Reforming the Monetary Union and the German Debate

Sascha Keil - 17/05/2020 [social and political notes]

The crisis coming along with the appearance of the Coronavirus represents an enormous challenge managing its economic and budgetary consequences. Since the member states of the Euro area are trapped in a contradictory monetary construction, the scope for action is not given by economic possibilities but by divergent ideas of how a monetary union should work. Differing views on the character of public debt render the community a paralyzed place. While, in light of the most severe economic crisis since the second world war, countries as Great Britain move to a kind of monetary financing of their government expenses, Europe struggles adjusting its monetary setting. Finding an appropriate answer is blocked due to the contrary visions of the southern and of the northern countries. The public discussion on these issues is often driven by moralistic prejudices rather than by scientific evidence. This article will sum up the political and scientific arguments made in Germany in the last month.

The Euro area is hit in a particular way. The problems of financing the member state's public budgets and of the sustainability of the respective public debt aren't solved so far. Understanding Germany's role within this situation is not straightforward. On the one hand, its economic model depends heavily on a high and stable trade surplus. Thus, Germany is highly dependent on the acceptance of this situation by its trade partners. On the other hand, Germany used its economic and politic strength to impede expansive economic policies of the Euro area states, hence its main trade partners. This kept the whole Euro area trapped in a quasi-recessionary and deflationary mood for a whole decade. Now, the coronavirus adds a new chapter to this story. The French President Macron may represent the most prominent as wells as serious voice in the current discussion. In its remarkable interview with the Financial Times he unfolds his criticism regarding the Euro area crisis management, adressed indirectly to the German political elites:

"It's obvious because people will say 'What is this great journey that you [the EU] are offering? These people won't protect you in a crisis, nor in its aftermath, they have no solidarity with you. […] When immigrants arrive in your country, they tell you to keep them. When you have an epidemic, they tell you to deal with it. Oh, they're really nice. They're in favour of Europe when it means exporting to you the goods they produce. They're for Europe when it means having your labour come over and produce the car parts we no longer make at home. But they're not for Europe when it means sharing the burden.'"

Unfortunately, German self-centred media and the public opinion pay only little attention or even completely ignore different perspectives on core issues coming from abroad. While the government remains silent on the matter, the general discussion on Europe's monetary problems is still dominated by prejudices. It is a widespread stereotype, fuelled by the media over decades, that the German taxpayer acts as the social welfare office of the world and has to pay for all other being reluctant to work harder. In this view, any concession to the "bad" countries characterized by a higher debt to GDP ratio has to be avoided.

While the German government appears not being able taking an unequivocal stand on the European answer, the usual suspects fill the gap saying NEIN. A prominent voice against an introduction of Coronabonds is the one of Friedrich Merz as one of the potential successors of Angela Merkel praised being an economic expert. Regarding the refused ESM loan offer by the Italian government he states on April 21th:

"Italy does not want to accept the EU financial assistance so far. Hence, Italy does not have urgent financial requirements, but aims, on the pretext of Coronavirus, getting unlimited possibilities of refinancing its public budget."

Also Gabor Steingart, an influential economic columnist, argues on similar lines:

"The favourite dish of the Italian elite consists of freshly-printed money, garnished with a stick of dynamite. […] The debt addicted wants a second helping. Why Germany should avoid entering a liability union. “

These quotations suggest that in the discussion on public finance and debt rules within the monetary union the macroeconomic logic fades easily away and becomes substituted by legal arguments. So, southern Europe wants to spend more in light of the Coronacrisis? Germany fears bearing further liabilities in case the others are not capable paying back their debts.

The public discussion is quasi free of knowledge of the conditions other European countries are in. The German public simply does not know what it means to be threatened by persistently higher interest rate on public debt than the others. The German public does not know how it feels to negotiate every year with foreign finance ministers and not-elected bureaucrats about their government expenses they voted for. That, for instance, Italy runs primary budget surpluses since 25 years is a completely ignored fact. This holds also true for other examples not fitting into the established German narrative. Other ignored examples are the direct financing of UK’s government expenses by the Bank of England or the monetary reality of Japan, managing almost 300% debt to GDP ratio, both without catastrophic consequences.

The main concern of Germany are liabilities due to higher public debt in the Euro area. However, the consequences of an economic collapse of its partners does not cause worries. This is surprising, since Germany depends more on the foreign demand than any other country in the world. For instance, France runs a huge bilateral trade deficit with Germany. If France enters into a severe prolonged recession the German export surplus model is threatened seriously. Unfortunately, academic economists explaining these macroeconomic interdependencies to the German public are difficult to locate currently. More probable is to find some German economist discussing the epidemiological usefulness of the lock-down, although not possessing any expertise on the matter. The research institutes remain rather hidden, too. This is noteworthy, since the early numbers of short-time work registrations (Kurzarbeit)[1] indicated already a deeper economic slump than 2009. Given the only 4.2% estimated GDP contraction by the joint forecast of the leading institutes, the severity of the situation appears to be underestimated.

The economic proposals made in the recent Leopoldina (national academy of science) statement are far from being innovative. The preservation of the German debt brake and the aimed repayment of the now necessary public debt remains a central issue for the Leopoldina economists. On the level of the Euro area they propose the introduction of a new credit line by the ESM. This should contain conditionality focussed on the pandemic consequences. The economics profession appears rather following and commentating the economic measures, rather than being their proponents.

However, it would be wrong to end this story here. Things are moving and the current German NEIN is weaker than in the aftermath of the Euro crisis. That another period of further forced austerity would be suicidal for the monetary union becomes obvious. Furthermore, it can’t be explained any longer to other countries why Germany can use its fiscal space while others don’t. Hence, most observers remained noticeable silent in the discussion about Eurobonds.

Europeanism is mainstream, although the most convinced Europeanists still ignore what the German government negotiates in Brussels. In this context, a remarkable article was published in the Spiegel by Thomas Fricke arguing not to repeat the failures of the past. The “ugly German” full of prejudices should be avoided at any cost because now it would seriously threaten Italy’s membership in the currency union.

“It is time to end this drama – maybe by Eurobonds as symbol for the common destiny […] otherwise in few years’ time the European union won’t be a Union anymore. In Italy as well as in France people will come to power […] who don’t want to join this game. The game representing the base for Germany’s wealth.”

Concluding it can be said, that there remains a window of opportunity for German politicians not blocking a “different” reform of the monetary setting. Conceding much more fiscal space and monetary safety to the Euro area member states without being considered to be negligent appears more possible than before. This requires a government which possesses courage, a clear vision of how a common monetary union should work and a certain degree of serious threat coming from outside Germany.

Qui la versione italiana tradotta dal Professore Lucarelli

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[1] A concept that describes a situation where the company has no orders, the employee works less and the state pays 60%-66% of normal salary. Normally the worker would be unemployed, but for a certain time of crisis the state pays part of the salary and the employment contract remains valid. So companies preserve the labour force.

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