At the end of January, European leaders agreed the wording of the new treaty aimed primarily at tightening fiscal policy in the euro area that was agreed in principle by 26 EU heads of government at last December’s European summit. The treaty reflects German positions rather than collective compromise. In particular, the treaty centres on a “fiscal compact” that compels all eurozone countries to incorporate into their constitutions a deficit limit modelled on the German Schuldenbremse, or “debt brake”. In addition, European leaders once again ruled out the possibility of using European Central Bank (ECB) funds to “leverage” the European Financial Stability Facility (EFSF) or European Stability Mechanism (ESM), and there was no mention of ECB bond purchases to help stabilise bond markets.

However, although the new treaty reflects views that are supported by a broad consensus in Germany (strict opposition to ECB intervention and a one-sided focus on fiscal austerity), there is actually only limited support for these views elsewhere in Europe. In fact, it has often been pointed out that German solutions to the euro crisis are quite different to those demanded by the financial markets and the international press. Germany has been widely criticised for its monetary policy, its inflexibility on austerity measures, its rigid legal approach to treaty change and its selfish view of trade imbalances. Much of what Germany has done to solve the euro crisis has caused concern and drawn criticism from its European partners.

Germany has also been widely criticised for what it has not done. In particular, both the Christian Democrats and the
Free Democrats, the two coalition partners in the German government, rejected two possible solutions to the euro crisis that were proposed by others in Europe: Eurobonds and the idea of turning the ECB into a lender of last resort for the eurozone along the lines of the US Federal Reserve. Both were seen in Germany as undermining the principle of monetary stability and creating moral hazard. Principles such as monetary stability are seen as sacrosanct by both the Christian Democrats and the Free Democrats. But where do they come from? Are they somehow rooted in the German psyche, as some claim, or are they liable to change with electoral majorities?

This brief aims firstly to explain to a non-German audience the historic and economic traditions that frame the euro debate in Germany. It will also show the ways in which this background is reflected in recent German political party programmes. Based on this account, it finally briefly considers how German positions might shift in the future. It argues that there is more to Germany’s distinctive approach to the euro crisis than the much-discussed historical experience of the hyperinflation in the Weimar Republic on the one hand and simple national interest on the other. Rather, there is an ideological edifice behind German economic orthodoxy with which Germany’s partners must engage. While a change in the government after the next general election, in 2013, would lead to a change in German economic policy, it is unlikely to dramatically change the country’s approach to the euro crisis.

The first part of the brief outlines the intellectual tradition – in particular, the economic theory of ordoliberalism – that underlies Germany’s approach to the euro crisis. It will also outline some of the essential tenets of German Ordnungspolitik such as price stability, central bank independence, state-market relationships and regulatory state interference in markets. It will contrast this position with the position more prevalent in the Anglo-Saxon debate and in international institutions such as the International Monetary Fund (IMF). The second part discusses the influence of this economic tradition on the five main political parties in Germany. The third part sketches out the possible changes in German economic policy that might follow a change of government in 2013.

Ordoliberalism as the basis of German economic thinking

It is often claimed that the German approach to the euro crisis, and in particular its emphasis on price stability, is based either on its narrowly defined interest as a capital surplus country or on the historical experience of the hyperinflation in the Weimar Republic. However, while these two factors do play a role in German policy, they are not sufficient to explain the German debate. On the one hand, the danger of a devaluation of external assets through inflation is almost never mentioned in the public debate and is probably less important in German policymaking than the losses that would occur if Germany’s foreign debtors defaulted. On the other hand, other countries such as Austria and Greece have also experienced hyperinflation in the past, but do not share Germany’s fear of inflation and resistance to ECB intervention in sovereign bond markets.

An important but rarely discussed reason for Germany’s emphasis on price stability is the influence on German economic thinking of “ordoliberalism” – a theory developed by economists such as Walter Eucken, Franz Böhm, Leonhard Miksch and Hans Großmann-Doerth as a reaction both to the consequences of unregulated liberalism in the early years of the twentieth century and subsequent Nazi fiscal and monetary interventionism. The central tenet of ordoliberalism is that governments should regulate markets in such a way that market outcome approximates the theoretical outcome in a perfectly competitive market (in which none of the actors are able to influence the price of goods and services). Ordoliberalism differs from other schools of liberalism (including the neo-liberalism predominant in the Anglo-Saxon world) in that it places a greater emphasis on preventing cartels and monopolies. At the same time, like neo-liberalism, ordoliberalism opposes intervention into the normal course of the economy. For example, it rejects the use of expansionary fiscal and monetary policies to stabilise the business cycle in a recession and is, in that sense, anti-Keynesian.

Politically, ordoliberalism is closely linked to the first phase of the social market economy from 1948 to 1966. Although it was broader and also included social goals, the concept of the social market economy incorporated the basic ideas of ordoliberalism, which were reflected in the legislation of the time – for example, the law on collective bargaining, the law against restraints on competition and the Bundesbank law. Having helped to create rapid reconstruction and a swift increase in its standard of living during this period, the social market remains one of the most positively charged terms in the German policy debate. As such, it resonates far beyond those who are engaged in economic analysis.

Germany’s “neo-classical” mainstream

While ordoliberalism nowadays is no longer an important academic current in Germany, most economists have at some point in their career been influenced by ordoliberalist ideas. Conversely, unlike in other European countries and the United States, there are very few influential Keynesian economists in Germany. It is therefore safe to say that most academic economists in Germany today would consider themselves to be liberal. Their thinking filters into ministries and the Bundesbank, which hires mainly from German universities. Thus, although there are differences among...
economists in Germany as there are in other countries, there is also a consensus around basic principles that is predominant among the German economic elite.

This German consensus is close to what is known internationally as “New Classical Economics” – that is, the modern branch of macroeconomics that builds on neo-classical microeconomics, with a strong influence on rational expectations. Economists of this paradigm believe that markets always work smoothly – that is, financial markets always get the price of assets right if they have all of the relevant information. They also believe that national economies have the capacity to swiftly adjust to shocks. They focus on the supply side of the economy in order to generate growth. Output and employment are determined mainly by supply factors. If demand falls short of supply, neo-classical economists believe that prices and wages will adjust swiftly so that demand increases again and any excess supply rapidly disappears. If prices and wages sometimes do not react quickly, they would argue that this is due to legal barriers such as collective bargaining or legal minimum wages. The solution is structural reform to make markets more flexible.

This perception of economic mechanisms leads to a number of policy positions.

Economic policy co-ordination

While many in France believe in co-ordinating economic policy (fiscal policies, wage increases, social security contributions and taxation) across the eurozone, Germans have been more sceptical. For example, when Germany lowered social security contributions in 2008 and increased VAT, this was perceived in France as a beggar-thy-neighbour policy: exports became cheaper because of lower wage costs in Germany and imports dropped as increased VAT lowered real disposable income and hence aggregate consumption. In Germany, however, few thought the move would have an impact on the rest of the eurozone. Instead, it was seen as a measure that would improve supply conditions and hence boost growth. From a German point of view, no co-ordination is needed as long as everyone has the correct policies.

This German view should be seen in the context of neo-classical economic thinking, which ignores the effect of improvements in supply-side conditions in one country on the demand conditions in others. The cut in social security contributions in Germany improved supply-side conditions there, leading to more output and employment. The lack of aggregate demand was not considered a serious potential problem and therefore neither were the changes in the contribution of exports and imports. As a result, the German elite neglected the fallout for the rest of the euro area. According to this mindset, excessive government deficits are the only area in which co-ordination is needed because they can lead to a debt crisis and ultimately to demands for bailouts. In order to prevent this, however, all that is needed is stringent application of the Stability and Growth Pact or the new framework of deficit control that will supersede it. As the German media and politicians constantly say: everyone just needs to do their own “homework” – that is, cut their own deficits.

External imbalances

A closely related issue is that of external imbalances in the euro area. Since 1999, current account deficits and current account surpluses in euro countries have increased to record levels. Greece, Portugal and Spain have experienced deficits of 10 percent of GDP and more while Germany has run surpluses of more than 7 percent at times. These imbalances are now seen by many outside Germany as major contributing factors to the euro crisis. The definition of a current account deficit is the variation in a country’s net external asset position. Large current account deficits thus lead to quickly rising external debt.

According to most economic theories, external imbalances are determined by two factors: prices and aggregate demand trends. Higher prices in one country make its products less competitive and therefore tend to burden the current account. Strong aggregate demand in one country increases imports and hence leads to a deterioration of the current account.

However, the German mainstream sees current account imbalances in the eurozone as a consequence of a loss of competitiveness and excessive consumption in the deficit countries and weak investment in Germany. Consequently, German neo-classical economists believe the solution is wage restraint or outright wage cuts in deficit countries. In their eyes, such a policy would increase price competitiveness in deficit countries to such an extent that exports would increase and imports would fall. Stronger wage growth in Germany, on the other hand, would simply hamper German competitiveness and reduce German investment.

Budget consolidation and bailouts

The German mainstream believes in quick and decisive budget consolidation to be achieved through reducing government expenditure and, to a lesser extent, increasing taxes. Significantly cutting the deficit favourably alters debt dynamics. As a result, the risk of future insolvency is reduced. At the same time, less new debt and less government spending today mean less taxation in the future. All this increases private sector confidence, which can in turn be expected to lead to more investment. According to this view, harsh austerity measures do not necessarily lead to a deep recession but rather improve the outlook for growth. Consequently, difficulties in reaching fiscal targets are seen as a failure on the part of the political class to make or pass the necessary cuts or tax increases.

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2 In contrast to the original neo-classical works, New Classical Economics has a stronger emphasis on rational expectations and hence on the efficiency of financial markets. However, since New Classical Economics and neo-classical economics are often used interchangeably in the public debate, we will also do so in the remainder of this brief.
In this context, the German mainstream sees the difficulties faced by indebted countries in implementing promised deficit reductions as a case of lack of will. The argument that excessive budget consolidation reduces growth and government revenue, and hence increases the deficit, is not widely accepted because large austerity packages are not expected to have any significant negative economic effects. The German mainstream therefore believes the debt crisis in the periphery is the result of overspending by irresponsible governments exploiting the low interest rates offered after entry into the Economic and Monetary Union (EMU). Financial markets’ demand for higher risk premiums and thus higher interest rates are seen as logical consequences of this.

The German mainstream therefore believes that loans from the EFSF or ESM should be expensive. As financial markets are seen as constructive disciplinary forces for profligate governments, EFSF or ESM loans should not be an easy way out that lets them off the hook. For a long time, it has therefore been the German government’s position that countries drawing from the EFSF should pay high interest rates so as to render access to these funds unattractive – a kind of deterrent effect. In fact, Greece, Portugal and Ireland initially paid interest rates that significantly exceeded refinancing costs. It was at the July 2011 summit that interest rates for these countries were cut.

Similarly, there is also general scepticism in Germany about bailouts, which are seen to risk affecting the incentives faced by governments in profligate countries. They make overspending possible even after financial markets realise their past mistakes and cut off the countries in question from the markets. Since excessive government borrowing is seen as the cause of the crisis, bailouts are seen as a genuine threat. Rescue packages are at best a necessary evil.

ECB bond purchases

Bond purchases by the ECB in order to stabilise interest rates of crisis countries are viewed with similar scepticism in Germany. Under its “Securities Markets Programme”, the ECB has purchased bonds worth several hundreds of billions of euros from crisis countries since May 2010. But to the German mainstream, the programme takes off the pressure imposed by financial markets on governments that engage in excessive spending sprees. Moreover, it fears it might become a slippery slope. Once the ECB owns large volumes of bonds from crisis countries, it will have an incentive to keep a country solvent even if it has embarked on an unsustainable debt trend. The German mainstream therefore worries that the ECB will find it hard to limit bond purchases going forward. Ultimately, bond purchases might lead to permanent financing of budget deficits through the central bank, with no instruments left to punish misbehaving governments. Such deficit financing could lead to inflation and an erosion of the monetary system.

The “New Keynesian” alternative

Of course, even in Germany, there are dissenting voices in the economic policy debate. The approach of these economists, who might be called “New Keynesian”, provides an alternative to the neo-classical mainstream approach. They see their allies in prominent American and British economists such as Paul Krugman and Martin Wolf – both vehement critics of the official German position – and feel supported by recent criticism (sometimes open, sometimes more subtle) of the German position from international organisations such as the IMF and the Organisation for Economic Co-operation and Development (OECD). While these dissenting economic voices are few and far between, some of their ideas have been picked up by centre-left parties, so understanding their thinking is necessary in order to grasp the political dynamic in Germany.

In particular, New Keynesian economists take a different view of the flexibility of an economy and how quickly prices and wages adjust. They emphasise a number of underlying economic reasons why, even after comprehensive structural reform, wages and prices only adjust slowly. For example, irrespective of the legal environment, a company does not like to cut its employees’ nominal wages because it undermines morale and productivity. Changing prices are also associated with a number of costs, such as that of printing new catalogues or menus. If prices and wages are sticky, however, a lack of aggregate demand increases unemployment. If high unemployment persists, it may turn structural and hamper a country’s long-term growth outlook. According to this view, the development of aggregate demand in the euro area and any given country is a key factor. Output will expand only if aggregate demand is increasing fast enough. Thus the demand side of the economy determines growth and employment to a large extent.

This view of economic mechanisms leads New Keynesian economists to different policy positions than the German neo-classical mainstream. They tend to be more favourable to economic policy co-ordination in a monetary union and often to co-ordination that goes beyond the mere control of budget deficits. They think tax reforms, changes in labour market institutions and shifts in the overall fiscal stance can have a bearing on aggregate demand at home and abroad through trade linkages. Depending on the position in the business cycle and the measures taken, they can lead to less growth and more unemployment or to overheating of the economy and more inflation. To prevent these negative outcomes, co-ordination is needed. In this view, the Stability and Growth Pact is not enough.

With regard to the adjustment of current account imbalances, New Keynesian economists disagree with the mainstream German position that it is only deficit countries that should use wage cuts to adjust. Such a policy of nominal wage cuts or of prolonged nominal wage stagnation is seen as creating problems of its own for deficit countries. Wages are important determinants of domestic demand. Wage
cuts are liable to lead to a period of stagnating consumption in crisis countries and in the euro area as a whole, thereby causing weak economic growth. Wages are also the main cost factor for companies, which may pass on cost changes to their customers. A policy of wage cuts could thus lead to deflationary trends in deficit countries. This is liable to increase the number of bankruptcies and non-performing loans and further burden the already weakened banking systems in euro crisis countries.

The proponents of this New Keynesian approach are not opposed to measures aimed at restraining wages or boosting competitiveness in deficit countries. However, they encourage surplus countries to take measures to support domestic demand, which can increase deficit country exports. They emphasise that budget consolidation always leads to a short-term reduction in aggregate demand. Since prices and wages do not decrease quickly enough, this leads to increased unemployment, which is liable to create a negative spiral and send an economy into recession. Harsh fiscal austerity measures can be counterproductive because they reduce economic growth and the tax base and increase payments for unemployment assistance, which in turn increases budget deficits. Where austerity is pursued simultaneously in different countries, trade linkages multiply its negative effects.

New Keynesians argue that in many of the cases where budget consolidation did lead to stronger growth there were special factors that do not apply within the eurozone. In particular, budget cuts were usually accompanied by a currency devaluation which in turn boosted exports. In other cases, the central bank cut interest rates to avoid recession. New Keynesians have less faith in perfectly functioning and permanently rational financial markets and focus less on moral hazard issues than the German mainstream does. In their view, rescue packages merely protect countries against volatile market sentiment, which can itself push countries into default. Bailouts are thus seen as important, if expensive, stabilisation instruments.

ECB bond purchases are also seen as a way to alleviate pressure on governments that have been pushed into liquidity problems because of volatile market sentiment. In fact, New Keynesians prefer bond purchases to other ways of bailing out indebted economies for two reasons. First, they are cheaper than other measures, since it does not necessitate capital injection by partner countries. Second, where the ECB credibly announces a stabilisation of interest rates, interventions will be much smaller. The very announcement will lead to a stabilisation in interest rates. The problem of moral hazard is seen as secondary, so there is little fear that the bond purchase programme will turn into a permanent policy and lead to an increase in inflation.

German political parties and the euro crisis

Mainstream neo-classical thinking and the ordoliberal tradition have informed the thinking of all five main political parties in Germany, but alternative New Keynesian thinking has also had some influence on the opposition parties.

The CDU/CSU

Together with its Bavarian sister party the Christian Social Union (CSU), the Christian Democratic Union (CDU) has traditionally been the biggest party in the Bundestag. Founded in 1945, the CDU understands itself as the party of Europe and of the social market economy. It began in the 1940s as an almost anti-capitalist party based on Christian values (for example the Ahlen programme of 1947). But in the 1950s, it began to develop the idea of the social market economy, associated above all with Ludwig Erhard (West German economics minister from 1949 to 1963 and chancellor from 1963 to 1966). Over the years, the party’s economic programme has become more market-oriented. In the 1970s, its manifestos began to include ideas such as independent monetary policy and free negotiations of salaries. During the last two decades, the CDU has moved even further away from its original egalitarianism towards growth, productivity, debt reduction and the liberalisation of the market.

The CDU’s analysis of the euro crisis has been heavily influenced by German mainstream neo-classical economic thinking. The CDU saw fiscal indiscipline as the primary cause of the sovereign debt crisis and therefore called for austerity and fiscal surveillance and an effort to increase Europe’s productivity and growth, in particular through the “Euro-Plus Pact” agreed at the European Council in spring 2011. The CDU argued against mutualisation of debt and Eurobonds, invoking the Maastricht Treaty’s “no bail-out” philosophy. It believed any “community of debt” would reduce political leverage for structural reforms and increase moral hazard within the EU. The CDU opposed the ECB bond purchase programme – which it saw as tantamount to “printing money” – and the idea of the ECB as a lender of last resort. The CDU advocates an independent ECB and opposes any monetarisation of government debt.

Meanwhile, the more Eurosceptic CSU has been even more orthodox in its response to the euro crisis. The CSU argued in favour of Greece leaving the eurozone, against the EFSF, against increases in the Greek aid tranches and, of course, against Eurobonds, which it sees as “debt socialism”. Last year, Peter Gauweiler, a CSU member of the Bundestag, who had already challenged the constitutionality of the Lisbon Treaty in 2008, was a plaintiff in a suit that challenged the constitutionality of the EFSF. (The constitutional court rejected the claim in September 2011.) In June 2011, the CSU published a “Five-Point Plan” opposing further European integration. The CSU’s Euroscepticism has seriously reduced Chancellor Angela Merkel’s room for manoeuvre.
Nevertheless, there are some indications that the CDU may be willing to make some concessions in its approach to the euro crisis. Some CDU parliamentarians such as Peter Altmeier and Steffen Kampeter seem to suggest that the EU should consider eventually moving towards common debt issuance if and when the institutional conditions are met. Rumours suggest that the party will eventually accept Eurobonds when they receive fiscal guarantees from other eurozone countries and see signs of successful structural reform in Italy, Greece, Spain and Portugal. However, there are legal as well as ideological barriers in Germany to a mutualisation of European debt. In fact, some argue that Germany would need to create an entirely new constitution in order to allow this.

The FDP

The Free Democratic Party (FDP) is a classical European liberal party. Founded under its current name in 1949, it originally put a strong emphasis both on civil liberties and economic freedom. For most of the period from 1949 to 1966, the FDP was a junior partner in the governments of Konrad Adenauer and Ludwig Erhard. In 1969, it changed sides and formed a coalition with the Social Democratic Party (SPD), though less for economic policy than for foreign policy reasons. This “social-liberal” coalition, first under Willy Brandt and then Helmut Schmidt, lasted until 1982, when the FDP fell out with the SPD on economic policy and once again became the junior partner in a coalition with the Christian Democrats under Helmut Kohl. Since the 1980s, the FDP has stood for tax cuts and, to a lesser extent, deregulation. Its focus is now much more on economic freedom than on civil liberties. It won a record 14.6 percent of the votes in the 2009 election and formed another coalition with the Christian Democrats under Merkel, but has lost support since then.

As a coalition partner in the federal government during the euro crisis, the FDP’s position has, of all the five main political parties in Germany, been closest to the mainstream neo-classical thinking. The FDP has defended the idea that indebted countries that find it difficult to access financial markets are in this position because of their own policy failures. It advocates harsh austerity measures and structural reform. It is in favour of high interest rates for rescue loans to maintain pressure on crisis governments to cut budget deficits and engage in structural reform. It demands automatic sanctions for violations of the Stability and Growth Pact and a stricter control of national budgets in case of violation of debt and deficit limits by the EU.

The FDP does not believe in the co-ordination at the European level of economic policy in the eurozone. Instead, it holds the view that no further co-ordination, beyond stricter control of fiscal policies, is necessary provided every country follow structural reforms of its own. FDP politicians have warned against the possible inflationary dangers of ECB bond purchases. They have also claimed that ECB interventions might bring down interest rates for periphery countries. This in turn would lower the pressure on periphery countries to reform and result in unwanted capital flows from Germany to the periphery. The FDP has also strongly opposed Eurobonds.

The SPD

The SPD has been a political force in Germany for more than a hundred years. When it was founded in the late nineteenth century, it was a workers’ party with a clear Marxist and socialist bent. Although it moved to the centre after the creation of the German Communist party during the Weimar Republic, it retained its Marxist ideology until well into the late 1950s. It was only in 1959, with the Bad Godesberg programme, that the SPD became a modern, social democratic party. It accepted the market economy and private property, and removed Marxist elements from the party programme. The Bad Godesberg programme paved the way for the SPD’s return to power, first in a Grand Coalition from 1966 to 1969 and then in the “social-liberal” coalition with the FDP.

During the 1960s, the Social Democrats integrated many Keynesian elements into their thinking and policymaking. Karl Schiller, the then economics minister, brought Keynesian ideas into the public debate. However, in the late 1990s, the SPD moved away from Keynesianism and formed a government with the Greens as junior coalition partner in 1998. Following the resignation of finance minister Oskar Lafontaine, the “red-green” government under Gerhard Schröder passed a number of neo-liberal reforms, which included income and corporate tax cuts, labour market and welfare reforms (“Hartz IV”) and an increase in the retirement age. The SPD refrained from using fiscal policy to stimulate the economy for quite some time.

The SPD changed course again during the global financial and economic crisis of 2008/9. The Grand Coalition under Merkel passed a substantial stimulus package that the SPD claimed as its own. However, it was Social Democrat finance minister Peer Steinbrück who pushed for a constitutional amendment limiting the structural budget deficit to 0.35 percent of GDP. This limit was included in the German constitution in 2009. Since leaving the coalition after the general election in 2009, the SPD has moved slightly to the left again. It has called for higher taxes to pay for public goods. A fraction of the party is also becoming more favourable to Keynesian arguments.

In response to the euro crisis, the Social Democrats have attempted to square a belief in fiscal responsibility with European solidarity, with a much stronger focus on the latter...
than the CDU/CSU and repeated calls for growth packages. They have made a clear commitment to rescue packages for indebted countries but also insisted on austerity as a condition for support. The party has therefore come out in favour of a stricter Stability and Growth Pact. It agreed with the government on the need for constitutional “debt brakes” to limit budget deficits in all eurozone countries. At the same time, however, the SPD recognises that austerity will hit growth in indebted countries and it wants an explicit growth strategy and investment programme to be developed in order to counteract these effects. In addition, it has welcomed the move to cut interest rates on rescue loans for Portugal and Ireland and does not adhere to the mainstream German position that countries should pay penal interest rates on EFSF/ESM loans.

Unlike the CDU/CSU and the FDP, the SPD has also stated repeatedly that closer economic policy co-ordination at the European level is needed, which should include financial market regulation and taxation issues. Leading Social Democrats such as Steinbrück and parliamentary leader Frank-Walter Steinmeier have also spoken out in favour of Eurobonds, but official party documents emphasise that they can only be part of a package deal that would include much stricter rules for fiscal austerity in other countries.3 The SPD is opposed to ECB bond purchases – in line with German mainstream economic thinking, several party officials have warned against the danger of possible inflation – but not as strongly as the CDU/CSU and the FDP.

The Greens

The Greens are a progressive left-wing party that was founded only in 1980. Its priority is to restructure the economy towards sustainable development and growth. Many founding members had a Marxist background but today the party is relatively fiscally conservative. However, since the German economic miracle does not play a role in the party’s history, it is not strongly linked to German mainstream economic thinking. Instead, the Greens aim to detach prosperity from constant growth and some Greens oppose globalisation. They have long been advocates of better financial market supervision and regulation, a financial transactions tax, the abolition of bonuses in financial services and the semi-nationalisation of banks and financial institutions.

This background has shaped the Greens’ approach to the euro crisis. A significant part of the party adheres to fiscal austerity, albeit for different reasons than neo-classical economists. They argue that in an economy without economic growth (which some Greens favour), government debt is not sustainable and hence public budgets should be balanced. On the other hand, the Greens never thought austerity was enough on its own and did not see fiscal surveillance mechanisms as the sole solution to the crisis. The Greens did not want to see the eurozone dominated by German economic paradigms. They argued instead for fully-fledged common European policies, particularly in the field of R&D and infrastructure programmes.

The Greens also committed to the introduction of Eurobonds very early on, basing the argument on the need for European solidarity, deeper integration and improved fiscal co-operation. The Greens also opposed the “Euro-Plus-Pact” of spring 2011 because they saw it as “biased” towards the supply-side questions like unit labour costs and productivity without also including measures such as tax harmonisation. Unlike mainstream neo-classical German economists, the Greens accept that Germany’s trade imbalance affects the economic equilibrium of the eurozone and they want “symmetric” rather than “asymmetric” adjustment within the eurozone. The Greens also take a less orthodox approach to the ECB than the other German parties and are closer to the more pragmatic stance of other European countries.

The Left

The anti-capitalist Left party was created in 2007 following a merger between the Party of Democratic Socialism (PDS) – the successor to the former East German Communist party – and the Electoral Alternative for Labour and Social Justice (WASG), a left-wing grouping led by former Social Democrat finance minister Oskar Lafontaine. Although the Left party has participated in a few coalition governments at the state level, leading SPD politicians have repeatedly excluded a coalition with it at the national level. Although it is not against the EU or the euro, it voted against the Lisbon Treaty and aims to radically reorganise European economic policy to deliver market regulation, financial market control, tax harmonisation and a financial transactions tax, and to control speculation and capital flows and improve social justice.

As a result, the Left’s approach to the euro crisis is very different to that of the German neo-classical mainstream. It has criticised the incapacity of the EU as a whole to control financial markets. Unlike the German mainstream, it has argued that the euro crisis is a structural crisis touching financial markets and also a crisis of neo-liberalism. For this reason, the Left opposed austerity measures for southern European countries. The Left has also argued for “democratic control of the ECB” and a broadening of the ECB’s remit to extend it beyond that of stabilising prices.4 It does not see a stricter Stability and Growth Pact or penal interest rates for indebted countries as part of the solution to the euro crisis. The Left is also in favour of Eurobonds. Of all the five main German parties, the Left is the most New Keynesian. But although some of its left-wing arguments are sound, it lacks credibility.

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3 See, for example, Frank-Walter Steinmeier and Peer Steinbrück, “Germany must lead fightback”, Financial Times, 14 December 2010, available at http://www.ft.com/cms/s/0/efb0eac0-07ba-11e0-a568-00144feabdc0.html#axzz1lzmXWwBB
Table 1

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<th>To what extent does the party favour a stricter Stability and Growth Pact, with tighter limits on government debt and less political discretion in imposing sanctions?</th>
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<th>To what extent does the party believe that adjustment of current account imbalances should come exclusively from deficit countries – rather than coming both from deficit and surplus countries, including higher wages and more domestic demand in surplus countries?</th>
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<th>To what extent does the party oppose the idea of closer integration of economic and fiscal policies, beyond the prescription of structural reforms and the limitation of government deficits, and including common European taxation or common European unemployment insurance?</th>
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<th>To what extent does the party believe that by cutting budget deficits decisively and quickly, positive effects stemming from improved confidence might outweigh the negative effects that consolidation brings to bear on economic growth?</th>
<th>CDU/CSU</th>
<th>FDP</th>
<th>SPD</th>
<th>Greens</th>
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<th>To what extent does the party believe that countries receiving EFSF/ESM loans should pay high interest rates in order to make taking out such loans unattractive?</th>
<th>CDU/CSU</th>
<th>FDP</th>
<th>SPD</th>
<th>Greens</th>
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<tr>
<td>0</td>
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<th>To what extent does the party believe that private sector debtors should be forced to accept debt write-downs in case of government payment difficulties?</th>
<th>CDU/CSU</th>
<th>FDP</th>
<th>SPD</th>
<th>Greens</th>
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| Net Sum (# of “+” minus # of “-”) | 12 | 15 | -3 | -7 | -12 |

“++”: Very much so; “+”: somewhat; “0”: can’t say/neutral; “-”: not really; “--”: not at all
Summarising the German parties’ positions

German party positions can be mapped according to how far they adhere to the traditional German view or alternatively to the New Keynesian approach. Figure 1 makes such an attempt for the five main German parties, based on party body decisions and party programmes, and it covers different policy questions discussed abroad. It shows there is a strong difference in the parties’ approach.

Figure 2 further aggregates this information. An index value for each party is compiled (and presented at the bottom of Figure 1), adding up the plusses in the table and subtracting the number of minuses. The index thus compiled can range from minus 16 (strong opposition to all traditional German positions) to plus 16 (strong agreement with all traditional German positions). While, of course, this index is very simplified given that it does not give differentiated weights to the different questions (which in itself would be problematic, as it would imply normative assumptions), it gives a good approximation where the parties stand. Figure 2 shows the FDP is the party closest to the neo-classical and ordoliberal approach, the Left the party closest to the New Keynesian approach, with the SPD and the Greens in between.

What would a different German government do?

As this brief shows, the political landscape in Germany is more complex and diverse than is sometimes realised elsewhere in Europe. This means that the German negotiating position in Europe could shift significantly should there be a change in government. This is important because negotiations over details of the new treaty agreed in January are likely to drag on for months and the ratification process could take years. Moreover, the treaty may not be the last if it is deemed insufficient by financial markets. The next general election is scheduled to take place in September 2013. It is possible, though at the moment not likely, that the government could collapse before then if the FDP were to leave the coalition and the Merkel government lose its majority. In that event, the Social Democrats or any other party would be unlikely to agree to form another Grand Coalition and the SPD would probably demand early elections.

Polls suggest that Merkel would be unlikely to be able to form another coalition with the FDP, which is expected to do much worse than in 2009. Whatever happens, since the FDP is the party closest to the mainstream neo-classical paradigm, a change of government is likely to result in a shift away from neo-classicism and towards New Keynesianism. The extent and nature of the shift will depend on who the coalition partners in the new government will be. There are four other possible permutations: a Grand Coalition; another “red-green” coalition between the SPD and the Greens; a “red-red-green” coalition between the SPD, the Greens and the Left; and a “black-green” coalition between the CDU/CSU and the Greens.

Figure 2
German parties’ adherence to the traditional German position in the euro crisis debate
(Index: 16 Points = perfect adherence)
The shift in German policy under a Grand Coalition would be minimal. The basic austerity approach would remain the same and it would be unlikely that there would be a change in the German stance towards the current-account adjustment, as the Social Democrats open to reforms here would be marginalised in a Grand Coalition. But there might be some movement on the question of Eurobonds should a new economic urgency on this issue arise and should other eurozone partners make sufficient guarantees for sustained austerity.

Under a “red-green” coalition, the shift might be rather more significant. Since both coalition partners are, in principle, in favour of Eurobonds, the discussion might become one of how and when, rather than of whether. Under a “red-green” coalition, Germany would also most likely be less opposed to the purchase of government bonds by the ECB. A three-party coalition featuring the SPD, the Greens and the Left is highly unlikely. But if it became a reality, it would mean the biggest shift towards the New Keynesian position. However, such a coalition including the Left party would be under massive pressure to prove it is serious with regard to economic policy. The most difficult to predict is a “black-green” coalition because the two parties have such different positions.

Whatever happens, however, the basic German approach to the euro crisis is unlikely to change. The mainstream neo-classical belief in the need for stricter fiscal rules is shared by the Social Democrats and also has strong support inside the Green party. The same goes for the question of current account imbalances: there is a broad consensus that the burden of adjustment should be borne by deficit countries. Although some Social Democrats would like to implement elements of an expansionary wage and fiscal policy that might lower Germany’s current-account surplus, this is not official party position. A significant portion of the SPD still thinks that “Germany cannot be punished for its export successes”. A change in government would therefore not overly affect the German position in this regard.

When negotiating with Germany, its European partners should focus on issues where some movement in the German position can be expected, rather than expect a change on issues on which there is a consensus in Germany. For example, instead of attacking excessive austerity and demanding a renegotiation of the new fiscal treaty, a more promising strategy would be to demand pan-European growth and investment programmes with more spending and taxation power shifted towards the European level. One approach would be to demand the channelling of unused EU funds into investment programmes for the ailing eurozone periphery to provide a short-term stimulus and build a more permanent institutional structure later. Similarly, instead of opposing balanced budgets, asking for more time in reaching them might be met with more understanding from Berlin. And instead of pushing for large ECB interventions, constructive proposals for Eurobonds are more likely to be accepted by the German political elite. From an outside perspective, the final outcome might still look very German. But it might still make life easier for Germany’s European partners.
Acknowledgements

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