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The Euro – A German Perspective

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Abstract

The Euro has been a hotly debated issue in Germany. Still 20 years after the introduction of the Euro there exist many opponents in Germany. Are their arguments correct? Has Germany benefitted from the Euro or is Germany suffering from the Euro? The article discusses these questions by looking back on the theoretical foundations for a single currency. Following this analysis, the macroeconomic performance of the Eurozone and especially of Germany is presented. Macroeconomic calculations show that Germany seems to be the biggest winner of the introduction of the Euro. The article presents some explanations for this result and makes a short-term and long-term appraisal about winners and losers and potential problems in the future. Different scenarios will be outlined for overcoming the problems with the Euro and lessons for the future will be drawn.

Keywords: European Monetary Union; ECB; euro; Optimal Currency Area; current account.

JEL classification: E52; F32; F36.

1. INTRODUCTION

The Euro has been a hotly debated issue in Germany which even led to the rise of a new party (Alternative für Deutschland - AFD Alternative for Germany - which achieved at the last federal elections 13% of the votes) opposing vehemently against the introduction of the Euro and the policy of European Central Bank (ECB). Still 20 years after the introduction of the Euro there exist many opponents in Germany, proclaiming that Europe does not need the Euro (Sarrazin, 2012) and that the monetary policy of the ECB is a complete disaster just serving the Italian interests driving Germany and the other members of the Eurozone into a ruin (Ferber, 2018). Are the arguments of the German opponents correct? Is Germany suffering from the Euro or has Germany benefitted from the Euro? The article discusses these questions by looking back to the emergence of the Euro and on the theoretical economic foundations for a single currency and the political considerations. Following this analysis, the macroeconomic performance of the Eurozone and especially of

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Germany is presented. Macroeconomic calculations show that Germany seems to be the biggest winner of the introduction of the Euro. The article presents some explanations for this result and makes a short-term and long-term appraisal about winners and losers and potential problems in the future. Different scenarios will be outlined for overcoming the problems with the Euro and lessons for the future will be drawn.

2. THE DISCUSSION ABOUT THE EURO: THEORY VERSUS POLITICS

According to our conventional wisdom gained from standard economic textbooks (Baldwin and Wyplosz, 2015; De Grauwe, 2016; Krugman *et al.*, 2018) a large currency area offers a number of benefits. These benefits include a reduction in transaction costs by exchanging each time in trade the national currencies instead of having one single currency. In addition, a single currency offers price transparency and eliminates the exchange rate risk. Moreover, it may enhance competition and have a positive impact on the quality of monetary policy (Baldwin and Wyplosz, 2015, p. 353ff). Members of currency union which had due to their unfavorable economic policy to pay higher risk premia will benefit from a stability oriented monetary policy of the Central Bank of currency area.

However, a common currency does not only bring benefits but also generates costs. The theory of the optimum currency area identifies these costs in a relative precise way. This becomes obvious in the case of asymmetric shocks or in case of symmetric shocks with asymmetric effects. Given one common exchange rate the countries hit hard by a shock in different ways due to diverse socio-economic cultures, e.g. labour market regulations and traditions, the differing relative importance of industrial sectors or financial and banking sectors, the country's external indebtedness etc. has no longer the possibility to use the nominal exchange rate as a tool of adjustment. Moreover, there is not any longer a national monetary policy available. And even the possibility of an internal devaluation of the currency due to a change of the national prices and price level cannot be achieved due to the stickiness of prices. These costs of monetary union with regard to asymmetric shocks can be usually only reduced by pursuing a strategy of making markets more flexible or by speeding up the process of political unification (De Grauwe, 2016, p. 52).

The theory of optimum currency areas has developed a number of criteria, which being met, may lead to a successful achievement of a monetary union. These criteria are:

- Labor mobility, mentioned by Mundell, that people move easily within the optimum currency area, is not fulfilled in the Eurozone, because internal migration from one member facing an economic downward trend, is far below 5% (Krugman *et al.*, 2018, p. 704).
- Trade openness, mentioned by McKinnon, means that countries that are very open to trade and trade heavily with each other are suitable for forming an optimum currency area. This implies that a price convergence is taking place between the prices in the member states of a currency union. So far in the EU in the 1990s price discrepancies decreased. However, after the start of the Eurozone no further convergence processes could be observed (Krugman *et al.*, 2018, p. 702).
- Production diversification, mentioned by Kenen, constitutes another criterium for a monetary union. The criterion states that those countries whose production and exports are widely diversified and of similar production structure may form successfully an optimum currency area (Baldwin and Wyplosz, 2015). It seems that the Eurozone with countries such as Germany and Greece or Portugal do not fulfill this criterion in a perfect way.

- For a good performance of an optimum currency area it would be useful if countries hit by adverse shocks could rely on fiscal transfers from member states not that negatively impacted and being interested in avoiding the mitigation of a recession on their own economy. Such a system of transfers does not exist in the Eurozone. Country-specific shocks cannot be offset by inflows of budgetary resources from currency-union partners, because there is no explicit centralized fiscal capacity for this purpose (Krugman *et al.*, 2018, p. 704).
- A fifth criterion mentions the homogeneity of preferences of member countries about the best way to deal with shocks. Since history, political and social institutions still are different among the various members of the Eurozone, the members have different views on the implementation of monetary policy. This is proven by the fact that the recent decisions of the European Central Bank are not taken unanimously. Homogeneity of preferences does not really exist.
- The last criterion to be mentioned is the solidarity criterion which can be formulated in the following way: ”When the common monetary policy gives rise to conflicts of national interest, these countries that form a currency area need to accept the costs in the name of common destiny.”(Baldwin and Wyplosz, 2015, p. 367). This criterion implies that the monetary union requires a political union.

Looking at these criteria one has to confess that the criteria of labor mobility, fiscal transfer, homogeneity of preferences and also solidarity, especially with regard to the Greek crisis, are not fulfilled. The criteria of trade openness as well as product diversification are met at best.

Consequently, one has to ask why the European Monetary Union has emerged? The idea of creating a European Monetary System (EMS) arose already in the 1970s when large exchange rate variabilities among the currencies of the EU members could be observed which were regarded as a danger for the integration process in Europe. The original EMS of 1979 consisted of an Exchange Rate Mechanism (ERM) and a European Currency Unit (ECU) which should contribute to a closer coordination of monetary policies and greater mutual exchange rate stability. The main objectives were to enhance Europe’s role in the world monetary system and to turn Europe into a truly unified market (Krugman *et al.*, 2018, p. 683). The original EMS still allowed for some monetary policy independence. Thus, frequent currency alignments took place. There existed still a widespread government control over capital movements. With the Single European Act of 1986 a necessity to create an economic and monetary union was felt. In 1989 the president of the European Commission Jacques Delors who had a headed a specific commission to work out a plan came up with a three-stage transition plan to set up an economic and monetary union. In December 1991 the so-called Maastricht Treaty was decided by the leaders of the EU countries which envisaged for the introduction of a single currency and European Central Bank no later than January 1, 1999. This union started with eleven members on January 1, 1999 and the Euro as single currency in cash was introduced on January 2002 (Welfens, 2012, p. 83). However, economic aspects were neglected by the politicians who thought that the economic divergences would be overcome by rationality. On the one hand side politicians believed that the overwhelming power of the German economy would be weakened due to the German Unification. Germany which had put a focus on macro-economic aspects would lose its dominance and the other EU members thought that they would have the same weight in participating in monetary policy decisions. Moreover, a single currency was regarded as a necessary complement for the Single market and freedom of capital movements would be completely accomplished. Thus, this would lead to political and economic stability in the European Union. On the other hand since important aspects such a common fiscal policy and wage and social policy were excluded, there was a strong concern especially in Germany that this EMU would lead to higher inflation rates (Welfens, 2012, p. 84). In order to take considerations into account that the potential members of an EMU would not fulfill the requirement for a stable EMU the Maastricht Convergence criteria were formulated and in 1997 a Stability and Growth Pact was established in order to avoid that members ran “excessive deficits”. The major criticism could not be wiped out that the Maastricht Treaty is an incomplete relational contract disguised as a complete contract (Richter, 2017, p. 269ff). Consequently, the contract has to be renegotiated and newly formulated when the circumstances at the time of its enactment have changed. Since the future is uncertain, we cannot exactly forecast the coming problems and thus not define precisely when and what the necessary economic policy measures will be. No wonder that those countries which eagerly defined in detail the criteria of convergence and the existence of an excessive deficit, Germany and France, were the first to break these criteria without any consequences.

Thus, the criticisms about the EMU are justified. However, a return to the Maastricht period will not be a solution because the economic and political environment and institutions have changed since then. The monetary union is incomplete without a fiscal and social union. The fundamental question still rests: Was Germany hit negatively or positively by the introduction of the EURO?

3. ECONOMIC DEVELOPMENT SINCE THE INTRODUCTION OF THE EURO

When the Euro was introduced, it was expected that there would be an economic convergence among the participating countries. In Germany this meant a slowing down of the growth process and an increase of the inflation rate. However, the actual development shows a different picture.

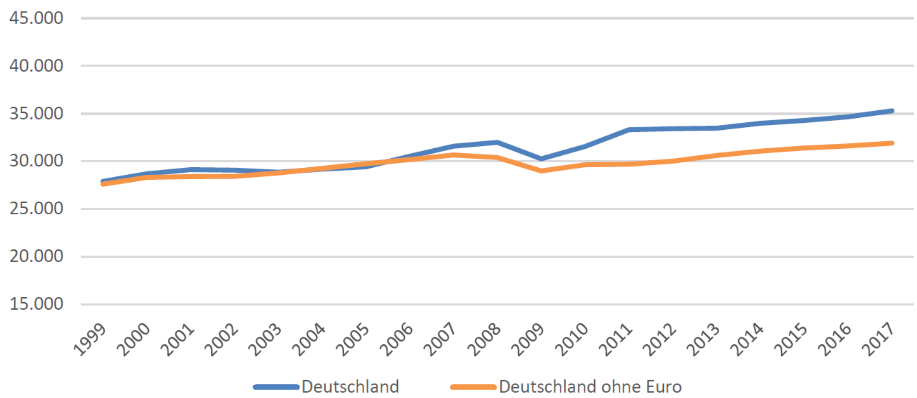

Figure no. 1 – GDP per Capita Development with and without Euro 1999-2017 (in Euro)
Source: Gasparotti and Kullas (2019, p. 7)

The German GDP per capita turned out to increase faster than in the Eurozone without Germany. Breaking the development to single years in Figure no. 2 it becomes obvious that Germany faced apart from 2004 and 2005 welfare increases in each year which sum up to a total of 1.9 trillion Euro for the whole period or 23.116 Euro per inhabitant as is shown in Table no. 1[1].

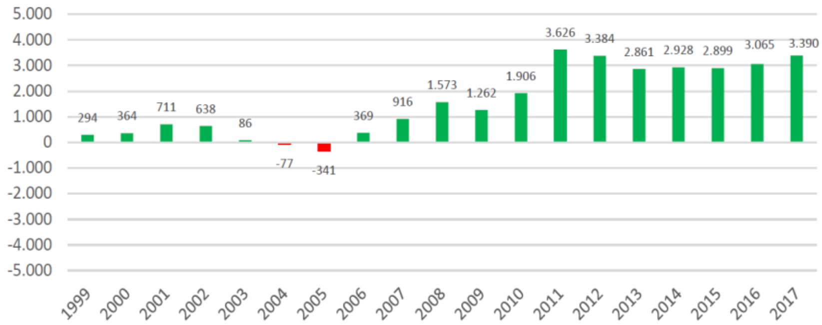

Figure no. 2 – Impact of the Euro Introduction on GDP per Capita 1999-2017 (in Euro)
Source: Gasparotti and Kullas (2019, p. 7)

Table no. 1 – Impact of the Introduction of the Euro on Cumulated GDP 1999-2017

Euro Country	Impact of the Euro introduction on cumulated GDP 1999-2017 per Capita (euro)	Impact of the Euro introduction on cumulated GDP 1999-2017 (bn. euro)
Germany	+ 23.116	+ 1.893
Netherlands	+ 21.003	+ 346
Belgium	− 6.370	− 69
Spain	− 5.031	− 224
Portugal	− 40.604	− 424
France	− 55.996	− 3.591
Italy	− 73.605	− 4.325

Source: Gasparotti and Kullas (2019, p. 4)

This is also corroborated by another study done by the Bertelsmann Stiftung (2013). The data reveal, that Germany was the major beneficiary of the Euro introduction. Since 2011 Germany always faced a relatively high amount of GDP benefits each year. In 2017 this corresponded roughly to 10% of the German GDP. The competitiveness of the German economy expressed by the development of the real exchange rate (REER) increased as can be seen from Figure no. 3. The negative development of the German REER compared to Italy, France and the whole of the Eurozone expresses that especially the labor costs in Germany rose less than in the other countries. This led to increasing current accounts surplus as can be seen in Figure no. 4. The German current account surpluses led also to capital exports which in turn promoted imports from Germany (Tokarski, 2019, p. 16). Yet, we have to take into account also the relatively strong German growth of productivity and the improvements of quality of German products. Moreover, Germany faced a relatively low development of domestic demand. In addition, the more flexible labor market institutions enabled Germany to reduce the rate of unemployment to a much larger degree than in the other Eurozone members such as Italy, France and all OECD countries as can be seen in Figure no. 6.

Table no. 2 – Impact of the Introduction of the Euro on GDP in 2017

Euro Country	Impact of the Euro introduction 2017 on GDP per Capita (euro)	Impact of the Euro introduction 2017 on GDP (bn. euro)
Germany	+ 3.390	+ 280
Netherlands	+ 1.116	+ 19
Belgium	− 920	− 10
Spain	− 1.448	− 67
Portugal	− 5.482	− 56
France	− 5.570	− 374
Italy	− 8.756	− 530

Source: Gasparotti and Kullas (2019, p. 4)

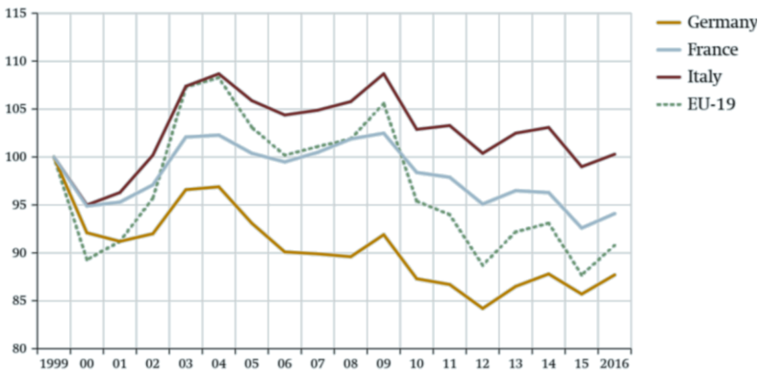

Figure no. 3 – Real Effective Exchange Rate in % (1999-2016)
Source: Tokarski (2019, p. 15)

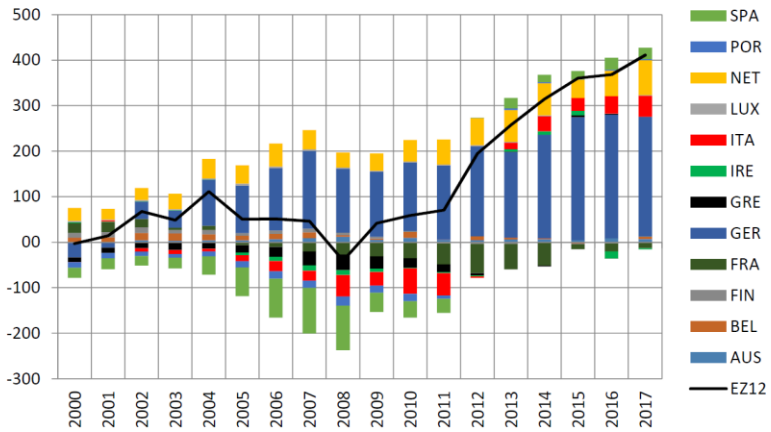

Figure no. 4 – Current accounts of the EA12 countries and EA12 as a whole, 2000-2017 (bn. euro)
Source: Mazzocchi and Tamborini (2019, p. 35)

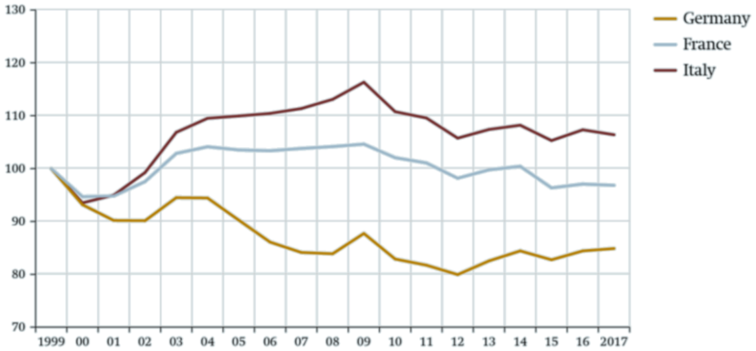

Figure no. 5 – Relative Labor Costs in % (1999-2017) (1999 = 100%)
Source: *Tokarski (2019, p. 16)*

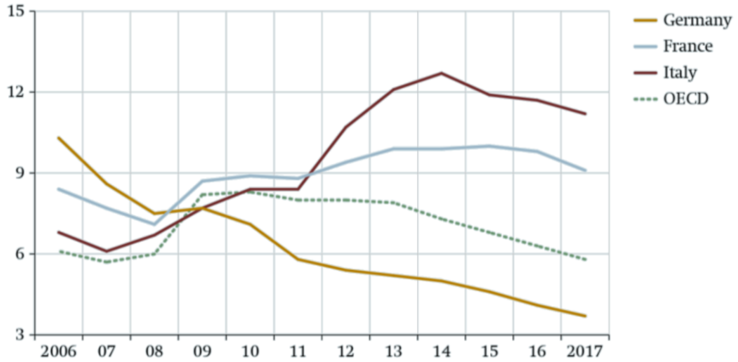

Figure no. 6 – Unemployment Rates in Germany, France and Italy in % (2005-2017) – Persons older than 15 years
Source: *Tokarski (2019, p. 22)*

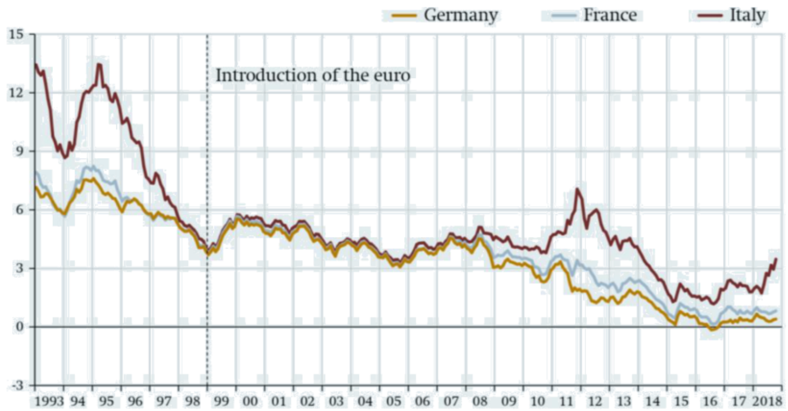

Figure no. 7 – Evolution of yields on ten-year government bonds in Germany, France and Italy in % (Jan. 1993–Oct. 2018)
Source: *Tokarski (2019, p. 17)*

Since fiscal policy is not perfectly coordinated in the Eurozone the gross indebtedness of Germany went after 2010 down and approached the 60% threshold mentioned in the convergence criteria in 2018 contrary to France where the accumulated indebtedness in relation to the GDP stagnated between 90 and 100% and in the case of Italy rose to more than 130%. This in turn had an impact on the development of the interest rates and yields on ten-year government bonds in Germany, France and Italy showing a rising divergence in the past years as can be seen from the Figures no. 7 and no. 8.

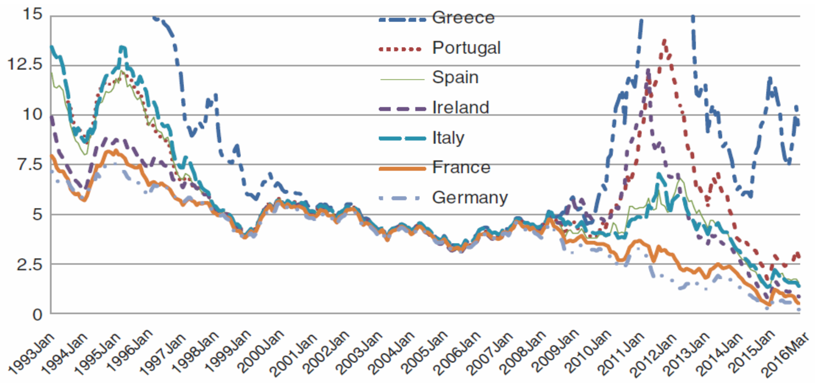

Figure no. 8 – Harmonized long-term interest rate for convergence assessment purposes (1993–2016)
Source: Marelli and Signorelli (2017, p. 92)

Finally, the apparently positive picture of the German economy being a member of the Eurozone is concluded by a look at the real convergence of per capita income as is provided in Figure no. 9. This demonstrates that a process of divergence instead of convergence has taken place between the first members of the Eurozone.

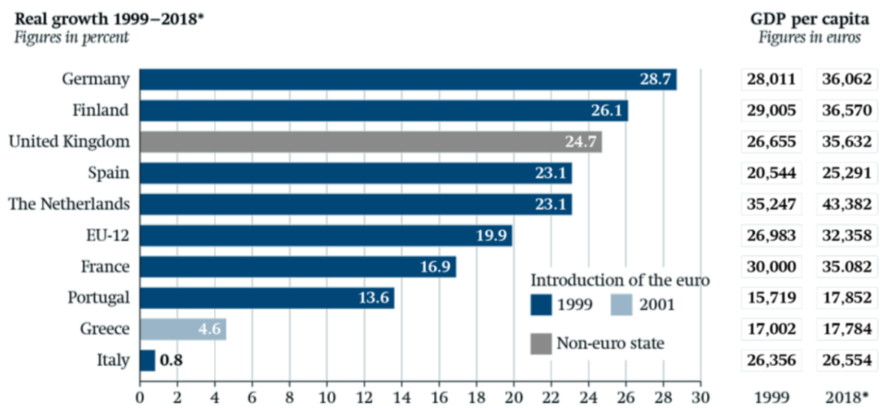

Figure no. 9 – GDP per capita in selected countries (forecast)
Source: Tokarski (2019, p. 21)

In the following parts the impacts of the European Currency Union on the German economy will be regarded from a short-term and long-term perspective and explanations for this diverging development from the rest of the Eurozone members will be given.

4. SHORT- AND LONG-TERM APPRAISAL AND EXPLANATION

In the short run the German economy seemed to benefit from the introduction of the Euro. The GDP per capita rose between 1999-2018 in real terms by 28,7%. The difference in absolute numbers between the EU-12 in 1999 amounted to 1.028 Euro. In 2018 the gap had widened to 3.704 Euro between the EU-12 and Germany. These data corroborate with the data of Table no. 1. The unemployment rate in Germany dropped to 3,5% or to 5,0% depending on the method of calculation. The German Minister of Finance saved interest payments due to the monetary policy of the ECB since 2008 of about 348 billion Euro according to calculations of the German Bundesbank. The real estate owners benefitted from the low interest rates for credits and mortgages and so did the shareholders of stocks because enterprise profits increased due to moderate wage increases and a strong demand from abroad leading to the enormous current account surpluses. The rate of dividends of the most important German companies listed at the stock exchange are far above the interest rates of bonds. In addition, stock prices went up.

Apart from the winners there are also losers. The private savings were negatively impacted. Private households lost since 2010 according to the calculations of the DZ Bank which is the central bank of the cooperative banks in Germany 358 billion Euro. A virtual misappropriation of private savers took place who faced in 2018 (in real terms) a negative yield of 0,8% on their savings. Moreover, the pension funds were no longer able to provide their members with guaranteed sums for their pensions. Following this line the core of the German banking system, the savings banks and the cooperative banks having a market share of more than 70% face serious problems with their business model.

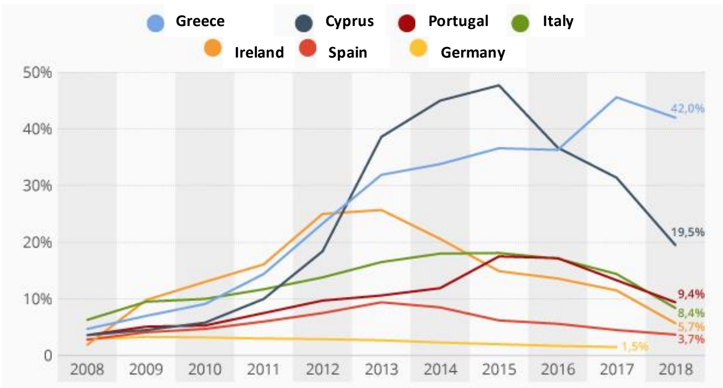

Figure 10 – The Development of Non-performing Loans in selected Eurozone Countries (share of non-performing loans of all credits)
Source: *Statista (2019)*

Due to the heavy imbalances in the current accounts Germany accumulated tremendous debt claims among them the target claims of the Deutsche Bundesbank which went up to 925 billion Euro in October 2018. The existence of huge current account balances is not a new phenomenon in the German economic history. It is due largely to undervaluation of the exchange rate and a deeply rooted characteristic of the German economic history at least since the beginning of the Bretton Woods era (Höpner, 2019).

The overall picture demonstrates that there is more divergence than convergence. Just the development of non-performing loans seems to offer a positive outlook that the monetary policy of the ECB which turned away from the priority goal of price stability to the financing of “huge debt towers” in order to prevent a break-down of the Eurozone is bearing some fruit in the Eurozone member states. However, the public debts seem to develop into an opposite direction. Thus, in the long-run the situation looks still gloomy. Monetary policy has lost its traditional role in keeping down inflation and stabilizing the economic activities via the interest rate channel together with an appropriate fiscal policy.

The reasons for these diverging trends which seemed to benefit predominantly the German economy may be seen in the different economic models underlying policy. Germany, a federal state, has set up a model of „Managed Capitalism“. The state guarantees free competition and regulates the economic activities following closely the systemic model of Ordoliberalism (Tokarski, 2019, p. 10). The German model is characterized by a model of export-driven growth and largely by supply-orientation: price stability first, economic growth, employment, equilibrium. France, on the other hand, a centralistic state characterized by state capitalism, where the state manages, by government control, Keynesianism, oriented towards national demand, demand driven policy, and primary goals such as economic growth and employment (Brunnermeier *et al.*, 2016, p. 78ff). Italy as the third player in the Eurozone incorporates a regional unitary state capitalism characterized by dysfunctional state and regionalized capitalism in which the state orients towards patronage and subsidies. Italy bears characteristics of Ordoliberalism and (Neo-) Keynesianism and pursues a demand-oriented policy. Priority is given like in France to economic growth and employment (Brunnermeier *et al.*, 2016, p. 293ff). At the end of the 1990s Germany was labeled “the sick man of Europe” because the German economy faced a continuous slow-down and did not adjust the institutional structures to the challenges of the future. However, the German government was able to implement during the years 2003 to 2005 a reform program called "Agenda 2010" which envisaged far reaching labor market reforms (Weber, 2008, p. 31ff) which led to a flexibilization of the labor market and a stagnation of real wages which just increased in real terms from 2000 to 2010 by 2%. The reform of the social system followed the slogan “demand and promote”.

The ultimate goal of that reform was to restore and improve the international competitiveness of the German economy. Thus, Germany could benefit from these institutional reforms and grasp the advantages of monetary union leading to more transparency, economies of scale and economies of scope which improved risk diversion and the efficiency of capital allocation (Weber, 2008, p. 34).

Consequently, the major issue at present is how to reconcile heterogeneous economic models of the various countries. This does not mean that the others should follow the German model exactly. The persistence to enforce the German model has caused to some extent the large imbalances in the Euro system. Germany has been a winner in monetary terms and seen from the macroeconomic perspective. However, the German way has produced in Germany an increase in uneven distribution and due to the slow adjustment processes and the missing negotiations on the further and future implementation of the apparently complete, but in reality incomplete Maastricht Treaty an economic, political and social turbulence in a number of Eurozone countries, namely France and Italy. One has to start negotiations about the coordination of institutional reforms, namely in the labor market, but also the other markets facing strong structural challenges. These structural challenges will be aggravated in the future due to the upcoming process of digitalization.

The discussion about potential scenarios does not in each case recognize the task of bringing the Euro to a sustainable and acceptable success for all members involved.

5. POTENTIAL SCENARIOS

Potential scenarios have been developed in detail in the various publications of Hans-Werner Sinn (Sinn, 2014, 2015, 2016). The first of the proposals outlined envisages the exit of the Eurozone of those states in trouble. The return to the national currency accompanied by a devaluation should lead to regain price competitiveness in the short run. However, this proposal neglects the origins and causes for the respective state at the brink of bankruptcy. There are a number of obstacles and barriers: the reaction of the population, the reaction of non-resident investors in government bonds, the impact of devaluation leading to higher indebtedness, the danger of imported inflation and the non-adjustment of the institutional structures etc.. There is no chance for a short-term turn around without a haircut. The causes of the lacking international competitiveness and the structural weaknesses of the economy are not wiped out. Thus, this proposal does not seem to have strong chances for an implementation.

The second proposal of forming two different currency areas (Northern und Southern area) will also not solve the problems leading to the divergencies. International competitiveness will not increase. Divergence is likely to persist, because the problems leading to the break-up have not been solved.

Thus, there is still the possibility of stabilizing the Eurozone by renegotiations of the Treaty of Maastricht making it more flexible on the one hand and on the other hand coordinate in a better way needed for structural and institutional reforms. These negotiations have to cope with the instrument of an Alert Mechanism Report by the European Council and EU-Commission giving country specific recommendations, the implementation of interstate fiscal transfers (Eurozone budget) when asymmetric shocks are coming up, the question of a single unemployment insurance system, the introduction of stability bonds, a mechanism of sharing of risks, the implementation of a Banking Union (European Deposit Insurance Scheme EDIS) among others. The position of the Deutsche Bundesbank seems to be in a number of issues clear (Weidmann, 2016, p. 14 and Thiele, 2017, p. 11): If you take over liabilities you should also have control. Control and liabilities have to form a balance. Independent fiscal authority has to control the national fiscal discipline. A decoupling of banks and states has to take place. Banks have to underlie their credits to the state by equity and have to respect an upper limit. A regular procedure how to handle state bankruptcy should be introduced. The national responsibility and individual responsibility of investors has to be fostered. The ESM has to be empowered to be able to manage the restructuring of the debts.

6. CONCLUSIONS

Summing up, we have to give incentives for the needed institutional and structural reforms on the national level. Financial sanctions or financial transfers cannot replace national responsibility. The Maastricht Treaty has to be renegotiated.

Monetary policy cannot restore the fundamental weaknesses of some states. Moreover, monetary policy cannot serve as a growth driver. The interest rates are already non-existent.

Innovation is needed as well as the use of more efficient investment by private as well as state partners e.g. in education in order to adjust to the digitalized economy and society in a globalized world. The present situation which overall seemed to benefit Germany is only a short-term success, in the long-term the strategy of muddling through will also turn out for Germany into a disaster.

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Notes

[1] The calculation is based on the synthetic control method. This can be criticized concerning the exact number. However, the results are pointing into a realistic direction and show the relative differences between the various member states of the EMU.

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