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Germany's Marriage to Austerity: Little Chance of a Quick Divorce

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The German government's belief that the best recipe for return to growth in the euro area is a combination of budget cuts and reductions in wages is one that is faced with constant, if not rising scepticism in Europe. However, hopes that Berlin will drop its austerity approach should be kept in check. The country's economic culture, doctrine, form of capitalism, as well as economic interests all speak to the policy's durability than its quick departure.

If the financial and economic crisis that began in 2008 in Europe has any winners, it is undoubtedly the word "austerity." It has become a short and concise synonym of a specific anti-crisis policy. Its main recipe for return to growth is to reduce domestic demand, mainly by cutting public spending, which should lead to a drop in prices and wages, thereby increasing the competitiveness of the economy. In the next stage, investments increase and help the economy recover its vigour.

Austerity is for sure painful therapy. It implies an increase in unemployment, a decline in living standards, and political instability, but even so, it was pushed through in Europe. This was mainly down to Germany, which since the crisis began has consistently demanded other members of the euro area apply austerity measures. However, the criticism is loud that the therapy has yielded too little for all the economic and political effort. A long list of opponents—from prominent politicians to Nobelists in economics—see a better chance to revive the economy by easing spending and taking a less restrictive approach.

Many wonder under what conditions Berlin would depart from its economic course. There are few indications that this will happen, however. Not only are there explicit statements against such a change by Angela Merkel, German Finance Minister Wolfgang Schäuble and influential Bundesbank officials, but also the German commitment to austerity is of a long-term nature and is deeply rooted in the country's economic culture, economic doctrines, its interests in the global economy, as well as in the institutions of Rhine capitalism.

Culture of Saving

In contemporary sociology and economics, "culture" is understood as non-market norms and values affecting the market activity of business entities.[1] Most often, religion is cited in this context, and particularly in the case of Germany. The Protestant ethic pointed the way to salvation through individual effort and responsibility, modest consumption and saving, that is, an austere approach to money. This

[1] J. Kochanowicz, S. Mandes, M. Marody, *Kulturowe aspekty transformacji ekonomicznej*, Instytut Spraw Publicznych, Warszawa, 2007, pp. 19–21.

differed from Catholic ethics, which emphasised the importance of community, relative value of the worldly possessions and the forgiveness of sins (including financial ones).

The "Weberian factor"[2] resounds also today. This is a conclusion from the research of Adrian Chadi and Matthias Krapf,[3] who with the help of data from Germany's Socio-Economic Panel (SOEP) showed how the attitude to the eurozone's problems differ in only Germany among Protestants and Catholics. The first group fears a particularly strong impact from the weakness of the monetary union and the debt crisis on their welfare. Catholics, in turn, seem to be, according to these studies anyway, less concerned about the state of the euro.

Commenting on this research, journalist Stefan Kaiser with *Spiegel Online* remarked, somewhat ironically, that this rule is true for most opponents of the single currency in Germany, mainly key members of the party Alternative fuer Deutschland. The tendency of the government to defer to "austerity" fits the fact that Merkel is Lutheran and Finance Minister Schäuble is a Baden Protestant. Looking from the other side: the current "soft" institutional shape of the euro area is the responsibility of Catholics Helmuth Kohl and François Mitterand, who in the early 1990s established the basis for a common currency. And today, important opponents of the restrictive German course in the EU are European Commission President Jean-Claude Juncker and Mario Draghi, the head of the ECB—both Catholics.[4]

Apart from religion, there also are some unorthodox explanations for the German's strong saving behaviour, for example, in linguistics. In 2015, Keith Chen of Yale University published the results of research[5] indicating that the way the future tense is formulated in various languages influences behaviour in terms of saving. In the so-called strong-future languages such as English, French or Turkish, a different structure is used for future tense, for example, in English with the use of the helping verb "will." However, weak-future languages use the present tense to describe the future by adding a term relating to the future, such as "tomorrow."

In the latter, the present and future overlap one another, creating a certain continuity. This group includes German, Chinese, Japanese, Dutch and the Scandinavian languages. Chen showed, using OECD data, that in both groups saving patterns are different. Countries with a weak-future language save an average of about 5% more. The differences are even visible in bilingual countries, such as Switzerland, Belgium or Malaysia: on average, 30% more people saved in weak-future speaking regions than in strong-future ones. Pension savings in the first group were 25% higher.[6]

Taking into account the cultural inclinations of Germans to save, the more the two periods of dramatic decline in the value of their money was etched into the social memory of the nation. The first was the famous hyperinflation of the 1920s,[7] which even today is second to none. The other was the period after World War II when price controls ceased to apply and the Reichmark began to rapidly lose value. The Germans' trauma and fear of inflation is, despite the passage of many decades since these events, still a dominant political argument explaining their obsession with stability, especially in the value of currency.

The Doctrine of Stability

The Germans' rigorous approach can also be explained by the domination of specific economic doctrine—*ordoliberalism*. The development of its foundations took place in the 1930s when economists such as Walter Eucken and Franz Boehm gathered as the so-called Freiburg School to discuss how to build a stable, crisis-

[2] M. Weber, *Etyka protestancka a duch kapitalizmu*, Test, Lublin, 1994.

[3] K. Matthias, A. Chadi, "The Protestant Fiscal Ethic: Religious Confession and Euro Skepticism in Germany," *Cahiers de Recherches Economiques du Département d'Econométrie et d'Economie politique (DEEP)*, no. 3, 2015, www.hec.unil.ch/deep/textes/15.03.pdf.

[4] S. Kaiser, "Katholiken und die Eurokrise: … und vergib uns unsere Schulden," *Spiegel Online,* 2 June 2015, www.spiegel.de/wirtschaft/soziales/katholiken-protestanten-und-die-eurokrise-a-1036790.html.

[5] M.K. Chen, "The Effect of Language on Economic Behavior: Evidence from Savings Rates, Health Behaviors, and Retirement Assets," *American Economic Review*, vol. 103, no. 2, 2013, www.anderson.ucla.edu/faculty/keith.chen/papers/LanguageWorkingPaper.pdf.

[6] F. Stocker, "Muttersprache entscheidet ueber das Sparverhalten," *Welt Online*, 2 April 2015, www.welt.de/finanzen/article139021856/Muttersprache-entscheidet-ueber-das-Sparverhalten.html.

[7] J.L. Spenkuch, *The German Hyperinflation of 1921-23: A Theoretical and Empirical Analysis from a Macroeconomic Perspective*, St. Gallen, 2007; W.C. Fischer, *German hyperinflation 1922/23: A law and economics approach*, Eul Verlag, Lohmer-Cologne, 2010.

free and freedom-oriented capitalist system. After the fall of the Third Reich, their ideas matched the times perfectly and became the cornerstone of the German economic system.[8]

The German version of liberalism—unlike the Anglo-Saxon version—saw the main threat to the free market to be the concentration of private economic power. The firewall against it would be, however, not the state only, which can ultimately be "hijacked" through active lobbying, corruption, or simply skilful propaganda directed to voters, but an "economic constitution." Under this motto hid a set of rules accepted by all the social actors and which, at the same time, could not be easily changed by an ordinary act of parliament. Two institutions were crucial in this context. First, an independent anti-trust authority guarding competition rules, and second, an independent central bank whose task was to protect the value of the currency, thus encouraging firms to develop by improving performance rather than because of demand driven by "empty" money. These two principles amalgamated after 1949 with the Bismarck social state, and thus established the social market economy (*Soziale Marktwirtschaft*).

This model gave Germans an economic miracle in two post-war decades, therefore it had no actual competitors on the doctrinal level. A challenge emerged only in the late 1960s, when the Social Democrats (SPD) came to power and proposed the Keynesian solutions of Minister Karl Schiller. But the ideas of *Globale Steuerung* (aggregate steering) were contested by the Bundesbank, which quickly trimmed the expansionist ambitions of the SPD in fiscal policy. The reason, as Mark Blythe wrote, was simple: "In ordoliberal terms, spending equals misuse and the central bank was specifically designed to prevent such misuse."[9]

The principle of *ordo* had its time of triumph in the 1970s, when a Europe mired in crisis looked enviously at the relatively healthy German economy and its low inflation. As a result, German liberalism began to shape the field of European integration, in particular, the first institutions of monetary integration. Two decades later, the macroeconomic convergence criteria of the Maastricht Treaty, the independence of the European Central Bank, the Stability and Growth Pact, marvel no one. Ordoliberalism became the intellectual foundation of the monetary union; and from the perspective of Berlin, it should remain so, and hence, the determined resistance against attempts to undermine the existing order through the politicisation of monetary and fiscal policy.[10]

Exporters and Creditors

The German commitment to austerity is also influenced by a specific understanding of the sources of vitality of its economy, which is dominated by an export orientation and a search for competitive advantages, primarily in high-quality production.

To understand this phenomenon, one must go back to the 19th century, when the Germans were a "late superpower," only aspiring to become an economic giant. They did not have such an ideal starting point as the British, who built their development on colonial expansion, or the United States, which benefited from the width of a continent. "Late" German companies did not grow spontaneously in open markets but entered markets already occupied and dominated, pitting them against the peak of much competition. The key to their triumph was a combination of low costs and high investment expenses. The state played a very significant role here as it focused, as Mark Blyth writes, "[...] in suppressing consumption and increasing savings to provide adequate pools of capital for large-scale industrial investments [...]. As such, the mantra of 'Erst Sparen, Dann Kaufen[11]' [...] formed the austere core of German economic thought long before the 1930s, when ordoliberalism appeared."[12]

This approach has perpetuated itself in the 20th century and has translated into an understanding of competitiveness as the ability to expand into global markets and achieve a structural surplus in foreign trade. The logic behind the Federal Republic's state achievements was simple: make incentives to keep labour costs under control and motivate companies to improve productivity and investment. The most

[8] M. Blyth, *Austerity: The History of a Dangerous Idea*, Oxford University Press, Oxford–New York, 2013, pp. 132–143
[9] *Ibidem*, p. 140.
[10] U.G.S. Dullien, "The Long Shadow of Ordoliberalism: Germany's Approach to the Euro Crisis," European Council on Foreign Relations, 2012, www.ecfr.eu/page/-/ECFR49_GERMANY_BRIEF_AW.pdf.
[11] In English: "First save, then buy."
[12] M. Blyth, *op. cit.*, p. 134.

recent example of this policy was overcoming the crisis of the beginning of the previous decade, mostly by freezing wages, while at the same time in other countries they quickly grew. The result is today's huge current account surpluses amounting to €200 billion per year. This adaptation model is, according to German politicians, most suitable for crisis-ridden countries to return to growth.

A trade surplus, however, adds yet another argument for austerity: a policy to protect the interests of creditors. Germany is a structural creditor. In the balance of payments, an export surplus means neither more nor less but a high deficit on the capital account. In short, what the German economy earns from a positive trade balance is lent abroad. Its NIIP (net international investment position), which shows the level of foreign liabilities of a country, both private and public, amounted in 2014 for Germany to +42.3% of GDP and has clearly increased since the pre-crisis period (2008: 18.2%). In absolute terms, this is a huge amount—€1.23 trillion. In relation to GDP, only some relatively small open economies such as the Netherlands, Belgium and Denmark, have higher ratios. Facing such a structural condition Germany fears foremost debt "haircuts" and would prefer adjustments on the debtor side by lowering state spending and saving, thus by austerity measures.[13]

Capitalism of Incremental Innovation

Germany has one more thing holding it on the course of austerity: a social system of production and innovation. The model of Rhine capitalism has not adapted to open, flexible and short-term focused markets characteristic of Anglo-Saxon countries. In Germany, a less liberal approach was preferred that stressed standards, stability and long-term goals.[14] This is visible both on the microeconomic and macroeconomic levels.

Let us start with the first one. Capital was made available by banks offering perennial, stable loans: something other than the hasty, short-term oriented stock exchange and equities. Further, employment conditions and wages were—especially in the second half of the 20th century—negotiated between the social partners, namely trade unions and employers' organisations and employees enjoyed far-reaching protection against dismissal. Socialism? Not at all. It was about creating incentives to so-called incremental innovation within the production of one specific group of products. The "patient" capital encouraged companies to think about long-term development of certain technologies. Workers, on the other hand, feeling safe about their employment conditions were more interested in investing in specific skills, crucial for specialisation and "incrementally" polishing the quality of products.

Importantly, all the parties were interested in macroeconomic stability. For trade unions and employers' organisations who annually negotiate the terms of labour and productivity growth it is important that the currency is stable because only that ensures their agreements are of any value. An independent central bank and "objective" stability norms of constitutional power are focal in this context: the more untouchable the value of money, the better it is for their autonomous business planning.

The German solutions are clearly different from those prevailing in liberal market economies. Businesses in such systems can relatively easily "employ" capital and labour during a boom and just as easily get rid of them when it fades. The stock market and flexible labour market assist with that. These are conditions conducive to radical innovation, for example, in the media sector, biotechnology, telecommunications and entertainment. Its flaw is the tendency to fall into deep depression and periods of overheating, which is why its actors do not expect the state to impose rigid rules such as those found in German capitalism, rather they trust in its ability to respond to crises in an effective, even if unconventional way. The liberal systems thus have a propensity to favour Keynesian ideas, which are quite unpopular in Germany.

Austerity Forever?

The arguments above suggest that the fundamentals of austerity policy in Germany are very strong and changes should not be expected. This impression may, however, be weakened a bit if we consider some

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[13] Eurostat, "Net international investment position—annual data: Eurostat—Tables, Graphs and Maps Interface (TGM) table," http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tipsii10&language=en.

[14] See the literature of the Varieties of Capitalism approach and discussions about the German model, e.g.: B. Hancke (ed.), *Debating Varieties of Capitalism: A reader* (Oxford University Press, 2009), in particular, the first part on "Capitalist Diversity."

creeping changes in German economic culture as well as listen to voices that say the peak of German influence in Europe—thus, austerity—has passed already.[15]

First, the ordoliberal doctrine in Germany is gradually weakening. Proof of this is seen in the results of a survey of 1,000 German-speaking economists conducted by the internet portal Wirtschaftswunder on behalf of the weekly *Sueddeutsche Zeitung*.[16] The survey results show increasing convergence of German economics to America's and a broader acceptance of the so-called new Keynesianism. Most striking is that only 12.6% of German economists claim the rigid policies of Merkel and Schaeuble are absolutely correct. The rest either do not agree with that claim or think there is no other way out of the situation. Other details are also meaningful. Between 2010 and 2015, the number of those who support stabilisation of the economy through fiscal policy increased from 17.9% to 36% (it was 12% in 2006). At the same time, the percentage of those who say it should be allowed only in exceptional cases, such as the crisis of 2008, fell from 70.1% to 53.3%. Only about 10% of economists surveyed are strictly against such an option. In the first such survey in 2006 these economists amounted to almost a third.

But this is not the only evidence of a changing mood among German research institutes. The question of whether lowering public debt requires economic growth (in other words, it is not possible during a recession) in 2010 was answered affirmatively by 61.5% of respondents, and then five years later was already 68.3%. At the same time, there was a decrease in the opposite opinion from 29.9% to 24.7%. In addition, now only 27.4% of economists oppose the active role of the central bank during a financial crisis. In fact, 53.7% support, at least with reservations, the ECB's "whatever it takes" policy, while only 36.2% oppose it. This is not really in line with the open criticism towards Draghi's decision heard from officials of the Bundesbank, such as Axel Weber or Juergen Stark.

The second argument, which leads to a certain caution in formulating hypotheses regarding the sustainability of the German approach to austerity, refers to economic structure. Since the reforms undertaken by the government of Chancellor Gerhard Schroeder in the early 2000s, German capitalism has changed its nature somewhat. The labour market has become more flexible, much more towards atypical and extremely flexible forms of employment, which have so far supported the country's ailing growth in the services sector and absorbed the low-skilled unemployed. At the same time, for two decades we can observe the weakening of the importance of trade unions and branch tariff systems. The negotiations are more decentralised and flexible, and thus less dependent on the promises of stability granted by the state.

Thirdly, it is still not clear whether the German anti-crisis policy in the euro area has proved successful. The great weakness of forcing austerity policy is that economic growth in crisis-ridden countries is still very weak if not absent, but instead there is a massive increase of the risk of political instability. In Greece, not only was there a fall of the government that first accepted the austerity measures but also the debt has deepened, not been reduced, despite a one-time reduction (haircut). The next candidate for political turmoil is Portugal. Even the case of Spain, which has been often presented as an example of a successful combination of austerity and supply-side reforms, provokes disputes among economists. Simon Tilford, an analyst at the Centre for European Reform, wrote that, "[w]ithout much more growth-oriented macroeconomic policies, and fiscal transfers to compensate poorer Eurozone members for the impact of capital and skilled labour concentrating in the wealthier core, Spain faces plenty more pain."[17] This does not sound like a recipe coherent with German priorities. In fact, Germany is becoming more and more alone in the eurozone, as far as the issue of anti-crisis policy is concerned. On the opposite side, are not only the countries of Southern Europe but also France, which intends to smuggle Keynesian-like anti-crisis policy into fiscal union projects.

Fourth, the expansion of austerity in Europe was connected to the phenomenal prowess of the German economy, its stronger proponent. After 2010, its economic growth and strong budget legitimised to some extent Berlin's demands towards the crisis-ridden economies in the south. However, this situation should not be taken for granted. Soon Germany may slip into serious economic troubles driven by multiple factors. The boom in China and the other BRIC countries is over, so could be the fabulous German export

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[15] D. Gros, "The End of German Hegemony," Project Syndicate, www.project-syndicate.org/commentary/germany-slowing-growth-by-daniel-gros-2015-10.
[16] T. Fricke, "Umfrage—Wie deutsche Ökonomen wirklich denken," *Süddeutsche Zeitung,* 20 June 2015.
[17] S. Tilford, "Gain or more pain in Spain," Centre for European Reform, 2015, p. 16, www.cer.org.uk/sites/default/files/publications/attachments/pdf/2015/pb_spain_st_19oct15-12137.pdf.

performance. Internal factors are worrisome, too, mainly the disappointing development in labour productivity but also the huge challenge of the refugee crisis. Nobody is able to foresee whether the latter will turn into a German plus, but even if so, it will be very difficult at least. Add to this the Volkswagen scandal and the sky over Rhine capitalism is not cloudless anymore. Without its economic and financial strength, the ability of Germany to enforce its austerity-based arguments will be much weaker.

In addition, there is also a political argument. With the already big and growing importance of Berlin in European politics, the pressure to take on more responsibility for the operation of the European Union is also growing. This means playing the role of an economic locomotive by pulling the continent along with larger budgetary expenditures and less rigid wage policy. This may mean also an accommodating approach towards other countries by designing the deepening of integration towards a fiscal union. Berlin may find itself in a position that a safer and more mature eurozone needs more openness to the arguments of France and Italy, which demand less rigid financial rules for Europe. So, the price for keeping German leadership intact may be the marginalisation of austerity.