

**Introduction: Germany from Civilian to Geo-Economic Power**

Since the early 1990s, Germany's relative power and influence – both in Europe and the wider world – have grown substantially. With the dawn of German reunification, a series of unrelated events have conspired to drape Europe's leadership mantle over the shoulders of Berlin's political elite. The EU decision to go forward with the single currency at Maastricht in 1992 without the United Kingdom, the slow but ultimately successful reintegration of the Eastern *Länder* into the German economy, the opportune timing of the *Hartz* reforms in the early 2000s, and the relatively weak economic performance of France and Italy have all combined to make Germany the de facto leader of Europe. Henry Kissinger's question – 'who do I call when I want to call Europe?' – finally has an answer: Angela Merkel in Berlin.

Since 1990, Germany has slowly morphed from a 'civilian power' into a 'geo-economic power.' In the 1990s, Germany used to define its interests broadly in civilian or normative terms, within a liberal internationalist framework of multilateral cooperation. Human rights, peace, democracy promotion, and a willingness to take on an uneven share of the burden in order to develop supranational institutions used to be the hallmarks of German policy (Maull 1990). But since the early 2000s, Berlin has increasingly acted in a geo-economic fashion, by elevating its narrow economic interests over other interests. It has been less shy to impose its national preferences onto others, and has shifted to a more selective multilateralism with a much more realist approach to international affairs (Kundnani 2015, Szabo 2015). Since the end of the Cold War, Germany has gradually transformed itself from a 'semi-sovereign state' (Katzenstein 1987) to a more normal 'middle range' power, and leveraged its considerable economic strength to increase its diplomatic clout and international prestige.

European integration is at a crossroads. The governance of the euro, the challenge of dealing with rising powers in the East, and the humanitarian and political consequences of the Arab Spring, all require more rather than less EU cooperation. Collective action is often hard to achieve, and since the traditional Franco-German engine has been crackling, there is a strong case for Germany to lead the way, both in its own enlightened interest as well as Europe's, just like a benign United States led the liberal world in the wake of World War II. While still uncomfortable with the label of being Europe's 'hegemon' or 'leader' for obvious historical reasons – the German word for leader is *Führer* – Berlin's policy elite has progressively embraced its newfound power, both in the economic realm (through its de facto position as biggest economy and main creditor state in Europe's Economic and Monetary Union), and in foreign affairs (by being NATO's main broker and interlocutor between the United States and a resurgent Russia). There is no doubt that over the past five years, German policy has been able to decisively shape events and has had a profound impact in both fields. However, as we will see, German leadership has so far failed to deliver either a more stable and prosperous Eurozone, or a safer and more democratic European neighborhood.

## **Conviction without Strategy: *Ordoliberalism*, Rules, and the Euro Crisis**

“Never did a ship founder with a captain and a crew more ignorant of the reasons for its misfortune or more impotent to do anything about it,” was Marxist historian Eric Hobsbawm’s stinging verdict of America’s role during the Great Depression (Hobsbawm 1999: 190). Any analyst of the slowly unfolding train crash that was the euro crisis starting in the spring of 2010 could be forgiven for saying the exact same thing about Germany’s role in it. While Greece had clearly broken the fiscal rules of the Stability and Growth Pact in the most egregious way, and was teetering of the brink of bankruptcy, the insistence early on of Germany’s lawyer-politicians to stick to the rules, i.e. no bailouts for Greece, would lead to outright panic in the bond markets and result in contagion to the rest of Europe’s periphery (Jones 2010, Matthijs 2014a).

From the beginning, there were two fundamentally different euro 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, an economic government, and a democratically more legitimate political union (Matthijs and Blyth 2015; McNamara 2015). ‘National’ accounts, preferred by the overwhelming majority of the German policy elite, focused on the flaws within individual member states, and often painted the crisis as a morality tale of ‘Northern saints’ and ‘Southern sinners’ (Fourcade 2013). Hard work, high savings, wage restraint, and fiscal prudence were seen as Northern virtues; a lack of competitiveness, low savings, inflated wages, excess consumption, and fiscal profligacy were seen as Southern vices. The adequate solution for flouting the EU’s rules therefore was one of necessary pain and redemption in the South, or austerity and structural reform (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 vain hope of bringing about long term stability.

Europe’s insistence on applying a heavy dose of both ‘ordoliberal’ and ‘neoliberal’ medicine as remedies to the crisis – a combination of fiscal rules stipulating austerity measures and structural reforms to enhance competition – meant that Europe’s Greek problem would go from a manageable fiscal crisis to a full-blown ‘sovereign debt crisis’ in a matter of months (Blyth 2013). Germany, with both Chancellor Merkel and her powerful Finance Minister Wolfgang Schäuble leading the euro pack, played a key role in this. As Merkel herself put it rather bluntly in 2010: “The rules must not be oriented toward the weak, but toward the strong. That is a hard message. But it is an economic necessity” (as quoted in James 2011: 530). In other words, Germany’s solution to the euro crisis was to run away from its partial responsibility as careless lender to the periphery during the boom period, and push most of the burden of adjustment onto Europe’s periphery (Matthijs 2015).

Of course, there was no malign intent on the part of the German government in any of this. Berlin’s policy elites genuinely believed that what they were doing was in Europe’s

best interest. And therein lies the tragedy of Germany's leadership during the euro crisis. This can be illustrated by Schäuble's own views on what responsible leadership entails during economic crises. In a speech in Paris in November 2010, Schäuble invoked the importance and relevance of the teachings of economist Charles Kindleberger for Europe's current predicament. For Kindleberger, the main cause of the Great Depression had been the fact that a much-weakened United Kingdom could no longer play the role of leader or 'hegemon' in the world economy, and that an isolationist United States was unwilling to do so (Kindleberger 1973). Kindleberger's view of leadership during crises was that of one state acting as the ultimate provider of 'global public goods,' including serving as a market for 'distress goods' (goods that cannot find a buyer), practicing countercyclical lending, acting as a lender of last resort, managing a system of stable exchange rates, and coordinating macroeconomic policy. Schäuble, a lawyer by training, had read Kindleberger very differently. For him, responsible leadership meant France and Germany respecting and following the rules they had set for themselves at Maastricht, practicing fiscal restraint and avoiding any moral hazard: exactly the opposite of what Kindleberger had in mind (Matthijs 2015).

If you assess Germany's performance as the provider of 'regional public goods' in a European context, before and during the euro crisis, one can only conclude that it has failed miserably (Matthijs and Blyth 2011). First, rather than being a market for distress goods, Germany has continued to export much more than it imports during the crisis, and refused to stimulate its own domestic consumption and investment. Second, instead of counter-cyclical lending, Germany's banking sector practiced the opposite, i.e. excessive lending to Europe's periphery during the boom combined with a sudden stop of capital during the bust. Third, far from allowing the ECB to reinterpret its mandate as being a real lender of last resort, Germany has consistently sought to limit the ECB's powers and emphasized its policy constraints. Fourth, Berlin has dictated a policy of 'austerity for all' to the rest of Europe in place of coordinating macroeconomic policy where the North would inflate by increasing spending while the South would deflate through austerity.

The contrast between Germany's role in the euro crisis and the United States' role during the global financial crisis of 2008 could not be starker: the US had learnt the lessons from the 1930s and led the world economy by providing all global public goods. This is one of the main reasons why the euro crisis has lasted for over five years, while the worst of the global financial crisis was over after just six months (Matthijs 2015). There is a historical rationale for Germany's obsession with rules, given the legacy of the *Rechtsstaat* rather than democratic government during the Wilhelminian period, and the experience of the *Third Reich* with its complete disregard for the rule of law. While rules should be at the heart of any multi-state currency union, they cannot replace leadership during periods of crisis, when enlightened leadership should be confident enough to ignore the rules temporarily for the common good (Jones 2009).

By 2015, European integration was in deep trouble. Rather than economic convergence, the euro had brought about significant divergence within the Eurozone. The gap in living standards between Northern and Southern Europe was back to where it was in the early 1990s. From a political perspective, the popular perception of an all-powerful Germany

imposing draconian terms on Southern Europe, especially in Greece, has also been very bad for the European project (Matthijs 2014b). The whole point of the European Union was to ban the ‘German Problem’ to the dustbin of history. After the long night of negotiations in July 2015, where Greece’s leftwing Syriza government was forced to choose between “Grexit” (exit from the Eurozone) or a humiliating acceptance of much harsher bailout terms than Greek voters had rejected in a referendum one week earlier, former German foreign minister Joschka Fischer observed “the return of the Ugly German” (Fischer 2015). By compelling a member of the Eurozone to leave ‘voluntarily,’ Fischer believed Germany “announced its desire to transform the Eurozone from a European project into a kind of sphere of influence” (Fischer 2015).

### **Strategy without Conviction: Foreign Policy between Interests and Values**

In the realm of foreign and security policy, Germany in the 21<sup>st</sup> century has been torn between its normative values as a ‘civilian power’ and its realist interests as a ‘geo-economic’ power, even though it has been slowly moving towards the latter (Kundnani 2015, Szabo 2015). On the one hand, in its capacity as civilian power, the country is fully embedded in the transatlantic alliance through NATO and the European Union, which are both built on liberal and western values, which include democracy, human rights, and the rule of law. On the other hand, as a geo-economic power, Germany is driven more by its economic interests, which often clash with those western values, not least when it comes to doing business with a fast growing but authoritarian China, and its energy dependence and commercial ties with a renascent Russia. Both states have poor human rights records, have their own idiosyncratic interpretation of the rule of law, and can hardly be called democratic. Yet Berlin has recently taken a more realist line by pushing aside some of its values in order to secure lucrative business deals.

Nowhere has this clash between interests and values been more obvious than in Berlin’s dealings with Moscow over the crisis in Ukraine in 2014. While Germany supported the European Union’s offer of a far-reaching trade deal with Ukraine in November 2013, consistent with its liberal values and soft power projection, it was caught quite off guard when then Ukrainian president Viktor Yanukovich cancelled the deal in favor of closer cooperation and commercial ties with Vladimir Putin’s Russia. While Germany is a key member of the European Union, it has a long history of engagement with Russia, and since Chancellor Willy Brandt’s *Ostpolitik*, a time-honored tradition of engaging with the East, known as *Wandel durch Handel*, or “change through trade” (Szabo 2015: 25).

When pro-EU protests in Kiev’s *Maidan Square* turned violent and Yanukovich was forced to resign in February 2014, Moscow interpreted the overthrow of Ukraine’s democratically elected and pro-Russian president as a coup d’état. The turmoil in Kiev was the pretext for Russia’s military invasion of the Crimea, and subsequent annexation in March 2014 (Mearsheimer 2014). Putin justified the offensive as Russia protecting its vital strategic interests, including its fleet at Sevastopol, given the risk of Ukraine joining NATO and a rival naval base in the Black Sea. In April 2014, protestors – with the help of pro-Russian paramilitary troops – seized and held government buildings of the East Ukrainian cities Luhansk and Donetsk, de facto splitting Ukraine in a pro-Western and

pro-Russian part. Russia's invasion constituted a clear violation of the postwar international system's rules of the game: it was the first time since World War II that Europe's borders were being redrawn by military force.

Germany has played a skillful diplomatic – but ultimately unsatisfying – balancing role during the Ukraine conflict, acting as mediator between Russia and the West. While on the one hand, Germany agreed with the US and its EU partners to impose a series of sanctions on Russia, and Ukraine signed a landmark Association Agreement with the EU in June 2014, Berlin has been careful to keep open the lines of communication with Moscow. Germany helped broker the Minsk truce between the Ukrainian government and pro-Russia rebels in September 2014, and a gas supply deal between Moscow and Kiev in October 2014. According to Stephen Szabo, “President Obama relied on Chancellor Merkel to take the lead in mediation attempts with Russian President Vladimir Putin and it was clear that whatever sanctions regime emerge[d] w[ould] only go as far as Berlin [permitted]” (Szabo 2015: 129).

The results of Germany's leadership of Western diplomatic efforts to deal with Putin's Russia are dismal. Europe has ended up with a divided Ukraine, and a Russia that has hardly been punished for unilaterally seizing a big chunk of territory of a sovereign country by brute military force. The Baltic States as well as Poland for the first time since the Cold War feel seriously threatened again in their security. German foreign policy, sympathetic to its Eastern neighbors' fears but wary to alienate its Russian business partners, lack a credible deterrent that would come with a much more powerful military. In the end, Berlin has done very little to allay their Eastern neighbors' fears, and the EU's agreement with Ukraine is a clear example of biting off more than one can chew. If a third bailout for Greece, a member of the Eurozone, is proving to be a gargantuan task, there is little hope for a financial package for Ukraine, a country with a much more corrupt government that is (and may remain) still a long way off from being a member of the EU.

While Germany's interests are to continue to do business with Russia, its values point in another direction. Unlike Lord Palmerston's Britain in the 19<sup>th</sup> century, which only had permanent interests and no permanent friends, Germany does have permanent friends in NATO and in the European Union. For better or worse, Germany's strategic future is tied up with the West and its liberal values. As opposed to economics, leadership in foreign policy entails enforcing the rules of a liberal world order rather than ignoring them when they conflict with commercial interests. A tighter Western bloc may have gotten Putin to rethink his own aggressive tactics. German weakness – both in terms of its principles as well as in terms of its military power – rather than German strength has undermined its leadership potential in foreign policy.

### **Conclusion: A German Europe and Its Discontents**

In a speech in Hamburg in 1953, German novelist Thomas Mann told an audience of German students: “We do not want a German Europe, but a European Germany” (as quoted by Garton Ash 2012). In the early 1990s, after German reunification and the

signing of the Treaty of Maastricht, it certainly looked like Mann had gotten his wish. Just over twenty years later, however, the tables seemed to have turned. While Germany has been forced into a difficult balancing act between rules and discretion in the Eurozone, and between interests and values in its foreign policy, we have ended up with a much more German Europe, but not necessarily for the better.

*Matthias Matthijs is Assistant Professor of International Political Economy at Johns Hopkins University's School of Advanced International Studies in Washington, DC.*

## **Bibliography**

Blyth, Mark (2013), *Austerity: The History of a Dangerous Idea* (New York: Oxford University Press).

Fischer, Joschka (2015), "The Return of the Ugly German," *Project Syndicate*, July 23.

Fourcade, Marion (2013), "The Economy as Morality Play, and Implications for the Eurozone Crisis," *Socio-Economic Review* 11: 620-627.

Garton Ash, Timothy (2012), "Angela Merkel needs all the help she can get," *The Guardian*, February 8. Online available at:  
<http://www.theguardian.com/commentisfree/2012/feb/08/angela-merkel-all-help-can-get>.

Hobsbawm, Eric (1968, [1999]), *Industry and Empire: The Birth of the Industrial Revolution* (New York: The New Press, W.W. Norton), first published in 1968.

James, Harold (2011), "International Order After the Financial Crisis," *International Affairs* 87 (3): 525-537.

Jones, Erik (2009), "Elusive Power, Essential Leadership," *Survival* 51 (3): 243-252.

Jones, Erik (2010), "Merkel's Folly," *Survival* 52 (3): 21-38.

Katzenstein, Peter J. (1987), *Policy and Politics in West Germany: The Growth of a Semisovereign State* (Philadelphia: Temple University Press).

Kindleberger, Charles P. (1973, [2013]), *The World in Depression: 1929-1939* (Berkeley, CA: University of California Press, 40<sup>th</sup> anniversary edition), first published in 1973.

Kundnani, Hans (2015), *The Paradox of German Power* (Oxford: Oxford University Press).

Matthias Matthijs and Mark Blyth (2011), "Why Only Germany Can Fix the Euro," *Foreign Affairs*, November 17.

Matthijs, Matthias (2014a), "The Eurozone Crisis: Growing Pains or Doomed from the Start?" chapter 14 in Manuela Moschella and Catherine Weaver (eds.), *Handbook of Global Economic Governance* (London: Routledge), pp. 201-217.

Matthijs, Matthias (2014b), "Mediterranean Blues: The Crisis in Southern Europe," *Journal of Democracy* 25 (1): 101-115.

Matthijs, Matthias (2015), "Reading Kindleberger in Washington and Berlin: Ideas and Leadership in a Time of Crisis," paper presented at 22<sup>nd</sup> *Annual Conference of Europeanists* (CES), Paris (France).

Matthijs, Matthias and Kathleen McNamara (2015), "The Euro Crisis' Theory Effect: Northern Saints, Southern Sinners, and the Demise of the Eurobond," *Journal of European Integration* 37 (2): 229-245.

Matthijs, Matthias and Mark Blyth (eds.) (2015), *The Future of the Euro* (New York: Oxford University Press).

Mau, Hanns W. (1990), "Germany and Japan: The New Civilian Powers," *Foreign Affairs* 96 (5): 91-106.

McNamara, Kathleen R. (2015), "The Forgotten Problem of Embeddedness: History Lessons for the Euro," in Matthias Matthijs and Mark Blyth (eds.), *The Future of the Euro* (New York: Oxford University Press), pp. 21-43.

Mearsheimer, John (2014), "Why the Ukraine Crisis Is the West's Fault: The Liberal Delusions that Provoked Putin," *Foreign Affairs* 93 (5): 77-89.

Szabo, Stephen F. (2015), *Germany, Russia, and the Rise of Geo-Economics* (New York: Bloomsbury).