

Germany: Europe's China

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Abstract: *The paper analyses Germany's ascent not only as Europe's most important economic power, but also as its leader. Figures show that Germany overcame the crisis; in fact the crisis legitimized its development model. Which would be Germany's main strategic choices, confirmed by the historic evolution of the recent years? First, its option for manufacturing, which allowed Germany to turn into Europe's factory. Second, the option for reform. "Agenda 2010", initiated by Gerhard Schroeder in 2003, is a crucial moment in the country's evolution. Special attention is paid to Germany's position on the single currency. Germany's performance is that it managed to turn the euro into a kind of European Dmark. The euro now formally "obeys" German rules, agreed upon from the very beginning, and is mainly coupled to the evolution of German economy. Germany is now sitting its most important exam: the European one. Today, Germany is Europe's most powerful state, but it must become its leader, whose development model would be accepted throughout the continent. Some German economic options are strikingly similar to China's.*

Keywords: *development model, federal vs. national approach, German reform, dominant/hegemonic power, strategic options, Euro crisis*

1. The crisis in the developed world

Four, five years into the crisis we can ask ourselves: who has benefited most in these difficult times and who has lost most? The obvious answer to the first question seems to be: those countries which have developed constantly (BRIC countries, for instance). Turkey, Mexico, South Africa, Indonesia, South Korea, Poland also join the ranks of those who took advantage of the crisis.

To grow is one thing; to transform growth into a development model is completely different. When can we refer to the beneficiaries of crisis, those states which have acceded to economic success and prestige because of the crisis? Not until the experience of a country has developed into a **model**, which can be inspirational to others, can

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guide development efforts in other parts of the world, can grow into knowledge which can be passed on irrespective of the evolution of source states. From this perspective, we can consider China and Germany as the two most important beneficiaries of crisis.

What brings these countries together? In short, patterns of development, which turned the former into the *world's factory* and the second, into *Europe's factory*. They are also united by their decisive focus on export: China is first and Germany, second, in world export volume. Most importantly, they have been guided by a **vision** of their own development, an effort to adapt, an evaluation and estimation of future developments. Crisis has merely acknowledged the validity of such insight.

Who are the main losers? The US is an obvious choice. At the beginning of the crisis, Germany's former finance minister, Peer Steinbrück, believed the new financial crisis to be "an American problem", a product of "American greed" and inadequate regulations – we would be justified in adding shortcomings in the American development strategy – which would cost the US its "superpower status."¹ Another choice is Europe, which has lost its former glory and faces a leadership crisis, far more dangerous than the economic crisis. The latest developments encourage us to believe that Europe is the favoured seat of crisis. In short, four, five years into the crisis **the main loser is the developed world, with its most representative actors: the US and Europe.**

The paradox lies in the fact that despite the European Union struggling against the crisis, Germany rises as one of the greatest beneficiaries of these difficult times. How can we account for this?

2. "Forget Bruxelles! Berlin has the real power!"

In a recent article, Gideon Rachman pointed to Berlin as the true capital of the Union.² Crucial decisions for Europe are now taken in Berlin. They are then effectively adopted in various European institutions, but their economic and judicial rationale comes from Germany's capital. Crucial decisions in Europe – from the European Central Bank's decision to buy bonds from financially stricken countries to bail-out for southern countries – have met with Berlin's approval first. It was the German Parliament that had the final say on the decision, not the European Parliament. The Union's most important institutions – the Commission and the Council – are still in Bruxelles, but the key decisions are made or at least reached in Berlin. In Rachman's words, "this power shift from Bruxelles to Berlin has been encouraged by the crisis". Encouraged, not created. Therefore, Germany's ascent can be explained through the causes of this power shift in Europe.

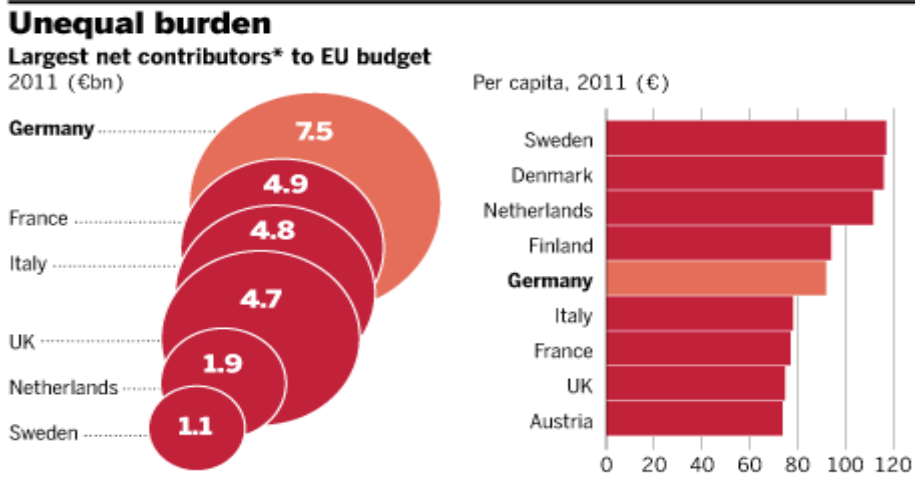
Germany is not only a great power, but a power which has passed the crisis exam successfully. Germany's evolution has been confirmed by the crisis. Germany rejoices not just power, but also **prestige**, which is essential for Germany's new status as a European leader.

Throughout the crisis, Germany has not had real competitors in Europe. Spain and Italy have their own challenges, Great Britain is not part of Eurozone and cannot have a

¹ Joseph P. Quinlan, *The Last Economic Superpower: The Retreat of Globalization, the End of American Dominance, and what We Can Do about it*. McGraw-Hill, 2011, p. 9.

² Rachman Gideon, Welcome to Berlin, the New Capital of Europe, *Financial Times*, Tuesday, October 23, 2012.

decisive say. What is left is France. Traditionally, Europe was ruled by a Franco-German partnership. “Merkozy” stood for this *dominant duo*. We find a diplomat’s declaration relevant for this situation: “France needs Germany to disguise how weak it is. Germany needs France to disguise how strong it is”. **Germany has no counterpart** in Europe. It is the main contributor to the European budget in absolute terms, as shown below.



Source: George Parker, Quentin Peel, Exasperated allies, *Financial Times*, November 7th 2012, p. 7.

All this and much more have triggered a change in Germany’s behaviour, in its self-perception, in its relationship with Europe. “After reunification the goal was always said to be <a European Germany, not a German Europe> ... But exasperation with rule-breaking and fiscal incontinence elsewhere in Europe is making the Germans less shy about insisting on the need for a more “German” Europe. The price of German financial assistance is, increasingly, going to be the acceptance of rules and laws designed in Berlin”³. From the height of a brilliant academic career, the last representative of the Frankfurt School, Jurgen Habermas, signals the same fact: “The reunification spurred a change in mentality in Germany which (as studies in political science show) has also affected the self-interpretation and orientation of German foreign policy and lent it a more pronounced self-centred character ... This transformation is also apparent in European policy, especially since the 2005 change of government. Hans-Dietrich Genscher’s conception of the ‘European vocation’ of a cooperative Germany is steadily deteriorating into an undisguised leadership claim of a ‘European Germany in a German Europe’”⁴.

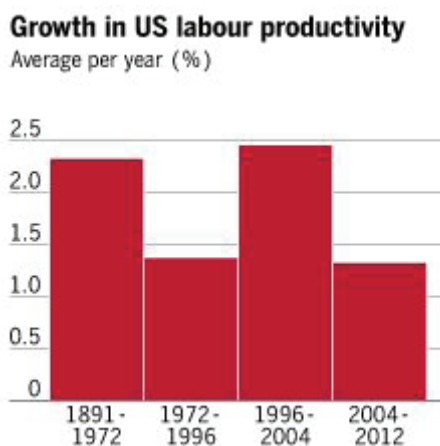
³ Rachman, G., *op. cit.*

⁴ Habermas, Jurgen, *The Crisis of the European Union: A Response*, Polity, 2012, p. 132.

3. Context always changes “the model”

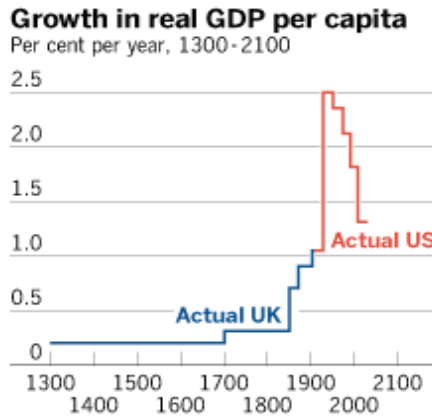
The American model must be ruled out from the talk about development patterns defying the crisis. A model fed by technological innovation, based on leaps in productivity allowed by great technological breakthrough. America impressed and changed the world through excellence in innovation. America was the queen of innovation. It may be said that Germany was on automatic pilot, doing what it could do best: cars, in line with its traditional advantages. It became a significant power, without America’s shine, without innovation that could change Germany and the world. Yet context always changes the model.

Martin Wolf recently published an article starting from a talk delivered by Professor Robert Gordon from Northwestern University, a specialist in productivity⁵. The whistle that the professor blows and Wolf amplifies is that for three hundred years, during the three great technological revolutions, technology stimulated productivity and, implicitly, the increase in production volume. Ours is a time of much innovation but no breakthrough: *“What we are now living through is an intense, but narrow set of innovations in one important area of technology. ... But the view that overall innovation is now slower than a century ago is compelling”*⁶. There are repercussions in the increase in productivity itself: productivity has been cut away from its roots. This is one explanation for productivity decrease (as shown in the tables below), which negatively influences the general economic outlook.



⁵Gordon Robert, *Is Economic Growth Over? Faltering Innovation Confronts the Six Headwinds*, NBER Working Paper No. 18315, at www.nber.org.

⁶ Wolf, Martin, *Is the age of unlimited growth over?* *Financial Times*, Wednesday, October 3, 2012.



Sources: Robert J. Gordon (NBER 2012); The Conference Board.

A second repercussion of productivity decrease in the world's first economy is the change at the top of world's economic hierarchy. *"If the rate of advance of the frontier has slowed catch up should now be easier."*⁷ A third is the change in the role of economic stimulus. Economic stimulus and technological development form a **successful couple**. Can economic stimulus compensate for lack of technological breakthrough? *"Transport and energy technologies have barely changed in half a century. Lower taxes are not going to change it."*⁸ A comparison with the relationship between fundamental and applied research is relevant at this point. Fundamental research is groundbreaking. So much so in the case of technology. A slowdown in technological innovation creates tremendous pressure on economic stimulus, which cannot fully operate without major technological breakthrough.

Other authors equally point to the relationship between technology and labour productivity in developed countries. *"I thought for a long time that we would be able to support leadership through technology and innovation, but this thing seems to be an illusion."*⁹ Many years before, Greenspan had warned against productivity decrease as one of the true causes of crisis.

If innovation is scarce indeed, which is the propelling force of rising powers? Classical instruments: hard work, concentration, identification of a niche or a branch which allows performance. This is how present developments cast a new light on classic approaches, on landmarks, on pillars in the equation of economic growth, irrespective of times. A difficult period for innovation – hence, for productivity – can modify the development equation and bring to the fore the classical elements of such development, from work to discipline and management, which are Germany's (and China's) classical advantages. The age-old question launched by the mercantilists can be given an answer: it is not the one who has the wealth that counts; it is the one who **can produce wealth**.

⁷ Gordon Robert, *op. cit.*

⁸ Gordon Robert, *op. cit.*

⁹ Verhofstadt, Guy, *leşirea din criză. Cum poate Europa salva lumea*, Bucureşti, Comunicare.ro, p 139.

4. From federal to national approach

Can Germany's position today be accounted for by avoidance of unilateralism and shortcomings or by the development of a model? In reality, Germany had a strategy. The novelty is that this strategy was not built deliberately at once but born gradually, as a result of a process, rather than a starting point.

A crucial moment was, in our view, 1994. Germany had reunited and was paying the costs of reunification, bringing former GDR to the level of FRG; in doing so, it would abide by its engagements towards the Union, but also towards a federal Union, announced by the Treaty of Maastrich. One solid truth is that Germany proposed "fiscal federalism" in the Union that year (states Attali), and France made "the terrible mistake" (in Attali's words) of turning Germany down¹⁰. In our opinion, this refusal started a debate in German elite's quarters and raised questions about Germany's development. Its economic potential had become increasingly important and it needed strategic guidelines. The federal direction could represent a strategic choice, one which was not shared by France at a crucial moment. Meanwhile, Germany has drifted away from this objective which is now undesirable.

The role of the Franco-German duo in the European Union is emphasized to the point where the two countries' different views of the Union's development are ignored. David Marsh is keen on this fact. *"France and Germany fought long struggles during the post-war era to construct a European framework in line with their predilections: the French wanted European institutions run by European politicians to protect high-growth policies from external monetary disruption; Germany wanted Bundesbank-style principles operating independently of governments to protect Europe from inflation. One of the prime reasons for the deep-seated malaise within the Euro area is that these philosophical differences between France and Germany have remained as strong as ever"*¹¹.

These are two countries growing apart in the European hard core, whose **different visions** for the Union's growth have weakened the outer layers of the Union. The main result is that strategic decisions have been postponed, because they would increase differences. The Union's lack of strategic dynamism in recent years can be explained in terms of incongruous visions. On the other hand, each proponent has attempted to define its own track as a decisive argument in the dispute over approaches. **Individual responses**, stimulated by different views, have hindered joint solutions. The decisive factor in solving strategic disputes within the tandem and the Union has been the quality of such individual choices. Unfortunately, France, along with other European countries, have been more preoccupied with integrating the German colossus in European structures, rather than **its own development**. Germany made development its main priority, leaving problems and strategic differences for later.

This choice led Germany where it stands today. It was only a matter of time for Germany to develop its power and increase the gap between itself and other powerful European countries. At this moment, the Franco-German tandem is almost blocked, and

¹⁰ Attali, J., *Understand Germany*. 2010. Available at: <http://blogs.lexpress.fr/attali/2010/12/12>

¹¹ Marsh, David, *The Euro: the Battle for the New Global Currency*, Yale University Press, 2011, p.278.

Germany's relationship with other European countries, tense. France has been slow in understanding that Germany can be restrained no longer, in Gerard Errera's words¹². The only solution for France is to rapidly modernize its economy to make it competitive once more¹³.

Taking advantage of its traditional, solid background of constant discipline, Germany has evolved along the lines of a strategy which is similar to what happened in this country's past. Paul Kennedy pointed that Germany's rise in the second part of the 19th century took place "right in the centre of the old European states system", under those countries' very eyes (compared to Japan's development, in geographical semi-isolation). In the same time, Germany's rapid development took everyone by surprise.¹⁴ Germany's present development takes place at the very heart of the European Union, at the same astonishing speed. Many years after the reunification, Germany, Europe's main engine, slowed down, due to the assimilation of GDR in the 90s and modernization of economy in 2000. Development boomed at the end of these processes, or so it seemed. In fact, development had been prepared by 20 years' arduous work. Germany's development is astonishing not because it was a success, but because what seemed a major drawback was turned into an advantage. This rare performance shows that Germany not only had a vision, but followed it to the letter.

Three strategic options of Germany encourage us to assert that this country's development efforts have been guided by a singular strategy in Europe.

5. Euro: the new European D-mark

Andrew Moravcsik, the director of EU program at Woodrow Wilson School of Public and International Affairs from the University of Princeton, recently made a historic confession. Immediately after the negotiation of the Treaty of Maastricht, Jacques Dellors, considered "the father of euro", told him that "*he saw the single currency as a failure because he had been unable to persuade the Germans to compromise. Berlin's nonnegotiable demand in exchange for monetary union was a European central bank that would be even more independent in its design and even more anti-inflationary in its mandate than the old Bundesbank. No provision was made for fiscal transfers or*

¹² Errera, Gerard, France Is Running Out of Time to Restrain Germany, *Financial Times*, Wednesday, November 2, 2012.

¹³ The French public space is rich in debates on the French economy's low competitiveness. A recent article (French Competitiveness, Shock Treatment. *The Economist*. November 3rd 2012), analyses the Report of a prestigious technocrat, Louis Gallois, who warns against the gap between French and German competitiveness. The World Economic Forum's study on competitiveness places Germany 6th in the world, while France is in 21st position. French public expenses represent 56% of GDP, 10% more than German ones. The volume of French exports in non-euro zone has been taken over by Dutch exports, even though the Netherlands' population is several times smaller than France's. The same publication's issue of November 17th 2012, discusses France as a time bomb at the heart of Europe, the argument being the same low competitiveness and delayed structural reform. Ever since 1981 France has constantly failed to balance its budget, the public debt has continuously increased to its present 90% of GDP, compared to 22% in 1981 (The Time-Bomb at the Heart of Europe, Why France Could Become the Biggest Danger to Europe's Single Currency. *The Economist*. November 17th 2012). Moody's downgrade of France from AAA to AA1 is a confirmation of this fact.

¹⁴ Kennedy, Paul, *The Rise and Fall of the Great Powers. Economic and Military Conflict from 1500 to 2000*. Random House, New York. 1987, pp. 209-210.

*bailouts among European states.*¹⁵ The story is important not only because it pinpoints the central problem created by the introduction of the single currency, but also because it has been confirmed by the euro crisis and everything it has generated.

Most analysts of the euro crisis identify the political rationale behind the introduction of the single currency as its main trigger. *“The more I read, the more I understood that the single European currency was not really about economics at all. The real truth, sometimes admitted on the Continent but always denied at home, was that it was overwhelmingly a political project. Facts had to give way to the vision of a united Europe and economic logic was not relevant unless it served this purpose”*¹⁶, says David Heathcoat - Amory.

Undoubtedly, the political reasons were of paramount importance in introducing the euro. Joschka Fischer, Germany’s former Minister of External Affairs, even asserted that euro introduction *“was not only the crowning-point of economic integration, it was also a profoundly political act, because a currency is not just another economic factor but also symbolises the power of the sovereign who guarantees it”*.¹⁷

Cormick was right to remark that never in the history of humankind did so many sovereign states consent to such an important measure, given that their currencies were part of modern national identity¹⁸. This truly historical step makes sense within the context of those years. Introducing the euro was the logical step in the Union’s evolution, meant to develop a Federal Europe. As Helmut Kohl said, the euro was a matter of “war and peace”, a crucial problem that would define the future of the region. In the aftermath of the Cold War, there was a time of change, when the Union had to redefine and reorganize itself, in order to restructure important geopolitical spaces. EU’s new political destiny was envisioned by the Treaty of Maastrich, and the euro gave economic and financial support to the project.

Therefore there are two different faces of politics here: when the euro was introduced, politics’ strategic dimension was brought to the fore. A new world was being born, and it was right for the political decisions **to leapfrog** stages in evolution and create instruments for desirable development. The English author’s highlight of the political reasons behind the introduction of the euro suggests that this was a superficial, hasty, petty decision. Yet a historical moment cannot and must not be explained in such terms.

There is a grain of truth in the euroskeptics’ criticism: to flourish, the single currency (with its implicit identical measures and standards – value, exchange rate and so on) must benefit from homogeneous economic reality. Otherwise, there is a high risk for the single currency to widen the gap between countries with vastly different economic performance or even **create such gaps**. The case of Greece is illustrative in these respects: gaps between Greece and Germany have increased, for instance. Does this mean that the single currency should not have been introduced? In our opinion, this

¹⁵ Moravcsik, Andrew, Europe after Crisis, How to Sustain a Common Currency, *Foreign Affairs*, May/June, 2012.

¹⁶ Heathcoat – Amory, David. Confession of a Euroseptic Pen&Sword. *Politics*. South Yorkshire. 2012, pp. 75-76.

¹⁷ Fischer, Joschka, in John McCormick, *European Union Politics*, Palgrave MacMillan, 2011, p. 344.

¹⁸ It is conclusive that these currencies appeared either during national organization of the states or in particular moments of their evolution: the Greek drachma was born in 1832, the Dutch guilder in the 17th century, when the Netherlands was one of Europe’s great powers, the Italian lira when the national state was born, the German mark in 1948, replacing the former Reich mark and later becoming a symbol of Germany’s postwar rebirth.

is not the case. There were strong reasons behind its introduction. Yet once the euro was introduced, the European politics should have developed **cohesion programs** to prevent widening gaps and ensure (quasi-) similar development levels among members. What missed from the birth of the euro should have been implemented later, based on clear vision.

We are raising question marks about the **subsequent** period. First, the Union's budget was not designed in such light or in view of reaching the higher, grander objective, to turn the Union into a federation, "the United States of Europe". Let us look at the federal budget sums in other countries. "The American federal budget accounts for some 24% of GDP; the Swiss one is roughly 12%. The EU budget, by contrast, amounts to just 1%"¹⁹. 1% of EU GDP is simply not enough for cohesion objectives. It is then legitimate to ask: does the EU still aspire to become a federation? The size of the budget gives a decisive 'no'.

The lapse of several years has shown that the euro was introduced for a fundamentally political reason, beside economic ones. In David Marsh's words, "*The Euro was designed to shackle Germany*"²⁰. Germany's reunification in the early 90s announced the rise of the Union's first economic power. France and Europe in its entirety were preoccupied with Germany's evolution and dominance.

What choices were open to Germany as Europe's first economic power when the euro was introduced? The first precaution was to regulate the functioning of the new currency. The rules bore the print of inflexible German position: no bail out, no political interference and so on. One special, highly symbolic condition was to establish the European Central Bank in Frankfurt. The currency was European, but its traits, as Moravcsik said, were German, which makes David Marsh assert: "*the D-Mark may have been sacrificed, but its spirit appears still to be alive*"²¹.

A question arises. Regulations have a major, yet formal influence. Currency is the financial expression of a country's economic power. In a federal organisation, real influence in finance is eventually given by position within the Union's economic power. Consequently, in order to increase this influence, formal regulations must be **doubled** by an increase in economic power. Germany's impressive work for its own development and modernization can be read in this key as well. The 20 years following its reunification are a period of maximum effort towards economic power and competitiveness increase. Germany is nowadays the main beneficiary of the Union and the single currency. It sacrificed its own currency, symbolising the success of postwar German reconstruction, but, because it developed constantly, because it understood faster that it is powerful economies that are financially powerful, it managed to change the euro into a new mark. Today we can call the euro **the new European mark**.

What seemed to be a disadvantage, the euro designed to "shackle Germany", has become a great advantage. The euro now formally "obeys" German rules, agreed upon from the very beginning, and is mainly coupled to the evolution of German economy. The euro's very existence is fundamentally influenced by Germany's attitude. All this is

¹⁹ Autumn renewal? Having Survived a Difficult Month, the Euro Zone is Grappling with its Taboos, *The Economist*, September 15th 2012.

²⁰ Marsh, David, *op. cit.*, p. 277.

²¹ *Ibid.*, p. 278.

an undoubted proof of vision. It is a great performance to develop in a European context which is more suspicious than it was in the 19th century, and in a system which was projected to contain you, and finally succeed in making the system dependent upon you. This is a performance no lesser than Bismark's, back in the 19th century.

6. The option for industry

The secret of Germany's transformation into the Union's first economic power lies in its option for industry and manufacturing. Axel Weber, former president of the Bundesbank, talks explicitly about this option of Germany but also about the fact that it deliberately left other European states to specialize in services and become real powers in this field: *"a move to Germany specializing in industrial activity, leaving other countries to be strong in services. Countries have the ability of altering the economic conditions that will attract certain industries by making changes to their economic structures. Germany has embarked on this path, and this provides a model for others to follow. There is really no alternative to this path that Germany has taken"*²². In his turn, Steven Rattner underlined that *"Germany embraced manufacturing, and much of its economic success is thanks to that decision"*²³. This is the open acknowledgement of an economic option which was confirmed by contemporary evolutions.

Nowadays, the option for manufacturing reveals its strategic implications. In a recent study from McKinsey Global Institute, one chapter reads: 'Why manufacturing matters'. This is the significance attached to the field by this Report: *"Manufacturing still matters a great deal, but its primary importance is as a driver of productivity growth, innovation and trade. Manufacturing continues to make outsize contributions to research and development, accounting for up to 90 percent of private R&D spending in major manufacturing nations. The sector contributes twice as much to productivity growth as its employment share, and it typically accounts for the largest share of an economy's foreign trade; across major advanced and developing economies; manufacturing generates 70 percent of exports"*²⁴. This is a relevant picture of advantages triggered by the option for manufacturing.

This choice is not automatically linked to development indices. It is true that the more a country develops, the less this sector counts in overall GDP; yet this tendency varies widely with the country's vision on the role of industry in its development. That is why there are wide differences among developed countries as to the manufacturing's share of GDP. In developed countries like Great Britain, France and the US, this figure is very low, while in other developed countries – such as Japan, South Korea or Germany, manufacturing's share is much higher, as the table below shows.

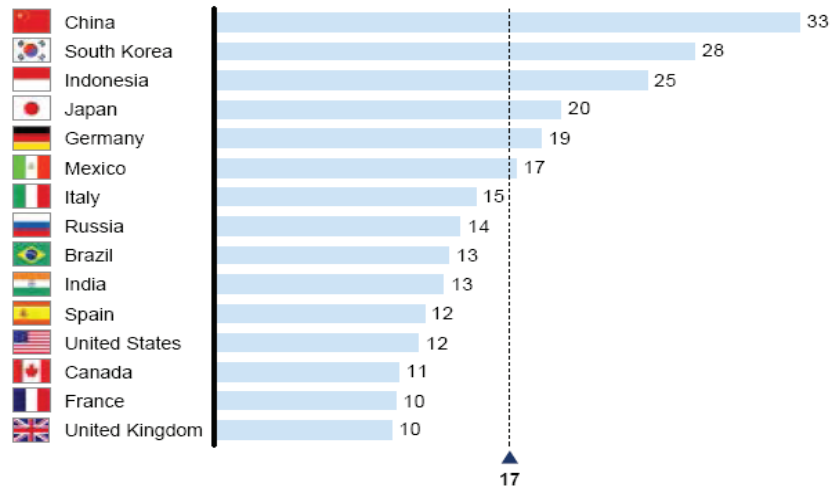
²² *Ibid.*, p. 279.

²³ Rattner, Steve, The Secrets of Germany's Success, What Europe's Manufacturing Powerhouse Can Teach America, *Foreign Affairs*, July/August 2011.

²⁴ McKinsey Global Institute, *Manufacturing the Future: The Next Era of Global Growth and Innovation*.

Manufacturing's share of GDP in the top 15 manufacturing nations ranges from 10 to 33 percent

Manufacturing share of GDP, 2010
%

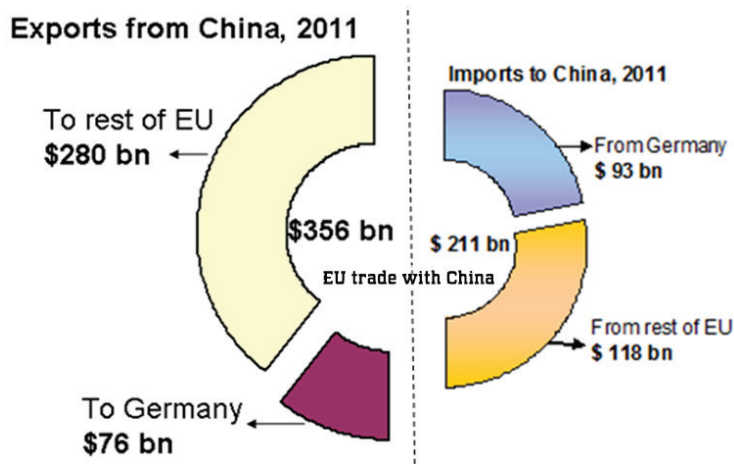


Source: McKinsey Global Institute, *Manufacturing the future: The next era of global growth and innovation*, November 2012, p. 24.

Recently, there has been a shift in the importance of manufacturing. It is significant that countries which maintained and stimulated manufacturing export more and generally have higher competitiveness. Manufacturing, as McKinsey Report shows, directly influences vital indicators in any economy, from productivity to innovation and research. That is why future years will see a shift in perspective, and the countries which maintained and encouraged this field already have the edge in today's economic competition.

The increase in exports is what stands out in Germany's recent evolution. The issue of export as a prominent trait in a country's development philosophy is much more complex than it appears at first sight, because export relies heavily on organisation and internal performance. Germany is now the world's second largest exporter, after China, with exports accounting for two thirds of the country's development in the last ten years. This is the result of efforts for internal modernization, increase in competitiveness, identification of branches where Germany could perform well, but mostly the result of a decisive option for manufacturing. Many countries believe the real trigger of growth is consumption and consequently encourage this direction. Germany's evolution today says that growth can occur by stimulating the country's capacity to produce wealth. Germany's GDP per capita grew faster than in any other developed country, due to massive exports and competitiveness.²⁵

²⁵ Rattner, Steven, *op. cit.*



Source: A special relationship, *Financial Times*, August 29, 2012, p 2.

This is a significant synthesis of Germany's role in Europe's import-export structure. We have chosen China because it is a highly competitive economy in exports and has significant surplus (approximately 150 billion dollars) with Europe. In import terms, Germany behaves like other important European countries (with a fifth of European imports from China). In export terms, it exports almost as much as the whole Europe. In the bilateral China-Germany relationship, Germany has a trade surplus of 17 billions, which is a performance in itself. Europe's trade deficit with China has increased three-fold in the last ten years²⁶. The great Asian power became a trade competitor, rather than a partner. This imbalance is not relevant in itself, but it announces a worrying tendency: Europe turns into another victim of China's production machine, after the US.

The option for manufacturing, correlated with efforts for competitiveness increase, ensures a strategic advantage for Germany in its balance of trade with the Union and reveals the Union's structural economic problems. Some members – most notably Germany and the Netherlands – have had large surpluses in trade with other EU member states and large current account surplus year after year. Both currently enjoy current account surpluses in excess of 5 per cent of gross domestic product. Others – most notably, Greece, Italy, Spain, Portugal, and France – have had large deficits in trade with other EU member states and large current account deficits year after year. Over the past 10 years, the Greek current deficit has averaged more than 13 per cent of GDP. That in Portugal has averaged almost 10 per cent. In France and Italy, the current account deficit has increased from less than 1 per cent of GDP in 2002-2006 to more than 3 per cent this year²⁷.

Such imbalance has its root in economic competitiveness differences. Consequently, while Germany can invest this sum, the countries with trade deficit must borrow huge

²⁶ Chaffin, Joshua, Tempestuous Trade Winds, *Financial Times*, Tuesday, May 29, 2012.

²⁷ Cameron, David R., Three Ways - All Painful - to Increase Competitiveness. *Financial Times*. Tuesday, November, 15. 2011.

amounts of money if they wish to maintain their imports level. For instance, the sum invested by Germans will evidently contribute to higher increase in productivity, which will widen the competitiveness gap. **A spiralling of trade deficit increase** has started.

In this context, one other problem is worth discussing: the option for manufacturing is met in the Asian space as well (an argument used to suggest similarities between Germany and the countries in Asia, especially China²⁸). Without ruling out such influences and connections, we believe that this option is not the result of mimetic behaviour, but of close “reading” of the present and realistic design of a medium and long-term development model. Neither Germany, nor China has been inspired by the other (although this would not constitute a fault in itself). The close reading of reality by the leaders of the two nations, who asked themselves what future to build for their countries – this was the common root of the two development strategies which are now successfully applied on two different continents.

It is clear that German strategy represented a different option than the uncritical promotion of services and their transformation into a top priority for contemporary society. Germany now has all the data to become **a model**. Its options have been confirmed by historical evolution. Which country should the Union follow, objectively speaking?

7. The option for reform and modernization

Little is known about former German Chancellor Gerhard Schroeder's launch, in 2003, of a fundamental document for Germany's development today: “Agenda 2010”. The former chancellor's words in an article from 2012 are the best definition of the program: *“With the help of the Agenda 2010 we adjusted the welfare systems in order to make it possible to pay for the welfare state and to enable it deal with the challenges of the future”*²⁹.

To better understand the significance of Agenda 2010, we need to consider the context of its launch. This was several years after the introduction of the single currency, when Germany's economic development was very modest. 13 difficult years had passed from Germany's reunification, with high levels of unemployment, of current account and “long – lasting strains of reunification”. At one point, Germany had even been called “Europe's patient”. At such a time, Schroeder rethinks not only Germany's productive capacity, but the whole system of public expenditure, and configures a lean, competitive economic and social profile, which allowed a speedy recovery after the 2009 downturn.

Following a discussion with the former German chancellor, David Marsh confesses: *“The new currency would tend to weakness; the Germans would keep their costs down and thus achieve a powerful competitive edge over countries that could no longer devalue within Europe. This development, Schroeder forecast, would make it easier*

²⁸ For instance, in literature, Germany is referred to as “a second China”.

²⁹ Gerhard Schroeder, Agenda 2010 – The Key to Germany's Economic Success, *Social Europe Journal*, <http://www.social-europe.eu/2012/04/agenda-2010-the-key-to-germanys-economic-success/>

for Germany companies not only to boost their exports throughout Europe, but also to acquire firms in other countries that had been weakened by the effect of the euro.”³⁰ In other terms, it takes a period of austerity to increase competitiveness of German products and gain a net exports advantage over European partners. Taking this road, Germany would not only amplify the force of its exports, but economic domination over exports as well.

There is another side of the former chancellor’s vision: the ascent of “market forces”, in fact, financial markets, which are now more powerful than states and promote economic criteria while ignoring social considerations, which national states are bound to take into account. If we wish to preserve our capacity to maintain the welfare system, says Schroeder, then we must rapidly modernize it, by becoming more competitive. Failure to do so results in incapacity impacting socially and economically. Rarely have we met with such acute characterization of the devastating impact of uncontrollable market forces on the life of peoples. Not to mention that such plead for competitiveness increase came from a social democrat: *“Either we modernize ourselves, and by that I mean as a social market economy, or others will modernize us, and by that I mean unchecked market forces which will simply brush aside the social element”*³¹.

Agenda 2010 consolidated Germany’s classical orientation for manufacturing. Seeking to save the social factor of economic activity, he prioritises economic performance to ensure the effectiveness and financeability of the welfare state. That Germany regarded these sides as inseparable allowed it to adopt a more flexible position throughout crisis in comparison with the US, as Steven Rattner³² shows. To preserve export competitiveness, German economy should have made people redundant. It opted instead for an ingenious solution, the “short program”. The total number of working hours was decreased to avoid redundancy, and the government compensated for part of the decrease in salaries by allotting 5 billion euro. Unemployment increase was thus avoided (500.000 jobs were kept), even though this measure impinged upon competitiveness and GDP as well. This shows a realistic vision harmonizing the demands of long-term growth with short-term gain and the natural tendency for maximizing productivity (of paramount importance for massive exports) and maximizing employment. *“The tension between maximizing productivity, or competitiveness and maximizing employment is something almost all developed countries face. In some ways, Germany and the United States are on opposite ends of the spectrum. Germany maximized employment, and its GDP suffered; the flexible US economy tends to maximize productivity, and it has a higher unemployment rate as a result.”*³³

The evolution of important economic indicators in the two most powerful countries in Europe, Germany and France, is relevant. They show the effects of timely reforms on performance. France hesitated to promote radical reforms on labour market, which were made in the Netherlands, Norway and Sweden in the 1990s and in Germany, in the 2000s. The direct consequence was evident in 1999 with the introduction of the

³⁰ Marsh, David, Co-Chairman of Official Monetary and Financial Institutions Forum, <http://www.omfif.org/OMFIF/news/commentary>.

³¹ Schroeder, Gerhard, *op. cit.*

³² Rattner, Steven, *op. cit.*

³³ *Ibid.*

euro, when the cost of French labour force was below Germany's, and France had a current account surplus. Today, shows *The Economist*, French labour force costs are far higher than Germany's, and the current account deficit is growing. Another field is the size of public expenditure. 15 years before, the public expenditure ratio in the GDP was similar in the two countries and higher than in Sweden. Nowadays, French public expenditure is 57% of GDP, 10% more than in the case of Germany. France has 90 clerks to 1000 people, while Germany has 50³⁴.

One final thing. Gerhard Schroeder pointed that: "The lesson learnt back then was that structural reforms can only make an impact if at the same time one stimulates growth. We must now give this opportunity to our European partner". The lesson learnt is that such structural reforms must be accompanied by economic growth for the population to share and not reject them later on.

8. Germany's European exam

The future validates answers that predict it, that come half-way, that decipher it earlier. Each country has a development strategy. Each country wants to develop and join the top powers. The countries that succeed are those that see further and are still prudent about fashions. From this perspective, Germany and China had surprisingly similar policies.

Germany is now at a crossroads: it could stay a European power or go on to become a global one. And such crossroads carry supplementary risks. In terms of certain economic indicators (export volume and competitiveness, for instance), Germany could claim to be a global power. At the moment, Germany is in a privileged position: it has no debts and its choices have been validated by history. In reality, Germany is at the forefront of European powers because these powers are in difficulty. The contrast is starker because of European powers' weakness, rather than Germany's power and performance.

One way of measuring Germany's real power today would be a comparison with its position at the end of the 19th century. The Germany of 2012 is decisively different from the Germany of 1880. Back then, Germany had the strongest universities and companies in the world, and a growing population. Now, Germany has some of the strongest companies in the world but is far from having the best universities and its population is decreasing.

Germany is the EU's main beneficiary. With the most competitive economy on the continent, Germany benefits most from the EU. Martin Feldstein was right to show that Germany's trade surplus with the EU, 200 billion euro (a significant figure), means trade deficit of the same size for the other countries³⁵. Therefore, Germany does not support the Union from philanthropy, but from realistic policy reasons. Europe is Germany's main market. With Europe backing it up, Germany will grow stronger. On its own, Germany will be middling.

In our opinion, Germany will work for the Union's economic consolidation. This is the significance of Chancellor Merkel's consent for the European Central Bank to

³⁴ The Time-Bomb at the Heart of Europe, Why France Could Become the Biggest Danger to Europe's Single Currency, *The Economist*, November 17th 2012.

³⁵ Feldstein, Martin, The Failure of the Euro, *Foreign Affairs*, January/February, 2012.

buy shares from governments in difficulty. The decision was all the more difficult because in the last years Germany prioritised currency internal stability, in agreement with Bundesbank. This time, its commitments to the EU were prevalent, despite Bundesbank's opposition³⁶. This shows the German government's considerable effort to adapt to circumstances, to change its position so as to identify joint solutions against the crisis.

The constraints before Germany must be taken into account as well, for at least two reasons. Germany's repositioning towards Europe must be gradual, so as not to contradict internal public opinion believing that the country credits and supports other people's "excessive consumption" and "waste". Political and electoral arguments weigh considerably in such decisions. For instance, Jean-Claude Juncker, the president of Eurogroup, said: *We all know what to do, but we just don't know how to get reelected after we have done it*³⁷. Especially in the case of Germany, taking strategic decisions a year before elections is a difficult choice, since public opinion is increasingly reticent about Germany's expenses on countries in difficulty.

ECB will surely have to resort to printing money, which means the implicit increase in inflation, which word sends shivers down Berlin's spine. This is a price Germany assumes after several years of inflexibility. Sebastian Mallaby underlines that ECB printed money whose value equals Greece's GDP for eight years³⁸. This intervention at the beginning of the crisis would have cost significantly less. In any case, Germany is now right in asking countries in difficulty to make efforts to get out of crisis, by improving the way they administer public finances, by drastically diminishing fiscal evasion, by decreasing public expenditure and tackling those factors that diminish overall competitiveness. This austerity process will bear the German print, but the vision of austerity itself will have to become flexible. Over the past year, the eurozone has indeed cut deficits sharply but the debt - to - GDP ratio has worsened. Programs are neither politically sustainable nor economically wise³⁹.

Germany has forged a strategy for itself, but not for Europe. Now, it is wished that Europe "embarked upon" a road that supposes efforts and cuts in consumption. Yet Europe is hit by successive waves of crisis. Most countries in Europe have not taken Germany's option and consequently do not have Germans' means to face efforts. This is a lesson that each must learn. Germany did not seek to extend its option either, nor did the other countries decipher or study Germany's lesson.

It is Europe's exam that Germany will have to sit. It will reveal what Germany really wants. Germany will become a leader if it builds a model that will be accepted at European level and will promote Europe. Germany will continue to be a leader in the old Germany-led paradigm, but in this case it will only be Europe's most powerful state, and not its leader. This is the exam Germany will have to sit.

³⁶ Stephens, Philip, Merkel Has Decided to Pay Up for the Euro, *Financial Times*. Friday November 16, 2012.

³⁷ Bordignon, Massimo, Buettner, Thiess and Friedrick van der Ploeg. Europe at a Crossroad. In Buettner, Thiess, and Wolfgang Ochel, *The continuing evolution of Europe*, MIT Press (MA), 2011, p.128.

³⁸ Mallaby, Sebastian, Europe's Optional Catastrophe, The Fate of the Monetary Union Lies in Germany's Hands, *Foreign Affairs*, July/August 2012.

³⁹ *Ibid.*

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