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GERMANY IS UNFIT FOR THE EURO

By: Joerg Bibow



Euroland has agreed to support Greece after all, really?

Germany and its media are in uproar about Mrs. Merkel's bowing to foreign pressures. After many years of belt-tightening, stagnant wages and fiscal austerity, it seems unfair that the spendthrift should be "bailed-out". Germans have done everything right, they are being told by their political leaders and the media, boosting competitiveness and balancing the budget. Don't make the Musterknabe pay for others' sins. Instead, let Europe follow the German example. Let the Greek do their homework and get their own house in order through hard work and thrift – the German way. There is talk that Germany's constitutional court might get busy again, providing new landmark judgments on what constitutes "stability" and

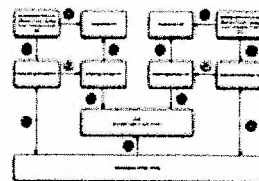
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16.03.2011

By: Satyajit Das

This paper takes a detailed and critical look at the CCP - the basic idea behind, its design, risks and effects on the market.

OUR PARTNERS**MUNCHAU'S COLUMNS**

Muddling through is

Greece?

By: Daniela Schwarzer
and Sebastian Dullien
01.03.10

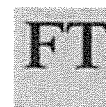
The Euro Area's political constraints

By: Wolfgang Münchau
16.02.10

what does not. For Germans have a constitutional right to stability, they are made to believe. If Europe is not ready to comply with the standards of stability, Germany will be forced to pull out. Perhaps the Bundesbank is already preparing for reissuance of marks. Germans are said to lose faith in the euro. Berlin does little to convince them otherwise. The train of European integration is rolling fast backwards. Not for the first time in its history the German people have been irresponsibly misled by a political leadership that seems to have lost any sense of history, any sense of order and stability in Europe, and any sense of Germany's key contributing role to the current crisis. As ever, the mindset of lawyers frames the political debate among a political class that seems inhumanly uneducated in matters of economics. If economic voices are heard at all, it is usually the voice of the Bundesbank. It is a peculiar democracy that expects either its constitutional court or central bank to have the final word of wisdom.

Regarding Euroland's economic performance since 1999, three stark facts or policy blunders stand out. First, while similar in size to the US economy, Euroland is

no option



FINANCIAL
TIMES

16.03.2011

By: Wolfgang
Munchau

There are only two ways to resolve a debt crisis: through bail-out or through default.

GLOBAL ECONOMIC SYMPOSIUM

A repository of solutions to global problems

25.06.2010

For two years now, leading policy makers, academics and businessmen have been meeting for discussions in the Global Economic Symposium to provide concrete solutions for the most pressing global governance issues the world will be facing this century. Here is the result of these discussions: a repository of concrete policy proposals.

remarkably export dependent and prone to domestic demand stagnation. The world economy boomed at record rate in 2003-7. Euroland for long was the "sick giant". Joining late, it crashed all the harder as the global crisis hit. Second, the 2001-5 period of protracted domestic demand stagnation saw finance ministers at pains to cut budget deficits below 3 percent, as the so-called Stability and Growth Pact prescribes, and the ECB similarly at pains to squeeze headline inflation below the 2 percent mark that seems to constitute price stability. Obsession with what lawyers judge to be stability produced rather perverse results. Hiking indirect taxes and administered prices to achieve their magic number, finance ministers thereby helped to keep inflation above the ECB's magical number. In turn, the ECB's obstinate refusal to care about domestic demand kept budget deficits above 3 percent, triggering further indirect tax hikes, and so on. Contrary to the notorious stability-oriented gospel, it is hard to conceive of a more counterproductive macroeconomic regime than this. Third, the brief history of the euro saw the emergence of stark divergences and buildup of grave imbalances within an economic area that can no longer rely on exchange rate realignments to solve them –

imbalances the implosion of which have left Euroland stuck in the mess it is in today, once again hoping for strong global growth to pull it out.

Sadly enough, Germany has been central to all of this. Germany is the biggest factor in Euroland's export dependence, growing on exports only while domestic demand, especially private consumption, is notoriously stagnant. Among the first countries to break the Maastricht deficit limit dreamed up by its own lawyers, Germany contributed most to the ECB's misses of its headline inflation mark by hiking indirect taxes. Worst of all, Germany reneged on the euro's cornerstone to abstain from beggar-thy-neighbor policies.

Germany likes to see its international competitiveness as the fruit of hard work and productivity. Yet, German productivity growth since 1999 does not stand out. What stands out is wage stagnation. Germany's improved competitiveness was derived from reducing German wages relative to its European partners; the equivalent of a beggar-thy-neighbor devaluation in pre-euro times. The consequences of this strategy have proved disastrous:

domestic demand stagnation in Germany, housing bubbles in partner countries with higher inflation, given that the ECB sets one rate that has to fit all. One way or another, the country that runs up trade surpluses must either lend or grant transfers to the deficit countries that make its own surpluses possible. Today, German policymakers refuse to do either. Fooled into believing that beggar-thy-neighbor was the right thing to do, popular demands appear to be just that. One cannot fail to see that insane austerity in the periphery serves to keep the euro low enough so that Germany can now grow on external exports.

That is neither what Europe needs nor what the world may reasonably expect from Europe. Sooner or later Europe may have to conclude that Germany is unfit for the euro. Let the Germans have their mark back if they are so keen. Let the new euro-mark rise to US dollars 2 or 2.50, so that the joys of stability are real. Euroland may then regroup around France. With Germany once again proving immature to provide constructive rather than destructive leadership, Europe's fate is in France's hands.

For a pre-crisis analysis of Euroland's regime flaws see: Bibow, J. and Terzi, A. eds.

(2007). Euroland and the World Economy – Global Player or Global Drag?, London, Palgrave-Macmillan.

For a post-crisis analysis see:
Bibow, J. (2009). The euro and its guardian of stability: The fiction and reality of the 10th anniversary blast, Levy Economics Institute, Working Paper no. 583."

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