Europe’s Twin Crises: The Logic and Tragedy of Contemporary German Power

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The crisis of the eurozone has accelerated processes of uneven development and political fragmentation in Europe. Once celebrated as a dramatic forward movement in European regional integration, the monetary union has evolved under German leadership into what has been aptly described as “eurozone fiscal colonialism” (Legrain, 2014). The Franco-German partnership—the motor force of integration since the early 1950s—has shattered amid France’s resentment of German-imposed fiscal rules and declining competitiveness. Germany’s authority over the Eurozone is virtually unchallenged. As the EU’s response to the war in Ukraine vividly illustrates, Germany has now also emerged as the predominant political power in the EU.

This article explores the origins and evolution of the two interlocking crises that now engulf the European continent: an imploding monetary union and the intensification of great power rivalry in Europe following the “end of the post-cold war era” (Trenin, 2014). Although the crises have distinctive origins and logics, one common denominator is the central role of Germany. Part I describes the relationship between the steady rise of German economic power and the transformation of the European monetary order. Part II explores the EU’s management of the Eurozone crisis, exercised formally by the Troika (The Commission and the ECB in conjunction with the IMF) but in which Berlin is arbiter on all substantive matters. At the onset of the crisis in late 2009 policymakers first sought to rescue their overextended banks and then to impose draconian austerity measures on debtor countries whilst preserving the Eurozone that, in its present form, serves as an instrument of German export mercantilism. The threat of Eurozone break-up has, with the exception of Greece, apparently been averted, but the crisis persists in the form of prolonged stagnation resulting in deep cuts in the welfare state, declining real wages, and mass unemployment.

Part III assesses the implications of this highly unstable power constellation for the broader European geopolitical space. Distinguished observers have speculated that the growth of German power in the context of global transformation portends a “fundamental breach” (Wallerstein, 2014) or “schism” (Kundnani, 2014) between Germany and the United States. However, whilst Germany is gradually abandoning its “culture of restraint,” it is unlikely that the German state and leading sectors of German capital will abandon the strategic orientation to Atlanticism or seek to resurrect the more cooperative relationship with Russia that was already fraying prior to the outbreak of war in Ukraine.

I. German State, Capital, and the Crisis of the Eurozone

Western Europe’s post-war project of steady growth, full employment, and social provision was predicated on the Bretton Woods fixed exchange system that facilitated the strategic focus on exports to the American growth locomotive. The collapse of the system and the transition to floating exchange rates accompanied by the rapid development of mobile transnational financial markets centered on Wall Street rendered this project obsolete and revealed Europe’s collective vulnerability to US monetary unilateralism. Growing monetary instability exacerbated the problems of uneven development in Western Europe arising from the perennial problem of superior German productivity. Especially in the context of reunification this constituted an immense challenge to the Franco-German relationship and thus to the EU itself.
The decision to adopt EMU was a result of many proximate factors operating in both the geopolitical and economic spheres—not least by the time of Maastricht the desire on the part of France to contain a reunified German and regain a measure of monetary autonomy. At the same time, the creation of a monetary union absent fiscal federalism led inexorably towards neoliberalism, the defining feature of the relaunching or “second” European project (Cafruny and Ryner, 2007). Ironically, in view of strong initial opposition from many sectors of German society, EMU has ultimately served to underwrite the export mercantilist model and thereby to enhance German economic power.

Since the late 1990s German capital has pursued a strategy of relentless cost-cutting and austerity closely linked to its export as well as foreign direct investment strategy. Crucial stages of the emergent “German Central Europe Supply Chain” (IMF, 2013) have been established or relocated throughout central and eastern Europe, thereby enabling the German export model to maintain its global competitiveness (Gross, 2013). Successive EU enlargements since 2004 have provided a more secure institutional and legal basis for the establishment of this German-dominated zone.

After reunification a series of reform programs and “employers offensives” (Kinderman, 2005) dramatically decreased German unit labor costs. Gerhard Schroeder’s Agenda 2010 reduced unemployment protection and social assistance, severing the link between export-led growth, wages, and the expansion of the internal market that characterized Germany’s post-war reconstruction phase (IMF, 2007; Bibow, 2009) The German economy is “structurally reliant on foreign demand for its growth” (Tilford, 2010, p. 6), running a close second to China in absolute value of exports and producing a current account surplus of almost 3%, the “largest ever generated in the history of financial markets,” (Saravelos, 2014). This represents the central factor in the crisis of the Eurozone (U.S. Dept. of the Treasury, 2013; OECD, 2014). EMU precludes the competitive depreciations against the DM that were occurring prior to 1992 and would certainly return in the context of break-up. German export mercantilism is thus both a cause and effect of stagnation, as deficit countries are compelled to adjust through internal devaluation. Put bluntly, “The euro is a ‘beggar-thy-neighbor’ policy for Germany, on condition that it beggars its own workers first” (Lapavitsas et al., 2012, p. 30).

II. EU Response to the Crisis

The onset of the 2009 banking crisis in the context of asymmetries that have haunted Europe since the last days of the Bretton Woods system posed an enormous challenges for European crisis management. Membership in the EMU initially insulated chronic debtor countries from currency crises even as it kept their borrowing costs artificially low. At the same time, as noted above, it precluded currency devaluation as a means of regaining competitiveness. Household debt in the “PIIGS” (Portugal, Italy, Ireland, Greece, Spain) skyrocketed to offset the structural current account deficit arising from the expanding German trade surplus whilst German and other core-nation banks became massively over-exposed. Former Bundesbank head Karl Otto Pohl characterized the rescue package for Greece in the following terms (Spiegel, 2010):

> It was about protecting German banks, but especially the French banks, from debt write offs. On the day that the rescue package was agreed on, shares of French banks rose by up to 24 per cent.
...you can see what this was really about—namely, rescuing the banks and the rich Greeks.

As the spread between German bonds and those in the Eurozone periphery rose, harsh austerity plans—effectively channeling public funds to the banks—were introduced as the price of emergency injections of capital to be repaid at punitive rates. Since 2010 a series of programs designed to bail out debtor countries, culminating in ECB President Mario Draghi’s declaration in July, 2012 that he would “do what it takes” to protect bond prices, has averted a full-blown crisis of default or exit even as it has socialized massive amounts of private debt. But the austerity policies that have accompanied the bailouts have deepened the crisis and expanded it beyond the financial sector and into the real economy and society. The continuation of present policies will condemn the Eurozone periphery to stagnation for years to come. Greece’s achievement of a primary account surplus in 2014 resulted from the full spectrum of neoliberal structural adjustment policies that have caused its economy to shrink by 23.5% and investment to decrease by 58% between 2008 and 2013. At the end of 2014 overall unemployment stood at 27% and youth unemployment at 60% (Eurostat, 2014). The bailouts and new bond sale have enabled Greece to contract additional debt at relatively high interest rates and thereby allow the overall debt load and debt/GDP ratio continue to grow, but not to remedy systemic economic deficiencies. Greece’s overall debt load in April, 2014 was 320 billion euros and it will continue to increase. In 2013 Greece experienced an absolute decline of exports (Eurostat, 2014).

The situation is not much less dire throughout the rest of the southern European periphery, even if, with the exception of Greece, the threat of default and exit has receded. In May 2014 Portugal executed a “clean exit” from its IMF-EU bailout program which nevertheless saw its overall debt expand from 93% to 129% of GDP and the welfare system “stretched to the breaking point” as unemployment reached 16.5% in 2013 (Financial Times, 2014). Since 2008 the Italian economy has contracted by 9% and output has declined by 25% (Banca d’Italia, 2014). The unemployment rate in October, 2014 soared to an all-time high of 13.2%. By March, 2014 eight EU countries were experiencing deflation; a further eleven were experiencing what the IMF calls “lowflation” of less than 0.5% growth as unemployment in the Eurozone reached 12% (Eurostat, 2014; Economist, 2014). Unemployment and debt deflation are advancing steadily northward from the periphery into the core. France registered a record 10.5% (3.5 million) unemployment in November, 2014 even as the French government now receives lectures on fiscal rectitude from German ministers previously reserved only for Italians and Greeks. Responding to German pressure in November, 2014 the Commission continued to enforce the fiscal pact limiting deficits to 3% of GDP and public debt to 60% of GDP, although granting France, Italy, and Belgium an additional three months to comply. In November, 2014 European Commission President Jean-Claude Juncker announced a “last chance” 300 billion euro investment fund amid great fanfare. However, only 21 billion euros of the fund would represent new public money, leading the Economist (2014; p. 38) to dismiss Juncker’s proposal as the “magical thinking” of a “medieval alchemist.” The ECB has announced its intention to carry out quantitative easing. However, in February, 2014 the German Constitutional Court provisionally declared “monetary financing” unconstitutional. The ECB will be kept on a short leash by Berlin.
Options for Germany

The Eurozone crisis is thus both a cause and effect of uneven development. This is abundantly clear from the paradoxical and unprecedented situation of IMF involvement in the crisis management of a Eurozone that has consistently generated trade and current account surpluses. Indeed, there is no shortage of observers who propose that Germany adopt the role of “benevolent hegemon” analogous to U.S. leadership of the Bretton Woods system after 1945 (eg. Soros, 2012; Varoufakis, 2013) Mayer, 2012) Blyth and Matthijs, 2011; Economist, 2013). Berlin is exhorted to underwrite the construction of a genuine European fiscal union underpinned by Keynesian policies including a banking union under ECB supervision, the establishment of a deposit insurance scheme for banks, the transformation of the ECB into a full-fledged lender of last resort, and the issuance of eurobonds. These policies would establish the institutional basis for a movement away from austerity, spearheaded by German reflation. They are advocated almost everywhere but Brussels and Berlin, including the IMF, the OECD, Washington, and Beijing.

The fulfillment of such a project would require massive resources. Here, what is perhaps most salient in accounting for the refusal of Germany to commit itself to such benevolence are not the strengths, but rather the profound underlying limitations of German power and corresponding vulnerability under any future scenario. On the one hand, even Germany’s incremental strategy of crisis management through bail-outs and austerity has itself become increasingly costly. Between 2008 and 2013 the Bundesbank contributed $874 billion to the Target2 credit system for which it remains liable. Between May, 2010 and June, 2012 the ECB bought more than 250 billion euros in sovereign bonds and now anticipates purchasing an additional 1 trillion euros. The mutualization of debt via the introduction of Eurobonds would represent a significant and potentially massive new liability. The establishment of a debt redemption fund—pooling debt over 60% of GDP—would amount to more than 3 trillion euros which explains why Germany has categorically rejected joint liability. Germany’s financial liability would also have increased substantially if a European deposit guarantee scheme—which Germany vetoed in an act of “brutal power politics” (Spiegel, 2014) had been introduced. By 2013 Germany’s public debt had reached 81.5% of GDP (Eurostat, 2014). Reflation would increase budget deficits and debt, reducing the ability to re-capitalise a still precarious banking system. Higher wages would increase unit labour costs thereby undermining international competitiveness. The moral hazard implicit in eurobonds would be likely to expand dramatically the cost of these programs. The growing popularity of euroskeptic parties and movements strengthens German resistance to further bailouts. Handelsblatt, the leading German financial newspaper, has called the Maastricht Treaty “Versailles without war.” (2010). Finally, Germany faces a host of longer term structural problems including extremely low growth rates far into the future, population decline, and the legacy of years of low public investment (Fratzcher, 2014). All of these challenges fuel domestic resentment. If the level of unemployment remains relatively low (6.6% in November, 2014) Germany will continue to insist on its zero-debt target for 2015 and circumscribe quantitative easing. If, on the other hand, unemployment rises, than Germany will resist even more strongly calls for a “transfer union.”
weak to exercise “benevolent hegemony” in Europe, but strong enough to continue imposing austerity on the rest of the Eurozone.

With a comprehensive Keynesian solution blocked by Germany, and the European Left in strategic retreat, the EU seems destined to opt for export-led growth driven by further wage compression in the form of labour market reforms, modest expansion of quantitative easing linked to fiscal orthodoxy under Berlin’s watchful eye, and further deregulation, perhaps through the mechanism of the Transatlantic Trade and Investment Partnership (TTIP), which has been strongly supported by Chancellor Merkel. Indeed, deeper transatlantic integration—whether or not institutionalized in the TTIP—represents for Europe the next logical step in a process of neoliberal consolidation that started with the SEA and EMU (see below). It is an expression of the EU’s attempt to resolve the problems of stagnation through competitiveness patterned on the model of German export mercantilism and it also has important geopolitical implications. However, the strategy depends on exports into a world market that is slowing down and would export deflation. Thus it would reproduce on a global scale all of the aforementioned problems and contradictions of the Eurozone.

III. Geoeconomics and Geopolitics

The forceful exercise of German economic power in the context of the Eurozone crisis has its counterpart in Germany’s greater assertiveness in foreign policy, not least in its policies towards Russia in the context of the war in Ukraine. It therefore raises more fundamental questions about basic European and Euro-Atlantic political-military structures. The management of the crisis has exacerbated existing inter-state rivalries and deepened the general crisis of the EU. It has coincided with the abandonment of common Franco-German industrial projects in the nuclear and military-industrial arenas including the failed attempt to merge BAE and EADS in 2012 and the ensuing deepening integration of the U.S. and European military industrial complexes (Cafruny, 2009). Notwithstanding the establishment in the Lisbon Treaty of an elaborate EU foreign policy architecture complete with its own diplomatic core, the CFSP and CSDP processes have been irrelevant to major security issues.

These developments have encouraged speculation concerning the emergence of a more independent German foreign policy, premised on the thesis of an emerging multi-polar world. There is a consensus within foreign policy circles that “Germany will have to take the lead more decisively and more often” (SWP-GMF, 2014) and abandon the “culture of restraint” that has defined its international outlook since 1945 (Sonne, 2014). Chancellor Angela Merkel’s use of sanctions over the objections of German export interests and the ongoing debate between pro-American and pro-Russian factions of German society (Tagesspiegel, 2014a, 2014b) suggest that the war in Ukraine has shattered the longstanding consensus on the need for collaborative relations with Russia and attempts to moderate the U.S.’s confrontational policies as occurred, for example, during the Russo-Georgian war of 2008.
Reflecting on the changing European balance of power as well as cultural shifts in Germany, Hans Kundnani (2014) imagines a “post-Western German foreign policy” that implies a tectonic shift in global power relations:

...a post-Western Germany could take much of the rest of Europe with it, particularly those central and eastern European countries with economies that are deeply intertwined with Germany’s. If the United Kingdom leaves the EU, as it is now debating, the union will be even more likely to follow German preferences, especially as they pertain to Russia and China. In that event, Europe could find itself at odds with the United States—and the West could suffer a schism from which it might never recover.

The causes of such a shift for Kundnani and others (inter alia, Wallerstein, 2014) are both economic and cultural. According to these scholars Germany has become increasingly dependent on emerging country markets, especially China whose weight in Germany’s export and investment portfolio vastly exceeds that of Russia. At the same time, anti-American sentiments within European and German society have deepened, in part as a result of revelations of concerning the activities of U.S. intelligence services in Germany. The Ukraine crisis has brought to the fore underlying Russophile strains in German society. All of these trends, alongside resistance to sanctions, suggest that Germany’s pro-American policy might not outlast the tenure of Chancellor Merkel (see also Schlapentokh, 2014). Indeed, Ivan Tsvetkov (2014) has characterized President Vladimir Putin’s calculations in the following terms: “In an open confrontation between Russia and the West, the long-standing schism between the U.S. and Europe will become deeper; Europe may even come to Russia’s side.” However, the assumption of a German exit from Atlanticism is unrealistic because it does not correspond to Germany’s fundamental economic and political interests.

To be sure, German foreign trade patterns are gradually shifting. Two decades after the Maastricht Treaty was signed German exports remain concentrated on the EU, which receives 59% in 2013. However, the eurozone share of German exports declined from 43% to 41% over the years 2008-11 whilst Asia’s share increased from 12% to 16%. France remains Germany principal trade partner but its share of German exports has declined significantly over the last two decades (from 13.2% to 9.6%) (DWStatis, 2014). China now receives more German FDI than France and appears poised to overtake the United States as Germany’s second largest trade partner. It is the largest market for Germany’s machine-tool industry; almost one-half of China’s exports go to Germany. These data underline the development of a “special relationship” between China and Germany outside of EU structures (Kundnani and Parello-Plesner, 2013).

There is a linkage between the changing patterns of German trade and greater German independence from the American superpower. In 2003 Germany voted in the U.N. Security Council against U.S. military intervention in Iraq. In March, 2011, Germany abstained in the U.N. Security Council—effectively siding with China and Russia—over the Anglo-French-U.S. proposal (Resolution 1973) to establish a “no fly” zone in Libya. With the exception of Serbia (1999) and Afghanistan (2001-14), Germany has refused involvement in all actual or proposed NATO military interventions, including most recently Syria.
Notwithstanding its significant energy dependence on Russia and growing trade and investment links with China, it is impossible to overestimate the continuing importance of the transatlantic economy for Germany. This is true with respect not only to the North American export market, but also to foreign direct investment (Hamilton and Quinlan, 2013). The transatlantic economy represents 46% of the world economy and one-third of global FDI. U.S.-European FDI flows exceed those with China by a factor of 10. The United States remains at the center of global technological innovation and GDP data vastly understate the continuing—if not enhanced—global power of U.S. capital (Starr, 2014), especially in its relationship to China. These data underline the strong objective interest and support of German big business and the state for the TTIP and associated Transpacific Trade Partnership (TTP). Given the growing irrelevance of the WTO, these treaties represent a key source of leverage for both the U.S. and Germany in trade negotiations with China, Russia and other emerging markets. At the present time there is massive popular resistance to the TTP as a result of its neoliberal provisions. However, the strong support given to it by European (and German) big business capital indicates the continuing centrality of Atlanticism.

Atlanticism is, perhaps, even more entrenched in the geopolitical sphere, where Germany and the United States share crucial interests, not least in their relations with Russia. German reunification was a joint U.S.-West German project undertaken against massive opposition from France, the United Kingdom, and a dying Soviet Union. Following a brief post-cold war interregnum during which the abolition of NATO was briefly contemplated, the United States by the mid-1990s adopted a forward strategy that included the expansion of NATO beyond its Western European base into the Balkan region and towards the gas, oil, and pipelines of central Asia and the Middle East and beyond. German firms expanded into central, eastern, and southeastern Europe where they obtained privileged status within strategic financial and industrial structures that were de-nationalised and privatised as a result of shock therapy and, later, the terms of the acquis communautaire with the EU. German-Russian relations also began to assume a quasi-colonial division of labour with the partial conversion of Russia into a market for industrial exports and source of raw materials imports resulting from Russia’s own de-nationalisation and deindustrialization during the 1990s.

Contrary to the assumption of many Russian observers, the absorption of Ukraine into the EU/NATO orbit is not an American attempt to reinforce a putatively precarious Atlanticism. It is consistent with the shared interests of Germany and the United States. Ukraine represents not only a geopolitical prize, but also a significant export market, source of cheap and highly skilled labour, and investment opportunity. The agreement on a Deep and Comprehensive Free Trade Area with the EU (DCFTA) that President Petro Poroshenko signed into law on June 27, 2014 imposes an extreme version of shock therapy on Ukraine. The agreement specifies the removal of all barriers to EU trade and capital, including the provision of services, the privatisation of oil and gas pipelines and their sale to foreign investors (EU, 2014). It will greatly diminish longstanding industrial linkages between Russia and Ukraine. Given the massive disparities between Ukraine and Western Europe the benefits of the CDFTA will flow disproportionately to EU (and to a lesser extent U.S.) firms. The liberalisation of investment is a key element of the agreement: one of the first laws passed by the new government specified that 49% of Ukraine’s gas and oil pipelines were to be privatised and sold to foreign investors.
That EU enlargement has been undertaken under the umbrella of NATO is a reflection of Europe’s (and Germany’s) continuing subordination to the United States. As a “geo-economic” power Germany does not possess the military strength independently to pursue a “logic of conflict” in a sphere that is contested by Russia. Although it is the world’s third largest armaments exporter (behind the United States and Russia), Germany’s own military spending has decreased as a result of the global financial crisis to less than 1.3% of GDP. France—with perhaps one eye on Berlin—has itself returned completely to the Atlanticist fold, as indicated symbolically by the return to NATO’s military structures in 2008 and its leading role in military and diplomatic operations in Libya, Syria, and Iran. The NATO Lisbon Summit of 2010 institutionalized the relationship between NATO and the EU (NATO, 2010). German concerns extend well beyond Ukraine. Following Vladimir Putin’s visit to Serbia in November, 2014 leading German politicians warned that “Russia is coming into the region as a competitor.” Chancellor Merkel asserted that “It’s not just about Ukraine, it’s about Georgia. If this goes any further, we will have to wonder about Serbia, about the Western Balkans?” (Financial Times, 2014)

Conclusion

Sixty years ago German Chancellor Ludwig Erhard proclaimed that “Foreign trade is quite simply the core and premise of our economic and social order.” (Ash, 1994, p. 244). Since that time the policy and practice of German export mercantilism has persisted in various forms, but the geo-economic component or “logic of conflict” featuring “disposable capital in lieu of firepower, civilian innovation in lieu of military-technical advancement, and market penetration in lieu of military garrisons and bases” (Luttwak, 1990; see also Kundnani, 2011) has become progressively more pronounced. The imposition of austerity throughout the eurozone is therefore not a “mistake” resulting from Germany’s unique history or culture, as is frequently assumed (eg. Mazower, 2013; Ozment, 2012), but a reflection of the lack of correspondence between the structural interests of German capital and the developmental needs of the Eurozone as a whole. European monetary relations thus serve as a metaphor for the more general condition of European international affairs. Germany lacks the power to lead a stable, autonomous European project analogous to the U.S.-led Bretton Woods system. The twin crises are mutually reinforcing insofar as the crisis of the Eurozone is disintegrative and therefore reinforces the EU’s dependence on the United States. At the present time, given the configuration of power the transformation to such a radically different project could not arise in Brussels or Berlin, but only from below, as a result of the pressure from Left parties such as Podemos in Spain and Syriza in Greece. Of course, a transformation of this type and magnitude would set in motion an altogether different type of crisis.

Although the geopolitical crisis has not coincided with a strategic movement away from Atlanticism, tactical differences and conflicts among the western powers are likely to increase as the crisis wears on. In 2013 EU exports to Russia amounted to $264 billion; U.S. exports over the same period were $11 billion. The cancellation of South Stream would exact a heavy toll on Bulgaria, Serbia, and Hungary. In the context of stagnation not only the Russians but also the Europeans are paying a heavy price for sanctions. The U.S.’s confrontational policy towards Russia is occurring in the context
of the virtual absence of debate within the media, government circles, or academia. By contrast, the still-influential pro-Russian industrial sector (and political prudence) will continue to moderate Berlin’s policies towards Russia and a similar dynamic can be observed in France and Italy. Nevertheless, the basic contours of Western policy are not likely to change, raising the possibility of potentially greater conflicts between Russia and a still-consolidated American-German and transatlantic alliance.

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