POWER, RULES, AND OUTCOMES:

GOVERNING THE EURO AND THE PERVERSE LOGIC OF GERMAN IDEAS

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ABSTRACT

Ideas are at their most powerful as an explanatory variable when they lead agents to go against any broadly reasonable construction of material self-interests. They become even more intriguing when they result in some sort of collective suicide, in which actors undercut or contradict their own stated goals. This contribution shows two dynamics between power and ideas to explain the German euro crisis puzzle. The first dynamic examines the changing macroeconomic consensus governing the euro. The second dynamic shows how adherence to German ideas and ordoliberal rules turned a containable fiscal problem in Greece into a full-blown systemic crisis.

KEY WORDS: euro, fiscal policy, Germany, ideas, monetary policy, power

If you try to fight the German stability culture, you are bound to lose. It's better not to start that game. (Gerhard Schröder, 2007)[i]

The rules must not be oriented toward the weak, but toward the strong. That is a hard message. But it is an economic necessity. (Angela Merkel, 2010)[ii]

INTRODUCTION: THE GERMAN QUESTION

The advent of the Eurozone debt crisis in the spring of 2010 and the long search for a comprehensive solution have shaken the core of the European Union (EU). The debt crisis has reopened old debates on the single currency's institutional design, including the mandate of the European Central Bank (ECB) and the effectiveness of the Stability and Growth Pact (SGP). The crisis has also reinvigorated scholarly interest in Germany's central role in Europe's Economic and Monetary Union (EMU). Key questions include the influence of *ordoliberal* ideas on Eurozone policy implementation as well as Germany's relative position of power as the currency union's largest economy and main creditor state.

By 2010, Germany was widely seen as Europe's 'indispensable nation' (Sikorski 2011). Scholars agreed that German power, interests, and ideas would be crucial in determining whether EMU would fail, continue to muddle through, or be put on a more sustainable path (Rodrik 2010; Moravcsik 2012; Blyth 2013; Thompson 2013; Bulmer 2014; Jacoby 2015; Newman 2015). While Germany has unquestionably played a leading role during

the crisis, it invariably provided either 'reluctant' (Newman 2015) or the 'wrong kind' of leadership (Matthijs 2014b) – stuck somewhere 'between hegemony and domestic politics' (Bulmer 2014). The type of leadership Germany offered had direct consequences for the Eurozone overall given its growing structural and financial power. In particular, Germany controlled which crisis narrative would carry the day, and thus would be the central player in crafting the response during a time of extreme uncertainty (Hay 1996).

From the beginning, there were two fundamentally different crisis narratives. 'Systemic' accounts pointed to the euro's flawed institutional design and the many forgotten unions that were never created (economic, fiscal, political, financial, debt and banking). If one subscribed to this view, the solution to the crisis was to build those forgotten institutions and introduce some kind of safe asset or common debt instrument (a Eurobond), an economic government (a fiscal union), and a democratically more legitimate political union buttressed by intra-EMU solidarity (Matthijs and Blyth 2015; McNamara 2015). This was the dominant reading of the crisis in the Anglo-Saxon world (Wolf 2014), and was widely believed to bring solace to the Eurozone's ailing economy and could set it relatively quickly on a sustainable path to recovery.

'National' accounts, preferred by the overwhelming majority of the German policy elite, focused on the flaws within individual member states, painting the crisis as a morality tale of 'Northern saints' and 'Southern sinners' (Fourcade 2013). Hard work, high savings, moderate consumption, wage restraint, and fiscal sustainability were seen as Northern virtues; a lack of competitiveness, low savings, excess consumption, inflated

wages, and fiscal profligacy were seen as Southern vices. The adequate solution therefore was one of necessary pain and redemption, and of translating ordoliberal and neoliberal ideas into actual policy in the crisis-stricken countries.[iii] If only the sinners became more like the saints, the logic went, all would be well (Matthijs and McNamara 2015). This solution to the crisis implied long recessions and painful adjustments, likely to make the crisis worse in the short term in the hope of long term stability.

The Berlin Puzzle

Of central interest to the study of ideas and policy outcomes is the fact that during the Eurozone crisis, Germany's crisis narrative would actually lead it down a road of *hurting its own material interests* by crippling important export markets and triggering contagion in the short run, while giving up further control over fiscal and financial powers in the long run, by delegating those powers to the EU level. Furthermore, one can show that Germany's ideas did not just lead to suboptimal outcomes from Berlin's interest point of view, they *actually caused the crisis by making it a systemic one*. As I will show in this contribution, the puzzle is indeed quite striking: the state that everyone perceived as calling the shots in the Eurozone took actions that went against its own interests, generating perverse 'reality effects' that went counter to the intended policy outcome – a return to stability – thus bringing about exactly the scenario it most wanted to avoid.

At first sight, Germany acted well within its interests in 2010. By pursuing a policy of austerity and structural reform in the crisis-stricken countries, Germany's policy put the

main burden of adjustment of the crisis on the periphery and left German banks that were heavily exposed to those countries' sovereign debt largely off the hook (Blyth 2013; Thompson 2013). Furthermore, German political elites appeased their electorate's opposition to bailouts and fear of moral hazard, working within the tight constraints placed on them by the Federal Constitutional Court (FCC) in Karlsruhe. So, from a purely rational and material 'national interest' point of view, we can understand why Merkel did what she did (Thompson 2013; Howarth and Rommerskirchen 2013; Bulmer 2014). But are things in fact so simple?

While we did see considerable austerity in the periphery, we also saw bailouts,[iv] increased scrutiny and budgetary oversight by the EU of *all* member states (not just the ones in trouble), de facto backstopping of the sovereign bonds of the periphery countries by the ECB in the summer of 2012, supervisory and resolution powers over German banks transferred to that same ECB, and all out Quantitative Easing (QE) in January 2015. Furthermore, due to the deflationary effects of austerity, the Eurozone as a whole slid back into recession in 2012 and 2013 (Blyth 2013). While the German government managed to limit the size of the bailouts and maintained strict conditionality, the fact that the Eurozone crisis refused to go away meant it would gradually have to give up on its ordoliberal principles and make way for more pragmatic 'systemic' solutions, even though those remain incomplete at the time of writing (Matthijs and Blyth 2015).

And if we look a bit more closely at how the crisis unfolded over time, we can see that the budding Eurozone crisis in the spring of 2010, rather than remedied by German ideas,

was caused by them: an actual instance of German ideas resulting in 'reality effects' with perverse outcomes. By March 2010, the Germans settled on the 'national' redemption route for Greece, and dithered for months with EU level support, which caused a huge amount of panic in sovereign bond markets (Jones 2010). After the Greek bailout in May 2010, German discourse and ideas would continue to intensify the crisis over the course of two years, leading to 'panic-driven austerity,' with widening sovereign bond spreads between Germany and vulnerable periphery countries justifying ever deeper cuts, rather than more austerity resulting in narrowing spreads (De Grauwe and Ji 2013).

This contribution will proceed in four sections. The next section will build on the existing literature on actor-centered constructivism and discursive institutionalism to flesh out the relationship between power, ideas, and public policy. Section three will analyze Europe's changing postwar consensus in monetary and fiscal policy from the perspective of national sovereignty, power and ideas. Section four will focus on the reality effect of German elite discourse on the euro crisis. Section five concludes.

BUILDING ON EXISTING THEORIES: POWER, IDEAS, AND POLICY OUTCOMES

To understand German ideas against German interests, and how those ideas could result in perverse reality effects, we first need to frame how policymakers come to see the national interest in terms of their country's relative power and the ideas they hold.

Power, Ideas, and Interests

Power is usually defined as the ability to get someone to do what she would otherwise not do. But power has more than one dimension. Dahl (1957) defined the first dimension of power as the extent to which one individual can modify the behavior of another within a *given* decision making process. The person who prevails within that process holds power. Bachrach and Baratz (1962: 949) added a second dimension by focusing on the ability of an individual to shape the agenda or set the boundaries of the decision making process. They argued that 'to the extent that a person or a group – consciously or unconsciously – creates or reinforces barriers to the public airing of policy conflicts, that person or group has power'. Later, Lukes introduced a third dimension referring to the 'ideational capacity' of any dominant actor to shape the preferences of other actors in such a way that they end up reinforcing the dominant actor's position of power (Lukes 2005; Béland 2010: 146). As Lukes put it: 'A may exercise power over B by getting him to do what he does not want to do, but *he also exercises power over him by influencing, shaping or determining his very wants'* (Lukes 1974: 23, italics added).

Building on Lukes' introduction of the ideational component of power relations, we are interested in isolating the power of ideas themselves rather than relegating them to a subcomponent of a relationship between two actors. By examining cases where powerful actors' own ideas actually diminish rather than reinforce their power by thinking it in their interest, despite concrete evidence to the contrary, to worsen their own economic prospects and give up some of their future discretion over policy, we can isolate the

power of ideas over interests. In this way, ideas are not merely tools to exert influence over the preferences (and therefore power) of another, but are drivers of decisions that determine how one positions oneself within a relation of power. In reference to the German puzzle, such an inquiry would answer the question: why did Germany adopt policies that worsened an already bad economic situation and would reduce its own power in the future when maximum discretion is in one's long term material interest?

This article's exploration of how ideas actually drive behavior responds to Béland's call for a more systematic integration of sociological and political science accounts on ideas and policy outcomes (Béland 2009: 712). To better understand under what conditions powerful actors' ideas matter for policy outcomes, I will borrow from, build on, and empirically apply existing approaches in 'actor-centered constructivism' (Saurugger 2013) and 'discursive institutionalism' (Schmidt 2010). Both approaches place the role of ideas front and center in their analysis. The first approach contrasts the 'logic-of-position' (material interests) with the 'logic-of-interpretation' (how we perceive our interests) (Parsons 2007, Béland 2010), while the latter approach makes use of the 'logic-of-communication,' by considering how ideas are communicated by analyzing the interactive process of discourse in both policy and political spheres (Schmidt 2008).

Actor-Centered Constructivism: Ideas Over Interests

As Saurugger has argued, actor-centered constructivism is one of the most promising conceptual frameworks in studying public policy outcomes in the EU, "as it allows for

the considering of both the strategic interests of actors as well as their embeddedness in cognitive structures" (Saurugger 2013). Such constructivist approaches, following pioneering work by Berman (1998), McNamara (1998), and Blyth (2002), combine a utilitarian logic of consequentialism with a more ideational logic of appropriateness. While powerful actors face serious challenges, including the pressures of globalization and the constraints of supranational institutions and domestic electoral politics, there are multiple ways to solve a given problem, and it is not guaranteed that the objectively 'best' solution will be forthcoming (Matthijs 2011).[v] The final policy outcome is usually the result of the cultural context and ideological climate in which political actors function and form their ideas (Saurugger 2013).

Therefore, in order to understand the euro crisis puzzle, we need first to carefully trace the ideas of the dominant actor, Germany, as well as the alternative ideas of the weaker actors – including the EU member states, the Commission and the ECB – over whom the dominant actor exerts its power. This approach thus begins using two strategies identified by Parsons in this collection on 'how to best show powerful ideas vis-à-vis the skepticism of non-ideationally-inclined theorists' (Parsons 2016): the 'ideas of the politically powerful' as well as the 'ideas empowering (weak) actors'. Tracing the ideas of the powerful will help us understand how key agents define their interests – both in the short and the long term – and why they undertake particular actions. Woll (2008), for example, showed how ideas of trade openness and liberalization shaped not only the interests of multinational and exporting firms, but also those of national monopolies and previously sheltered sectors, when it came to lobbying their governments in international trade

negotiations. Parsons himself (2003) illustrated how ideas of a 'community Europe' crosscut the French political left-right spectrum and eventually determined which path of European integration was chosen.

Discursive Institutionalism: Perverse Outcomes and Self-Denying Reality Effects

Carstensen and Schmidt (2016) in this volume dissected the literature on discursive institutionalism and find three relevant ways in which ideational power influences policy outcomes, all of which are directly relevant to our German puzzle. First, what they call 'power through ideas', or the ability of the most powerful actors to persuade others of the general validity of their arguments by appealing to 'common sense' – like Angela Merkel's appeal to the image of the *Schwäbische Hausfrau* who lives a frugal and moral life. Second, what they term 'power over ideas' is the capacity of powerful actors to exclude alternative ideas from the overall acceptable discourse, like the rejection of Eurobonds. By insisting that the risk of moral hazard of any premature common debt instrument undermined any potential benefits, the German political and business class managed to close the debate on any systemic solution to the crisis, and steered it back towards national responsibility. Finally, Carstensten and Schmidt also see 'power in ideas', referring to the more subtle authority certain ideas enjoy over others, by focusing on the deeper discursive practices and institutional setups. This makes one set of ideas superior to another, almost from an intrinsically normative point of view, usually by emphasizing the logic of no alternative. By invoking the 'no bailout clause' of Maastricht, the ECB's sole mandate of price stability, as well as the sacredness of fiscal

rules, the German political elite managed to frame any solution to the euro crisis from an ordoliberal point of view.

To understand how German ideas and discourse could have worsened the crisis, thereby forcing Germany to gradually abandon its own ideas, we need to understand how ideas can generate perverse and self-denying 'reality effects' in the financial markets, followed by their 'self-fulfilling' effects on policy outcomes. Studying discourse through a close analysis of official German statements during the euro crisis, and how financial markets responded to them, allows us to do so.

Merton (1968) was the first to observe that ideas can become a 'self-fulfilling prophecy.' MacKenzie took this observation one step further by noting that certain ideas can actually become an 'engine' for markets – an 'active force transforming its environment' – rather than 'a camera passively recording it' (MacKenzie 2006: 12). By studying the widespread use of the Black-Scholes options pricing model by financial market participants, and how the application of particular financial technologies gradually made the financial world over time more like the theory, MacKenzie was able to show the 'performative effect' of ideas as powerful governance technologies.

Rosamond and Hay (2016), in their contribution to this collection, develop the idea of 'reality effects' in studying discourses on globalization. Building on their previous work (Hay and Rosamond 2002), and on earlier insights of Merton and MacKenzie, Rosamond and Hay posit that the concept of 'self-fulfilling prophecy' remains under-used by those

scholars interested in proving the causality of certain economic ideas on economic outcomes. In section four of this paper, we will see such a 'reality effect' of German economic ideas, which have both 'self-fulfilling' and 'self-denying' prophecies. The self-fulfilling part is due to German ideas making the crisis worse, increasing debt-to-GDP ratios in the periphery, which made it seem that it was high sovereign debt that caused the crisis all along rather than the response to it. Just like the self-fulfilling prophecy of globalization and corporate tax rates in in Rosamond and Hay's example,[vi] so does austerity increase states' debt-to-GDP ratios, which then in turn justify further austerity measures to tackle what has now in reality become a crisis of 'sovereign debt.' The self-denying prophecy comes from the fact that ordoliberal ideas played a central role in causing the crisis.

The next two sections will apply the methodological insights of both actor-centered constructivism and discursive institutionalism in illustrating the power of German ideas in (1) changing the macroeconomic consensus in Europe and thereby advancing ideas over interests, and (2) the reality effects of applying ordoliberal rules in an effort to solve the euro crisis.

IDEAS OVER INTERESTS: EXPLAINING EUROPE'S CHANGING POSTWAR CONSENSUS

Prior to the 1992 Maastricht Treaty, the Europeans had largely kept the basic tenets of what John Ruggie called the 'embedded liberal' compromise, which had been established

in 1944 in Bretton Woods and had endured well beyond the breakdown of the fixed exchange rate system in the early 1970s (Ruggie 1982). In practice, this meant that most tools of economic policy remained at the national level during that period. Embedded liberalism allowed individual countries to pursue multiple goals at once, including full employment, robust rates of economic growth, the maintenance of a universal welfare state, and relatively stable prices. Also, national governments could choose which adjustment mechanism to use in the face of an economic downturn, i.e. demand stimulus, austerity measures, devaluation, or as a last resort, default (Matthijs 2014a).

The signing of Maastricht meant a radical change in economic policy consensus in continental Europe: away from limited national monetary and broad fiscal discretion to supranational monetary and national fiscal rules. EMU member states voluntarily agreed to give up those powers to better coordinate their economies around a single currency. This change from national discretion over economic policy to EU imposed rules in the early 1990s has been exhaustively analyzed from three main angles, i.e. interests, institutions, and ideas. While Frieden (1991) and Moravcsik (1998) explained the decision to launch EMU by looking at the rational and objective interests of EU member states' main pressure groups, Pierson (1996) and Heisenberg (1999) looked at the shift through a historical institutionalist lens, rationalizing EMU through the ubiquity of both intended and unintended consequences of member-state policy preferences, as well as path dependent mechanisms with the monetary institutions of its most powerful member state, Germany. McNamara (1998) saw EMU as the eventual result of elites colliding around neoliberal ideas in the late 1980s, following the breakdown of Keynesian ideas as

well as the exemplary success of Germany in fighting inflation during the 1970s. Jabko (2006) stressed the role of the European Commission in using the idea of 'the market' as a polyvalent strategic tool that had different meanings for different audiences, but was instrumental in moving Europe towards the single market and EMU.

The ideational explanation remains the most convincing to this day, as Germany was only willing to give up its national sovereignty over monetary policy if the rest of Europe agreed to create the euro after the D-mark's image (Marsh 2011a: 99-137; Heipertz and Verdun 2004: 771). But the new consensus would not last all that long. In 2003, both France and Germany – the European Union's two most powerful member states – violated the rules of the Stability and Growth Pact by running fiscal deficits in excess of 3 percent for consecutive years.

In response to the violations by its two key member states, the 'excessive deficit procedure' was substantially weakened in 2005 to allow the European Council – where the larger member states have a stronger voice – more discretion in interpreting the reasons for any violations of the 3 percent rule. Before the 2005 reform, 'exceptional circumstances' had been defined as cases in which a country experiences an annual fall in real GDP of at least 2 percent. After the 2005 reform, a severe downturn was understood as a negative annual real GDP growth rate or an accumulated loss of output during a longer period of very slow GDP growth (TEU 104, 3-6). The ECB on the other hand, having been in charge of monetary policy since 1999, kept to its sole mandate of price stability, having defined its inflation target as 'lower than but close to 2 percent.' In other

words, the new consensus meant that fiscal policy, once again, would be the legitimate domain for nationally elected politicians, allowing for much more flexibility during hard times, while monetary policy continued to be conducted by rule by the ECB.

This new 2005 consensus seemed to become consolidated during Europe's response to the global financial crisis. Initially, in the immediate wake of Lehman Brothers' collapse in September 2008, most European governments announced their own fiscal stimulus plans, heeding the calls of both the G-20 and the International Monetary Fund (IMF) for a global stimulus of 2 percent of GDP (Ban 2014). The dominant narrative of the crisis had been driven by the US government and the IMF, and had emphasized the need to spur demand as a response to the crisis. There was, however, very little coordination at the European level, and the fact that 24 of 27 EU member states were in breach of the 3 percent deficit rule of the SGP in 2009 once again underlined that they no longer saw 'the corrective arm of the SGP to be a sanction-equipped threat to their fiscal sovereignty' (Heipertz and Verdun 2010: 189). This episode seemed to underline the 2005 consensus, with fiscal policy the central domain of national governments, and monetary policy including liquidity provision to Eurozone banks (not governments) the exclusive realm of the ECB.

But by late 2010 and early 2011, in the midst of the fog of what had quickly become framed as a European 'sovereign debt' crisis, the economic policy consensus would change for the third time in just two decades. Like most economic and financial crises, the Eurozone debt crisis was a situation of extremely high uncertainty for the

policymakers who had to craft a response to it. However, compared to the global financial crisis, the response would be quite different. Since the German government had quickly framed the crisis as a twin crisis of fiscal profligacy and lack of competitiveness in the southern periphery (Matthijs 2014c; Matthijs and McNamara 2015), fiscal policy would revert back to the original consensus at Maastricht, but with substantially stronger guarantees of actual implementation.

Exactly twenty years after Maastricht, European heads of government met in Brussels in December 2011 to sign a new Fiscal Pact. Inspired by German ordoliberal thinking, and Germany's *Schuldenbremse* introduced in 2009, the Treaty on Stability, Coordination and Governance (TSCG), was signed in March 2012, and called for a national balanced budget rule to (ideally) be enshrined in all member states' constitutions. The Treaty also included quasi-automatic sanctions in case a member state was found in violation of the deficit or debt rules. Commission decisions could only be overturned by a two-thirds majority of all member states in the European Council, and the Commission gained additional powers in national budget monitoring through the European Semester, which gave Brussels veto power over a member state's budget. In other words, Berlin managed to get its ideas implemented, but by doing so, it significantly constrained not only the other member states' discretion over fiscal policy (which it wanted), but also its own.

On the monetary side, initially, the ECB stuck to its limited mandate of price stability. When the crisis broke in early 2010, German policymakers, including Chancellor Merkel and her finance minister Wolfgang Schäuble, as well as German members of the ECB

governing board, Axel Weber and Jürgen Stark, referred to the 'no bailout clause' in the Maastricht Treaty to stop the ECB from directly buying the bonds of countries in distress. Only in November 2011, when Mario Draghi replaced Jean-Claude Trichet at the helm of the ECB, did the ECB start to move away from a narrow reading of its mandate. First, the ECB launched two rounds of Long Term Refinancing Operations (LTROs) in December 2011 and March 2012, followed by a pledge to do 'whatever it takes' to save the euro in July 2012, and the rollout of Outright Monetary Transactions (OMTs), in which the ECB committed itself to outright buy the bonds of periphery countries if they were willing to sign up to strict conditions. Furthermore, after the June 2012 European Council summit, the principle of banking union was agreed, and the ECB was set to significantly increase its powers in banking supervision and resolution, including of course over German banks.

In sum, the ordoliberal ideas of the powerful Germans made them frame the euro crisis as a fiscal crisis with a fiscal solution, resulting in a recession, and give up future discretion over fiscal policy. German ideas informed monetary policy only during 2010 and 2011, after which the ECB gradually moved away from its rules-based mandate of price stability towards much more discretion to directly intervene in European markets, well beyond German control and against German interests. An IR realist or a rational choice theorist would be able to explain the shift in 2003 from supranational fiscal rules back to more discretion, as a simple power game of two dominant states wanting to maximize their national interests. But they would have a much harder time to understand the shift in 2010. After all, why would powerful states (a) further limit their national powers over fiscal policy, after already having introduced a structural balanced budget rule at home,

and (b) give even more powers to supranational institutions, such as the European Commission and the European Central Bank, which they do not directly control, unlike the European Council, which they do? The most compelling answer lies with the power of ordoliberal ideas, which forced Germany not only to act against its own long-term material interest, but would play a central role in making the Greek crisis a systemic one.

TRACING THE REALITY EFFECTS OF GERMANY'S ORDOLIBERAL INTRANSIGENCE (2010-2012)

While ideas may occasionally go against a powerful state's material interest, they very rarely lead to some sort of suicide, or at least usually do not result in 'self-denying' dynamics where the way in which actors behave largely undercuts or even contradicts their goals as they understand them. Demonstrable examples are rare in public policy. There are lots of unintended consequences and failures, of course, but it can be hard to argue that the policies powerful actors chose were fairly clearly dysfunctional and non-instrumental to their overall goals. The euro crisis actually presents us with such a rare case. Broadly speaking, we have a set of interactions during the euro crisis that are dominated by German power, and yet the Germans actually caused a crisis that then forced them to do what they most wanted to avoid, i.e. bailouts, quantitative easing, and giving up further budgetary powers to the Commission and supervisory powers over their own banks to the ECB. The fact that Germany had a chance through successive iterations of crisis and response demonstrates that it was not a learning curve situation: Germany

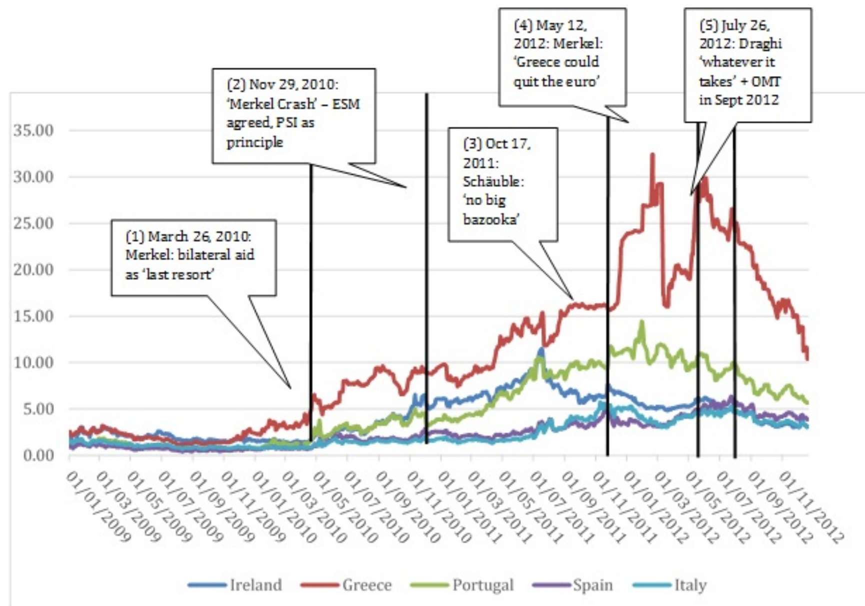
would stick to its ideas despite evidence that the resultant policies were materially damaging.

Figure 1 shows the ten-year sovereign bond spreads between Germany and the five periphery member states in the eye of the euro storm between 2009 and 2012. Tracing German elite discourse over those four years helps us understand the direct interaction between German ideas on how to respond to the crisis and which policies to implement, as well as the reaction of financial markets. As one can see from figure 1, spreads between Germany and Greece initially started edging upwards in November 2009, after the initial Greek admission by Prime Minister Papandreou that his country's fiscal deficit was a lot higher than expected. Jones (2010) observed that while Merkel's early 2010 statements could be understood from a domestic electoral policy lens, 'her policy toward Greece was folly in many senses of the term'. As Jones put it, '[Merkel] failed to anticipate the speed with which, and the extent to which, the Greek crisis would spread' (Jones 2010: 22).

I have identified four episodes where German policy statements on the crisis, directly informed by ordoliberal thinking – mainly by crucial players like Merkel, Schäuble, Weber, Stark, and Weidmann – can be shown to have a direct impact on the markets, which would then feed back into further austerity policies. All four moments in time happen at the beginning of a rapid worsening of the crisis as measured by widening bond spreads. Only the fifth episode, between July and September 2012, when Mario Draghi

intervened in a theatrical way by moving the ECB away from its previous orthodoxy, can we see bond spreads starting to narrow and the crisis beginning to recede.

Figure 1: Ten-Year Sovereign Bond Spreads with Germany (2009-2012)



The *first episode*, from February to March 2010, is marked by a sequence of German statements that first confused the markets, and then sent them into an outright panic. On February 11, 2010, Merkel stated that 'Greece would have to focus on meeting its fiscal consolidation targets because 'the rules must be followed'' (Jones 2010: 21). Two weeks later, on the question whether there was a possibility of a Greek bailout, Merkel responded on German public television channel ARD:

> 'There is absolutely no question of it… We have a (European) treaty under which there is no possibility of paying to bail out states in difficulty… Right now we can help Greece by stating clearly that it has to fulfill its duties' (Weisenthal 2010).

Less than a month later, on March 26, Greek spreads topped 5 percentage points after Merkel announced that 'Germany would only extend bilateral aid to Greece as 'a last resort… when market financing is no longer possible' (Jones 2010: 21). By now, spreads on Irish and Portuguese bonds had also started to go up at alarming rates, and the Greek crisis quickly reached systemic proportions. Jones contrasts Merkel and Schäuble's responses to the Greek crisis in the spring of 2010 with the response of Peer Steinbrück a year earlier. Schäuble's predecessor as German finance minister stated in February 2009, after Greece's first upward revision of its public deficit figures, that 'the [other member states of the eurozone] would have to rescue those running into difficulty' (Jones 2010: 26). Market fears immediately receded after that, as illustrated in figure 1.

The *second episode* where German discourse had a direct role in worsening the euro crisis was in the fall of 2010, referred to by financial market participants as the 'Merkel crash.' On October 18, 2010, Merkel met with French President Sarkozy in Deauville and the two leaders agreed on a limited revision of the Lisbon Treaty in order to allow for the European Stability Mechanism (ESM) to go into effect. Merkel emphasized that the crisis mechanism would only be valid in the event of the euro as a whole being in danger. Merkel and Sarkozy also agreed on the principle of 'Private Sector Involvement' (PSI), a euphemism for saying that private investors would have to bear a portion of the costs of the losses if they made risky loans like they did in the case of Greece (Spiegel Online 2010). By late November 2010, after a huge spike in Spanish and Portuguese government bond yields (figure 1), 'the market [was] finally being forced to price in the default risk

for eurozone countries' (Hume 2010). The crisis had spread to Spain and Italy, directly threatening 40 percent of the Eurozone economy.

While the crisis would slowly intensify over the course of 2011, the *third episode* where German ideas again directly intervened with markets to worsen the situation was during the months of October and November 2011, when two democratically elected leaders – in Greece and Italy – were forced to step down and replaced by former EU technocrats. On October 17, right after Moody's announced that France could lose its triple-A rating, Schäuble added to the market uncertainty by hinting that there was no 'big bazooka' solution to the euro crisis (Inman 2011). Then, on November 11, Jens Weidmann, the new president of the Bundesbank who previously served as Merkel's economic adviser, repeated that the peripheral states had seen 'many years of wrong developments' that were caused by 'home-made' errors, squandering their 'post-EMU dividend on disproportionate investment in private home-building, high government spending or private consumption' (Marsh 2011b).

While a period of relative calm returned to the Eurozone after Mario Draghi took charge of the ECB in November 2011, and added fresh liquidity into the Eurozone's banking system by launching two rounds of LTROs, the crisis would return in April 2012, with renewed fears of contagion to Italy and Spain (see figure 1). The *fourth episode* where German discourse again made a fragile situation worse was in May 2012, right after fresh Greek elections led to political stalemate in Athens, and France ejected Nicolas Sarkozy after one term in office, replacing him with the socialist François Hollande. On May 14,

2012, Merkel suggested that European support for Greece would end unless Athens held to the bailout terms agreed with Brussels and Berlin. She also admitted to the press for the first time that Greece 'could be forced to quit' the euro, sending the markets into another tailspin that week (Faiola and Birnbaum 2012).

Two interventions during the summer of 2012 would finally put financial markets' fears to rest, and both were a movement *away* from ordoliberal ideas and Berlin's 'national' sin crisis narrative towards more 'systemic' solutions. In late June 2012, European leaders agreed on the principle of a European banking union with a single supervisory mechanism and common resolution powers in the case of bank failures. One month later, on July 26, ECB president Mario Draghi gave a speech in front of a London investment conference where he pledged to do 'whatever it takes to preserve the euro', emphatically adding 'and believe me, it will be enough' (Jones 2013: 10). In September, Draghi rolled out the ECB's OMT plan, which committed the bank, under certain conditions, to buying up unlimited amounts of peripheral bonds. As one can see in *episode 5* on figure 1, bond spreads between Germany and the periphery countries rapidly fell, ending the acute phase of the crisis.

To sum up, as long as German policymakers stuck to their crisis narrative of 'national' sin and the need for redemption – follow the rules, implement austerity measures, and enact structural reforms – the Eurozone debt crisis kept getting worse, and went from a containable Greek problem to a systemic crisis. Only when the crisis narrative shifted towards a more 'systemic' one – with the need for a Eurozone banking union and single

supervisory mechanism, as well as the need for the ECB to start acting like a real lender of last resort through OMT – did the crisis gradually start to wane. Throughout the euro crisis, there were plenty of alternatives to the German solutions to the crisis, many of them constantly launched and re-launched in Anglo-Saxon circles. But the German narrative stuck and won out every time against those perfectly viable alternatives.

CONCLUSION: THE POWER OF RULES

Ideas are at their most powerful as an explanatory variable when they lead agents to go against any broadly reasonable construction of objective and material self-interests. They become even more intriguing when they result in some sort of collective suicide, in which actors act largely to undercut or contradict their own stated goals, as they objectively understand them. This will be even more apparent when a large majority of other actors involved are simply puzzled by such behavior. Those instances, by definition, are rare, but show the power of ideas over other theoretical variables.

This contribution showed two dynamics between power and ideas to explain the German euro crisis puzzle. The first looked at a situation of 'ideas against interests' by analyzing the changing macroeconomic consensus governing the euro. While the reform of the SGP in 2005 was a case of German power and ideas reinforcing German interests, the many policy innovations instituted during the euro crisis between 2010 and 2012 were much more a case of ideas going directly against interests, by diminishing the discretionary

power over fiscal policy, and empowering the ECB and the Commission, two institutions Germany does not control.

The second dynamic showed how adherence to German ideas and ordoliberal rules turned a containable fiscal problem in Greece into a full-blown systemic crisis, and kept making it worse until those ideas gradually made room for other ideas, ironically by reducing the legitimacy of the original ideas themselves. This particular aspect of German ideas showed the reality effects, and the self-fulfilling as well as self-denying prophecies of ideas. Germany's position of power in the Eurozone enabled it to push for more rules, while at the same time underestimating how powerful those rules actually were by changing the reality on the ground.

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NOTES

[i] As quoted in Marsh (2011a), p. 227

[ii] As quoted in James (2011), p. 530

[iii] With 'ordoliberalism' I mean the German tradition of the importance of following certain rules for economic stability and practicing fiscal restraint, as undergirding a

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stability culture needed a functioning social market economy. With 'neoliberalism' I mean the Anglo-Saxon economic tradition of free markets, competition, a limited role for the state, and the centrality of liberalizing structural reforms in labor and product markets as a way to lower unemployment and increase the economy's long-term growth potential.

[iv] For Greece and Ireland in 2010, Portugal (and Greece again) in 2011, Spain's banking sector in 2012, and Cyprus in 2013.

[v] Most constructivists would argue that what is 'objectively' the best solution is itself very much subject to debate, and will depend on the ideas of the person who judges on the objectivity.

[vi] The 'idea' of globalization drives down corporate tax rates in competitor countries, and the lower corporate tax rates then become evidence of the existence and structural power of globalization.

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