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European integration studies, European Monetary Union, and resilience of austerity in Europe: Post-mortem on a crisis foretold

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Abstract

Europe's Economic and Monetary Union was presented in terms of an idealized, teleological narrative of 'ever closer union' that obscured substantive conflicts within and among the member states of the eurozone as well as the EU as a whole. Despite its limitations the narrative persisted, because it was instrumentalized by powerful social forces and states and reproduced by the mainstream European studies academic cohort, which was strongly influenced by the European Commission. At the present time economic stagnation is giving rise to demands from Keynesian and heterodox quarters for an alternative to neoliberal austerity. However, the resilience of austerity should be understood not primarily as a result of a dominant, if flawed, intellectual discourse, but rather as an expression of Europe's distinctive power relations and the imperatives of German export mercantilism.

Keywords

Economic and Monetary Union, integration, Eurozone crisis, German monetary policy, ECB, mercantilism

Introduction

Since the onset of the global financial crisis in 2008, much of the world has experimented with Keynesian fiscal and monetary expansion. In 2009 China launched an unprecedented $546 billion stimulus programme. The United States followed suit with its own $847 billion stimulus package, accompanied by unconventional monetary policies that would ultimately expand the Federal Reserve's balance sheet from less than $1 trillion in December 2008 to $4.5 trillion in October 2014. In 2013 Prime Minister Shinzo Abe launched a two-year

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programme of 'shock and awe' monetary expansion designed to add $1.5 trillion to the Bank of Japan's balance sheet.

The response of the European Union (EU) has been very different. Between 2008 and 2014 the ECB's balance sheet actually contracted; the European Central Bank (ECB) raised interest rates in 2008 (and again in 2011). Despite running current account surpluses of $400 billion in the past decade, representing almost 3% of GDP and which, if sustained, would be 'the largest ever generated in the history of financial markets' (Saravelos, 2014), Brussels and Berlin have subjected eurozone member states to what has been aptly termed has called 'eurozone fiscal colonialism' (Legrain, 2014), demanding massive austerity in the form of deep cuts in the welfare state, declining real wages and soaring unemployment. As a result of this surplus the EU is exporting deflationary tendencies on a global scale (US Treasury, 2013; OECD, 2014). The Obama administration has emphasized 'philosophical differences' with the EU (Smythe, 2014) and has repeatedly identified fiscal and monetary orthodoxy as the central factor in the eurozone crisis (US Treasury, 2013, 2014).[1] The IMF itself has recognized that its structural adjustment policies have been excessive and counterproductive; it has criticized the imposition of austerity in the eurozone (Blanchard and Leigh, 2012), including the terms imposed jointly by the IMF and EU on Greece and Ireland in 2010, and called on EU member states, and Germany in particular, to pursue more expansionary policies (Thomas and Alderman, 2014). 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: 38) to dismiss Juncker's proposal as the 'magical thinking' of a 'medieval alchemist'.

This article explores the EU's apparently counterintuitive pursuit of austerity in the context of the limitations of the dominant intellectual discourse about the monetary union. A common thread running through mainstream EU scholarship ever since the 1950s has been the tendency to adopt a 'problem solving' approach to the study of European institutions and policies in which the 'problem' is defined as obstacles to further integration. The focus on the concerns of policymakers has come at the expense of understanding the substantive, socio-economic implications of policies and developments, and this has been especially true of monetary relations. As Chris Rumford and Philomena Murray have observed, EU scholarship has privileged 'approaches which confirm the developmental, gradualist, and deterministic nature of the EU' (2008: 86). Thus, at least until very recently Europe has been said to be marching inexorably towards an 'ever closer union' in which even crises and 'setbacks' can be viewed as opportunities for further integration. As the spearhead of closer union, EMU has been viewed as the culmination of a process of integration starting in the spheres of trade and capital market liberalization, but also as a means of compelling greater integration: the preservation of monetary union thus *requires* political union. This restrictive and one-sided narrative has greatly impeded efforts to understand the origins and significance of monetary union.

As Part I shows, one of the most significant aspects of European monetary relations since the early 1970s is continuity in the form of the chronic inability to resolve uneven development in the context of German economic power. Part II explores the intellectual and sociological factors that have precluded a deeper and more comprehensive analysis of the eurozone and its crisis. Since the early 1990s, critical international political economy, heterodox and left-Keynesian scholars had anticipated the problems and contradictions that were inherent in the monetary union. However, the EU – and particularly the

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Brussels–Berlin axis – has resisted their analyses, as well as the more recent – albeit less comprehensive – Keynesian critiques that have emanated from Washington, the IMF and the OECD. EMU was presented to the European public in terms of an idealized, teleological narrative of 'ever closer union' that obscured not only substantive socio-economic power relations but also geopolitical continuities in European monetary affairs, characterized, above all, by German *geoeconomic* power. Despite its limitations, orthodoxy has persisted, because it has been instrumentalized by the Commission and powerful social forces and reproduced by the mainstream European studies academic cohort under strong Commission influence. As Part III argues, the present crisis has given rise to increasingly visible demands from Keynesian and heterodox quarters for alternative policies, and the consensus among transnational capital in Europe is breaking down, as evidenced not only by continuing challenges to austerity from Europe's southern flank but also by growing rebellion in France and Italy. However, the persistence of austerity is ultimately not discursive, but rather a function of Europe's distinctive power relations and the imperatives of German export mercantilism.

Rivalry and monetary union in the first and second projects of integration

Ever since the collapse of the of the Bretton Woods international monetary system, Europe has confronted two seemingly permanent challenges: first, that of US monetary unilateralism, with its chronic inflationary pressures; second, that of accelerating uneven development within Europe, greatly exacerbated by the steady rise of Germany as a *geoeconomic* power. During the post-war 'golden age', France and Italy relied on periodic external adjustments to underwrite Keynesian and mercantilist strategies predicated on exports into the US market (Bellofiore et al., 2010; Loriaux, 1991). West Germany, by contrast, maintained a fixed but overvalued exchange rate consistent with its greater competitiveness. These stances became increasingly untenable as, on the one hand, growth began to slow down and, on the other, US monetary instability began to transmit inflation to Europe, placing upward pressure on the DM (Parboni, 1982).

As tensions mounted, France and Germany sought to establish a 'zone of stability' against the dollar, but each on their own terms. France's objective was greater monetary autonomy, as this was being lost to the Bundesbank in the context of relative lack of competitiveness. Germany sought to prevent competitive devaluations among trading partners. The Werner Report (1970) and Delors Report (1989), of course, approached these problems in radically different ways, expressing respectively the transition from the 'embedded liberalism' that characterized Europe's first project to the neoliberalism of the second project (Cafruny and Ryner, 2007; Magnusson and Strath, 2001). Commissioned as a result of the Hague Summit in 1969 in the aftermath of de Gaulle's resignation, the Werner Plan established the template for an essentially social democratic and Keynesian EMU. Monetary policy was designated to serve as an instrument of economic growth and full employment, and to be developed in the context of tripartite corporatist plans. The Werner Plan did not contain a provision for a European central bank. However, it implied a very large role for a unified and substantial community budget enabling demand management and corporatist policies. The decoupling of the dollar from gold in 1971 and pressure from Washington halted plans for monetary union, and the Werner Plan was formally abandoned as a result of US–French consultations in 1971 (Syrrakos, 2010). Although none of its key provisions survived, it nevertheless inspired the establishment of a European Monetary Cooperation

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Fund (EMCF), initially conceived as an embryonic Federal Reserve System with the capacity to serve as a 'transfer union'. Even this was strongly resisted by West Germany, and the EMCF remained 'a rather subsidiary and shadowy institution' (James, 2012: 13). While the Delors Committee would subsequently blame 'institutional ambiguities' and 'lack of internal momentum', the central substantive cause of the failure of the Werner Plan was West German opposition based on its view that there were 'insufficient constraints on national policies' (James, 2012: 15).

The 1970s gave rise to more modest forms of monetary coordination in the form of the 'snake' and European Monetary System (EMS). These efforts once again demonstrated the difficulty of intergovernmental cooperation and revealed Europe's vulnerability to US monetary unilateralism, chronic uneven development and relatively high levels of labour militancy that made it impossible to maintain sufficient discipline or 'internal adjustment' and thereby pass the burden of fixed exchange rates on to labour. The central imbalance between productivity levels in West Germany and most other EU member states meant that the D-mark was a powerful magnet for international capital seeking a safe and noninflationary haven. The experience of the EMS, established in 1979, exemplified this tendency. The system of fixed exchange rates (within a band of 2.25% and 6% for Italy) evolved into a de facto D-mark zone. Even more than during the dollar–gold standard, the burden of adjustment fell on the debtor countries. As long as European economies were expanding EMS members could raise their interest rates in order to maintain parity with the rising D-mark. However, the Bundesbank refused to conduct inflationary monetary and fiscal policies and the proposed European Monetary Fund aroused 'intense hostility' from Germany. French Finance Minister Eduard Balladur had criticized the EMS for its 'bias towards deflation and the overvaluation of Europe's currencies' which placed 'the burden of adjustment on weaker currencies to raise their interest rates' (James, 2012: 231) and the Bundesbank 'feared that this would be the beginning of large transfers to weaker and poorer states' (James, 2012: 234). The crisis of the ERM thus foreshadowed the present crisis: then, as now, Germany refused to accept inflation to promote European solidarity. When in 1992 the Bundesbank raised interest rates to unprecedented levels it ushered in a period of sustained stagnation in the fledgling single market, placing massive pressure on France and ultimately forcing Italy and the UK to withdraw from the ERM.

Amid these deepening conflicts, the 1988 European Council authorized the Delors Committee to present its report to the European Council in 1989. The template for EMU that emerged as a result of the Delors Report and was signed into law at Maastricht in 1991 of course emerged as the centrepiece of the second, or neoliberal, project. It was formulated not by politicians, as with the Werner Plan, but by central bankers (James, 2012) expressing the vision of European transnational capital (Carchedi, 2001; van Apeldoorn, 2002). The Report reversed the substantive underpinnings of the Werner Plan: notwithstanding the rhetoric of 'social Europe', employment and social policies were effectively subordinated to the goal of 'sound money' and, like fiscal policy, confined to the national sphere (see Durand and Keucheyan, this issue).

In the context of the single market and emergent competitiveness agenda – and more broadly within a historical conjuncture defined by the collapse of socialism and the massive expansion of the global labour market – the Delors Plan thus expressed the quintessential neoliberal policy. From the standpoint of European transnational capital, it resolved the underlying substantive defects of Werner and thus ultimately became

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acceptable to Berlin, although never entirely to the Bundesbank or German *ordoliberals*: in contrast to Werner, the architects of EMU placed great emphasis on monetary and fiscal discipline. They projected an independent central bank not subject to democratic control and legally bound to 'sound money' policies, most notably article 123, which prevents central bank financing of debt. By contrast, fiscal policy was legally the purview of the member states, which were, however, subject to supranational surveillance and policing. Starting with the convergence criteria and the Growth and Stability Pact – the price of German acquiescence to EMU – and continuing with the Treaty on Stability, Coordination, and Governance in the EMU (the 'Fiscal Compact') of 2013, counter-cyclical policies were prohibited and the burden of adjustment was placed on labour. Thus, the Maastricht convergence criteria and successive fiscal pacts subordinated macroeconomic policy to short-term global financial markets. The 'straitjacket' compelled neoliberal policies and 'Europe' became a covert rallying point for fiscal austerity (Talani, 2003) and a competitiveness project. Given the monetarist remit of the ECB, flexible labour markets and other structural reforms – now identified as 'internal devaluation' – were presented as the only means of averting the break-up of the eurozone. EMU – and more generally the second project – of course derived strong support from European transnational capital 'as a whole'. However, these policies greatly accelerated uneven development and Germany has been able to exploit them most effectively. As a result, the consensus is breaking down. EMU still provoked tensions between the Bundesbank and its commitment to monetary orthodoxy at all costs on the one hand, and Berlin as representative of dominant German export capital on the other. However, if Germany's acquiescence resulted in part from a Franco–German bargain concerning reunification, it also resulted from a confidence that Germany was sufficiently powerful to control the main contours of EMU to express the interests of export capital.

Scholarship and EMU: a post-mortem on the project of an 'ever closer union'

Given the troubled history of European monetary cooperation, it was hardly surprising that the Delors Plan and subsequent Maastricht Treaty provoked a great deal of scepticism. Perhaps the strongest reservations were registered by the Thatcherite British Right and German political leaders, and by academic economists with close ties to the Bundesbank and the *ordoliberal* tradition. Whereas the former opposed British membership in a project that would inevitably enhance German power and threaten the City of London (Connolly, 1997), the latter feared that constitutional brakes against monetary expansion in the Maastricht Treaty would not be sustainable and that intergovernmental fiscal pacts would be broken. In 1990 the Central Council of the Bundesbank noted that monetary union 'is an irrevocable joint and several community which, in the light of past experience, requires a more far-reaching association in the form of a political union if it is to prove durable' (quoted in Hewitt, 2013: 29). Profound scepticism was also voiced from within the American economics profession, which was largely insulated from Brussels and therefore immune to the wave of euphoria; from heterodox, left-Keynesian economists (e.g. Godley, 1990; De Grauwe, 1998; Grahl, 1997); and from emergent strands of critical and neo-Gramscian political economy (e.g. Gill, 1992; van Apeldoorn, 2002).

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American economists

In December 2009 two economists from the staff of the Directorate-General (D-G) for Economic and Financial Affairs issued a comprehensive report on scholarship on EMU in the United States (Jonung and Drea, 2009). The report is extraordinarily useful and revealing for its detailed and systematic analysis of the perspectives and concerns of the American economists. It also reveals the strong currents of hubris and triumphalism concerning the euro that flowed through European institutions right up until the Greek and Irish crises in 2010. The authors found it 'surprising that economists living in and benefiting from a large monetary union like that of the U.S. dollar were so skeptical of monetary unification in Europe.' They started from the premise that the euro was clearly a success:

> This unparalleled experiment in monetary unification is a milestone in the European integration process. By now, the euro has emerged as a major currency, even challenging the U.S. dollar as the global reserve currency. In a very short period of time, it has transformed the European economic and political landscape. Never before have sovereign nation states surrendered their national currencies to a common central bank, abstaining from monetary sovereignty. In short, the euro is one of the most exciting experiments in monetary history (Jonung and Drea, 2009: 1).

The task was, therefore, to determine how and why the critics were wrong. The economists' critique focused on three problems that Jonung and Drea believed were greatly exaggerated: first, the convergence policies were seen as overly restrictive (Kenen, 1992); second, the Maastricht timetable was considered to be too short given the incomplete harmonization of national policies (Branson, 1993; Dornbusch, 1993); and third, perhaps most crucially and generally, because of the absence of fiscal federalism, the long-term sustainability of EMU relied exclusively on surveillance rather than collective policy formulation.

Optimum currency area theory (OCA) was central to the critique. OCA assumes two countries given the choice of a fixed exchange rate (or currency union) or a flexible exchange rate and examines the cost–benefit calculus between a single currency, on the one hand, and the loss of macroeconomic independence on the other (Mundell, 1961; Tobin, 1998). Not surprisingly, the United States was frequently used as a basis for comparison. Although there was considerable scepticism concerning the ability to operationalize OCA, most of the economists in the survey concluded that Europe was not a suitable monetary union because of the absence of significant fiscal transfer mechanisms, sticky wages and a single monetary policy objective of price stability (Tobin, 1998). As a result, member states could be expected to face substantial adjustment problems and these were likely to result in political conflict and instability. In 1996, for example, Rudiger Dornbusch, summarizing the opinion of most US economists, argued that while the single market 'was seen as contributing to prosperity and thus political stability... the [EMU] is seen as carrying a high risk of contributing to a recession and thus political trouble' (quoted in Drea and Jonung, 2009: 13). Martin Feldstein, similarly, asserted that EMU would be an 'economic liability'. Absent labour mobility and wage flexibility as well as centralized fiscal policy, EMU would increase cyclical unemployment. More ominously, it would aggravate tensions among the member states and especially between France and Germany. Feldstein's conclusion confounded Europhiles at the time, but in retrospect appears more prescient: 'If EMU does come into existence... it will change the political character of Europe in ways that could lead to conflicts in Europe and confrontations with the United States' (1997: 60).

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Left-Keynesians

The aforementioned concerns of American economists were shared by left-Keynesians, many of whom were based in the UK and associated with the increasingly marginalized left wing of the Labour Party. Wynne Godley's (1992) extraordinarily prescient critique of the EMU in the aftermath of the collapse of the ERM, Danish rejection and a hotly contested French referendum on the Maastricht Treaty in 1992 deserves particular attention. Godley emphasized the neoliberal underpinnings of EMU, which would destroy the European 'social model'. In contrast to the Werner Plan, the Maastricht design for EMU represented a 'crude and extreme version of the view which for some time now has constituted Europe's conventional wisdom (though not that of the US or Japan) that governments are unable, and therefore should not try, to achieve any of the traditional goals of economic policy, such as growth and full employment' and that 'subsidiarity' masked the extreme centralization of monetary policy and, hence, 'the main thing that defines national independence...If a country or region has no power to devalue, and if it is not the beneficiary of a system of fiscal equalisation, then there is nothing to stop it suffering a process of cumulative and terminal decline leading, in the end, to emigration as the only alternative to poverty or starvation' (1992: 3–4).

Whereas Godley focused primarily on the inevitability of macroeconomic shocks, the Belgian economist Paul De Grauwe emphasized the implications of the absence of regulatory restraints and centralized bank supervision, or what is, in contemporary parlance, 'banking union'. The combination of national regulatory segmentation and complete capital liberalization laid the basis for future crisis, which De Grauwe (1998: 9) illustrated, with uncanny prescience, with reference to a hypothetical property bubble in Spain. As De Grauwe went on to note, such local boom and bust cycles have occurred repeatedly in the United States, albeit in the context of a single currency and a substantial federal budget. While it is true that EMU would eliminate speculative currency crises, of course such crises have simply been carried over into bond markets such that the contemporary euro is nominally one currency but remains a de facto international monetary order (see below). The implication of the left-Keynesians was that the euro could only survive in a single polity. With respect to this possibility they expressed varying degrees of optimism and pessimism. During the 1990s, especially in the UK, there was much discussion of the possibility that the euro could serve as a means of blunting American monetary power and thus providing a basis for the restoration of social democracy 'in one continent' (Cafruny, 1997).

Within Germany, of course, there was widespread fear of EMU amid recognition that a monetary union in the absence of political and economic union was a recipe for disaster and that economic integration must precede monetary union. On one hand, the absence of a central budget would, as Keynesians recognized, impose intolerable burdens on deficit states. On the other, the creation of a central authority would raise the issue of moral hazard and make it difficult to avoid a 'transfer union.' Thus contemporary opposition to the euro in Germany reprises the broad consensus among the German public and economists in the 1990s.

EU scholarship and the Eurozone crisis

The common factor in this otherwise disparate scholarship and political commentary is that it emanated from outside the 'magic circle' of the Eurocracy. But it casts an even more

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unfavourable spotlight on the record of the European studies scholarship with respect to EMU (Ryner, 2012), much of which has been carried out under the shadow of the European Commission. Between 1993 and mid-2009 the prestigious *Journal of Common Market Studies* contained only five (of 732) articles that were pertinent to the topic of economic and monetary union. A similar and striking lack of curiosity concerning the potential underlying factors which precipitated the crisis of the eurozone is readily apparent in the hundreds of papers delivered at the European Union Studies Convention of May 2009.[2]

With respect to EMU, mainstream scholars pursued two basic lines of inquiry. On one hand, economists assumed *a priori* the stability of monetary and financial integration based on equilibrium models derived from neoclassical analysis. Central to these models was the rejection of OCA analysis (e.g. Drea and Jonung, 2009). On the other hand, political scientists and sociologists generally uncritically accepted neoclassical assumptions concerning economic growth and stability. They paid scant attention to economic dynamics, but rather emphasized the sociological concept of 'density' to measure the scope of integration. In fact, the anomaly of a vast misallocation of financial resources into a speculative credit boom followed by bust, bad debt and financial panic must be considered a rather compelling falsification of neoclassical and equilibrium models (Ryner, 2012). Political sociology, similarly, has had very little to say about the causes of the crisis.

To be sure, intergovernmentalism will always offer important insights on EU politics, especially in the context of deepening inter-state rivalries, the growth of nationalism and gathering Franco–German tensions. The approach has much more difficulty in explaining why a monetary union that accorded with the broader neoliberal project was chosen and how and why a crisis resulted. Constructivism, focusing on the causal significance of ideas and norms, usefully emphasizes the attractiveness of neoliberal ideas to Europe's political and business elite (Hay and Rosamond, 2003; McNamara, 1998). However, these ideas did not arise in a vacuum, but rather as expressions of the interests of powerful social forces and states (see Jessop, this issue).

Here it is notable that the analysis of the EU has been limited by the failure of mainstream scholarship to embrace political economy in the classical sense of the term: as the study of production and power broadly conceived. Rather, since its inception in the 1950s, at first strongly influenced by the US State Department (Milward and Sorensen, 1993), mainstream EU scholarship has reproduced a division in the social sciences that was accomplished at the end of the nineteenth century and reinforced after the Second World War. The connection between 'politics' and 'economics', once widely assumed to be organic, was either severed altogether or presented in a highly idealized form (Cafruny and Ryner, 2009). This has generated a variety of perspectives on integration that are wholly inadequate to the task of understanding the reasons for the contemporary crisis of the euro and the EU.

If the absence of a political economy approach provides one explanation for the limitations of mainstream scholarship, the particular sociology of knowledge of the EU has also been very important. From the late 1980s the European Commission strongly influenced the academic study of the EU in the United States and Europe. The Commission was instrumental in establishing the European Union Studies Association (EUSA), the key American and global academic organization for EU studies, and it continued well into the 1990s to provide funding for many of its activities, including publications, executive board meetings and bi-annual conferences.[3] The European Commission has also established and funded numerous 'Centers of Excellence' throughout the United States. According to the Commission's website the Jean Monnet Programme has an annual budget of 170 million

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euros and funds no less than 2139 Jean Monnet Modules. Between 1990 and 2011 the Commission established 162 Jean Monnet Centers of Excellence and 875 Jean Monnet chairs, thus bringing together 1500 professors and 500,000 students every year (European Commission, 2014: pp. 56–57; Klinke, 2015; see also Hockenos, 2013). The EU Commissioner for Education, Training, Culture, and Youth has called Jean Monnet professors 'ambassadors of European integration in member states, the candidate countries, and around the world' (quoted in Klinke, 2015). To emphasize the indirect role played by the Commission in influencing the content of academic studies is by no means to level accusations of bad faith. More than a decade ago Craig Calhoun noted that European studies constituted 'an ideological-pedagogical project' that promoted 'a European self-understanding supportive of the EU' (2003: 13).

There has been, moreover, a strong and persistent functional connection between the normative *ethos* of EU studies – above all the distinctive commitment to 'Europe' and integration – and the legitimization of an essentially neoliberal EMU in which the inability to devalue in the context of the absence of a federal budget has demanded that states pursue the full spectrum of austerity policies. Neoliberalism, the imposition of market discipline over society and economy, emerged unevenly on a global scale as a result of a combination of coercion and consent (Harvey, 2005). In the former Soviet bloc, it enjoyed considerable elite and (at the outset) mass support as a reaction to communism. Throughout much of the global south, by contrast, neoliberalism was essentially imposed by western governments and banks, although of course it also enjoyed considerable support from elites. The Anglo-American sphere was, by virtue of its distinctive classical liberal political culture, particularly susceptible to the calls for 'freedom' that accompanied Margaret Thatcher and Ronald Reagan's assault on unions and the welfare state. The Thatcherite project was presented in national terms and was consolidated before the Maastricht Treaty was signed. By contrast, the European continent was and to some extent remains more resistant to neoliberal discourse. The austerity demanded by EMU has been legitimized with respect to a variety of claims, but the appeal to 'Europe' has been foundational. Of course, in Sweden and Denmark social democracy remained so deeply entrenched that their citizens remained immune to the siren calls of Europe, which may have found its last tragic echo in the popular demands of Ukraine's *euromaidan* to submit to a quintessentially neoliberal Association Agreement.

A Keynesian solution?

Notwithstanding the optimistic declarations from Brussels of Eurozone progress that followed Greece and Portugal's return to the bond markets (see below), there is general agreement that the EU as presently constituted faces years of stagnation or outright deflation, and that a resolution of the eurozone crisis would require a sharp transition from the present austerity union to a set of policies resembling the Werner Plan. Such a plan would require constitutional changes in the role of the ECB so that it could act as a lender of last resort, a genuine banking union and a common fiscal policy. There is, of course, no shortage of such proposals (e.g. *Euromemorandum*, 2014; ETUC, 2011; Glienicker Gruupe, 2013; Maier, 2012; Soros, 2012; Jager and Springler, 2014; Flassbeck and Lapavitsas, 2014) amid growing resistance to EU budget rules imposed from Paris and Rome. But the prospect of political union is utopian not only because sovereignty in general has proved to be far more resilient than the 'optimists' had hoped, but also for two other quite specific reasons. First, the unity

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of the eurozone itself is nominal, and not real. Cross-border lending within Europe and the transatlantic space has greatly diminished in favour of closer links between banks and sovereigns, resulting in what Spanish economy minister Luis de Guindos has called the ‘renationalization of finance’ (Sri Kumar, 2012; Alloway and Braithwaite, 2012). The inability of the ECB to control interest rates and real economic conditions has led ECB President Mario Draghi himself to raise the problem of ‘convertibility’.[4] Nominally a ‘monetary union’, the eurozone has in fact become a de facto international monetary order, more akin to the ERM that collapsed in 1992, and in which bond market attacks and ‘internal devaluation’ take the place of currency speculation while various ‘exit strategies’ – and the prospect of competitive devaluations to come – are mooted. Second, the geoeconomic power of Germany, ever present since the late 1960s, has become far more pronounced. Here the key issue is not ultimately intellectual or discursive – the persistence of macroeconomic orthodoxy across the political spectrum – but rather geopolitical: can the structural interests of German capital be made consistent with the developmental needs of the eurozone as a whole? In his seminal work, *The World in Depression*, Charles Kindleberger argued that stable monetary orders require a single leader or ‘hegemon’ powerful enough to resolve collective action problems and extend concessions to subordinate allies (1973). Although it is commonplace to propose a role for Germany analogous to that played by the United States after 1945 (Blyth and Matthijs, 2011; *Economist*, 2013; Maier, 2012; Soros, 2012; Varoufakis, 2013; Wolf, 2014), the nature and purpose of German *geoeconomic* power would appear to preclude this type of leadership. Prior to 1989 West Germany could be considered a *civilian* power, because it was engaged in the pursuit of cooperation through multilateral institutions (Maull, 1990). Since reunification, however, German policy has evolved in a very different direction. *Geoeconomic* power refers to ‘the admixture of the logic of conflict and the methods of commerce... the harder edge of Germany’s pursuit of national interest within Europe and its reluctance to use military force or even to project power in a traditional sense in the wider world’ (Luttwak, 1990: 17). At the present time Germany pursues a policy of ‘selective multilateralism’ within a ‘logic of conflict’ according to which ‘methods of commerce’ displace ‘military methods’ with ‘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: 22).

The central organizing principle of German (geoeconomic) foreign policy is exports. As Ludwig Erhard wrote 60 years ago, ‘Foreign trade is quite simply the core and premise of our economic and social order’ (in Ash, 1994: 244). Throughout the post-Second World War period Germany has pursued mercantilist goals, but the *geoeconomic* component – the ‘logic of conflict’ arising from Germany’s ‘macroeconomic exceptionalism’ (Munchau, 2014) – has become even more pronounced in the context of the eurozone crisis. German capital has pursued a strategy of relentless cost-cutting and austerity closely linked to its foreign direct investment strategy. Crucial stages of German manufacturing and commodity supply chains have been relocated throughout central and eastern Europe, thereby enabling the German export model to compete globally (Gross, 2013). Successive EU enlargements since 2004 have provided a more secure institutional and legal basis for a de facto enlarged German manufacturing zone or ‘German Central Europe Supply Chain’ (IMF, 2013).

Germany’s relatively modest record of growth since that time has been achieved largely on the basis of exports. The German economy is ‘structurally reliant on foreign demand for its growth’ (Tilford, 2010: 6). German exports account for 50% of GDP, in comparison to 30% for Italy, France and the UK. A succession of reform programs and ‘employers’

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offensives' (Kinderman, 2005) undertaken by both the CDU/CSU and SPD-led governments dramatically decreased unit labour costs, especially after 2002 in conjunction with fiscal austerity and ensuing Hartz IV labour reforms. Agenda 2010 resulted in sweeping changes in unemployment protection and social assistance. As a consequence, the link between export-led growth, wages and the expansion of the internal market that characterized Germany's post-war phase has been severed (Hugh, 2007; IMF, 2007; see also Bibow, 2009; Dumas, 2010, esp. pp. 162–175). German export mercantilism requires the eurozone in order to preclude the competitive depreciations that were occurring prior to 1992 and which would certainly return in the context of break-up. As Costas Lapavitsas and colleagues have written, 'The euro is a 'beggar-thy-neighbor' policy for Germany, on condition that it beggars its own workers first' (2012: 30). As noted above, there can be little doubt that, notwithstanding the objections of the Bundesbank and *ordoliberals*, German banks and export firms – but not the German working class – have benefited greatly from EMU. The severe downturn experienced by Germany in 2008 and 2009 when Germany's exports were hit hard by the global recession is a reflection of its extremely high export dependence. Germany registered a growth rate of just 0.5% in 2013 even as its trade surpluses exceeded 17 billion euros per month (Eurostat, 2014).

The limits of German power

The single currency not only prevented periodic devaluations against Germany within the eurozone, but also served to limit the appreciation of the euro in relation to the dollar, pound and renminbi. According to the IMF, Germany's effective exchange rate is undervalued by 8% on a historical basis as a result of the euro (IMF, 2013). The low interest rate regime allowed German banks to participate in a debt-financed bubble throughout the southern periphery in the first decade of the twenty-first century, the necessary counterpart to export surpluses. When the boom ended, as noted above, programmes such as the EFSF, the ESM and various schemes for ECB financing allowed German and other core banks to reduce their own exposure while imposing much of the cost on peripheral countries and core country taxpayers. Finally, the crisis has allowed the German government to issue debt not on the basis of German 'fundamentals', but rather on the basis of 'flight to safety'. Joshua Rosner has calculated that, as a result, German 10-year yields 'should' be twice their current level of 1.2% (Rosner, 2012: 17).

To be sure, the costs of even a Greek exit from the eurozone for Germany would be substantial; it is possible and perhaps even likely that exit and subsequent default would be likely to trigger a wholesale collapse of the single currency by increasing pressure on Spain, Portugal and Italy. The loss of the euro would, moreover, gravely damage the single market. Notwithstanding the fact that German exporters have become somewhat less dependent on the eurozone, German banks and the German state would also suffer severe consequences from a generalized break-up and default. A Greek exit, although involving just 2.3% of eurozone GDP, could still involve very high costs for the German and French states and be very destabilizing for the eurozone (Das, 2013; Dor, 2012).

The alternative to break-up and default would be the construction of a genuine European fiscal union under a 'benevolent' German hegemony, including a Treasury and system of common taxation, 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 provide the institutional basis for

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a movement away from austerity, led by German reflation. They are advocated almost everywhere but Germany itself, including, as noted above, by the IMF, the OECD and the US Treasury. Yet the resources that would need to be expended would be substantial and, arguably, beyond the capacity of the German state.[5]

Here, what is perhaps most salient in accounting for the persistence of Germany's support for austerity is the profound vulnerability of Germany under any future scenario. On the one hand, Germany's present 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.[6] In addition, between May 2010 and June 2012 the ECB bought more than $250 billion in sovereign bonds, and EFSF and ESM support has totalled $500 billion (Glover, 2012). The mutualization of debt via the introduction of eurobonds would represent a significant 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 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-capitalize banks. Higher wages would increase unit labour costs, thereby undermining international competitiveness. The moral hazard implicit in eurobonds would be likely to dramatically expand the cost of these programmes. The growth of eurosceptic parties and movements in Germany strengthens resistance to a 'transfer union.' 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).

A break-up of the euro in the short term, then, would certainly impose further massive costs on Germany. Alternatively, Germany could greatly increase its (already implicit) demands for real industrial and commercial assets in return for debt guarantees along the lines of privatization plans for Greece, but this would have enormous political consequences (Michaletos, 2012). Whether or not the eurozone breaks up, Germany appears destined to acquire massive liabilities amid growing austerity and resentment. If the level of unemployment remains 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, Germany will even more strongly resist calls for a transfer union. European Commission proposals for a 'banking union' under which the ECB would become the principal supervisor of large European banks and a eurozone-wide deposit scheme would be implemented were vetoed by Germany in an act of 'brutal power politics' (*Spiegel*, 2013). In December, 2014 the Bank for International Settlements concluded that new EU laws did not meet global standards and would be unable to prevent a future financial crisis (BIS, 2014).

Since 2010 a series of programmes designed to bail out debtor countries, culminating in the introduction of the outright monetary transactions (OMT) programme and ECB President Mario Draghi's declaration in July 2012 that he would 'do what it takes' to protect bond prices, have averted a full-blown crisis of default or exit even as they have socialized massive amounts of private debt. But the austerity policies that have accompanied the bail-outs have both 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 prolonged stagnation. Greece's achievement of a primary account surplus in 2014 resulted from the full spectrum of neoliberal structural adjustment policies that have caused its

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economy to shrink by 23.5% and investment to decrease by 58% between 2008 and 2013. Overall unemployment in the country stands at 27% and youth unemployment at 60% (Eurostat, 2014). The bail-outs 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 to 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 (Alderman, 2014; Eurostat, 2014).

The situation is not much less dire throughout the rest of the southern European periphery. Prodded by the Commission and Germany with the coming European elections in mind, in May 2014 Portugal also executed a 'clean exit' from its IMF–EU bail-out programme, 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), and the unemployment rate in October 2014 soared to an all-time high of 13.2%. In March, 2014 eight EU countries were experiencing deflation; a further 11 were experiencing what the IMF calls 'lowflation' of less than 0.5% growth as unemployment in the eurozone reached 12% in 2014 (*Economist*, 2014; Eurostat, 2014). Unemployment and debt deflation are advancing steadily northward from the periphery into the core. 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.

Germany's *geoeconomic* strategic orientation (Kundnani, 2011) – expressing a 'logic of conflict' via economic means – has thus been entirely consistent with European austerity (Cafruny, 2015). The resilience of austerity should ultimately be understood not as a result of a dominant, if flawed, intellectual discourse, but rather as an expression of Europe's distinctive power relations and the imperatives of German export mercantilism. Given the configuration of power, the transformation from austerity to a more progressive and expansive order is unlikely to originate 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. With comprehensive Keynesian solutions blocked by Germany, 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[7] and further deregulation through the mechanism of the Transatlantic Trade and Investment Partnership. Indeed, deeper transatlantic integration represents for Europe the next logical step in a process of neoliberal consolidation that started with the SEA and EMU. It is an expression of the EU's attempt to resolve the problems of stagnation through competiveness patterned on the model of German export mercantilism. However, the strategy depends on exports into a world market that is slowing down. Moreover, given the size of the eurozone economy, this strategy would inevitably serve to export deflation. Thus it would reproduce on a global scale all of the problems and contradictions of the German model.

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Notes

1. The Report states: 'To ease the adjustment process within the euro area, countries with large and persistent surpluses need to take action to boost domestic demand growth and shrink their surpluses. Germany has maintained a large current account surplus throughout the euro area financial crisis, and in 2012 Germany's nominal current account surplus was larger than that of China. Germany's aneemic pace of domestic demand growth and dependence on exports have hampered rebalancing at a time when many other euro area countries have been under severe pressure to curb demand and compress imports in order to promote adjustment. The net result has been a deflationary bias for the euro area, as well as for the world economy.'
2. www.aei.pitt.edu/conference/cc0012009april23252009.html
3. The author was a member of the executive board of the EUSA from 1993 to 1995.
4. 'Then there's another dimension to this that has to do with the premia that are being charged on sovereign states borrowings. These premia have to [do], as I said, with default, with liquidity, but they also have to do more and more with convertibility, with the risk of convertibility.' http://ftalphaville.ft.com/blog/2012/07/27/1097961/premia-there-and-everywhere/
5. Susan Watkins (2014: 6) observes that ever since the Delian League, stable leadership of a federation has required 'a good third of the total's demographic, economic and military weight'. Germany accounts for about 17% of the EU's population and GDP; its military capability lags significantly behind that of France and Britain.
6. Target2 (Trans-European Automated Real-time Gross Settlement Express Transfer System) is a payment system that settles cross-border fund flows. The present massive imbalances reflect peripheral countries' need for external financing as core country banks have ceased lending. Since 2008 these imbalances have been financed via the ECB. 'A Greek importer, for example, might place an order with a German company. Payments to and from the accounts of the buyer and seller are channeled via central banks, so the German exporters bank gets a credit from the Bundesbank, which in turn has a claim on the ECB. The Greek importers bank owes its local central bank, leaving the Bank of Greece with a debt at the ECB... The Bundesbank effectively ends up with loans to the other central banks that are reflected in Target2 claims on the Eurosystem' (Glover, 2012).
7. Having failed for two years to reach its 2% inflation target in October 2014, the ECB announced its first steps towards quantitative easing. However, between 20 October and 28 November it purchased only 18.2 billion euros of a projected 1 trillion euros (Ewing, 2014: B2).

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