The Timing of Politics and the Politics of Timing

Wade Jacoby[1]

This chapter is the first of three in this volume addressing the future of the euro. It uses Germany as a prism for the large and sprawling discussion about what might be done next. Researching the future—always a challenging task—is made harder when multiple state actors contend for prominence on the basis of shifting coalitions at home, all while interacting at an international level. That said, almost everyone accepts that German choices will play the central role in the path ultimately chosen. This chapter thus foregrounds Germany's role in shaping the way ahead.

Any discussion about that way ahead presumes some effort to understand how we got where we are. Much analysis of Germany's behavior during the slow motion unraveling of the Eurozone has dwelled on the perplexities of Germany's modest response to a crisis of frightening proportions. Why has the biggest state so often had the smallest imagination? When not being charged with economic illiteracy (see Jones, 2010)[2] or a sadistic streak (see Shaw 2013), the general explanation for Germany's conservative, cautious, and incrementalist policies generally have been either ideological—with a heavy emphasis on the importance of ordo-liberal thought (Silvia 2011; Dullien and Guerot 2012)—or institutional—with the emphasis on ministerial prerogatives, federalist veto points, or active checks from the Constitutional Court (Zimmermann 2012).

---

[1] I thank the Department of Political Science at Brigham Young University, the Austrian Marshall Fund, and the SAIS Center for Transatlantic Relations for research support.

[2] Adam Posen's comment that 'Merkel does not get basic economics' was widely reported. See *Spiegel Online International*, March 31, 2009. http://www.spiegel.de/international/world/us-economist-adam-posen-merkel-does-not-get-basic-economics-a-616561.html

This chapter adds an electoral dimension to Germany's policy responses. Indeed, while almost nobody abroad is happy with German policy, almost nobody at home is upset with it. Angela Merkel's approval ratings run 36% ahead of her opponent, who, in any event, offers little substantive alternative when it comes to policy towards Europe. But the chapter goes beyond considering merely 'what voters want', for here, as so often, they want many things all at once. German voters overwhelmingly wish to stick with the Euro (about 2:1 in summer 2013), but they also support other policies—particularly austerity—that leave the Euro highly vulnerable. Rather than merely stressing the obvious point that German voters are conflicted and confused, I broadly follow Pierson (2004) in injecting an element of 'time' into what are too often otherwise static considerations of German policy.

I do so by considering both the 'timing of politics' and the 'politics of timing.' In the former consideration, while German policymakers accept the need for a massive intervention in sovereign bond markets of other Eurozone members, they want to pick the optimal time of intervention to maximize the efforts of private actors and deter public and private behavior that might require more bailouts in the future. Their central focus is on moral hazard, and their aim is that their political choice—to save the Euro—come at the 'right' time. In the latter consideration, a concern about the 'politics of timing' means that German elites also feel they cannot intervene until they have properly prepared their voters. However, by the time elites have sold a bailout of a certain envisioned size to their voters, the problem has grown such that this size is no longer adequate to the job. Here, the elite focus is centrally on the legitimacy of their policy choices. Adding to the difficulty, if one focuses primarily on the timing of politics, then patience is a virtue, and elites should wait and minimize future moral hazard concerns. If one

focuses primarily on the politics of timing, however, then patience is a vice, as windows of opportunity for stemming the crisis slam shut, one after another. The broad point of the chapter is that the first concern has always won out over the second.

In simplified form, the argument of this chapter proceeds in three interrelated steps. First, a fundamental and still very much unsolved problem in the European economy consists of imbalances in both trade flows (Bibow 2013, Scharpf 2011, Jacoby 2011, Dullien and Fritsche 2009) and financial markets (Jones, this volume). Second, while these imbalances contributed to the crisis in the Eurozone, their resolution—such as it is—has depended primarily on adjustment in the peripheral countries. Meanwhile, Germany, having benefited once as the imbalances accumulated, has benefited again from their subsequent consequences, including the 'flight to safety.' I call this 'Germany's exorbitant privilege' (c.f., Eichengreen 2010). Together, these benefits create conflicting pressures. On the one hand, there is a strong bias toward the status quo that has benefitted Germany so handsomely. On the other hand, there is a clear recognition that others in Europe are struggling and the Euro, and its benefits to Germany, is in danger. Germany resolves this dilemma by innovation on the institutions of Euro-area governance flanked with a ferocious defense of fiscal austerity and structural reforms. In other words, Germany's exorbitant privilege has helped prevent the rise of an alternative discourse and justified policies that suppress growth in other states. Third, with the taming of the German boom and the onset of the 2013 electoral campaign, we have reached an impasse. Yet the electoral impasse only mirrors a deeper impasse: Germany cannot run persistent trade surplus, avoid meaningful fiscal transfers, and still have a monetary policy with an independent central bank and a no bailout-policy (Bibow 2013). As both the Eurozone and emerging market

growth slows, the pain is hitting Germany.

The rest of the chapter proceeds as follows: The first section acknowledges the importance of ordoliberal ideology but denies it can explain German behavior. The second introduces frustrations with Germany's pace of reform, an ongoing issue in the chapter. The third develops the data on imbalances and explains the dominant 'timing of politics' dynamic. The fourth explains Germany's exorbitant privilege. The fifth section discusses why the current hopes for banking union are unlikely to deliver the Eurozone from its troubles. The sixth concludes with gloom, though not despair.

Ordoliberalism: We can't Explain Diversity with a Constant

Many authors have stressed ordoliberal thinking as a key explanatory factor (Silvia 2011, Dullien and Guerot 2010). There is no doubt there is such an ideology and that it has a profound and pervasive influence in Germany. For example, Schieritz (2013) shows that the dominance of ordoliberal thinking extends well beyond economics departments and encompasses also media and politics, with the *Frankfurter Allgemeine Zeitung* coming in for particular criticism as the enforcer of orthodoxy in the political class. In particular, German voters cannot draw a distinction between increases in money supply as a result of central bank activity and effective increases in money in circulation, which would be required for inflationary impulses. That much of the money created by the ECB remains parked in bank accounts has thus not penetrated the domestic discourse (nor indeed that inflationary effects generally would still require non-existent supply constraints to raise prices).

Yet while ordoliberal ideology is very important in Germany, it cannot adequately

explain German responses to the crisis because ordoliberals are on all sides of every debate. Ordoliberalism is an incomplete theory of economic life whose most important insights and axioms are used quite inconsistently in the German debate.[3] Thus, while invoking ordoliberalism is popular in explaining why German responses differ from those of other states, this explanation appears to underdetermine outcomes. Ordoliberal principles—never completely worked into a full theory of the economy—are invoked in *all* parts of the German debate.[4] Indeed, the June 2013 oral arguments in Karlsruhe often witnessed the government invoking ordoliberal principles of rule-making in defending the ESM while its attackers invoke ordoliberal principles as well.[5] The leader of the new Euroskeptical party *Alternative für Deutschland* is a longtime CDU member and professor economics, and some CDU members of parliament, such as Klaus-Peter Willsch, continue to insist that the government is unwisely breaking with core ordoliberal principles. Constitutional Court debates on the Euro have often pitted opponents and proponents of rescue instruments. Some ordoliberals wish to rescue German banks (or at least not hasten their decline by allowing the ECB to find more problems than it can fix); others would prefer to liquidate the weak ones sooner rather than later.

One way to read the ferocious debate *among* ordoliberals revolves around the concept of 'stability,' a word obsessively invoked by the Chancellor.[6] This ritual invocation hides

---

[3] Some inconsistencies can be traced back to original Hayekian formulations (Bronk 2013; Blyth 2013).

[4] Beyond the indeterminacy of ordoliberalism when it comes to detailed matters of institutional design, there is the additional point that not all German thinking is ordoliberal. While it is true that Keynesian economics is underrepresented in the German academy, it is not true that the German debate takes no account of the criticisms of an 'austerity only' approach to European reform (Dullien)

[5] See, for example, the interventions of Berlin Public Finance Professor Markus Kerber.

[6] German politicians throw around the word stability like American ones throw around freedom (Foner 1999).

considerable differences in meaning. For some, stability requires the old rules be followed. Stable policy will bring stable, positive outcomes. For other, however positive the old rules were, we now confront a situation where following them will break the euro *and this would not be stable*.[7] Thus, stability is used by both sides but to back substantially different reform proposals. To exaggerate for sake of clarity, one camp defines stability as the continuity of core German practices of political economy as extended to the European level through an independent European Central Bank, the Stability and Growth Pact, and the no bail-out clause. Policy 'innovations' are to be feared since they threaten the recipe for economic success at both regional and national levels. If this camp defines stability as 'saving the institutions,' the other camp defines stability as 'saving the euro.' Policy innovation is critical since, whatever the success of German policies at the national level, other European states have been unable or unwilling to make them work.

Even though Merkel talks about exporting Germany's 'stability culture' along with its rules, we know that institutional transfer is not a matter of culture. Jacoby (2000) shows that Germany could not export pure ordoliberal rules to Eastern Germany. In fact, a variant of this same fight happened in Eastern Germany where, for example, the practice of nationally-binding collective bargains pushed up wages to a level that sparked mass layoffs and a wave of bankruptcies among low quality post-socialist firms. The choice was either to keep the rules and destroy the entire economy or search for a flexible solution that invented new measures. This experience showed, to those with eyes to see, the impossibility of pure ordoliberalism in an

---

[7] This appears to be Draghi's position. In announcing in July 2012 the possibility of extraordinary steps, he implied it was appropriate to imply that the ECB's 'mandate' demanded that it do 'whatever is necessary' to preserve the Euro. If the Euro failed, this would not be in keeping with 'stability.'

economy not already attuned to these practices.[8]

This dilemma of saving the institutions or saving the currency union flows directly into a broader debate about German assistance for other members of the Eurozone. Here, there are three basic positions: First, Germany is economically healthy, and some other European states are not, so Germany should help them. This formulation has both a self-interested and an altruistic inflection. The latter version is most familiar as the straw man position in the populist *Bild Zeitung*, but the former version is much more common: Germany has a huge investment in the Eurozone and can and should make a substantial contribution to its survival. The second position is that Germany is economically healthy, and others are not, so Germany should *not* help. Again, there is both an economic case here – the ‘why sink the rescue boat?’ argument (Sinn 2012) – and a more normative economic Calvinism case in which the culpable must pay the wages of their sin.[9] Third, Germany is not economically healthy either, and is in no position to help anyone. For example, Das (2012) argues Germany will be ‘the biggest loser’ of the Eurocrisis and puts the total German exposure at €211 billion to the EFSF and another €600 billion to TARGET2 and suggests Germany’s combined obligations will swamp its economy and damage its creditworthiness.[10] So far, the German consensus has been around the first position—‘help’—but the subsequent question has been *what* to do.

---

[8] See Newman (this issue) shows, for more on the ways in which the unification experience shaped Germany’s response to the Eurozone crisis.

[9] Merkel herself has spoken of countries that have to ‘pay for their past sins.’ That this is a line she’d love to have back does not diminish the importance of its sentiment for German thinking on the crisis.

[10] http://www.eurointelligence.com/eurointelligence-news/comment/singleview/article/the-euro-zone-debt-crisis-we-need-to-talk-about-germany.html

Do Something!

Germany is beset on all sides by those who would have it 'do something!' The exhortations began with heads of government in Europe's Mediterranean periphery, and extended to Hungary's socialist prime minister in 2009[11], Poland's liberal foreign minister in 2011[12], the US president[13], Italian prime minister and ECB President in 2012[14], and the European Commissioner for financial matters in 2013[15] Some of this criticism is also present in the domestic debate. For example, in April 2010, Joschka Fischer's Dusseldorf speech lamented Germany's waiting on IMF approval before assisting Greece. Fischer paraphrased Heine: '*Denk ich an [Europa] in der Nacht, bin ich um den Schlaf gebracht*.'[16] Vaclav Klaus, a very different politician, expressed in Berlin the next day a similar concern about German dithering. Helmut Schmidt's 2012 *Parteitag* speech blasted the German government for not noticing or not caring that its policies were tearing Europe apart.[17] Thus, there has been concern across the political spectrum, the European continent, and even the Atlantic.

In the crosshairs of these complaints, one can forgive the Germans for feeling wounded and defensive (e.g., Schwarzer and Lang 2012). Most obviously, Germany *has* done 'some

---

[11] http://www.washingtonpost.com/wp-dyn/content/article/2009/03/01/AR2009030100389.html
[12] http://www.economist.com/blogs/easternapproaches/2011/11/polands-appeal-germany
[13] http://www.spiegel.de/international/europe/german-finance-minister-rejects-obama-criticism-of-crisis-management-a-840749.html
[14] http://www.bloomberg.com/news/2012-05-31/merkel-s-isolation-deepens-as-draghi-criticzes-strategy.html
[15] http://online.wsj.com/article/SB10001424127887324879504578601780260101590.html
[16] A loose translation: 'when I dream of Germany in the night, instead of sleep my mind feels fright.' http://www.youtube.com/watch?v=1g7AP2Qrrn4 (the talk is split in two).
[17] http://www.youtube.com/watch?v=CHhu3zsGdWw

things.' Schelkle (2012), Zohlnhoefer (2011), and Bergsten and Kirkegaard (2012) show Germany has done at least an average amount on the fiscal side compared to the rest of the OECD, especially when compared to the rhetorically activist but fiscally constrained France (Schwarzer 2013; Vail, this volume). Moreover, essentially non-stop summitry since spring 2010 has left an impression in the minds of many German voters of well-nigh frenetic German activity.

It is, however, hard to say *exactly* what Germany has done. Partly, this is down to the proclivity for European leaders to 'repackage' what they had already pledged in prior discussions. This criticism can certainly be leveled at the lengthy search for a new set of fiscal rules for the Eurozone states, but it also applies to the emergency bailout packages negotiated to date. Each summit grinds out new pledges that, upon closer inspection, are composed substantially of old pledges (Mabbett and Schelkle 2013).

Voters are confused. Estimates of the size of German commitments vary wildly. As an intermediate starting point, one could look at the €190 billion figure cited by the German Constitutional Court in its decision to allow the European Stability Mechanism.[18] On the other hand, by stressing Germany's TARGET2 liabilities of around €600 billion, Sinn (2012) claims German exposure amounts to $1.3 trillion. Yet since Germany's primary tool has been loans rather than grants and since the loans—apart from bilateral loans to Greece of €53 billion in 2010—have all been raised on the markets, it is impossible to know what Germany's true exposure is. In mid-2012, *Business Week* reported that only about €15 billion out of Greece's €340 billion in loans came from Germany, though other sums did come from international

[18] The Court said Bundestag approval would be required for any increase above the €190 billion (of the ESM total of €500 billion) already committed by Germany.

organizations that Germany is party to, including the EU and the IMF.[19] At the extreme, Reuters notes that none of the 'northern' European states have paid a single Euro in aid at this point.[20]

With voters anxious and confused, German policy elites confront European economic problems with several broad and generally reasonable (though not always explicit) assumptions in place: 1) Germany must help because it is the indispensable nation in addressing Europe's economic woes; 2) Germany's own economic and leadership capacities are finite; 3) Germany itself could be damaged by ill-designed rescue efforts; 4) German voters can be made to understand the first point—Germany is indispensable for crisis resolution—only if it is reassured the government understands the second and third points. In simple terms, the logic – shared across wide swaths of the German elite – can be encapsulated in these four ideas: Germany can do some important things. It cannot do everything. The rescue cannot be allowed to mortally damage the rescuer. Whatever Germany does must bear public scrutiny. The next section shows how these apparently sensible parameters have buttressed a reform argument that cannot work.

The Imbalances Problem

Blyth (2013) shows that in both the United States and Europe, a quintessentially private banking crisis has been rhetorically transformed into a crisis of 'public' debt. In an analogous but also complementary fashion, Europe has seen its substantial current account imbalances—again, phenomena that have their primary roots in private consumption and savings choices—recast as

---

[19] http://www.businessweek.com/articles/2012-05-24/bloomberg-view-germanys-banks-must-assist-in-europes-cleanup

[20] http://uk.reuters.com/article/2013/05/02/uk-eurozone-bailouts-idUKBRE9410C920130502

crises brought about almost exclusively by faulty political choices, whether of levels of government consumption or improper regulatory coddling of inefficient private producers. No country has done more than Germany to promulgate this understanding of the enduring economic misery in Europe. This understanding justifies a view that German *advice* must be followed before German *money* can do any good. At the same time, German officials have been keen to downplay new and more sober limits on financing current account imbalances as an independent source of stagnation. This section of the chapter explores the implications of Germany's strong and sustained trade surpluses for the politics of crisis resolution—implications that are likely to persist in some fashion going forward. On the 'strong and sustained' claim there can be little doubt. By 'sustained', I mean primarily that Germany has run a goods surplus *every single year* since 1951; by 'strong', I mean that this surplus was below 2% of GDP in only five years since 1950 and has been as high as 8%.

The basic idea behind this 'imbalances problem' is relatively straightforward and, by now, well understood: as global liquidity increased in the early and mid-2000s, a significant amount flowed to Spain, Iceland, Greece, Portugal and other states where, despite rapid convergence in interest rates with Germany and others, somewhat higher yields were available (Blyth 2013). These capital inflows contributed to strong asset bubbles (Spain, Ireland), surging demand (Italy, Greece, Bulgaria), or both (Estonia, Latvia, Portugal) (Scharpf 2012; Jacoby 2013). They also created permissive space for steady rises in unit labor costs, even as Germany's stayed flat (Bilbow 2013). As competitiveness eroded in these states, current accounts went heavily into deficit, which required additional capital inflow (Bastasin 2013). Meanwhile, Germany's deep strength in high quality manufacturing goods whose purchase was

enabled by such liquidity provision led to sustained export booms in several manufacturing sectors.[21] As loose monetary policy in the US and Europe boosted liquidity, initial German advantages in intra-European competitiveness were magnified, while the fruits of that competitiveness were recycled back into those countries requiring higher financing to sustain growing levels of consumption.[22]

As noted, German officials resolutely deny that the surpluses of German manufacturing are a cause of the build up of debt in the European economies.[23] There are two important consequences of the German denial that its permanent surpluses are a problem. The first is that it tends to lead German officials to overestimate the potential of their alternative solutions in *substantive* terms. The second is that it leaves Germans deeply uncertain about the timing of reforms in *procedural* terms. This section treats both issues.

In substantive terms, the current German government has an interest in maintaining the narrative that the Eurocrisis is one of public debt since the alternative interpretation—that it is driven in substantial ways by underlying trade imbalances—is an explosive one. Since trade deficits generally have to be financed by private debt, the alternative narrative opens Germany to the charge that it is private debt, not public debt, that most determines the problems in the Eurozone. This is why debates in the German Bundestag contain constant references to Greece—where the narrative of public profligacy is easy to substantiate—and few references to Spain, which had low debt-GDP levels and was running a 4% budget surplus at the onset of the

---

[21] By contrast, Germany's service sector is not terribly competitive. Its last surplus was in 1961.
[22] For a characterization of Germany as Europe's 'Company Store', see Jacoby 2011.
[23] For a representative effort to deflect these criticisms, see Foreign Minister Guido Westerwelle's Paris speech.
http://www.auswaertiges-amt.de/DE/Infoservice/Presse/Reden/2013/130524-BM_Le_Monde.html

crisis.[24] If Greece didn't exist, the CDU-FDP coalition would have had to invent it, it plays an essential rhetorical purpose. Indeed, in a way, the populist *Bild Zeitung* has already 'invented' a Greece that consists almost exclusively of corrupt public officials and a private sector awaiting its early retirement.

In addition to public debt, the German government also stresses a substantial competitiveness gap between Germany and others. This gap is said to result from unrealized structural reforms in the weaker countries, and the German government routinely references prior German reforms as a positive model. Yet Germany's own experience with structural reform in the boom period of the early 2000s is likely to be an exceptionally poor guide to such reform during the post-2008 bust (Bastasin 2013). It is far easier to undertake structural reforms in a time when trading partners experience surges of growth since painful dislocations are quickly compensated by new employment. Moreover, the major German reforms of the early 2000s were accompanied not by state austerity but instead were conducted in a period in which Germany was breaking the Stability and Growth Pact rules with debt levels above 3%. German voters seem to elide both of these facts—first, that structural reform paid faster dividends when regional growth was strong and second that such reforms were not accompanied by austerity but indeed by its opposite. Certainly, Germans have limited appetite for cutting government spending at home. In a 2013 Pew poll, German respondents were

[24] Most references to Spain are from the Left Party, which has not made electoral headway with the argument that the suffering in the Eurozone periphery is linked to Germany's export dominance. Those ordoliberals who now hope to see Germany use a different currency from Spain, Greece, and Portugal also stress the enormous suffering in the South that is a predictable consequence of clinging to a common currency and forcing all adjustment through domestic wages, prices, and employment (Sinn 2012, Kestler). In that sense, the German left and right have made very similar arguments, while the rest of the nation 'plugs and shrugs.'

second only to Swedish ones in approving current levels of their government's spending (GMFUS 2012, chart 10). This is good news insofar as Germany is not practicing even more extreme levels of austerity, but it tends to make Germans appear hypocritical in the eyes of other Europeans. Statements like CDU Chief Whip Volker Kauder's that, 'Europe now speaks German'[25] add to this triumphalist tone while ignoring the fact that Germany's sinking debt-GDP ratios have come more from strong growth than from austerity, while rising rates in the periphery come despite sharp cuts in government spending.

Meanwhile, Germany's policy prescriptions have powerful unproven assumptions. Take the assumption that government austerity does no great harm to general levels of economic activity. There is good evidence, however, that the effects of state austerity on growth are contingent. In a period of normal growth, the effects of austerity might be low, 0.2-0.4% as estimated by the IMF. This means a 1% cut in public spending equates to a 0.2-0.4% decline in GDP. And yet when monetary policy is not playing an active role, the effects of cuts in public spending may be much higher, from 0.9-1.7% according to recent IMF estimates (2012). The latter figure accords also with historical evidence from the Great Depression—the last time that monetary policy put interest rates at or near the zero lower bound—and suggests a figure of around 1.6% (Almunia et al 2010).

Would an alternative German government behave differently? In the short term, probably not. It is true that under a 'Grand Coalition' that included an SPD Minister of Finance, the German government in 2008-2009 had its own 'Keynesian moment' (see Vail 2010; Farrell 2010; Blyth 2013). However, the fact that German stimulus spending was right at the OECD

---

[25] http://www.presseurop.eu/en/content/article/1194641-myth-german-economic-discipline

average was already belied by a clear reluctance of both parties to talk openly about stimulus. In late 2010, there was a very short-lived effort by the SPD to propose a version of Eurobonds, but this quickly died. (Steinbrück and Steinmeier 2010). Rhetorically, the SPD acknowledges the imbalances issue. For example, party chair Sigmar Gabriel stated in December 2012

> It is not about having more Europe. It is about a different Europe, a Europe where innovation and competitiveness are actively promoted, and where one doesn't simply believe that markets will do it, a Europe in which Germany does not use low wages and low taxes as a weapon against the competitiveness of its neighbors.… Of course the imbalance in Europe, especially our current account surpluses, are one cause of the problem (Bundestag Drucksache 17/214: 26201).

The problem is that the party understands this is an electorally dangerous message. The 2013 SPD Party Conference virtually ignored the European issue, which has played essentially no role in the campaign.

Meanwhile, the German government treats the undeniable fact of significant imbalances as an irrelevance, posing rhetorical questions about whether Germany is expected to produce inferior goods as a way of 'solving' the imbalance issue. Given the imbalances noted, the intransigence of the German government, and the modest alternative agenda developed by the opposition, the scope for policy reform has been limited. More precisely, whenever Germany has innovated on the monetary policy side, it flanks this with stubbornly conservative policies on fiscal and structural issues.

That said, it would be a mistake to charge Germany with pure obstructionism (Beck 2013). Rather, the German dilemma in facing the prolonged European financial and economic slump is that they want to intervene neither too early, nor too late, neither too big, nor too small. Their reasons are easily understood from within the ordoliberal paradigm. If they are too early,

they fear they will exacerbate moral hazard problems. If they are too late, they increase the odds of contagion. If they are too big, they put German taxpayers on the hook for costs that others could and should bear. If they are too small, they run the risk of using up their 'powder' in an ineffective intervention. Thus, throughout the crisis, German elites have sought to convince German voters that they have a package that is both *timely* and *appropriate*. They have to be 'in the right policy place at the right time.' If they can do so, they will have public support to put Europe on a better track. To date, however, the government has stayed consistently 'behind the curve,' a metaphor that German policymakers themselves have often employed.[26]

The basic political economy of these four scenarios deserves explication. The 'too early' fear is that rent-seeking machine politics in the Eurozone periphery will not change their ways if rescue comes too quickly. German patience thus increases pressure for reforms. This scenario imagines the German state pitted against supposedly 'austerity-weary' peripheral states in an epic game of fiscal chicken. To blink is to endure another round of a self-reinforcing dynamic in which peripheral governments resist the hard reform choices. These themes—modified only slightly for polite public discourse about one's partners—are a staple of Chancellor Merkel's periodic reports to the German Bundestag. She speaks of the need to export Germany's basic 'stability culture' to the rest of Europe and of the urgency of structural reforms that have been too long delayed. Germany, the Chancellor argues, is prepared to take extraordinary steps to flank these domestic reforms, but the central reform agenda lies, in her

[26] For some (e.g. Beck 2012), German delay has, itself, been a tool for exercising power. While this chapter does not deny that German delays can increase the desperation of their European partners to find a deal and thus lead to terms more confortable for Germany, the stress here is on Germany's own dilemmas of disorientation.

telling, inside the Eurozone states in trouble.

The 'too late' fear is that financial markets will lose confidence in those peripheral Eurozone governments and make the rescue more expensive than it would otherwise be. In the worse case, the rescue would be too expensive to contemplate, leading to a Euro breakup. This scenario posits the right policy combination will secure or restore investor confidence. Germany long betrayed little obvious concern with this problem. Indeed, for the first two years of the Euro crisis, Germany's obsession with retooling the Stability and Growth Pact into the so-called Six Pack and other fiscal surveillance measures seemed to side-step the necessary measures on the monetary side (Mabbett and Schelkle 2013). As predictions of a Euro break up multiplied in summer 2012 and bond rates for Spain and Italy approached 7%, the 'too late' fear began to take precedence. With Merkel's blessing of the Draghi proposal for OMT in summer 2012, the fear of 'too late' gained the upper hand over concerns about moral hazard, at least temporarily (Gros 2013).

Germany's 'too big' fear is that the member states might agree, out of fear, on a massive intervention when a smaller, more targeted one would be preferable. The political economy revolves around some of the same rent-seeking fears from the periphery that were present in the 'too early' scenario. But here there is an additional worry that certain moves might work to the benefit of a few large banks but have relatively little beneficial effect for the rest of the European economy. In the worst case scenario, banks are given 'too big' a boost, and they sit on it such that it still makes no appreciable difference to the regional economy, though it may make one or another balance sheets more healthy (Admati and Hellwig 2013). In the German context, the Ministry of Finance experts' report on 'strategies for an exit' of the federal

government from 'crisis-induced participation' in banks crystallizes these concerns (Expertenrat 2011).

Finally, the 'too small' fear is focused on investor confidence and posits that while large interventions may shock the system back towards a virtuous circle, small and medium interventions only eat up potential rescue resources without actually fixing the core problems. This became known as the 'bazooka' debate, in which various EU-level rescue measures were judged inferior and inadequate.[27] A second incarnation of the 'too small' fear is that some form of mutualization of new debt—for most Germans, an already worrisome possibility raised in the 2012-13 discussion around banking union—might still be inadequate to relieve states of the crushing burden of older debts. Thus, while very expensive, some mutualization of future debt might be largely irrelevant to solving the ongoing Eurozone problems.

Different combinations of these anxieties have surfaced repeatedly in the German debates. Hans-Werner Sinn has worried that is possible to go both 'too big' and 'too early' and, as a result, reward both rent seekers at home (mainly the banks) and abroad (mainly peripheral state governments) at one and the same time (Sinn 2013). 'Too big' and 'too late', by contrast, would likely allow some exposed counterparties to benefit from 11th hour desperation on the part of the government (Admati and Helwig 2013). Meanwhile, the logic of 'too small' is not rent-seeking but rather that it is merely symbolic behavior. This opens the way to different flavors of ineffectiveness, depending on whether the 'too small' is 'too early' or 'too late.' For example, the important effect of 'too small' and 'too early' is to raise the number of market participants that hope for a bailout and, by sending confusing signals, increase the

[27] A dated and bizarre metaphor since the bazooka is no longer a particularly fearsome weapon and given that the original, highly visible weapon often got the operator killed for his troubles.

subsequent hold up problems. This has essentially become the mainstream German view of the May 2010 Greece package, which failed to include bail-in mechanisms and is seen to have set the wrong signal going forward that states would bear the full burdens of bank rescue.

Stepping back from these varieties of anxieties, Germany's main challenge is that it does not have the resources to experiment and to get the rescue wrong in a big way and still have the capacity to come back and try again. This was already true during the period in which its growth and employment performance diverged wildly from other Eurozone members, and it is even more evident in times when its growth is far more modest. Whatever its strengths, it must choose very carefully the time and modality of its intervention.

In sum, German voters are completely ignorant of the imbalance problems in the European economy. German leaders have celebrated export success for so long that they have no effective vocabulary for problematizing export success, even if they were inclined to do so. In any event, they are not so inclined; acknowledging imbalances might threaten to shift some of the burden of adjustment to Germany as a matter of a fundamental course correction. Instead, German leaders have much preferred to contemplate various forms of assistance to manage the effects of imbalances but without taking steps to correct the imbalances themselves. To the extent Eurozone peripheral countries' current accounts have recently come back into balance, this is due far more to import declines than to export gains.[28]

Thinking Slow and Fast: German Patience and its Exorbitant Privilege

To an extent, the claim that German officials have been resistant to fundamental changes in

---

[28] And does nothing to address a near-decade of accumulated debts.

German policy is contradicted by the many Eurozone policy innovations that have already been tried with German support and sometimes its leadership. It's certainly not correct to say that Germany gets whatever it wants in EU summits. In fact, time and again, Germany has moved off of its initial positions—whether that was authorizing and then expanding the European Financial Stability Fund (EFSF), making it permanent with European Stability Mechanisms (ESM), later allowing ESM to participate in direct bank recapitalization, allowing ECB purchases of government bonds on the primary and secondary markets (Securities Market Program), or agreeing to Draghi's line to do 'whatever it takes.'

As a consequence, the outcome to understand is not German rigidity in any absolute sense. Instead, the pattern has been that the more institutional ground Germany cedes on the monetary side, the more determined it grows to exact changes on the fiscal and structural side. This is an underdeveloped insight in the literature so far, and it helps explain why we have the strange combination of frustration and even rage against ordoliberalism outside Germany and the despair of ordoliberals inside Germany. Every time there's a new concession on one side, Merkel doubles down on the calls for fiscal rectitude and structural reform—calls that cannot all be met in electoral democracies. By flanking her institutional concessions in this way, Merkel has, so far, kept both the Constitutional Court and the voters on her side.[29]

Notwithstanding these policy innovations, a hallmark of German policy has been slow and deliberate measures (Beck 2012). This pattern was most pronounced with the long run up to the German elections in September 2013, but it was visible long before then. This section

[29] Most observers expect another 'yes, but' decision from Karlsruhe that allows government policy to stand but adds some additional restrictions or qualifications. That said, the Court's questioning of the government position was notably sharp in the June hearings.

makes two points. First, it analyzes four coherent reasons for German delay and identifies actors Germany has expected to take the lead on reforms. Second, it makes the point that Germany began reaping unexpected benefits of the crisis—what I call its 'exorbitant privilege'—that actually made it harder to embrace a shift away from the status quo, further cementing this politics of delay.

Citizens of the countries most afflicted by the Eurozone crisis are desperate for relief, but German policy has stressed incremental reforms of the Eurozone framework and, especially, the deeper constitutionalization of fiscal balances already agreed in earlier periods. Why the slow, painstaking reinvention of fiscal wheels when the problems evidently lie so much deeper? The German government has had several aims in buying time, such that the slow pace of reform is overdetermined. To be clear, the German government would love to solve the Eurocrisis and has, at times, clearly been desperate to do so. But it judges that no available options are superior to the course it has chosen, and that course, because it requires very extensive adjustment in the peripheral states, is understood to be a long-term project.

First, the most commonly-invoked rationale for delay is simply that the fundamental reform impulses must come from the states whose financing models are most under threat. That is, the German delays ramp up—or at least fail to relieve—the reform pressure on governments in the Eurozone periphery. For example, from the German perspective, such states have avoided difficult labor market reforms. And yet the degree of labor market reform in the Eurozone peripheral states is contested (see Hopkins, this volume). Generally speaking, even before the onset of crisis these states had reformed labor market rules and trimmed pension

benefits such that the leverage of more labor market reforms for the quick reversal of the ongoing crisis is questionable (e.g. Armingeon and Baccaro 2012; Hall 2012). Moreover, as already noted above, Germany's own earlier and more aggressive labor market reforms came precisely during a period in which state spending was expanding rather than contracting. This fact seems to have escaped the German popular imagination, which often implies some version of 'we made the tough choices to promote competitiveness and now so must others' (Privatera 2013; Bastasin 2013).

A second rationale for moving slowly is to increase pressure on private counterparties to accept haircuts in those cases where states and financial institutions have debts beyond their ability to service. Merkel's insistence that private counterparties accept losses ('adequate participation of private creditors') in the second restructuring of Greek debt suggest this motive was already operative by the October 2010 Deauville summit, at latest. Though the fallout from this decision was considerable, Merkel fought to keep bail-ins on the table in subsequent discussions. Here, German stubbornness has led to a broader acceptance of the need for bail-ins. The most consequential was the Cyprus deal in early 2013, when Germany and other member states pushed bailing-in of €7 billion out of a €17 billion total rescue package.[30] The most recent agreement on bank resolution at the EU level calls for a minimum of 8% participation from private sources—creditors and owners—before public money can be used.

More broadly, the Cyprus case reflects Berlin's experiments with a harder 'reform or go under' message to troubled states. Finance Minister Wolfgang Schäuble worked to prepare the debate for the possibility of a Cypriot crash, suggesting the Eurozone could survive the end

[30] The SPD and Greens attacked the Merkel government for a deal that initially exposed small depositors, but they too generally accepted the need for large depositors to take losses.

of Cypriot participation. While Cyprus—like Greece—is easy to single out for especially bad behavior, Merkel is not steering for the mere survival of the Eurozone but rather is using the crisis to oblige Germany's European partners to reform in the face of globalization. This is why so often German policies on structural reform seem so disconnected from the reality of the Eurocrisis: they are often about something else. The issue then becomes whether the Eurocrisis is a legitimate lever for obliging the kinds of reforms that previously could not garner majority support in various European democracies.

While Germany has aggressively pushed the costs of adjustment onto other states, a third motive for German policy delay does lie closer to home in the troubled situation of Germany's own banks. Germany sought to provide a window in which banks could get healthy after heavy exposure to the bonds of Southern European states. The evidence is mixed on whether German banks have been able to exit the periphery. BIS data suggest German banks had just over €700 billion exposure to Italy, Portugal, Greece, Ireland and Spain by the end of 2009.[31] Various bailouts have allowed German banks to repatriate some of those claims (German banks 'brought home' about €319 billion from other European countries between 2009-2011—including from the countries named above, plus France and Belgium). The Bundesbank absorbed most of these liabilities through the TARGET2 system, but in the event of default, Germany would be responsible for 28% of the burden – not 100% (or whatever portion of German banks' liabilities it chose to cover). Consistent with this claim, *Forbes* claims that many major European banks are no longer much exposed to PIIGS sovereign debt.[32] On

---

[31] http://www.businessweek.com/articles/2012-05-24/bloomberg-view-germanys-banks-must-assist-in-europes-cleanup

[32] http://www.forbes.com/pictures/edkg45fff/data-sources/

the other hand, other recent accounts say the opposite, often using the same banks.[33] Gros (2013) shows that German banks are actually still the most exposed to sovereign debt (their own state's and others') of any banks in Europe. Bundesbank officials acknowledge that they have no comprehensive inventory of German bank exposures;[34] one of the critical tasks of the Single Supervisory Mechanism to be built into the European Central Bank will be to conduct an 'asset quality review' to ascertain these exposures.

A fourth motive for buying time might have been the significant mismatch between Germany's own very static financial regulatory practices and substantial new experiments in the financial sector over the 2000s. Germany has long sought to upload its domestic practices – in function if not always in form – to the European level. While this tendency admittedly had tapered off after the end of the Kohl governments (Paterson and Bulmer 2010), Germany has no appropriate system of financial regulation to upload. Instead, it has a badly fragmented financial supervisory system that is essentially a permanent tug of war between the Bundesbank and the *Bundesanstalt für Finanzdienstleistungsaufsicht* (Zimmermann 2012). Germany also has multiple deposit insurance schemes corresponding to different types of banks, and this diversity has been one factor in its reluctance to envision a single European entity for deposit insurance and bank resolution (interviews, Ministry of Finance, June 2013).

These are coherent reasons why a Germany eager to solve the Eurocrisis might still drag its feet on proposed reforms. As a matter of timing, they join with the complexities in the first section in which the German government's obsession with moral hazard severally complicated

---

[33] http://www.businessinsider.com/european-banks-praying-for-solution-euro-crisis-2011-11?op=1

[34] An effort to build such a database has been underway in the Ministry of Finance since 2012.

efforts to find a solution. Influenced by this inclination towards incrementalism, as the crisis has dragged on in the periphery while Germany enjoyed excellent labor market performance and strong exports, German officials have become more and more wedded to their favored narrative: they both celebrated Germany's excellent record and grew increasingly bold in prescribing 'German-style' reforms for troubled Eurozone states (Privatera 2013; Bibow 2013).

The final point of this section is that to all the other reasons for policy conservatism, we have to add that the striking success of the German economy has reinforced Merkel's conservatism and that of German voters. Merkel's policies towards the Eurocrisis have been clearly successful in a political sense, as voters credited her government with solid management of the German economy and of her European policies. In fact, Pew Data (2013) show a massive gap between German attitudes and those in much of the rest of Europe when it comes to the Eurocrisis.[35] Satisfaction with the economy in Germany was 66 points above the EU average, while smaller gaps separated Germans from the EU average on personal finances (26%), European integration (28%) and German leadership (48%). Only in Germany do a majority (54%) still believe that economic integration would strengthen national economies. Perhaps related, German respondents also were, by far, the most likely to support further centralization of power in the EU. Meanwhile, Merkel is Germany's most popular politician. Her approval ratings in an ARD poll in April 2013 were 68%, compared to 32% for her challenger for the Chancellorship.

---

[35] These figures should be treated with caution. Cost considerations meant Pew could sample in only eight EU members (Germany, Britain, France, Italy, Spain, Greece, Poland and the Czech Republic).

If Merkel has benefitted politically, German itself has benefitted economically to an extent. In fact, as the Eurozone periphery countries began to falter, Germany began to benefit in certain ways from the stress and strain in other parts of the Eurozone. By far the most important of these is the bottoming out of interest rates in Germany. Ten-year rates on German bonds went from above 3% to just over 1% in spring 2013 as the 'flight to safety' produced negative real interest rates that dramatically reduced German debt service costs. One estimate, by the Allianz insurance company, calculated German interest savings at around €67 billion over several years.[36] Other estimates have been lower, but no one disputes that these benefits have accrued (indeed, the government plays them up in public reports, presumably as a way of countering the fear that German generosity has gone too far). Of course, these low rates have stimulated private investment in Germany as well, and area where rates have been strikingly low for a long time. Another very real benefit has been the influx of skilled labor into Germany from more distressed Eurozone economies. Germany's net labor inflow was 420,000 in 2012. (Fratzscher 2013).

To be sure, this German version of 'exorbitant privilege' is clearly not of the same scale or duration as that long enjoyed by the United States (Eichengreen 2010). But it has been an unexpected boon that makes the struggles in the Eurozone periphery beneficial to the German economy. Of course, my argument is not that Merkel's government designed these advantages. Instead, the point is that the flight-to-safety dynamics made even more popular, policies of restraint *that were already wildly popular* in Germany. With Eurobonds and true fiscal federalism off the table and with austerity and structural reforms predictably failing to

---

[36] http://uk.reuters.com/article/2013/05/02/uk-eurozone-bailouts-idUKBRE9410C920130502

fundamentally alter the crisis dynamics, the search resumed for another tool.

Can Supranational Banking Union and Intergovernmental Fiscal Restraint Save the Eurozone?

The first major section of the chapter stressed the imbalances of the past, and the second stressed the current predicament. The chapter's final section looks more to the future. It begins by noting Merkel's intergovernmentalist approach to economic union and concludes with the discussion about a banking union to complement monetary union. This chapter has been animated by the irresolvable tension between a Germany that genuinely seeks a solution to the European financial crisis and a Germany that is determined to minimize the costs of such a solution. The result has been halting and contradictory policy. The last section showed that in addition to German fears of being called on to rescue other Eurozone states, the crisis in the periphery has actually brought very concrete benefits to Germany, further undermining the political incentives for policy change. The chapter's final section projects this tension forward, looking in particular at the banking union as emblematic of Germany's policy timing and substance dilemmas. Once again, we see a Germany that slow walks the crisis every chance it gets and that it emphasizes fiscal rectitude and structural reform as the solution to the Eurocrisis.

For a time, it appeared the Merkel government was interested in flanking short-term rescue policies with a series of European-level initiatives that foresaw tighter integration. A high point of this discourse came during the 2012 party convention of her CDU/CSU party, after which Merkel began using the formulation that 'more Europe, not less' was the solution. This discourse has cooled considerably in the run-up to the German elections in fall 2013. Instead,

Merkel, in a series of speeches and interviews, has articulated an intergovernmentalist vision for reform in which each individual member state—not just those in economic peril—negotiates a binding bilateral reform agreement with the European institutions (Kornelius 2013). At the same time, Merkel has been explicit that there be no additional powers granted the European Commission.[37]

It remains unclear what would motivate member states to oblige themselves to undertake these unpopular reforms. Merkel has a penchant for characterizing decisions made under great duress as voluntary choices. For example, while Merkel often stresses that austerity choices in other member states are made not by Berlin but by democratically-elected governments, it is worth noting that these governments' choices can hardly be linked to their voters' appetites for these reforms. Pew data found that 97% (Greece), 96% (Italy), and 94% (Spain) of respondents were dissatisfied with the direction in which their country was headed (Schmitz 2013). Instead, the sense across much of Europe is that states in the Eurozone periphery are taking these decisions because they are insisted upon by Germany as a condition of other assistance. Not surprisingly, the Pew data also shows Germans are widely seen as the most arrogant and least compassionate of Europeans (Stokes 2013).[38]

While the intergovernmental route to economic union is likely to continue the pattern of incremental change, the banking union announced in summer 2012 was, at least in principle, due to move much more quickly. A primary trigger for banking union was the awkward combination

---

[37] c.f., http://www.reuters.com/article/2013/06/02/us-germany-merkel-eu-idUSBRE95103J20130602

[38] Though Germans are also widely seen as the most 'trustworthy' people in Europe, suggesting that if other Europeans undertake their reform commitments, they trust the Germans to make good on their promises.

of supranational banking activity and national regulation, which, in the post-2008 period, had led to widely diverging credit conditions such that similar firms in different states had very different access to capital (Veron 2013: 4). Moreover, baking union promised to break the 'doom loop' between banks and sovereigns and, as such, promised a way forward without the Eurobonds that Merkel had ruled permanently out of bounds. As currently conceived, banking union is to rest on four interrelated pillars: regulation, supervision, deposit insurance, and resolution.

The outlines of the supervision dimension are already clear. Ultimate responsibility for supervision will rest with a single entity, the European Central Bank, which will develop a new apparatus to engage in so-called asset quality reviews of systemically important banks and will take over supervision of these banks by summer 2014. This handover will create what Wolfgang Schäuble refers to as a 'timber-framed' banking union (2013). If he has his way, this will be followed, at a later point, by substantial change of the European treaties to pave the way for a 'steel framed' banking union. German support for the SSM has been contingent upon some accommodation of the politically important savings banks (*Sparkassen*), whose local structure means they have connections in every electoral district in the country.

This will be a major undertaking. Veron (2013: 5-6) shows that while the existing treaties can support envisaged legal innovations in both prudential regulation (article 114 of TFEU) and SSM (article 127(6) TFEU)—though, it is likely that smaller-scale treaty adjustments will be undertaken at a later date—the legal basis for both European-level resolution and deposit insurance mechanisms are lacking and would require a treaty change for a robust basis. Interviews in the German Ministry of Finance and with CDU and SPD officials confirm that while the EU has been able to engage in constitutional innovation though

intergovernmental treaties in cases such as the ESM and the Fiscal Compact, the legal basis sought for resolution, in particular, is likely to be more robust and to be sought through the main EU architecture and not as separate agreements. Indeed, in July 2013, the Finance Ministry even obliged formal transposition of an EU provision that had direct effects.[39]

After German objections led to the imposition of a minimum threshold, the ECB will supervise all banks with more than €30 billion in assets.[40] This will correspond to more than 130 banks that hold 80% of Eurozone banking assets.[41] Starting in late 2013, a process of 'publically-led triage, recapitalization, and restructuring' will commence (Veron 2013: 8). The daunting technical challenges are made somewhat easier by the ECB's likely much better access to clean information than was true of the earlier European bank 'stress tests.' A major impediment may still lie in the fact that as the ECB uncovers banking problems, the member states will still be responsible for resolving them. This 'handover problem' is critical (Veron 2013: 9). The ECB has every incentive to ensure that the banks it will take under its supervision have a healthy basis. But the financial resources that will likely be required in any vigorous assessment would need to come from member states. Germany's preference for strictly rules-based regimes for handling such recapitalization and resolution issues is also unlikely to prevail given the likely substantial involvement of politically-sensitive creditors—including national pension funds.

German opposition has also prevented use of the ESM for bank recapitalization, a situation that seems likely to persist until after the handover of authority to the SSM in 2014. An

---

[39] See the testimony at https://www.bundestag.de/bundestag/ausschuesse17/a07/anhoerungen/2013/index.html
[40] The Sparkassen continue to push for upward revision of this figure to €45 or even €70 billion.
[41] The number of banks could go as high as 200.

important consideration will be the extent to which legacy debts can be identified, legally realized and nationally-resolved prior to such a handover. The most credible forward-looking situation would be one in which rigorous European-level reviews and ample national restructuring and resolution funds take place in advance. These are, of course, exactly the circumstances most likely to strike hard at the most fiscally-exposed Eurozone states and to open the possibility that, for example, senior unsecured creditors may get far more favorable treatment in fiscally solid states than in those states with more severe funding pressures. That said, ESM ought to be available to backstop these states, if not, as noted, the banks directly. Moreover, Veron (2013: 13) argues that markets have, to an extent, priced in large if necessarily uncertain resolution costs for certain Eurozone members and thus resolution costs ought not to lead to a loss of market access.

On the Single Resolution Mechanism, we have clear conflict between the Commission and the ECB on one side and the German government on the other. Part of the problem is that there is little clarity on the size of potential bank losses. Financial journalists have estimated such losses at €1-1.6 trillion, though the higher estimates seem to assume bad assets will equate automatically to the need for new capital (Munchau 2013). Assuming some asset recovery plus available loss provisioning, others come up with figures closer to €400 billion—still daunting but not as cataclysmic as €1.6 trillion (Kapila 2013).[42]

An additional worry is that any credible asset quality review and stress test would seem to require frank acknowledgment that holders of bonds of some Eurozone governments face the

---

42 http://www.roubini.com/forum?utm_source=contactology&utm_medium=email&utm_campaign=RGE%20Daily%20Top%205%20Wednesday%20June%2026%202013#{%22thought_id%22%3A%22thought.1372180325275%22}

risk of at least partial default. This would imply an end to the practice of rating these bonds as zero-risk. And yet any such move would raise future borrowing costs for governments, possibly sparking financing problems that would hammer both governments and the banks (Gros 2013).

Such difficulties are emblematic of a host of potential problems for a single resolution authority. When the European Commission announced its plan for such a European-level resolution authority in July 2013, two problems immediately surfaced. The first was explicit German opposition to the idea of a European authority in the first place on the grounds that banking problems were a matter for sovereign states to regulate. Merkel and Hollande released a paper to this end just prior to the Commission announcement.[43] Second, the Commission failed to call for the use of the ESM as an initial backstop for such a mechanism.[44]

One major reason for Germany's opposition to several facets of the banking union is the receding of pressure on the Eurozone and the growing sense they can muddle through. Berlin has clearly backed away from any idea of an early intergovernmental conference that would be required for major change to the European treaties. Berlin will still seek the smaller changes that would allow them to have economic union—essentially, Merkel hopes, in the form of a kind of Lisbon Process with teeth. One can draw up the intergovernmental contracts noted earlier under existing treaties, but to either punish or reward (with EU budget funds) contracting states would require treaty change. Germany has also dropped the idea of a 'super-commissioner' to enforce budgetary discipline, a Schäuble idea that Merkel never supported. Germany perceives other

43 http://www.bundesregierung.de/Content/EN/Reiseberichte/2013/2013-05-30-merkel-paris.html

44 Reuters, July 10, 2013. http://uk.reuters.com/article/2013/07/10/uk-eu-bankingunion-idUKBRE96908H20130710

risks from moving ahead expeditiously. The European Parliament might oblige a formal convention—they did not do so for ESM—in part because a larger convention might open the door to greater powers for the EP.[45] Meanwhile, other member states have their own wish-list for a treaty change, some uncongenial to Germany, and this seems, for now, to have convinced the German government to trudge forward without a treaty change.

Its overall position puts Germany substantially at odds with the European Central Bank. Jörg Asmussen, who was an economic advisor to Merkel before joining the ECB Executive Board, had made an explicit call for a 'European Backstop' in a speech in London just prior to the Commission announcement (2013). The Commission proposal, though it does foresee a European agency, would not have resources to help close an ailing bank. Germany's alternative proposal is for a resolution mechanism that coordinates those of the member states. On the one hand, this position perfectly replicates its general orientation against exposing German taxpayers to banking resolution problems in other states. On the other hand, it does nothing to address the issue that many national programs are woefully underfinanced and completely incapable of resolving troubled banks in the states in question. Schoenmaker and Gros (2012) are among several academic studies that warn that European-level supervision and national-level resolution will lead to misaligned incentives. They mirror the position of the ECB as articulated by Asmussen that separate national resolution funds will invite jurisdictional fights that hamper rapid responses to banking crises (Assmussen 2013: 6).

Given the main thrust of this paper, it is comprehensible why German politics should be

---

45 http://www.cer.org.uk/insights/germany%E2%80%99s-plans-treaty-change-%E2%80%93-and-what-they-mean-britain

fixated on slowing or preventing the establishment of a new authority on deposit insurance and resolution. These activities are traditional areas of national discretion and—and this is more relevant to Germany—pooling liabilities might expose Germany to bank losses in other member states. While this paper has stressed that German behavior and German rhetoric are often out of synch with one another, banking union appears to be an area where apparent German refusal is indeed built upon a foundation of actual German refusal.

Conclusion

Why has it been so hard to get the right Eurozone policy at the right time? Many accounts of German behavior stress the role of ordo-liberal ideology, but this chapter begins from the obvious fact that adherents of the ordoliberal world view are actually quite divided on whether and how to 'save' the Eurozone. Rather than elite ideology alone, this paper has tried to make sense of the future of the Eurozone by looking at Germany's institutional constraints and at the beliefs of ordinary citizens. If Germans sometimes appear dogmatic today, this is a superficial phenomenon. Once one scratches beneath a veneer of populist *Bild Zeitung*-fueled patter that is as self-deceptive—because conditions for German reforms were far more supportive—as it is self-congratulatory, many Germans doubt very much their instincts on what is the right way forward. The uncertainty and tentativeness is sufficient to keep them from enacting policies that might have (and perhaps might still) refashion the Eurozone in a more sustainable way. And because they dither conceptually, they give an additional advantage to those who would defend some version of the untenable status quo, which, in crudest form, is simply 'prosperity for us; austerity for you.'

After dealing with deficiencies in the ordoliberal ideology explanation for German policy, this chapter covered three main issues: the problem of trade imbalances, which German leaders and voters do not perceive as a problem; the exorbitant privilege that unexpectedly accrued to Germany during the Eurocrisis and that helps prevent a major course correction by Germany; and the partial banking union now being constructed in a period of relative calm that has reduced German incentives for a more far-reaching design. The chapter showed that each of these already complex issues was made more complex by issues of timing.

Going forward, there is every reason to think the imbalance problem—deeply anchored in German fascination with exports and grounded in deep strengths in German manufacturing—will persist in some form. It seems much less likely that the various aspects of Germany's exorbitant privilege will endure. The flight to safety saved Germans tens of billions in financing costs, but can negative real interest rates for one country and punitive ones for another be a stable outcome? This seems doubtful. And the boom in immigration, while helpful to Germany, may also prove short-lived. An OECD study suggests most Greek and Spanish immigrants return to their home country within a year of moving to Germany.[46] So what if the imbalance stays, the privilege goes, and the banking union—in any event, a mechanism to deal with future problems but with virtually nothing to say about the resolution of past problems—never really arrives in any full-fledged way?

Until new crises emerge, it seems the current muddling is foreordained. German voters heartily approve of it and would be unnerved by any decisive steps by the German government

---

46 http://www.spiegel.de/international/germany/oecd-study-finds-large-numbers-of-immigrants-leave-germany-a-905583.html

that broke from this course. The current path keeps the pressure for adjustment almost exclusively on other countries, and this is seen as entirely correct in the German debate, owing to the self-evident vice of the deficit countries and self-evident virtue of the surplus countries. While there has been some recent real wage growth in Germany, public finances remain focused on balance. Indeed, a recent IMF report on Germany felt compelled to caution that the country should not be 'overperforming on consolidation.'[47]

Meanwhile, export outlets outside the Eurozone have grown in attraction while established Eurozone customers may have low purchasing power for years to come. Germany's ferocious export boom that started around 2003 eventually led, by 2007, to a more than €100 billion external surplus with the Eurozone at a time that Germany's surplus with non-EU states was under €40 billion. But times have changed. As the Eurozone stagnated, demand from outside the EU boomed. By 2012, the positions had nearly reversed, with non-EU 27 states running a nearly €100 billion deficit with Germany while the Eurozone deficit had shrunk to about €55 billion.[48] Germany has very successfully diversified its export portfolio, and this seems to have eliminated some of their urgency to resolve the Eurozone crisis. The only problem is the specter of trade and currency battles with trading partners around the globe.

But if the muddling is undeniable, it's not clear the Eurozone will really get through. Whether and how Germany should try to fix the Eurozone also depends on one's view of the medium run. Even presuming the 'imbalances' approach stressed here is correct, it's actually not obvious that this euro can be repaired. For the most part, the imbalances argument *tends* to

---

47 http://www.spiegel.de/international/business/imf-tells-germany-to-loosen-its-fiscal-stance-a-915268.html

48 Bundesbank data.

be used by those who question German sanity. The form it takes is 'Germany profited enormously from this euro, and this is why its austerity mania is *hypocritical* (because Germany gained all along from others' indulgent spending), *unwise* (because it fails to do more to rescue the system that has made it prosperous), and tactically *clumsy* (because it synchronizes deflationary impulses).

But one could also accept the imbalances approach and simply say that while it was good while it lasted, the euro experiment has hit its endpoint and German leaders have concluded that it can't be reformed for another round. To be sure, this position is one where the glass is acknowledged to be half empty: much of the apparent export success of recent years will have to be compensated by German taxpayers resolving, recapitalizing, or bailing out the German banks that financed it (though other European partners and the IMF will now be on the hook for some of it).[49] But, according to this view, German efforts to strengthen and retain the Eurozone would just mean throwing good money after bad.

Looking ahead, there is every reason to expect that German goods trade surpluses—a feature of the German economy for five decades—are likely to persist. The receipts from these sales will either be invested productively—Gros and Mayer (2012) argue for a German sovereign wealth fund to enable outlets outside the Eurozone and thus allow the Euro to lose some value—or lost (Sinn 2012; Das 2012), or Germany and the Eurozone will muddle through. Again, muddling through is easier to envision if one sees Germany's permanent goods surplus as a *reflection* of national strengths rather than as a *cause* of supranational weakness.

In defending her calls for structural reforms, Merkel often perpetuates a kind of

---

[49] The notion that the imbalances can be corrected is actually the position of the Commission, with its excessive imbalance procedure.

'governance illusion.' In her retelling of the story of German success, Merkel often stresses structural and fiscal reforms by the German state. But in both labor markets (Morgan and Riesenbichler 2012) and product markets (Bastasin 2013), German successes today build at least as much on the restructuring choices of firms as on the far-sightedness of the state. One implication is that a conversion of the rest of Europe to a more German approach to the political economy is likely to be far slower and much less the automatic result of structural policy changes.

The politics of timing starts with the 'intrusion' of the German voter into the domain of financial politics, something that has typically been an elite domain in Germany. Banking bailout politics are now so expensive, however, that mass politics has forced its way in. But while German voters are most certainly now paying attention, the dilemma is that by the time politicians convince them of the need to support a certain financial remedy, the Eurozone problems have grown to such a size that this remedy no longer works. A new remedy is required, and the process of explaining the need for it begins again, only this time with increasing voter skepticism that the elites know what they are talking about.

While German voters don't have 'moral hazard' in their active vocabulary, they start with the simple question, 'Why should we pay for somebody else?' It's a hard question in Germany—a country in which geographical solidarity is deeply-anchored institutionally (through something known as the *Länderfinanzausgleich*) but not terribly popular (or at least, its popularity varies widely across the net payer and net recipient states). Voters certainly know that national bailouts in the EMU were forbidden by treaty. And once the press starts in with the 'moral hazard' language, voters find they can hum the tune right from the start. Like any good

pop song, each verse is a bit different but the chorus is the same: we worked smart, we worked hard, we saved; you worked less, quit early and bought more.

Germany's populist discourse, along with the institutional divisions in German politics, grants Merkel an important edge in her negotiations. Typically, at the nearly 30 EU summits since 2009, Merkel bargains hard but makes some concessions. A breakthrough of some kind is announced and a certain collective sigh of relief is registered in Europe. At that moment, other actors in German politics often begin to counter or at least delay what Merkel has agreed. Such actors include the Bundesrat, the Constitutional Court, and, above all, the Bundesbank. These are not entirely quiet rearguard actions, and if they were, they would lose one of their most important functions: to calm German voters. Evidence this is working can be seen in Merkel's own approval figures, near 70%. Indirect support comes also in the fairly feeble effort of the major opposition party, the SPD, to mount a coherent alternative to Merkel's policies. Only a highly unlikely SPD-Green-Left Party coalition might make a significant break from current policy.

All of this reverses the usual picture of the 'semi-sovereign state' in Germany (Katzenstein 1987). According to the Katzenstein formulation, policymaking in Germany moves slowly and deliberately because a plethora of actors are constitutionally-empowered to participate in decisionmaking. Once the system produces a decision, however, the general assumption is that it will be carried out expeditiously and faithfully by the very corporate partners who gave their assent in the first place. What was a hindrance in conception becomes a help in execution. What we are seeing now, however, is a different, in some ways opposite, story. Merkel goes to summits and, however grudgingly, agrees to things, which then get walked

back in succeeding weeks. For instance, in early summer 2012, many European leaders thought Merkel had agreed that the ESM could directly fund ailing banks. In subsequent weeks, the Bundesbank strongly disputed this, leaving other European partners wondering. More important, the apparent breakthroughs on banking union in June, September, and December 2012 now appear much less secure. Thus, does German indecision persist, as does the misery in Europe. There is little reason to expect it to abate any time soon.

Works Cited

Admati, Anat and Hellwig, Martin (2013). *The Bankers' New Clothes*. Princeton: Princeton University Press.

Almunia, Miguel, Benetrix, Agustin, Eichengreen, Barry, O'Rourke, Kevin, and Rua, Gisela (2010). "From Great Depression to Great Credit Crisis: Similarities, Differences and Lessons," *Economic Policy* 25(62):219-65.

Armingeon, Klaus and Baccaro, Lucio (2012). "The Sorrows of Young Euro: The Sovereign Debt Crises of Ireland and Southern Europe," in Jonas Pontusson and Nancy Bermeo (eds), *Coping with Crisis: Government Reactions to the Great Recession*. Ithaca: Cornell University Press.

Asmussen, Jörg (2013). *Building Banking Union*. Speech given at the Atlantic Council, London, 9 July 2013.

Bastasin, Carlo (2013). "Germany: A Global Miracle and a European Challenge," Brookings Global Economy and Development Working Paper #58.

Beck, Ulrich (2012). *German Europe*. Cambridge: Polity.

Bergsten, C. Fred and Kirkegaard, Jacob Funk (2012). "The Coming Resolution of the European Crisis," Peterson Institute for International Economics, Policy Brief PB12-1.

Bibow, Jörg (2012). "The Euroland Crisis and Germany's Euro Trilemma," *International Review of Applied Economics*, 27(3):360-85.

Blyth, Mark (2013). *Austerity: The History of a Dangerous Idea*. New York: Oxford University Press.

Blyth, Mark, and Matthijs, Matthias (2011). "Why Only Germany Can Fix The Euro," *Foreign Affairs*, 90(6).

Bronk, Richard (2013). "Hayek on the wisdom of prices: a reassessment," *Erasmus Journal for Philosophy and Economics*, 6(1):82-107.

Das, Satyajit (2012). "The Euro-Zone Debt Crisis – It's Now ABOUT Germany, NOT UP TO Germany!" *Naked Capitalism*, http://www.nakedcapitalism.com/2012/06/satyajit-das-the-euro-zone-debt-crisis-its-now-about-germany-not-up-to-germany.html (accessed 6 August 2013).

Dullien, Sebastian and Fritsche, Ulrich (2009). "How bad is Divergence in the Euro-Zone? Lessons from the United States of America and Germany," *Journal of Post-Keynesian Economics*, 31(3):431-57.

Dullien, Sebastian and Guerot, Ulrike (2012). "The long shadow of ordoliberalism: Germany's approach to the euro crisis," European Council on Foreign Relations, Policy Brief 49.

Eichengreen, Barry (2010). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*. New York: Oxford University Press.

Eurobarometer 79 (2013). European Commission, fieldwork May 2013.

Expertenrat (2011). 'Strategien für den Ausstieg des Bundes aus krisenbedingten Beteiligungen an Banken: Gutachten des von der Bundesregierung eingesezten Expertenrats.' http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Internationales_Finanzmarkt/Finanzmarktpolitik/2011-02-15-gutachten-bankenbeteiligung-anlage.pdf?__blob=publicationFile&v=3 (accessed July 25, 2013).

Foner, Eric (1999). *The Story of American Freedom*. New York: Norton.

German Marshall Fund of the United States, *Transatlantic Trends: Key Findings 2012*.

Gros, Daniel (2013). "EZ banking union with a sovereign virus," *VOX*, http://www.voxeu.org/article/ez-banking-union-sovereign-virus (accessed 6 July 2013).

Hall, Peter (2012). "The Economics and Politics of the Euro Crisis," *German Politics*, 21(4):355-71.

Hopkins, Jonathan. This volume.

International Monetary Fund (2012). "World Economic Outlook: Coping with High Debt and Sluggish Growth," *IMF World Economic and Financial Surveys*.

Jacoby, Wade (2000). *Imitation and Politics: Redesigning Modern Germany*. Ithaca: Cornell University Press.

Jacoby, Wade (2011). "Germany: Europe's Company Store," *Crooked Timber*, http://crookedtimber.org/2011/01/19/germany-europes-company-store/ (accessed 6 May 2013).

Jacoby, Wade (2013). "The EU Factor in Fat Times and in Lean: Did the EU Amplify the Boom and Soften the Bust?" *Journal of Common Market Studies*, 52(4).

Jones, Erik (2010). "Merkel's Folly," *Survival: Global Politics and Strategy*, 52(3):21-38.

Jones, Erik. This volume.

Kapila, Jennifer (2013). "Jennifer Kapila on Europe 'ignoring the scale of bank losses'," Roubini Global Economics, 26 June 2013.

Katzenstein, Peter (1987). *Policy and Politics in West Germany: The Growth of a Semisovereign State*. Philadelphia: Temple University Press.

Kornelius, Stefan (2013). *Angela Merkel: Die Kanzlerin und ihre Welt*. Hamburg: Hoffmann

and Campe.

Mabbett, Deborah and Schelkle, Waltraud (2013). “Searching under the lamp-post: the evolution of fiscal surveillance,” Council for European Studies, Amsterdam.

Morgan, Kimberly and Riesenbichler, Alexander (2012). “From ‘Sick Man’ to ‘Miracle’: Explaining the Robustness of the German Labor Market During and After the Financial Crisis 2008-09,” *Politics and Society*, 40(4):549-79.

Münchau, Wolfgang (2013). “Europe is ignoring the scale of bank losses,” *Financial Times*, 23 June 2013.

Newman, Abraham. This volume.

Paterson, William E. and Bulmer, Simon (2010). “Germany and the European Union: from ‘tamed power’ to ‘normalized power’?” *International Affairs*, 86(5):1051-73.

Pierson, Paul (2004). *Politics in Time: History, Institutions, and Social Analysis*. Princeton: Princeton University Press.

Scharpf, Fritz (2012). “Monetary Union, Fiscal Crisis, and the Preemption of Democracy,” *MPIfG*, Discussion Paper 11/11.

Schäuble, Wolfgang (2013). “Banking union must be built on firm foundations,” *Financial Times*, 12 May 2013.

Schelkle, Waltraud (2012). “Policymaking in Hard Times: French and German Responses to the Eurozone Crisis,” in Jonas Pontusson and Nancy Bermeo (eds), *Coping with Crisis: Government Reactions to the Great Recession*. Ithaca: Cornell University Press: 130-61.

Schieritz, Mark (2013). *Die Inflationslüge: Wie uns die Angst ums Geld ruiniert und wer*

daran verdeint. Munich: Droemer Knaur.

Schmitz, Gregor Peter (2013). "Pew Study: Europeans Rapidly Losing Faith in Europe," *Spiegel Online International* [online journal], http://www.spiegel.de/international/europe/new-pew-study-finds-europeans-losing-faith-in-eu-project-a-899588.html (accessed 14 May 2013).

Schoenmaker, Dirk and Gros, Daniel (2012). "A European Deposit Insurance and Resolution Fund: An Update," DSF Policy Paper 26.

Schwarzer, Daniela (2013). "Crisis and Reform in the Euro Area," *Current History*, 112(752):83-7.

Schwarzer, Daniela and Lang, Kai-Olaf (2012). "The Myth of German Hegemony: Why Berlin Can't Save Europe Alone," *Foreign Affairs*, 91(5).

Shaw, Mark (2013). "Still Mentioning the War? Perceptions of Germany in Britain during the Eurozone Crisis," IASGP Annual Conference, London, 12 May 2013.

Sinn, Hans-Werner (2012). "TARGET losses in case of a euro breakup," *VOX*, http://www.voxeu.org/article/target-losses-case-euro-breakup (accessed 6 August 2013).

Silvia, Steven (2011). "Why do German and US Reactions to the Financial Crisis differ?" *German Politics and Society*, 29(4):68-77.

Simms, Brendan (2013). "Cracked heart of the old world," *The New Statesman*, 14 March 2013.

Steinmeier, Frank-Walter and Steinbrück, Peer (2010). "Germany must lead fightback," *Financial Times*, 14 December 2010.

Stokes, Bruce (2013). "Threat to EU: German Exceptionalism Poses a Challenge," *Spiegel Online International* [online journal], http://www.spiegel.de/international/europe/pew-research-study-shows-europeans-are-divided-about-state-of-europe-a-899460.html (accessed 14 May 2013).

Streeck, Wolfgang (2013). *Gekaufte Zeit: Die vertagte Krise des demokratischen Kapitalismus*. Berlin: Suhrkamp Verlag.

Truger, Achim, and Will, Henner (2012). "The German 'debt brake' – a shining example for European fiscal policy?" Berlin School of Economics and Law, Working Paper No. 15.

Vail, Mark. This volume.

Véron, Nicolas (2013). "A Realistic Bridge Towards European Banking Union," *Peterson Institute for International Economics*, Policy Brief Number PB13-17

Zimmermann, Hubert (2012). "No Country for the Market: The Regulation of Finance in Germany after the Crisis," *German Politics*, 21(4):484-501.

Zohlnhöfer, Reimut (2011). "Between a Rock and a Hard Place: The Grand Coalition's Response to the Economic Crisis," *German Politics*, 20(2):227-42.