answered how the troubled countries’ structural problems can be resolved by, foremost, more expansionary German policies. This is because, on the one hand, German additional stimulus may foremost lead to a worsening of achieving its
national economic goals while, on the other hand, it will simultaneously hardly result in any improvements of the troubled countries, everything else the same. For example, stimulating German real wage growth may decrease German export competitiveness and lead to a worsening of its labour market, but at the same time French and Italian competitiveness may hardly benefit because their production is not at the same level of product sophistication and cannot be substituted for German production. Moreover, the negative impact of the Spanish improved cost competitiveness of its products (at a similar level of product sophistication as in France and Italy) outweighs the small positive effects of a loss of German competitiveness (cf. Artus 2014a). Therefore, starting the still lagging reform efforts (cf. Artus 2014c) in France and Italy remains inevitable even if Germany pursued more expansionary policies. The latter would, however, according to simulation studies hardly help: “…should the German government expand spending by 1% of German GDP in both 2015 and 2016, it might raise GDP in Italy, Spain and France by between 0.1% and 0.2% per year” (Kraemer 2014) – certainly not enough to what is actually necessary in terms of economic growth in these countries. Similar arguments hold for an EMU-wide stimulus (cf. Gros 2013). As the evidence also appears to demonstrate there is a risk that own structural reform efforts in these countries may decrease as soon as more foreign aid is made available to them. Also the argument that Germany has pursued a ‘beggar-thy-neighbour’ policy is on thin ice only. Empirical studies particularly incidate that the German structural reforms roughly a decade ago had only a limited effect on the current account as import demand also increased with the rise in aggregate income. ... Moreover, it is evident that the structural reforms contributed to German wage moderation after 2005. However, this had no dampening effect on import demand, as the rise in employment overcompensated for the decline in real earning. Thus the effect of the reforms on other countries – in this case the rest of the euro area – was slightly positive on balance, ".. Overall the results indicate that Germany’s structural reforms do not constitute a ‘beggar-thy-neighbour’ policy: in contrast to targeted depreciation of the nominal exchange rate in order to gain export demand at the expense of other nations” (CGEE 2014, Box 22; cf. also Matthes 2014).
Finally, the focus on a problem of “bad deflation” in the countries in crisis – as a troubling sign of an economic depression because it aggravates the problem of excessive debt in the short term – in large parts of the international debate appears misplaced to some extent at least. This point of view neglects that low inflation or even deflation is signalling the ongoing painful adjustment process through structural reforms and that low inflation allows the central bank to keep interest rates low. As in the eurozone the negative and positive effects of disinflationary and deflationary pressures interact, Germany should contribute by a stronger growth-enhancing economic policy in order not only to improve its economic growth but also to achieve an inflation rate somewhat above the EMU average in order to make intra-EMU rebalancing somewhat less arduous for the countries still struggling with the crisis (cf. Schneider 2014: 11).

THE CAUSES OF THE CRISIS AND ITS RESILIENT SOLUTION

According to modern ordoliberal diagnosis, the crisis in the EZ has to be addressed at several levels simultaneously due to wrong incentives at the national as well as the supra-ational EMU-wide level. In retrospect, we can diagnose several causes behind the crisis in the EZ: first, the very high public debt levels prior to 2009-10 and their dramatic increase especially in Ireland, Italy, Portugal, Greece, and Spain after 2008-09; and secondly, the increasing divergence (rather than the expected convergence) in the competitiveness of the individual member states. Problems were caused by demanding too much of the available distributional margin based on productivity growth. That implies, thirdly, a failure of national governments to enforce much needed structural reforms to break up the still existing insider-outsider problems, which led to an overburdening of the distributional leeway limit and caused economic distress both for national economic actors and abroad. As one observer has aptly put it: ‘the crisis of the southern European euro countries is not simply a sovereign debt crisis; it is also a growth and competitiveness crisis resulting from insider power’ (Iversen 2013: 77; cf. also Matthes and Busch 2012). This has also been a neglected factor in the current debate; it mirrors the Federal Republic’s experience for some decades after the 1980s, until the German insider-outsider problem was overcome in the context of globalization
and Europeanization, combined with measured reforms of the welfare state (Funk 2000, 2010 and 2014).

The dramatic rise in interest rates for the sovereign debt of the countries in crisis endangered their ability to pay, and the risk of those countries’ insolvency threatened the stability of the entire European banking system with its transnational web of loans. With the help of massive rescue measures that critics in Germany, in particular, regard as out of line with the European treaty on monetary union that was agreed at Maastricht in 1991, it has so far been possible to avoid the insolvency of states and systemically important banks. The justification for those measures – buying time to implement the required structural reforms – was accepted by the governments of Germany and of other countries, and to some extent by the German Bundesbank and the German constitutional court (Deutsche Bundesbank 2012: 22-3; Mody 2014). Nevertheless, this approach meant the gradual substitution of private creditors by taxpayers, whereby the latter are bearing more burdens than are probably justified.

So far, the crisis is by no means finally resolved despite of definite progress in the right direction according to moderate ordoliberals (e.g. Fuest 2014). Potential solutions are still being hotly debated. The countries in crisis need to regain their competitiveness – their ‘national business models’ prior to the crisis have proved unsustainable. The adjustment process must continue, even though the crisis and the adjustment measures taken so far have caused huge losses in the countries particularly affected. A few months of positive economic growth cannot compensate for losses of average per capita incomes between 2007 and 2013 of up to roughly a quarter (Greece) in the countries in crisis, which was and still is accompanied by very high unemployment.

At the same time, public and private debt need to reach sustainable levels, and the banking systems have to be both stabilized in the short term and made sustainable in the longer term. The dilemma is that usually the longer-term resolution mechanisms lead away from other important objectives in the short-term. This explains why
controversies will go on there appears to be no 'ideal path' from the perspective of all the countries and actors involved (cf. details Funk 2015).

Trying to overcome such problems enduringly is at the heart of the German ordoliberal school of thought, which focuses on institutionalizing sanctions against (short-term) misbehaviour or free-riding at the expense of others, as this is likely otherwise to cause ‘revenge’ and thus destroy mutually beneficial gains from economic interactions. If short-term gains hurting others are forgone, in the medium and longer term all actors are usually better off. Taking this into account also explains why German ordoliberals are so reluctant to adopt short-term expansionary fiscal policy to stimulate the economy in a short-term recession, as the result is usually only a passing fancy without lasting positive effects on economic growth or structural (un)employment.

From the German perspective, the pathway taken in the eurozone crisis - pursuing a step-by-step approach of solidarity for stability - was an attempt to minimize (in a situation of huge uncertainty) the costs for Germany, while simultaneously striking a balance between solidarity – since the alternative of strictly applying the EMU’s no-bailout rule was regarded as worse for the countries affected – and putting pressure on the countries in crisis to ensure ongoing reforms at the necessary speed. Although it is often argued that the current problems and potential solutions to them were hardly dealt with at the time of the launch of the euro, it is interesting to see that in the German debate the measures taken now have been predicted roughly 15 years ago by leading ordoliberal inspired mainstream economist: Despite of the no-bail-out clause

“the political pressure for transfers granted by the European Union or by member countries will become perceptible in the future. Thus, if transfers have to be made after all – in spite of liability being excluded – the donor of transfers, as well as the recipient, may develop an interest in keeping these transfers as low as possible, replacing them by a rather lax monetary policy” (Siebert 1999: 224).
Moreover, John Maynard Keynes’ insight in this context must not be forgotten: It should not be a surprise to the participating countries of EMU (to which they voluntarily signed) that the correction of current account imbalances has so far occurred foremost in deficit countries. According to Keynes (prior to the Bretton Woods talks) such adjustment is “compulsory of the debtor and voluntary for the creditor” (Rehn 2012).

For Chancellor Merkel and the finance minister in her two coalitions since 2009, Wolfgang Schäuble, all alternatives to the euro in its current geographic territory have so far appeared to be worse under realistic conditions. Knowing this may explain Merkel’s often repeated and sometimes ridiculed verdict on the issue: ‘If the euro breaks, European integration will also break’ (‘Scheitert der Euro, scheitert Europa’; quoted from Marsh 2013: 20). Economic analysis suggests that the acute dimension of the crisis as a self-fulfilling crisis of confidence with highly destructive potential could indeed have resulted in a break or breaks. The largely German-led crisis management, therefore, based as it was on a “cautious and muddling-through approach towards a permanent solution”, may well have been adequate, and was certainly superior to either the quick exclusion of crisis countries from EMU or the introduction of debt mutualization (Heinemann 2013: 38).

The recent crisis has made the new German SME into a kind of role model for other countries, at least to some extent. In fact, Germany’s leading role in preparing blueprints for structural reforms was based on lessons learned from Germany’s own experience of fighting persistently high unemployment and low economic growth in the past. The ‘Brussels consensus view’ (Hirschel 2013) that has emerged is to a large extent inspired by the pillars of Germany’s SME and by Germany’s recent experience of a turnaround, within a period of few years, from having a lagging and sick economy to being the country with the best recovery in Europe during a time of deep crisis in the EU. According to Finance Minister Schäuble, flaws in the euro-architecture have been amended since the start of the crisis (Schäuble 2012: 17). For him the euro rescue is in the best interests of Germany, if it is done properly: A collapse of the currency union would be substantially more expensive for German citizens than the obligations that
have been made so far in the form of credit guarantees. The loans were only granted under very strict conditions, whose implementation should put the recipients back on their feet economically. Particularly inspired by the German ordoliberal discourse is also the German finance minister’s insistence on “a high priority on ensuring that shareholders and creditors bear the main responsibility for the costs incurred in winding up troubled banks” (Schäuble 2013), that is the importance of manageable and predictable ‘bail-ins’ for all partner involved.

However, the measures that address structural issues (cf. more details Funk 2015, 366) can be summarized as follows (without shorter-term stabilisation mechanisms):

- Unified and effective banking supervision and single resolution mechanism;
- Mandatory introduction of debt brakes and stricter handling of public deficits;
- Implementation of European stabilisation mechanisms initially temporary and then permanently;
- Precautionary measures against macroeconomic imbalances;
- Early coordination of budget and economic policies among member states by European Commission; and
- More effective control of public budgets.

All this, however, can still not suffice to stop a self-fulfilling crisis of confidence, as such a crisis “cannot be contained through an improvement of long-run fundamentals alone” (Heinemann 2013: 39).

This is not to suggest that short-term emergency aid suffices or can substitute for structural measures. Additional sweeping reforms will be necessary despite all the efforts that have been made up till now. In addition to the measures implemented by now the continuing design faults of the original EMU system have to be removed. If full fiscal union is not acceptable in EMU, we still need an answer to the question of the “incomplete monetary union” (Mody 2014), that is how a currency union with sovereign member states can ensure sufficient discipline without in practice abolishing fiscal
sovereignty at the national level. In the foreseeable future, steps towards a full fiscal union are regarded as politically unenforceable (not only in Germany), and alternative institutional mechanisms will be needed to overcome the depression-like fall in real incomes in the crisis countries as well as their ongoing solvency problems. The announcement of the so-called outright monetary transactions in July 2012 was an emergency measure that, in retrospect, has helped to prevent a break-up of the eurozone so far. But no more can be achieved by such a rescue measure (Funk 2014: 321). Despite the Bundesbank’s (and, in February 2014, the German Constitutional Court’s) rejection of the OMTs (Mody 2014, Weidmann 2014), a good number – though most likely not the majority – of German economists regard them as an appropriate emergency measure compared to its alternatives. The promise of the ECB’s president Mario Draghi to do ‘whatever it takes’ to rescue the euro will not deal with the huge remaining solvency problems, as the ECB can only resolve uncertainties with respect to liquidity; in practice, it will act as a lender of last resort for sovereign debt, something many economists (especially outside Germany) regard as a suitable mode of rescue for financial institutions that can be regarded as solvent but have liquidity problems in panic situations, when investors suddenly remove money from financial institutions. The problem remains, however, that this measure can help only in the case of illiquidity of states that are still solvent. If a country is not solvent anymore, however, the ECB’s hands are bound by its constitution. In mid-2014 it became clear that further measures, such as lower interest rates and unconventional measures (in particular asset purchases), would be implemented by the ECB, as a result of very low inflation which it regards as too low compared to its mandate of an inflation rate just below 2% and in order to boost progress towards the structural policy changes needed in some of the crisis-afflicted countries (Funk 2014: 321). At the same time, the German Constitutional Court ruled that the ECB was overstepping its mandate regarding the OMT. On the other hand, it dismissed the argument that the OMT was legitimate because it ensures that monetary policy works well, while on the other hand, disagreeing with the idea that it is the job of monetary policy to avert euro exit. In late 2014 the decision of the European Court of Justice, to whom the German Court passed the case, was pending.
The original ‘no bail-out’ clause has already been replaced, in effect, with a limited joint bail-out fund, following the implementation of the European stability mechanism ESM and the fiscal pact to improve the enforcement of fiscal goals compared with the original SGP and its successor. Further measures will nevertheless be needed, as prior to the crisis fiscal policy in many member states was structurally deficient. Banking union appears to be indispensable in order to get rid of the link between banking crisis and sovereign debt crisis in the eurozone which essentially means breaking the “doom loop” of weak banks and weak governments lending to each other. Apart from the measures already taken, it will be essential to implement a credibly financed joint single resolution mechanism (SRM) for de facto bankrupt large banks. It is widely accepted among German ordoliberal economists at least that resilient solutions to address the problem of the incomplete EMU enduringly and to overcome the crisis lastingly boil down to two approaches only, the centralisation model and the decentralised liability model (cf. Fuest 2014; Sinn 2014).

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<td>(3) Unstable due to the separation of liability and control</td>
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Source: own composition based on ideas of Fuest 2014.
Table 2: Institutional Design options of Fiscal Policy in the Eurozone
The former one is potentially stable but currently and in the foreseeable future politically unacceptable in many member states due to the necessary loss of national sovereignty, as mentioned before. The model decentralized control and liability is economically potentially stable if implemented in a credible way. This model requires that each country takes responsibility for its own debts with its creditors bearing the cost of a default. “Faced with that risk, creditors claim higher interest rates from the outset or refuse to grant additional loans, thereby imposing a measure of discipline onto debtors” (Sinn 2014). Other solutions will prove unstable as they allow free riding at the expense of other nations, which is regularly regarded as unacceptable by some member states. For example, “a situation in which national control over fiscal policy is combined with mutualisation of government debt” will prove to be unstable over time (Fuest 2014: 14). In other words, not only according to ordoliberal thinking ongoing mutualisation will turn to be dynamite, not cement for a new more resilient architecture of the EZ (cf. Sinn 2014).

CONCLUSIONS

In many member states of the EZ the economic and fiscal policy remained suboptimal and had considerable influence on the highly divergent economic development in the single states of the euro zone. In this light, the focus of the German Government as well as of international institutions such as the OECD, the World Bank, and the IMF on the need for meaningful structural reforms seems justified. Apart from accepting inevitable emergency measures, this strategy was inspired foremost by ordoliberal ideas. Simplistic Keynesian recommendations all too often leave unanswered the key question how the troubled countries’ structural problems can be resolved lastingly. The evidence also suggests that domestic structural reform efforts often tend to decrease as soon as immediate pressure to reform is evaporates that is, for example, as soon as more foreign aid is made available without conditionality.

Furthermore, it must not be forgotten that the debt crisis has also left the German economy vulnerable (cf. e.g. Gros 2013). The following statements explain the problems
succinctly: "... Germany's economic power and financial strength is overstated. Germany remains dependent on its neighbours, with 69 per cent of total exports going to European countries, including 57 per cent to the member states of the European Union" (Das 2013). The author further adds with respect to the EZ countries in crisis as far as they prove unwilling to reform sufficiently: "Continued weakness in these troubled countries will affect German economic prospects. ... Peripheral countries will be forced to rely on the European Stability Mechanism and European Central Bank to provide financing directly or indirectly via cheap funds to banks to purchase government bonds which will be used as collateral for the central bank loans. National central banks will also use the “Target 2” payment system to settle cross border funds flows between eurozone countries financing peripheral countries without access to money markets to fund trade deficits and capital flight. Over time, financing will become concentrated in official agencies, the ECB and national governments or central banks. Risk will shift from the peripheral countries to the core of the eurozone, especially Germany and France."

Considering also the current weaknesses of France and Italy as well as Germany’s own dependence on growth in the world economy, the pressure will probably be especially big for Germany which could potentially be “getting too weak to pull Europe out of its crisis” (The Economist 2014). It might prove to be too small to bear such burdens with negative consequences also for the countries in crisis. Moreover, the benefits must not be forgotten

“that accrue to the rest of the euro area when at least one of the region’s anchor economies is exercising budget discipline. Berlin’s careful management underpins Germany’s commitments to stabilize the rest of the euro zone. France and Italy, let alone Greece, would not be financing their own budget deficits on as favorable terms if Germany also were spending and borrowing indiscrimately” (The Wall Street Journal 2014).
At the same time a certain German caution in promoting public investment at the expense of consolidation is understood even in parts of France. While it is true that due to the crisis public investment has been very low since the start of the crisis and that currently at low interest rates it appears easy to find investments whose returns appears to be higher, this does not necessarily imply that existing excess savings in the EZ due to a current account surplus largely from Germany should be used for public investments rather than “to reduce fiscal deficits (and to virtually wipe them out by 2017) and to stem the rise in public debt ratios and the reduce them” (Artus 2014b: 1). This is because inefficient investments may burden future budgets and because it is unclear whether the return on public investment really exceeds that on corporate investment which could be promoted instead. Finally and often forgotten but definitely also in line with the ordoliberal view is the following statement: “The existence of useful public investment does not exempt governments from needing to stop financing public transfer spending with debt; it should only be financed by taxes since it does not generate income in the future” (Artus 2014b: 1).

It has to be noted also that it remains unclear why reckless behaviour foremost of political and business elites in beneficiary nations is hardly addresses by the critics of Germany even though the risks and duties that the fiscally healthier countries have to bear are much bigger than was signed in the treaties to implement EMU and much higher than the stabilisation packages that the academic critics of the current rescue packages usually are planning to spend on the countries in trouble if they exit under emergency pressure. Why did the now troubled countries not prepare appropriately in good times for potentially worse times in the apparently dangerous belief that fair weather periods last forever? Furthermore: Why is it hardly mentioned by critics that even the current allegedly too strict approach to help the troubled nations has already been a very delicate balancing act for Chancellor Merkel. For example, apart from the emergence of a new anti-Euro party, the Alternative for Germany (AfD) that did quite well in European and some regional elections, she has been fiercely attacked by many leading German academic economists and law professors for allegedly acting irresponsibly for at least bending of legal clauses and thereby hurting German interests.
And finally: Despite of the criticism of the German strategy by leading Keynesian-inspired US-economists in particular, it must not be forgotten that other leading US-Noble prize winners have supported the strategy inspired, above all, by Germany’s ordoliberal heritage (Phelps 2012, Spence 2011).

Taking all this into account it is difficult to understand or justify the often imbalanced nature of the debate despite of the fact that it pretends to be of an academic nature. Nevertheless, instead of having growth-hampering reforms on its agenda at home, Germany’s current government could pursue more vigorously efficiency-enhancing structural economic policies that would serve both the economic well-being of Germany by increasing its growth potential and the crisis-affected countries by supporting the troubled nations’ economies (e.g. as suppliers to German exports) to some extent. This might also reduce the kinds of criticisms of Germany that this chapter has highlighted and “take critics the wind out of the sails” (Konradt 2014: 499); and such reforms might simultaneously address foreseeable future problems for Germany.

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