Germany and the Euro Crisis: Ordoliberalism in the Dock

Oliver Landmann
University of Freiburg

June 2018

Prepared for
Malte Dold & Tim Krieger (eds.): „Ordoliberalism before, during and after the Eurozone Crisis: Between Realpolitik and Economic Utopia“

Universität Freiburg
Institut für Allgemeine Wirtschaftsforschung
Platz der Alten Synagoge
D-79085 Freiburg
Germany
phone ++49 761-203-2326
e-mail: oliver.landmann@vwl.uni-freiburg.de
http://www.macro.uni-freiburg.de/news/home

Germany and the Euro Crisis: Ordoliberalism in the Dock

Oliver Landmann[1]

Who is responsible for the eurozone crisis?
The simple answer: Germany
Simon Wren-Lewis (2015)

The Germans have a name for their unique
economic framework: ordoliberalism
Wolfgang Münchau (2014)

1. Introduction

Not too long ago, a Freiburg economist traveling abroad was unlikely to be quizzed by foreign colleagues about ordoliberalism, the doctrine formed in the second Quarter of the 20th Century by the "Freiburg School of Economics" around economics professor Walter Eucken and law professor Franz Böhm. At best, ordoliberalism was acknowledged as a somewhat parochial German variant of free-market economics, of some importance to the evolution of the post-war Social Market Economy in Germany perhaps, but not widely known outside of Germany.

This changed quite rapidly when the financial crisis of 2007/08 led straight into a crisis of the eurozone which culminated in the imminent default of the Greek government in May 2010. The handling of this crisis and the subsequent management of the eurozone in the years

---

[1] University of Freiburg, Germany; oliver.landmann@vwl.uni-freiburg.de. The author thanks, without implicating them, participants at conferences and workshops at Nagoya University, Meiji University, the German Keynes Society, Harvard University, Freiburg University, and the Walter-Eucken-Institut, Freiburg, for valuable comments and suggestions.

thereafter gave rise to bitter disagreements over the proper conduct of economic policy in general, over the binding force of the agreed rules of the eurozone, and over the amount of political integration required to make the European Monetary Union (EMU) viable in the long term. These controversies continue at the time of writing (Spring 2018) as French President Emmanuel Macron has proposed far-reaching reforms to deepen European integration which Germany has been rather reluctant to embrace. What divides Germany and some of its northern neighbors from the Mediterranean countries along the southern rim of the eurozone is more than just a conflict of national economic interests. More fundamentally, it is, as Brunnermeier, James and Landau (2016) have put it, a "battle of ideas". In this battle, Germany stands for responsibility and accountability, fiscal rectitude, sound money, and an insistence on binding rules. The Latin European tradition, in contrast, prioritizes flexibility over rigid rules and rejects any constraints that might hamper crisis management and the pursuit of macroeconomic stability. It is in the context of this deep ideological divide that the German set of policy views has come to be branded "ordoliberal" by its critics - the epithet often being used in a similar way as the more common "neoliberal": with a pejorative overtone and with little regard for the precise meaning or origin of the term (Young 2017).

This sudden prominence of the doctrine of ordoliberalism has revived academic interest in the doctrine and triggered an outpouring of publications explaining it to a broader public and exploring its significance to the current political debate in Europe (Beck/Kotz 2017, Biebricher/Vogelmann 2017, Hien/Joerges 2017). This debate spans a broad range of economic and non-economic issues. The remainder of this Chapter offers some thoughts on just three of them:

1. To what extent can German policies, and the German stance on European policy issues, be regarded as ordoliberal in the sense of the set of policy prescriptions associated with the Freiburg School of Economics? One cannot properly address this question without going back to the origin of EMU, the Maastricht Treaty of 1992, in which the rules of the game for the eurozone are enshrined and which bears a distinctly German signature.

2. What role did Germany play in the string of events that led to the crisis of the eurozone and, subsequently, in the management of the crisis? And again: Were pertinent German policy decisions guided by ordoliberalism in any meaningful sense?

3. As the attention of European policymakers begins to shift from the immediate concern of crisis containment to the reform of the institutional foundations of the common currency, what lessons should be drawn from the failure of the original set of rules that has become apparent in the crisis and its aftermath? Does ordoliberalism provide any guidance?

Each of these questions would easily deserve a full paper of its own. The present Chapter cannot possibly do justice to them. What it does attempt, though, is to add some sober macroeconomic perspective to a debate which at times has become highly emotional, both inside and outside Germany.

2. Do German euro policies follow an ordoliberal script?

To answer the question about the influence of ordoliberalism on German euro policies, it is useful to remember that ordoliberalism was not founded as a doctrine to guide the design of a currency area. Rather, it was a response to the malfunctioning economic and political system of the Weimar Republic and the authoritarian decadence of the Nazi regime which had held the principles of individual freedom and free markets in contempt. The early ordoliberals thus focused on a set of rules that would guarantee the smooth operation of a system of free competitive markets and they emphasized the absolute precedence of these rules over the discretion of policymakers as a necessary precaution against the abuse of power of any sort.

Remarkably for a doctrine that reflected on Germany's sorry experience of economic depression, political dictatorship and war, ordoliberalism never paid much attention to the subject of macroeconomic stability. The sole macroeconomic element of ordoliberalism is its insistence on the "Primacy of Monetary Policy", i.e. on the principle of sound money. This postulate was motivated by the experience of the collapse of monetary exchange brought on by the 1922/23 hyperinflation as well as that of the deflation during the Great Depression. But why did the mass unemployment of the Great Depression not leave more of an imprint on the ordoliberal doctrine? Eucken never warmed to Keynesian economics. In line with Austrian business cycle theory, he believed that recessions were purgatory periods of adjustments in the wake of excessive credit expansion and overinvestment.

Eucken decisively rejected fiscal "full employment policy", both in his principal monograph "Grundsätze der Wirtschaftspolitik" (Eucken 1952) and in his London Lectures, delivered in London shortly before his death in 1950 (Eucken 2001). It is somewhat disingenuous, therefore, to argue that he "was not generally opposed to expansionary fiscal policy", simply because in 1931, in the darkest hours of the Great Depression, he put his weight behind the Lautenbach plan for fiscal stimulus (Feld et al. 2017, p. 43). As Eucken (2001, p. 46) explained himself, he did so not because he would have subscribed to a Keynesian diagnosis of the depression, but rather out of desperation in the face of the collapse of the democratic order and the imminent power grab by Hitler's NSDAP. He never accepted macroeconomic stabilization as an integral element of economic policy in a market economy, on an equal footing with the prevention of market concentration or the protection of property rights. His hostility towards the concept of full-employment policy was strongly shaped by his observation of how the initial job creation schemes of the Nazi regime quickly morphed into a system of extensive price controls and other oppressive interventions into markets. Eucken concluded that any full employment policy was incompatible with a free market system. He did not live to see this generalization proven wrong by the further history of business cycles and demand management in the second half of the 20th Century.

With its unwavering faith in the self-adjusting capacity of a market economy, the German variant of free-market economics followed a track quite different from the Anglo-Saxon mainstream which quickly embraced Keynesian economics, not as an alternative to any doctrine of free markets, but rather as a framework suitable for understanding how the stability of the system as a whole can be maintained. The complementarity of macroeconomic stabilization policy and the efficiency of free markets was the core idea of Samuelson's (1955) "neoclassical synthesis". Philosophically, Ordoliberalism, in contrast, is more in line with the Chicago tradition of economics with which Eucken was in close contact (Feld et al. 2017). The more modern variants of the Chicago School, from Friedman's quantity-theoretic approach to money and the rational expectations revolution down to real business cycle theory, share the ordoliberal skepticism towards Keynesian economics and its interventionist flair, but differ from the Freiburg School in their acceptance of neoclassical general equilibrium theory as the analytical foundation for the analysis of economic dynamics.

As German economics gradually caught up with the international mainstream after the war, Keynesian macroeconomics spread in academia and found its way into the realm of practical policymaking for the first time when countercyclical stimulus was applied in the fight against the first major post-war recession in 1967. In German universities, macroeconomics is taught with the very same textbooks that are in use across the globe. Ordoliberalism may be covered as one strand of thought on economic policy in general, but certainly not macroeconomic policy. Still, the attitude towards the principle of macroeconomic stabilization policy remained ambivalent in Germany. When the financial crisis had caught up with Germany in the autumn of 2008, the German Finance Minister grandiosely ruled out that Germany would emulate "the crass Keynesianism" of the British stimulus package which at the time was already under way. Only a few weeks later, Germany had cobbled together its own, rather extensive stimulus package. But then again, when the eurozone embarked on generalized fiscal austerity long before its deep recession was over, another German finance minister denied that this would have much of an effect on economic activity. In short, there is simply no such thing as a consistent doctrine guiding Germany's stance on macroeconomic policy.

The same lack of consistency characterizes Germany's approach towards the governance of the eurozone. Pragmatism and the imperatives of domestic politics have regularly prevailed over the rule-bound "steadiness" of economic policy favored by ordoliberalism. Germany was among the first eurozone members to violate the deficit limit as early as in 2003 when it suffered from anemic growth and high unemployment. A few years later, when the imminent default of Greece shook up the eurozone, Germany quickly gave in to the demands of France and the European Central Bank and agreed to a bail-out, throwing the no-bail-out clause of the Maastricht Treaty overboard. The main concern at the time was the risk of contagion, i.e. of the speculative pressure spreading from the bonds of the Greek government to those of other highly indebted countries in which French and German banks were invested to the tune of several hundred billion Euro. Thus, the breach of the Maastricht rules was pure national self-interest, or perhaps rather domestic political expediency: Neither the French nor the German governments felt their voters and taxpayers were prepared to pay up for another bail-out of banks only two years after the financial crisis, let alone to commit the money needed to ring-fence the bonds of governments that were fundamentally solvent, but at risk of becoming the target of a speculative attack nevertheless. Simply to follow the rules was not an option under these circumstances.

Germany's cavalier way with the rules of the Maastricht Treaty is all the more remarkable as these very same rules had been put in place because Germany insisted on them. When the Treaty was negotiated, a large body of academic research on "optimum currency areas" (Mundell 1961) could have provided guidance. This research had emphasized the vulnerability of a currency union to macroeconomic instability once member stated had handed over their monetary policy autonomy to a common central bank. But these were not the issues the architects of the Maastricht Treaty had in mind when they crafted the rules of the game. What mattered instead was the need to allay the deep-seated fears of German public opinion which was overwhelmingly opposed to giving up their beloved Deutsche Mark.

Those fears were fed by two overwhelming concerns: First, would a new currency, resulting from a merger of the Deutsche Mark with notoriously soft currencies, be as stable as the Mark has been historically? 62 German professors of economics circulated a manifesto in 1992, criticizing the Maastricht Treaty on the grounds that the European Central Bank would not achieve price stability as the diverse interests of national decision-makers would not allow it to muster the will to do so. The second objection concerned the moral hazard of governments abusing a common currency to free-ride on others. Thus, the threat of a European "transfer union" turning Germany into the paymaster of the eurozone loomed large. As a consequence, Germany insisted on building safeguards into the Maastricht Treaty strong enough to guarantee a stable currency and to prevent any resource transfers on which it did not have a veto. A long list of rules can be traced to these German concerns. The strict mandate and the independence of the central bank, the prohibition of the monetization of government debt, the ceilings on debts and deficits, the no-bail-out clause: They were all designed to win the trust of the German population.

As it happens, the rules Germany insisted on to be included in the Treaty of Maastricht are in line with two fundamental principles of ordoliberalism: the principle of sound money and the liability principle, the latter demanding that decision-makers be held accountable and bear the consequences of their actions. What Eucken regarded as necessary constraints on the actions of individual households and firms in the market place, Germany attempted to impose on governments sharing a common currency.

To sum up, ordoliberalism has provided guidance in crafting rules for EMU intended to protect Germany against inflation and fiscal exploitation, while neglecting the elementary preconditions of macroeconomic and financial stability. Nevertheless, whenever these rules collided with German self-interest once they were supposed to be applied, German policymakers did not hesitate to put discretionary self-interest above compliance with the rules.[2]

3. Germany's role in the eurozone crisis

When the Global Financial Crisis engulfed the eurozone in 2008, it came as much as a surprise as anywhere else. Only three months before the bankruptcy of Lehman Brothers in September 2008, the European Commission (2008) had hailed the Euro as "a resounding success". Clearly, the turmoil that was brewing on Europe's financial markets was not widely appreciated. Initially, the financial crisis and the subsequent slump of economic activity in the eurozone did not appear to differ much from that in the United States. But the eurozone was much less prepared to face a crisis of this sort and scale than the United States. As Rodrik (2010) aptly put it early in the crisis,

> "Europe's bad luck was to be hit with the worst financial crisis since the 1930's while still only halfway through its integration process. The eurozone was too integrated for cross-border spillovers not to cause mayhem in national economies, but not integrated enough to have the institutional capacity needed to manage the crisis."

The lack of institutional capacity was most visible in banking policy where fragmented national regulators hesitated to act forcefully to clean up the financial sector and where national resources were strained to the limit by the rescue of troubled banks. Fiscal policy was fragmented as well, with each government constrained in its countercyclical actions by the openness of its economy, the deficit rules of the Maastricht Treaty, and the threat of losing access to the capital market. In the absence of a fiscal capacity at the center of the system, no one was in charge of the aggregate stance of fiscal policy for the eurozone as a whole, let alone would anyone coordinate fiscal policies, taking into account cross-border spillovers. This left the European Central Bank (ECB) as the only player in the economic policy arena

[2] This assessment appears to be largely shared by Feld et al. (2017).

with clout and a sense of responsibility for keeping the eurozone on track. But even the ECB was severely hampered by controversy surrounding most of the measures it took in the face of multiple threats to the financial and macroeconomic stability of the eurozone.

These institutional weaknesses were mainly responsible for the sluggish recovery of the eurozone which trailed that of the United States by a substantial margin. Domestic demand, in particular, hardly got off the ground, held back by the long-lasting slump of investment and harsh fiscal austerity. Sustained growth of eurozone GDP did not set in before 2015 while it took domestic demand a full ten years until 2017 merely to recover its pre-crisis level, which is to say that all of the growth of GDP attained in the decade since the onset of the crisis was owed to the growth of net exports. Put differently, the eurozone, did not add any steam of its own to the recovery of the world economy from the Great Recession, but merely sailed on the coat-tails of the more dynamic regions of the world. No doubt, this lopsided recovery fuelled the protectionist sentiment confronting Europe’s export industries in recent years.

Where does Germany come into this story, and why is Germany so widely held responsible for the depth of the crisis? To answer this question, one has to go back to the first decade of the EMU, the one declared a “resounding success” by the European Commission. Below the surface of that success, the potential for trouble was continuously growing due to rapidly increasing current-account imbalances between the core and the periphery of the eurozone. Germany’s export surplus was mirrored by a corresponding import surplus in the periphery while German excess savings were happy to fund these imbalances. At the same time, price levels and unit labor costs drifted apart, rising significantly above the eurozone average in the periphery and falling below this same average in Germany. When the periphery suffered a sudden stop of capital inflows in the wake of the financial crisis, it faced the triple challenge of a collapse of domestic demand, a large overhang of foreign debt, and a loss of competitiveness resulting from years of excessive inflation.

Narratives about this sequence of events differ widely. The prevailing view in Germany is that the periphery was having a party for a decade, living beyond its means on borrowed money and now had to tighten its belt, bring down its mountain of debt, and catch up on delayed structural reform in order to recuperate its competitiveness and to revive economic growth. Outside Germany, and with some critical minds in Germany as well, the narrative suggesting that the travails of the periphery had nothing to do with Germany did not go down well. An alternative narrative rather maintained that Germany's success story was largely built on a beggar-thy-neighbor strategy of lowering unit labor costs. According to this narrative, Germany's export surplus was not so much the result of its industrial prowess as of its wage policies undercutting the European trading partners. Some critics suspect an intentional mercantilist industrial strategy designed to advance German interests at the expense of foreign economies (Cesaratto 2010).

There is a grain of truth to this alternative narrative in that German workers, with very few exceptions, have been keenly aware of the significance of wages for the international competitiveness of German manufacturing. This is particularly true for the post-war 'Wirtschaftswunder', but continues to apply more recently. It is incorrect, however, to identify this sensitivity to competitiveness with a conscious mercantilist policy. Wage growth is not decided by any policymaker, but is negotiated on an industry basis between employers and unions and as such subject to exogenous influences on labor market conditions that may have their origin in policies of the German government as well as in developments abroad. Germany had its rude awakening to globalization earlier than other western countries in the early 1990 when the iron curtain fell and German manufacturing all of a sudden was confronted with low-cost competitors right at its doorsteps. German employers, unions and work councils responded by increasing the flexibility of wage setting, taking into account threats to employment literally down to the firm level (Dustmann et al. 2014). Later, the flexibility of Germany's labor market was further enhanced by the much heralded Hartz reform of 2005. But an inspection of the data reveals that the downward trend of Germany's real exchange rate vis-à-vis the rest of the eurozone set in as early as 1994, years before the start of EMU, and persisted until about 2010.

This German wage flexibility contributed to a fall in the equilibrium unemployment rate and hence boosted the production capacity of the economy. Elementary economic principles suggest that any expansion of the supply capacity of an economy should lower the relative price of domestic goods in terms of foreign goods - which amounts exactly to the real depreciation experienced by Germany over some 15 years. The downward trend of the relative price of German goods was reinforced when the convergence of interest rates in the run-up to EMU acted as a strong asymmetric shock on the eurozone, boosting the periphery and pushing up prices there, as described above. The handling of this asymmetric shock was the first time the deficiencies of the eurozone's German-inspired institutional design were revealed. The ECB, setting its policy rates with a view to the average condition of the eurozone, could not do anything about the increasing disparity of cyclical conditions in the eurozone. By design, there can only be a single monetary policy stance for the entire eurozone, which was much too loose for the needs of the periphery and somewhat too tight for Germany under the circumstances prevailing at the time. The asymmetric countercyclical policies that would have been required to contain the destabilizing effects of the asymmetric shock simply did not exist in the playbook of EMU. Since most periphery economies – with the notable exception of Greece – were well below the debt and deficit limits of the Maastricht Treaty, there was no pressure on them to tighten their fiscal policies to cool their booming economies.

Thus, the increase of the German current-account surplus from near zero at the beginning of EMU to more than 8% of GDP by 2017 can be explained as the combined outcome of a textbook-like response to well-understood exogenous forces and the lack of countercyclical stabilizers in the architecture of EMU. No conscious German strategy of wage dumping, let alone mercantilism were at work. The notion, put forward by some of Germany's critics that a currency union "should" have roughly uniform inflation rates and that countries are under an obligation, therefore, to keep the growth of their unit labor costs aligned with the inflation target of the common central bank is both *dirigiste* and at odds with elementary market logic. When the determinants of fundamental real equilibrium exchange rates change, there should be enough breathing space for inflation differentials to bring about the required adjustment. If such adjustment is deemed to strain the adjustment capacity of the currency union, the appropriate policy action should focus on the underlying disturbance, e.g. by adjusting fiscal policies. Heavy-handed intervention in the wage-setting mechanism, in contrast, would merely address a symptom while leaving the underlying problem unresolved.

Where Germany's critics do have a point, however, is with regard to the handling of the crisis management once the sudden stop of capital flows had occurred. The order of the day was to restore financial and macroeconomic stability as quickly as possible. The initial response - slashing interest rates, providing liquidity to the financial sector, and fiscal stimulus – was correct, largely uncontroversial and successful in stopping the implosion of the system. But soon, the appropriate course of action became more contentious. Should interest rates be raised in response to an uptick of prices that was due to a rise in commodity prices? Should the ECB follow the example of the U.S. central bank and embark on quantitative easing? Should the ECB assume the role of a lender of last resort if a government faced a liquidity crisis? Should fiscal policies quickly return to debt reduction in the face of high public debt? The German answer to all of these questions was to choose the more conservative, more austere option. In some cases, the German opposition to further stimulus got its way; in others, it at least succeeded delaying or weakening expansionary policies. In the case of the ECB's so-called "Outright Monetary Transactions", the promise to support governments threatened by a liquidity squeeze due to speculative pressure on their bonds, a lawsuit filed by German plaintiffs challenged the legality of the promised policy action and thereby damaged ECB credibility.

The strong German opposition to any monetary or fiscal action that had the potential of speeding up the recovery of the eurozone from its severe recession certainly did not facilitate this recovery. It would be a gross exaggeration to say that the German stance on these policies was dictated by an ordoliberal mindset of the German government. To be sure, the hawkish views on monetary policy and the opposition against anything that might soften the liability of national governments for their own debt perfectly matched the ordoliberal emphasis on sound money and liability. The low regard for the necessity of macroeconomic stabilization was a feature shared with ordoliberalism as well. But clearly, the more prosaic motive of national self-interest was more important - "Teutonomik", as Burda (2017) put it. One need not believe in ordoliberalism to resist debt mutualisation if the debt in question is someone else's.

Where national self-interest most definitely played a part was in the way Germany's remarkable resilience during the crisis influenced its attitude towards fiscal and monetary policy choices. Although the German economy took a heavy hit in the crisis, with GDP down by 5% in 2009 alone, the recovery was swift and employment held up surprisingly well, given the steep fall of production. Soon, Germany was back on a path of solid growth, not much below that of the United States. This resilience was owed in part to good policy, in particular labor market policy, and in part to the robust recovery of the world economy which offered growing markets to the highly competitive German export industries. Against this backdrop, Germany, unlike the rest of the eurozone, had little to gain from further demand stimulus – or rather, it feared to suffer adverse repercussions from policies designed to lift eurozone production back towards potential and eurozone inflation back towards the target rate of close to 2%.

A number of German opinion leaders go as far as to question the legitimacy of the ECB's 2% inflation target, preferring a number closer to zero as a matter of principle, but also on the grounds that Germany is doing just fine with its inflation rate of under 1% whereas generalized demand stimulus for the eurozone would risk pushing the German inflation rate well above 2% (Stark 2015). Undeniably, the price level in the periphery needs to fall against German prices if the competitiveness of the periphery is to be restored - as it must once the domestic demand boom is over. This adjustment of relative prices can be brought about either by deflation in the periphery or by inflation in Germany. But why should Germany suffer inflation, Germans argue, if the point is to undo the effects of past excess inflation in the periphery? Wouldn't prices be ratcheted up every time a eurozone member state has experienced a period of excess inflation if other countries were subsequently asked to engage in catch-up inflation to redress relative prices?

This line of reasoning is flawed on the grounds of both fact and logic. First of all, the decade of the periphery's domestic demand boom was not a period of generalized excess inflation in the eurozone. Quite to the contrary, the ECB kept the overall inflation rate reasonably close to its 2% target so that above-target inflation in the periphery was roughly matched by below-target inflation in Germany. Secondly, if the ECB aims at 2% average inflation while the periphery needs a real depreciation, it is a matter of pure arithmetic that the only way both of these aims can be accomplished is by German inflation running above 2% and inflation in the periphery running below 2% for a while. Rejection of this symmetry of adjustment is tantamount to imposing a deflationary bias on the eurozone and outright deflation on the periphery. This would be extremely costly, unfair, and against the inherent logic of a well-run currency union. Germany's refusal to accept symmetric adjustment is reminiscent of the final years of the Gold Standard, another period when the surplus economies – the United States and France, at the time – imposed the entire burden of adjustment on the deficit countries which were thereby forced into deflation. This violation of the rules of the game ultimately led to the demise of the Gold Standard.[3]

4. Reforming the eurozone

Having lingered on for nearly a decade, the crisis of the eurozone is far from being resolved. Despite progress on some fronts, high public debt, high unemployment, weak balance sheets in the banking sector and the spread of nationalist, anti-European sentiments in many countries continue to cast a shadow over the future of the common currency. However, as the recovery of economic activity from the depths of recession has gained strength, attention increasingly turns to the question of how to correct the flaws and omissions in the architecture of the eurozone. In the debate on the desirable nature of such a reform, the two camps of the "Battle of Ideas" are once again at cross. Whereas France and Southern Europeans call for more insurance, more solidarity and more centralized institutions in the quest for monetary and financial stability, public opinion in Germany is strongly opposed to anything that smacks of "transfer union" and of weakening market discipline.

The task of creating a more resilient institutional framework for the eurozone is complicated by the fact that institutional reforms cannot start with a clean sheet, but are burdened with the legacy of the past - be it high public debt, non-performing loans in the balance sheets of commercial banks, or macroeconomic imbalances. The difficulty is to deal with the inherited problems effectively while at the same time ensuring that legacy issues do not stand in the way of creating institutions for enhanced resilience in the future. Devices for risk reduction and risk pooling illustrate the point. As the crisis of the eurozone has made abundantly clear, asymmetric shocks and the adjustment burdens they bring about can quickly outstrip the capacity of individual member states to deal with them. The Banking Union, which is in the process of being built, and a fiscal capacity, which is under consideration, address exactly this problem.

---

[3] The parallel between the Gold Standard and the EMU has been highlighted by Eichengreen/Temin (2010).

In Germany, opposition against such schemes runs high. Although the need for some form of mutual insurance may be acknowledged in principle, Germans suspect that they will be asked to bear a disproportionate share of the cost. Specifically, the fear is that countries suffering from the continuing costs of past accidents will attempt to cover their damages out of common pools built to insure against future hazards. Would an insurance company, critics object, offer fire insurance for a building that has burned yesterday? In this spirit, a manifesto signed by 154 German professors of economics and business (Manifesto 2018) warns, among other things,

- against using the European Stability Mechanism (ESM) as a fiscal backstop in dealing with unsustainable banks, on the grounds that this would ruin the incentive to deal with the problems in the banking sector;
- against transforming the ESM into a European monetary Fund (EMF), on the grounds that this would eliminate the veto of the German Parliament on certain expenditure decisions;
- against a European Deposit Insurance System, on the grounds that this would collectivize the costs of mistakes committed by national banks and governments in the past;
- against a European Finance Minister, on the grounds that this would politicize monetary policy even more than it already is.

In short, the manifesto rails against anything that might commit German taxpayer money for purposes that are not under the direct control of this very same taxpayer. The underlying premise is that any policymaking on the European level is biased towards redistribution at the expense of creditor countries. Any European solution in the cited areas is regarded as a collectivization of liability that destroys good incentives and creates bad ones, leading to outcomes that are inferior to those achieved by keeping the respective decision-making authority on the national level. In view of the dismal record of national banking supervision agencies in dealing with the vulnerabilities of national banks, for example, one might question the factual basis of this judgment. But the manifesto is more interested in sacred general principles than in policy details. Explicitly, it invokes a core principle of ordoliberalism: the „liability principle as a cornerstone of the Social Market Economy“. It thereby claims to represent an ordoliberal view of the European Union. No thought appears to be wasted on analyzing the optimal allocation of decision-making authorities to different levels of political organization - European, national, and sub-national - along the lines of the subsidiarity principle nor on ways of establishing effective democratic control and hence legitimacy of European policymaking institutions. If ordoliberalism is understood as a doctrine concerned with the effective organization of a market-based economic system, the manifesto's ordoliberal credentials are more than questionable.

Quite obviously, for progress towards an effective reform of the eurozone to materialize, the task is to find a middle ground between the need for some elements of risk-pooling, coordination and centralization on the one hand and German fears of a "transfer union" on the other. Such a middle ground does exist (Zettelmeyer 2017) and operational ways of defining it have been proposed (e.g. Bénassy-Quéré et al. 2018). In line with ordoliberal thought, any such reform must start form the insight that a system of decentralized decision-makers who act in their perceived self-interest and who interact with each other via multiple channels requires a set of strong institutions and enforceable rules if the interaction is to work smoothly. If ordoliberalism focused on rules for firms and households interacting on competitive markets, the same insight applies to sovereign nations bound together by tightly integrated markets and a common currency. In either case, contrary to ordoliberal thought, it is not enough to implement broad principles like stable money, liability, and steady, rule-based policies. The design of a currency union - of any monetary system, for that matter - must safeguard macroeconomic and financial stability as much as the stability of the price level.

The two key areas of eurozone reform are banking policy and fiscal policy. There is a broad consensus on the need for the former, at least on a general level. Its implementation was initiated in 2012, but disagreements on the handling of legacy issues and the funding of fiscal backstops have so far prevented its completion. Fiscal union is more contentious. Full fiscal federalism, along the model of the United States of America, is not on the table at this stage of European integration. The authority to raise and spend the citizens' tax money is the essence of sovereignty and accordingly a tightly guarded prerogative of the nation states. It is all the more important, therefore, to analyze with great care and in great detail which aspects of public finance require central coordination on the European level to make the eurozone more resilient in the future.

It is precisely this type of analysis that was missing, or ignored, when the rules and institutions of the eurozone were crafted. The debt and deficit limits as enshrined in the Treaty of

Maastricht, and later in the European Stability and Growth Pact, were a failure on all accounts: They failed to identify the relevant trouble spots that would jeopardize the stability of the EMU. Excess public borrowing was not the source of the crisis of the eurozone - given that Greece alone was never big enough to unsettle the entire currency area. The true risks to the sustainability of public households were not located in what was visible in the public accounts that were regulated by the EMU's fiscal rules. The relevant risks stemmed from the invisible fragility of the banking sector. In this sense at least, completing the Banking Union should be the more urgent priority for the European Union than any fiscal capacity. The fiscal rules also fell short in their neglect of the question of enforceability. By giving eurozone finance ministers (Ecofin) the last word on enforcement and sanctions, the rules allowed the accused to act as their own judges - a breach of the most elementary principles of good governance, but reflecting the reluctance of member states to give up even an inch of ground on their national fiscal policy autonomy.

When the fiscal rules were followed, they acted as a destabilizing force, exacerbating macroeconomic disturbances procyclically. In the absence of nominal exchange rate adjustments as shock absorbers, fiscal policy must assume a key role for macroeconomic stabilization in the event of asymmetric shocks. The response to symmetric aggregate shocks can normally be left to monetary policy, provided the central bank has traction. If interest-rate adjustments are ruled out because of a binding zero lower bound, however, fiscal policy becomes even more important for macroeconomic stability. In addition, national fiscal policies create spillovers to other countries, which raises the issue of policy coordination if the external effects are to be internalized. The case for coordination is particularly strong if monetary policy is constrained by the zero lower bound (Landmann 2018). All of these considerations were neglected by the fiscal rules of the EMU so that fiscal policies badly failed to operate as a stabilizing force.

Several proposals for reforming the fiscal policy framework of the eurozone have been put forward. Since a fiscal capacity strong enough to contain asymmetric cyclical disturbances on its own is not feasible politically at the level of the EMU in the foreseeable future, most proposals aim at nudging national fiscal policies toward a more countercyclical stance. Whatever mechanism is most promising to achieve this, it cannot be left alone in this task. As stated above, the resilience of the financial sector is crucial for the state of public finances, which means that fiscal policy cannot be a stabilizing force unless the “doom loop” linking governments and banks is effectively broken. Moreover, the design of national fiscal policies must take into account that governments lack a national central bank as backstop in the case of major borrowing needs. The excessively tight aggregate fiscal policy stance in the 2011-2014 period can largely be explained by the observation that governments which needed a fiscal stimulus most urgently lacked the resources to fund it while governments with fiscal space did not need that much of a stimulus in the first place. It follows that any framework providing for a consistently countercyclical orientation of fiscal policies must ensure that borrowing constraints do not get in the way of the required budgetary stance. The availability of such a backstop, in turn, requires an effective mechanism disciplining fiscal policy across business cycles so that sufficiently large surpluses are accumulated in boom times to keep public debt on a sustainable long-term path. In addition, a blueprint for an orderly default is required if the bond market is to play an effective part in disciplining governments.

Fiscal policy in a monetary union can be both counter-cyclical in the short-term and sustainable in the long term. As seen above, however, an intricate system of complementary conditions and precautions must be put in place to that purpose. Importantly, all these elements must be in force simultaneously if such a fiscal framework is to work as desired (Bénassy et al. 2018). Europe has paid dearly for underappreciating the complexity of this task upon the creation of the EMU.

Setting the technicalities of constructing a functioning fiscal-policy framework aside, the fundamental impediment to progress on this front is the tension between the very need for such a framework and the reluctance of Germany and other eurozone members with a creditor status to give up any amount of fiscal autonomy in favour of a European institution that would care about the macroeconomic stability and balance of the eurozone as a whole as opposed to the purely domestic focus of national fiscal authorities. As pointed out above, what is at stake is not necessarily the delegation of control over significant amounts of money to a central European body, but the willingness to accept guidelines and constraints on those aspects of fiscal policy that are important for the macroeconomic performance of the eurozone. If a fiscal council or a European Finance minister had the authority to coordinate the fiscal impulses emanating from national fiscal policy decisions - as measured, say, by the change of structural primary budget balances -, this would still leave the lion’s share of tax and spending decisions national electorates care about in the hands of domestic, democratically elected policymakers.

The ordoliberal emphasis on the congruence of decision-making authority and accountability might appear to suggest that even the delegation of such limited fiscal powers to some European institution requires the establishment of a full European federation with which citizens identify and by which they feel represented as much as they do nationally. Even if one is prepared to share this view, the question of sequencing remains open. Feld (2018) forcefully argues that federation must come first, with fiscal delegation following only subsequently. It is not clear, however, whether this sequencing is viable. If effective macroeconomic stabilization of the eurozone is delayed until citizens feel ready to think of themselves as Europeans rather than as Germans, Dutchmen and Italians, chances are there will be no Europe left to identify with. One might as well argue that it takes political leadership to win citizens over to the idea that the economic organization of countries in a currency union, as Europe has adopted it, requires a proper set of rules and institutions to get satisfactory results just as a national market economy does.

Seen in this light, Helmut Kohl - who was not known for his patience with the details of economics - proved remarkably clairvoyant when he insisted that monetary union can only succeed if it is accompanied by political union in due course. But how can this message sink in with the citizens if political leaders do not go ahead and spread it with conviction? Would Germany have written its success story of the 'Wirtschaftswunder' if Ludwig Erhard had waited with liberalising prices until he had won German hearts and minds over to the concept of free markets?

5. Conclusion

Ordoliberalism is widely criticized as the theoretical basis of policies that have exacerbated the crisis of the eurozone. Is this criticism justified? Answering this question, one should bear in mind that ordoliberalism was designed as a rulebook for running a market economy, not as a blueprint for the architecture of a currency union. Moreover, to the extent that criticism is directed against policies adopted or favored by Germany in the face of the euro crisis, it would be highly misleading to imply that Germany followed a consistently ordoliberal script. If the strict compliance with rules is taken to be the core prescription of ordoliberalism for the conduct of euro policy, it was correctly pointed out by Burda (2017) that Germany, while often demanding such compliance from others, has never hesitated to put its own discretionary national interest above the rules as it saw fit.

That said, there is certainly a significant amount of common ground shared by German conservative opinion leaders, policymakers and ordoliberalism. The two most conspicuous elements of this common ground are the strong preference for hard money policies and the insistence on the liability principle, both solidly enshrined in the 1992 Treaty of Maastricht. Almost all the actions the ECB undertook to prevent deflation and to support the sluggish recovery of the eurozone from the Great Recession received heavy flak from Germany, no matter whether the existence of the euro was at stake or the economy was still in the depths of recession. Even the very definition of price stability adopted by the ECB as a rate of inflation below, but close to 2% is subject to criticism in Germany. While the macroeconomic rationale for defining price stability as an inflation rate above zero is rock-solid, legal experts in Germany question whether this definition is covered by the letter of the Treaty. The unshakable faith in the dogma of hard money is put above sober economic analysis.

Germany's insistence on hard money as well as its invocation of the liability principle when it objects to reforms that would confer some fiscal policy responsibilities to eurozone institutions conveniently align the defense of purely national interests with the "sound" principles of ordoliberalism. As argued above, however, both the German national interest and the ordoliberal agenda tend to neglect the macroeconomics of the eurozone at large. Ordoliberalism never warmed to the very idea of macroeconomic analysis, let alone macroeconomic stability beyond the stability of the price level. A narrative of the eurozone crisis which attributes most of the hardship suffered by individual countries to national policy failures rather than to systemic macroeconomic failures of the overall fiscal and financial architecture of the currency union sits comfortably with ordoliberal thought and may contribute to the widespread perception outside Germany of being lectured by German decision-makers in a moralizing tone.

This is not to deny, of course, the numerous shortcomings of economic governance on the national level that are in urgent need of reform. It would be a dangerous illusion, however, to think that most problems would go away if only national policymakers did their homework and tackled their backlog of structural reforms. Structural reforms on the national level and systemic stabilization on the supranational level are not mutually exclusive alternatives, but must rather complement each other. A key lesson of the first twenty years of EMU is that a group of countries sharing a common currency must be conceived as a macroeconomic entity in its own right, requiring system-wide institutions and policies to maintain monetary, financial and macroeconomic stability. Those who refuse to take this lesson on board and instead trace any national problem to a lack of national structural reforms, are easily led to discredit any macroeconomic stabilization policy as a reward for past bad behavior and hence to reject it on the grounds that it creates incentives for more such bad behavior in the future.

This line of reasoning is dangerous. It may be true in many cases that painful structural reforms have become politically feasible only under the pressure of economic hardship. But it would be wrong to believe that economic hardship is generally conducive, let alone a necessary condition for structural reforms and to conclude that macroeconomic policies with a potential of alleviating such hardship should preferably remain on the shelf. History provides more than enough examples of how this logic can backfire. Populist political movements feed from economic hardship and gain support as voters are disillusioned by protracted high unemployment and the lack of economic perspectives. And populists are not known for embracing the principles of sound economic policy with enthusiasm.

Much more is at stake for Europe at this juncture than the technical issues involved in fine-tuning of its financial and macroeconomic architecture. The German Chancellor Angela Merkel has often been accused of hyperbole when she stated, at the height of the crisis, that if the Euro fails so will Europe. There may actually be more truth to this statement than meets the eye. The successful reform of the EMU requires Europeans to perceive the eurozone as a macroeconomic entity rather than as the sum of 29 national economies - which means that economic well-being depends on proper rules, institutions and policies on the level of the eurozone as much as in the individual member states. Beyond its importance for safeguarding macroeconomic and financial stability, an integral European perspective is indispensable if Europeans are ever to to rally behind broader European causes of geopolitical significance. Is it conceivable, for example, that Europe could find a common answer to the global rise of protectionism and keep its common market intact with 28 independently managed currencies and with 28 central banks constantly jostling for national competitive positions?

Undoubtedly, for any progress towards a fully operational and resilient currency union, difficult trade-offs will have to be resolved along the way. In some instances, ordoliberal concerns about incentives and liability will have to be weighed against concerns about macroeconomic and financial stability. It has become abundantly clear by now that in order to sustain a fully centralized monetary policy, the political decision-making authority in a number of related policy domains will have to be relocated between the national and European levels as was generally acknowledged e.g. in the case of the banking union. In line with the subsidiarity principle, each policy area should be allocated to an appropriate decision-making level so as to get maximum policy effectiveness.

In Germany, resistance against any form of coordination and centralization in monetary and financial matters runs high as skeptics sense moral hazards at every turn. More often than not, the opposition against any further deepening of the currency and banking union is phrased as a defense of fundamental ordoliberal principles, such as the liability principle and the avoidance of moral hazard. While these concerns are legitimate, it is at times hard to shake off the impression that the respectability of ordoliberalism is used as cover for a thinly veiled nationalist conservatism. Ordoliberalism has deserved better than that. After all, it is a doctrine with a deep understanding of the crucial importance of well-functioning and enforceable rules and institutions for complex systems in which independent entities, driven by self-interest, interact. The eurozone is such a complex system – a system badly in need of a shared political determination of Europeans to cooperate towards financial and macroeconomic stability.

References

Beck, Thorsten and Hans-Helmut Kotz, eds. (2017), Ordoliberalism: A German Oddity? VoxEU.org Book, CEPR Press, London.

Bénassy-Quéré, Agnès et al. (2018), Reconciling risk sharing with market discipline: A constructive approach to euro area reform, CEPR Policy Insight No. 91, CEPR, London.

Biebricher, Thomas and Frieder Vogelmann, eds. (2017), The Birth of Austerity. German Ordoliberalism and Contemporary Neoliberalism, London/New York.

Brunnermeier, Markus, Harold James and Jean-Pierre Landau (2016), The Euro and the Battle of Ideas. Princeton.

Burda, Michael (2017), Ordnungsökonomik or Teutonomik? In Beck/Kotz (2017), 53-60.

Cesaratto Sergio (2010): Europe, German Mercantilism and the Current Crisis. In: Brancaccio Emiliano, und Fontana Guiseppe (Hg.): *The Global Economic Crisis. New Perspectives on the Critique of Economic Theory and Policy*. London: Routledge.Eucken, Walter (1952), Grundsätze der Wirtschaftpolitik. Bern/Tübingen.

Eucken, Walter (2001), Wirtschaftsmacht und Wirtschaftsordnung. Münster.

European Commission (2008), EMU@10: Successes and Challenges After 10 Years of Economic and Monetary Union, European Economy, 2.

Feld, Lars (2018), The Need for a Fiscal Capacity, in Campos, Nauro and Jan-Egbert Sturm (eds.), Bretton Woods, Brussels, and Beyond, VoxEU.org Book, CEPR Press, London, 135-140.

Feld, Lars, Ekkehard A. Köhler and Daniel Nientiedt (2017), The “Dark Ages of German macroeconomics” and other alleged shortfalls in German economic thought, in Beck/Kotz (2017), 41-50.

Hien, Josef and Christian Joerges, eds. (2017), Ordoliberalism, Law and the Rule of Economics, Oxford.

Landmann, Oliver (2018), On the Logic of Fiscal Policy Coordination in a Monetary Union, Open Economies Review, 29, 69-87.

Manifesto (2018), „Der Euro darf nicht in die Haftungsunion führen“, signed by 154 German professors, Frankfurter Allgemeine Zeitung, May 22.

Münchau, Wolfgang (2014), The wacky economics of Germany’s parallel universe, Financial Times, November 17.

Mundell, Robert (1961), A Theory of Optimal Currency Areas, American Economic Review, 51(4), 657-65.

Rodrik, Dani (2010), Thinking the Unthinkable in Europe, Project Syndicate, December 10.

Samuelson, Paul (1955), Economics, New York.

Stark, Jürgen (2015), In Europa herrscht Deflations-Paranoia, Neue Zürcher Zeitung, January 8th.

Wren-Lewis, Simon (2015), Who is responsible for the eurozone crisis? The simple answer: Germany, The Independent, December 13.

Young, Brigitte (2017), Ordoliberalism as an 'irritating German idea', in Beck and Kotz (2017), 31-40.

Zettelmeyer, Jeromin (2017), German ordo and Eurozone reform: a view from the trenches, in Beck/Kotz (2017), 155-163.