POWERFUL RULES GOVERNING THE EURO:

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 interpretation of their material self-interests. They become even more intriguing when they are instrumental in actually *causing* a crisis, in which actors undercut their own stated goals, and then continue to make matters worse by sticking to those same ideas even in the light of clear evidence that the policies they inspire are not working. This contribution shows two dynamics between power and ideas to explain Germany's behavior during the euro crisis. The first dynamic examines the changing macroeconomic consensus on how to conduct monetary and fiscal policy that governed the euro from 1999 to 2012. The second dynamic shows how a strict adherence to Germany's ordoliberal ideas of budgetary rules and structural reform turned a containable Greek fiscal problem into a full-blown systemic sovereign debt crisis.

KEY WORDS: euro, fiscal policy, Germany, ideas, monetary policy, ordoliberalism.

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 foundations 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) governing the single currency. The euro 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 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 (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 and Blyth 2011) – 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 great uncertainty (Hay 1996; Blyth 2002; Matthijs 2011).

Rather than focusing on systemic responses to the crisis (McNamara 2015; Matthijs and Blyth 2015), like Eurobonds or a more symmetric economic adjustment, which were widely deemed necessary across the Anglo-Saxon world to rescue the Eurozone's ailing economy (Wolf 2014), the overwhelming majority of the German policy elite preferred to emphasize the flaws within individual member states, like fiscal profligacy and a lack of competitiveness, thereby painting the crisis as a morality tale of 'Northern saints' and 'Southern sinners' (Fourcade 2013; Blyth 2013; Matthijs and McNamara 2015). The German 'ordoliberal' crisis solution of fiscal austerity and structural reform, however, implied long recessions and painful asymmetric adjustments in the Eurozone, which would make the crisis worse in the short and medium term (Matthijs 2014a).

I follow Stark (2015) in defining ordoliberalism as "an approach arising from the recognition that markets need rules to be set and enforced by government" that is mainly focused on maintaining price stability, balancing budgets, promoting competition in all markets, and strongly believes individuals (and countries) should bear the risks of their own decisions. However, I agree with Jacoby (2014) that there exist multiple varieties of

ordoliberal thinking within Germany, and that it is better to see ordoliberalism along a wider spectrum. While all mainstream political parties in Germany are to some extent guided by 'ordoliberalism' in setting economic policy, some parties adhere to a more flexible variant (SPD and Greens), while other parties uphold a much stricter version of it (CDU, but especially FDP). It is also true that while it has been widely documented that German policymakers have followed ordoliberal principles during the euro crisis (Dullien and Guérot 2012), there have been multiple unintended consequences from that pursuit as documented by Nedergaard and Snaith (2015) and Steinberg and Vermeiren (2015).

The Berlin Puzzle

At first sight, Germany acted well within its interests during the onset of the euro crisis in 2010, if we define its 'national' interest to include both short and long term economic (growth and currency stability) and political (democratic legitimacy and the promotion of EU integration) goals. By pursuing an ordoliberal policy of austerity-*cum*-reform in the crisis-stricken countries, Germany's policy shifted the main burden of adjustment of the crisis away from Germany toward the periphery. At the same time it left German banks that were heavily exposed to those countries' sovereign debt largely off the hook, and allowed them to slowly repair their balance sheets (Blyth 2013; Thompson 2013).

Beyond longer-term considerations of the national interest, German political elites also acted to appease their electorate's opposition to bailouts and fear of moral hazard due to the country's experience with reunification in the 1990s (Newman 2015), and worked within the tight constraints placed on them by the Federal Constitutional Court (FCC) in

Karlsruhe (Jacoby 2014, 2015). So, from a purely rational and material 'national interest' point of view, we can understand why Merkel did what she had to do (Howarth and Rommerskirchen 2013). But are things in fact so simple?

While we did see considerable austerity in the periphery, we also saw bailouts,[iii] 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, and supervisory and resolution powers over German banks transferred to that same ECB. 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 some of its ordoliberal principles and make way for more pragmatic and systemic solutions, even though those remain incomplete at the time of writing (Matthijs and Blyth 2015).

Furthermore, 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 being remedied by German ideas, was actually caused by them. By March 2010, the Germans settled on the national redemption route for Greece, and dithered for months with EU level support, causing 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 deepen 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). These policies would create 'sovereign' debt crises in countries where none had existed before (Blyth 2013).

Germany's ordoliberal policies would actually lead it down a road of *hurting its own national interests* by 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. 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 Berlin puzzle is striking: the most powerful state that everyone perceived as calling the shots in the Eurozone took actions that went against its own interests, generating perverse outcomes that went counter to the one intended (a return to stability) thus bringing about exactly the scenario it wanted to avoid most.

In order to do solve this puzzle, I 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 theoretical relationship between power, ideas, and public policy. Section three will analyze the Eurozone's changing consensus in economic policy from the perspective of national sovereignty, power and ideas. Section four will focus on the interaction between German elite discourse and sovereign bond markets during the euro crisis. Section five concludes.

BUILDING ON EXISTING THEORIES: THE POWER OF IDEAS AND THE IDEAS OF THE POWERFUL

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 market, policy and political spheres (Schmidt 2008).

Ideas Over Interests

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 the one that eventually materializes (Matthijs 2011).[iv] 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 outcomes, we first need to carefully trace the ideas of the dominant actor, Germany, as well as the ideas of the other actors – including the EU member states, the Commission and the ECB – over whom the dominant actor exerts its power. This approach thus uses 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.

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 can be directly applied to our Berlin 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 powerful 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 (Matthijs and McNamara 2015). 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 the SGP's fiscal rules, the German political elite managed to frame any solution to the euro crisis from their preferred ordoliberal point of view.

Perverse Outcomes and Self-Fulfilling and Self-Denying 'Reality Effects'

To understand how German ideas and discourse could have worsened the crisis, thereby forcing Germany to partially abandon its own ideas, we need to understand how ideas can generate perverse and self-fulfilling 'reality effects' in the financial markets, followed by their self-denying effects on policy outcomes, as I will explain further below. 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.

Building on the previous work of Hay and Rosamond (2002), who studied the discursive construction of economic imperatives in the face of globalization, and on earlier insights

of Merton (1968) and MacKenzie (2006), I posit that the concept of 'self-fulfilling prophecy' and 'reality effect' remains under-used by scholars interested in proving the causality of certain economic ideas on economic outcomes.

In section four of this contribution, I will illustrate the 'reality effect' of German economic ideas, which had both 'self-fulfilling' and 'self-denying' prophecies. The self-fulfilling aspect of ordoliberalism was due to Germany's insistence on austerity and reform as solutions to the crisis. This made the crisis worse in the short-term, by increasing debt-to-GDP ratios in the periphery, which made it seem like it actually *was* high sovereign debt that caused the crisis all along. Just like the self-fulfilling prophecy of globalization and corporate tax rates in Hay and Rosamond (2002),[v] 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' (see also Blyth 2013). The self-denying aspect comes from the fact that the crisis would only start to go away once a narrow conception of ordoliberal ideas was gradually abandoned in favor of more flexibility, as Merkel would give her tacit support to the ECB's reinterpretation of its own mandate in the summer of 2012 to do 'whatever it takes' to safeguard the euro (Spiegel 2014).

The next two empirical 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 the Eurozone and thereby gradually advancing a stricter interpretation of ordoliberal ideas over German national

interests, and (2) the reality effects of Germany's insistence on applying ordoliberal rules in Europe's collective effort to solve the euro crisis, with the crisis getting worse due to too close an adherence to ordoliberalism, and the crisis only starting to go away as those same ideas were partially deserted.

IDEAS VERSUS INTERESTS: EXPLAINING GERMANY'S ROLE IN THE EURO'S CHANGING ECONOMIC POLICY CONSENSUS

The signing of Maastricht in 1992 meant a radical change in economic policy consensus from national discretion over fiscal and monetary policy to EU imposed rules in the early 1990s. The institutional design of EMU 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 colluding 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 nonetheless instrumental in driving 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 very long. In 2003, both France and Germany – the EU's two most powerful member states – violated the rules of the SGP by running fiscal deficits in excess of 3 percent for consecutive years. At the time, Germany was governed by a coalition of Social Democrats (SPD) and Greens, two parties with a less stringent interpretation of ordoliberalism. Then chancellor Gerhard Schröder saw the need for greater budgetary flexibility and discretion, especially at a time of low growth and with his government in the midst of enacting long-term structural reforms to the economy, known as the *Hartz* reforms (Newman 2015). However, it needs to be emphasized that the main reason the SPD-led government could justify large fiscal deficits, is exactly because the *Hartz* reforms were injecting a serious ordoliberal dose of market-enhancing competition into the German economy. So, while seemingly moving away from ordoliberalism on the budgetary front, Schröder's government was doubling down on structural reform (Jacoby 2015).

In response to the violations by France and Germany, 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 Angela Merkel's CDU won the general election in September 2005, her narrow victory forced her to govern with the SPD in a 'grand coalition' with social democrat Peer Steinbrück as her finance minister. Faced with a weak economic recovery and continuing high unemployment in Germany, this also meant that the newly established norm of relatively more fiscal discretion would not immediately be questioned. In fact, the new consensus seemed to become consolidated three years later 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 2015).

The dominant narrative of the crisis had been driven by the US government and the IMF, which both 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 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). By the summer of 2009, it was understood in the EU that fiscal policy was the central domain of national governments, as long as monetary policy – including liquidity provision to Eurozone banks (not governments) – remained the exclusive realm of the ECB. But the outcome of the German general elections of September 2009 would change that. With 23 percent of the overall vote, the SPD recorded its worst postwar electoral result, and Merkel's CDU/CSU was able to form a coalition with the liberals of the FDP, who recorded their best result ever with 14.6 percent. The FDP in general takes a much stricter view of ordoliberalism, and felt emboldened by its stellar electoral performance to advocate a much tougher line on fiscal policy, both at home and in the context of the European Union, and gnaw away at the new EMU consensus (Zimmermann 2014).

Hence, by late 2009 and early 2010, the economic policy consensus in EMU would change again, as a direct consequence of the new German political situation. Since the German government of Christian Democrats and Free Market Liberals had quickly framed the crisis as a twin crisis of fiscal profligacy and lack of competitiveness in the southern periphery, fiscal policy would revert back to the original and rules-based consensus at Maastricht, but with substantially stronger guarantees of actual implementation of those rules (Matthijs 2014b).

Exactly twenty years after Maastricht, European heads of government met in Brussels in December 2011 to sign a new 'Fiscal Pact'. Inspired by a stricter version of German ordoliberal thinking, and Germany's own *Schuldenbremse* that had been introduced in 2009, the Treaty on Stability, Coordination and Governance (TSCG), was signed in March 2012. It 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 austere ordoliberal views 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. In future crises, it would be a lot harder for Germany itself to make use of its own national budgetary powers as a potential economic shock absorber. One could make the case that, in the short term, this earns market credibility and thereby boosts confidence, thereby enhancing the national interest. In the long term, however, it is not clear that giving up all budgetary discretion is as wise and rational a decision.

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. As we shall see in the next section, this kept making the crisis worse and is therefore another case of ideas going against interests. The ECB’s modest bond buying programs triggered the resignations of both Weber and Stark in April and September 2011 respectively. Only in November 2011, when Draghi replaced Trichet at the helm, did the ECB start to move decisively 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, something Germany initially opposed, but by June 2012 – the most acute phase of the euro crisis – felt compelled to give into.

The stricter interpretation of ordoliberal rules by the second Merkel coalition government of CDU/CSU and FDP 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. Ordoliberal 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 how Germany interpreted its own 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 – Germany and France – 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 explanatory power of ordoliberal ideas, which forced Germany not only to act against its own long-term material interest, but would transform the Greek crisis into a systemic one, as we will see next.

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

While ideas may occasionally go against a powerful state's material interest, either short or long term, they are seldom the trigger for an actual crisis, or at least usually do not result in a reality 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, even though they thought it to be quite the opposite at the time. The euro crisis presents us with such a 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 discretionary 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 underlines that it was not a learning curve situation. Until the summer of 2012, Germany would stick to a narrow version of its ordoliberal ideas despite evidence that the resulting policies were systematically doing damage in material terms.

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 an important part of the interaction between German ideas on how to respond to the crisis and which policies to implement, as well as the reaction of financial market participants. As one can see from figure 1, spreads between Germany and Greece initially started edging upwards in November 2009, after the initial admission by Greek 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, 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.

The main point of this section is not to show that German crisis statements were the sole causal factor in explaining rising bond spreads, but rather to illustrate that they interacted with material factors to make the situation worse, and therefore acted as a key explanatory variable. The counterfactual would be to show that the opposite statement could have made the situation significantly better, as illustrated below with Peer Steinbrück's market intervention in February 2009.

<Insert figure 1 about here>

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. It is instructive here to contrast Merkel’s response to the Greek crisis in the spring of 2010 with the statements made by SPD finance minister Peer Steinbrück a year earlier. In February 2009, after Greece’s first upward revision of its public deficit figures, Steinbrück told the assembled press at a meeting in Düsseldorf that ‘the [other member states of the eurozone] would have to rescue those running into difficulty’ (Jones 2010: 26). Market fears immediately receded after Steinbrück’s intervention, as one can also see in figure 1. Key German policymakers who hold different interpretations of ordoliberalism thereby can have a very different impact on the markets, underscoring the reality effects of ideas.

The *second episode* where German discourse played its part 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. The ordoliberal quid pro quo Merkel negotiated with Sarkozy was 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 had made risky loans (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 (Matthijs and Blyth 2011). On October 17, right after Moody's announced that France could lose its triple-A rating, Schäuble added to the market uncertainty by saying 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, 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 (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 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 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, with the tacit support of Merkel but against loud

opposition of Weidmann, Draghi rolled out the ECB's OMT plan, which committed the bank, under certain conditions, to buy up unlimited amounts of peripheral bonds (Spiegel 2014). 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.

As long as German policymakers stuck to their strict ordoliberal 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, though only to morph into a more long-term crisis of deflation and economic stagnation.

THE RULES OF THE POWERFUL AND THE POWER OF THEIR 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 directly lead to a crisis, in which actors behave in ways that largely 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 next to other plausible explanatory 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 making the euro crisis worse, and diminishing its discretionary powers through the empowerment of the ECB and the European Commission, two institutions Germany does not directly control.

The second dynamic showed how a strict adherence to ordoliberal rules turned a containable fiscal problem into a full-blown systemic crisis, and kept making it worse until those ideas gradually made room for a more flexible variant of ordoliberalism, 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.

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 against those perfectly viable alternatives.

NOTES

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

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

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

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

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