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Europe, German Mercantilism and the Current Crisis

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Abstract - Contributions to Brancaccio and Fontana (2011) look at a variety of aspects of the current crisis, some of them focusing on the contingent financial causes, others on the underlying contradictions of capitalist economies. In this context, less attention has been paid to the role of Europe and particularly Germany. Europe has not been distinguished by an assertive and cooperative economic policy stance in the aftermath of the current crisis. German mercantilist policies are said to be behind the European policy stance and a source of regional and global imbalances. After a brief examination of the main pillars of European economic policy and German behaviour during the present crisis, these notes suggest an embryonic interpretation of the origins of mercantilist behaviour, dwelling on the nature of mercantilism in economic theory and commercial practice, and of the allegedly German mercantilist model. The suggested interpretation is that in the German case, the national mystique of a trade surplus may have had a role in disciplining the labour market and at the same time assuring profits. Recent developments in Spring 2010 have shown the gravity of the European imbalances in the global crisis (see Cesaratto 2010) and the relevance of the background issues discussed in the present paper.

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1. INTRODUCTION[1]

Contributions to Brancaccio and Fontana (2011) look at a variety of aspects of the current crisis, some of them focusing on the contingent financial causes, others on the underlying contradictions of capitalist economies.[2] Some contributors touch on the international dimension of the crisis, the so-called global imbalances. In this context, less attention has perhaps been paid to the role of Europe and particularly Germany. Europe has not been distinguished by an assertive and cooperative economic policy stance in the aftermath of the current crisis, to the point that pundits have looked at the so-called G2 as the most authoritative global body. German mercantilist policies are said to be behind the European policy stance and a source of regional and global imbalances.[3] After a brief examination of the main pillars of European economic policy and German behaviour during the present crisis (sections 1 and 2), these notes suggest an embryonic interpretation of the origins of mercantilist behaviour, dwelling on the nature of mercantilism in economic theory and commercial practice (section 3), and of the allegedly German mercantilist model (section 4). The thesis I suggest is that in the German case, the national mystique of a trade surplus may have had a role in disciplining the labour market and at the same time assuring profits. Mercantilism can also be a natural course once it is recognised that absolute and not necessarily relative advantages may determine participation in international trade. Further developments in Spring 2010 have shown the centrality of the European imbalances in the global crisis (see Cesaratto 2010) and the relevance of the background issues discussed in the present paper.

1. EUROPEAN ECONOMIC POLICY

European economic policy has deliberately *not* built on the idea of macroeconomic policy cooperation. This is seen as unnecessary since growth and employment are regarded as problems to be dealt with at national level. The European Monetary Union (EMU) is based on three pillars: unified monetary policy, absence of assertive fiscal policy and flexibility of national labour markets. Let us examine them.

The theoretical reference framework for monetary policy is well known: the latter has no real effects in the long run, and if effective, may be harmful in the short term; it is therefore better to leave it in the hands of an independent central bank whose sole objective is price stability. This stance marks a significant difference with respect to the Fed that also considers adequate growth and employment as targets. The Treaty of Lisbon that came into force on 1 December 2009 ratifies the independence of the Central Bank and price stability as its primary target, as if these were general principles like, say, civil rights, and not disputable academic and political stances about which European citizens should have a say. This framework is plainly wrong: monetary policy is effective in the short and long run. Expansionary monetary (and fiscal) policies sustain growth and employment. Inflation is not the automatic result of monetary policy per se, but of the distribution conflict that becomes fiercer when economies approach full employment. The mandate of the ECB is not to accommodate distribution conflict, and it accomplishes that role by threatening or adopting a restrictive monetary stance. An ‘independent’ central bank is therefore a watchdog of labour market discipline.

European fiscal policy is only expressed in negative terms: the well-known ‘constraints’ inscribed in the Treaties of Maastricht (1992) and Amsterdam (1997). As a result of repeated violations of these treaties by the main European powers, namely Germany and France, and as a repercussion of the crisis, these constraints have been relaxed or abolished, although they remain a reference point. The theoretical inspiration of this stance is to be found in the conventional thesis that profligate countries could profit from the EMU due to lower interest rates that do not include devaluation risk. This would imply crowding-out of prudent countries’ savings. By contrast, from a non-conventional point of view, it can be argued that frugal countries’ exports benefit from careless countries’ profligacy, and that the resulting trade surplus finances that profligacy.

The framework provided by the first two pillars is thus quite remote from the idea of coordinated European macroeconomic policy. The EU indeed has a European board concerned with economic policy, *Ecofin*, the council of EU ministers of finance, and after *Ecofin* meetings, the ministers in EMU meet the governor of the ECB, in the so called *Eurogroup* (cf. Panico and Vazquez Suarez 2008).[4] However, this is not a formal decision-making authority since the Germans have always rejected the idea of an official, political counterpart to the ECB.

Finally, it is a firm tenet of EU economic philosophy that employment is a national target that must be pursued at national level through labour market reforms. The neoclassical idea that lower wages lead to full employment is behind this. The European strategy has been called ‘competitive deflation’ and is clearly a zero-sum strategy. It is a policy of competitive devaluation under false pretences that cannot be collectively successful; it may perhaps favour single countries, but to the detriment of the others.

The conclusion is that in the absence of a fully coordinated macroeconomic framework, it comes as no surprise that the EU does not play an assertive role in the determination of global macroeconomic policies, let alone support a coordinated policy. The question is then why the main European power, Germany, traditionally opposes this kind of policy at regional and global level.

2. GERMANY AND THE CURRENT CRISIS

There is little doubt that Germany is a great export machine. Since the early 1950s her trade and current balances have been in surplus, with few exceptions, and export, import and surplus ratios on the GDP have steadily risen. In the last decade, the ratio of imports of goods and services increased from 33 per cent in 2000 to 41 per cent in 2008, that of exports from 33 per cent in 2000 to 47 per cent in 2008, the surplus from slightly positive in 2000 to 6% per cent in 2008. By way of comparison, the corresponding percentages for France in 2008 were 28, 26 and -2, and for Italy 29, 28 and -1 (source: Eurostat). Data for trade in goods is more impressive (Germany being in deficit for trade in services). The trade surplus on the GDP rose from 2.8 per cent in 2000 to 7 per cent in 2008 with export on GDP being 28 per cent in 2000 and 39 per cent in 2008. The corresponding percentages for France in 2008 were -3.5 and 20, and for Italy 0 and 23. In absolute terms, German exports were €983B in 2008 against 971B of China, and the respective trade surpluses were 177B and 202B (194B and 191B in 2007). Notoriously, intra-EU trade is the main component of German total trade. In 2008 German exports in the EU27 were 24 per cent of German GDP, imports 20 per cent, the corresponding percentages for France being 13 and 16, and for Italy 13 and 12. This is important for two reasons: first, the European macroeconomic context is particularly relevant for German external performance; secondly, the German economy is increasingly integrated with peripheral countries, Eastern Europe but also Italy. In this respect Germany has been defined as an industrial hub (De Cecco, *La Repubblica* 19 January 2009) or, more negatively, as a bazaar economy (Sinn 2006). The remarkable share of foreign trade on the German GDP is therefore not only explained by the export orientation of the economy, but also by decentralisation of less complex phases of the production cycle.

In the course of the present crisis, German exports of course suffered the fall in global demand; however Germany reacted in line with her traditional economic stance, which is non cooperative at global and European level, relying basically on export-led recovery and adopting the measures necessary to preserve her productive capacity and skilled labour force.

In early summer 2008, when the gravity of the impending crisis was already visible, the ECB disgracefully raised the interest rate to intimidate Ig-Metall. The crisis naturally took charge of trimming down Ig-Metall's claims, showing the futility of that move. In fall 2008, German policy makers began accusing the Americans of causing the financial crisis, which in their opinion justified German inaction in the hope of export-led recovery led by those allegedly responsible: 'We can only hope that the measures taken by other countries ... will help our export economy', stated Michael Glos, then German minister for the economy (*Financial Times* 30 November 2008). The German banks were indeed involved in financial excesses to the tune of $1,500B of toxic assets. As De Cecco ironically explains: Germany had no house bubble at home, house prices have been depressed in Germany for years, so they looked for one in the US (*La Repubblica* 22 June 2009), as a way to allocate the external financial surplus.
In autumn 2008, at the outbreak of the financial crisis, French President Sarkozy repeatedly argued that the ECB had to be flanked by an official authority (*Eurogroup*) concerned with fiscal policy (headed by himself to give it authority). The Germans declined, fearing that the independence of the ECB would suffer (a political committee would have higher status than ECB technocrats). This was not the first time Germans said no to France in this regard. So when *Eurogroup* national leaders last met in October 2008 to co-ordinate a response to the chaos unfolding on the financial markets, Sarkozy, who chaired the meeting, proposed continuing the practice, but was rebuffed by Germany.

The G20 meeting in May 2009 was preceded by German refusal of any American-sponsored global macro policy coordination, and indeed nothing happened in this direction. Later in June, Angela Merkel reproached the ECB for indirectly sustaining the mounting European public deficit by injecting abundant and cheap liquidity that banks then used to buy government bonds. Later that summer, Germany reinforced her conservative-mercantilist stance by introducing a balanced-budget clause in the German Constitution; moreover a sentence of the German Constitutional Court ruled any hypothetical European federal economic governance to be unconstitutional, reaffirming the nature of the EU as a club of independent states.

In January 2010, the Spanish Prime Minister José Luis Zapatero, inaugurating the Spanish EU Council Presidency, apparently supported by Herman Van Rompuy, the new European President, and by José Manuel Barroso, chairman of the European Commission, maintained that the French idea of holding meetings of the *Eurogroup* at the level of heads of state and government was 'still alive'. He sustained a 'qualitative leap' in common economic governance of the EU, arguing that a new 'dialogue' should be inaugurated between the ECB and the 'European Council' of national government leaders. However, we are informed that few days later the Spanish foreign minister and the EU puppet President played down the proposals, after prompt censure by Rainer Brüderle, the German minister for the economy, who described them as 'not very useful'. A few weeks later, the Greek case of public debt on the verge of default erupted.[5] Germany initially opted, albeit reluctantly, for direct bail-out of Greece to avoid any idea of concerted fiscal help from Euroland. However, German public opinion firmly opposed bailout of the 'profligate' southern partner, having accepted the domestic rigour of the German economic stance over the previous decades. Once again the French authorities seized the opportunity to ask for co-ordination of European economic policy. As a result, the German Chancellor Angela Merkel vaguely conceded something in that direction, but once again only at EU and not EMU level, to avoid any idea of limiting ECB independence (to be reinforced by the appointment of Axel Weber, the orthodox Bundesbank President, as next director). Further developments regarding the Greek and, by now, the European crisis, are illustrated in Cesaratto (2010).

3. THE GHOST OF MERCANTILISM IN THEORY AND PRACTICE

3.1. Mercantilism as a disharmonic view of international economic relations

Germany seems a good example of a mercantilist economy: focus on trade surplus, production and productivity; wage moderation and compression of internal consumption; concern about a competitive real foreign exchange rate.

Mercantilism is a somewhat mysterious phase in the history of economic analysis. The existence of a consistent school of thought thus defined has been defended by some and denied by other historians of the discipline. A broad definition of mercantilism inspired by the German historical school, and subscribed by Eli Heckscher (1955: I-21) in his classical treatise, refers to the set of economic and trade policies pursued by nation states in order to establish their political power. A narrower classical definition of mercantile policies identifies them with pursuit of a trade surplus.

As well known, Adam Smith ferociously attacked the mercantilist doctrine. In theory, he asserted the advantages of international trade for all participating nations through exchange of surplus products, market expansion and thereby extension of the division of labour (1776: 446-7). In practice, he accused the mercantile doctrine of looking after the interests of merchants and producers, while sacrificing those of consumers (ibid.: 661-2). Note that Smith held a theory of *absolute* advantages from trade which is very different from the theory of *comparative* advantages attributed to David Ricardo.[6] A theory of absolute advantages is in principle consistent with the pursuit of mercantilist policies, e.g. trade policies aimed at developing and safeguarding national absolute advantages. In other words, despite his attack on mercantilism, his theory of international trade is not inconsistent with a disharmonic view of international political relations. On the other hand, the theory of comparative advantages and neoclassical theorems of international trade support a harmonic view of international political relations, one in which international *laissez-faire* brings benefits to all participants. Both theories are, however, open to criticism.[7] According to the disharmonic view, unequal economic power of nations may lead late-comers to limit free trade; and, in the case of more balanced industrial powers, full exploitation of the mutual advantages of free trade may require deliberate macroeconomic cooperation among the main economies. In both cases, there are limitations to *laissez-faire* policies. It is not by chance that Keynes, who did not believe in the harmonic virtues of *laissez-faire*, wrote sympathetically on mercantilism in the *General Theory*. It can be appreciated that mercantilism does not reject the potential advantages of international trade, but rebuffs the idea of automatic benefits from trade and reproaches *laissez-faire* (Heckscher, 1955, part V).

As Keynes' revival in the *General Theory* shows, the ghost of mercantilism has not been laid to rest, despite Smith's excommunication. The mercantilist ghost speaks to those who do not believe in 'immanent social rationality' but that 'social causation [the existence of objective social laws] and state interference could go together' (Heckscher 1955: 321-2). As often the case with influential ideas or authors, it is difficult to discern the original thought (assuming that something resembling organic mercantilist thought existed, which is likely) from how it has later been perceived. The mercantilist ghost reappeared with the pro-developmental theory of Friedrich List and the German Historical School, which greatly influenced East Asian economic development, and with a gloomier stance in periods of economic crisis when the terms neo or new mercantilism covered protectionist practices or threats, as in the 1930s and early 1970s. *International Political Economy* has also been much influenced by mercantilism (Gilpin 1987).

3.2. Mercantilist economics and mercantilist economies

Summarising the argument so far, *as a theoretical source of inspiration*, a mercantilist tradition can be identified in rejection of the existence of harmonic, beneficial and immanently rational natural laws (that acquire a theological flavour) in favour of a rational belief in the existence of natural laws that are not automatically harmonic, beneficial and immanently rational and that can be, must be and are actually managed by political intervention. In a broad sense, mercantilism is the opposite of *laissez-faire*. *As a practical behaviour*, what has been defined as *benign* mercantilism has represented the ideology and practice of national policies of industrialisation and welfare as parts of the process of building state and full sovereignty (Buzan 1984: 608). Benign mercantilism might include the Keynesian pursuit of international macroeconomic cooperation as a pre-requisite for trade liberalisation, and recourse to *defensive* protectionism to defend domestic employment and welfare in the absence of a cooperative stance, especially from big industrial powers. *Malevolent* or *aggressive* protectionism is defined as the pursuit of economic and political power through a trade surplus. Obsession with production and productivity and repression of wages and domestic consumption has been identified with this view (Furniss 1920).

3.3. The origins of malevolent mercantilism

Scholars of mercantilism have long debated the ultimate aims of the policies that go under this label, and in particular the aim of a trade surplus. Heckscher (1955: I-24) regarded the 'state's external power, in relation to other states' as the ultimate purpose of mercantile policies. Notoriously, Jacob Viner (1948) retorted that 'wealth' – private as well as national - was at least as important as 'power' in the original mercantilist literature. Heckscher only superficially accepted the criticism, continuing to regard wealth as a basis for state power (ibid I-25). In this respect a trade surplus should be regarded as an instrument of *relative power* with respect to competing nations. Among others, Heckscher (II-22) quotes a German mercantilist who argued that: 'Whether a nation be to-day mighty and rich or not depends not on the abundance or scarcity of its powers or riches, but principally on whether its neighbours possess more or less than it. For power and riches have become a relative matter, dependent on being weaker and poorer than others.' According to Furniss (1920: 11-14) and Johnson (1937: 366) the mercantilist had the idea that a trade surplus amounts to a quantity of domestic labour paid by foreigners (the so-called 'balance of labour'). Full employment as a basis of relative economic strength, accompanied by low wages was indeed a central objective for a typical mercantilist (Furniss 1920: 8, 40; Heckscher 1955: II-165). The capacity to create wealth was regarded as more important than wealth itself (ibid: II-124). Evocative as it may sound, the idea of relative national power obtained by a trade surplus contains some element of vagueness, at least to those who do not believe in a generic concept of overall national interest to be pursued against other countries. More substance should therefore be given to this concept by referring, for instance, to the specific concerns of the dominant elites.

We also find the idea that net exports are the only source of economic surplus for a nation in mercantilist literature. A widely quoted author is Charles Davenant 'It is the Interest of all Trading Nations, whatsoever, that their Home Consumption should be little, of a Cheap and Foreign Growth and that their own manufacturers should be Sold at the highest Markets, and spent Abroad; Since by what is Consumed at Home, one loseth only what another gets, and the Nation in General is not at all the Richer; but all Foreign Consumption is a Clear and Certain Profit' (1697, quoted by Heckscher: II-115). A Kaleckian flavour might be read in this passage, net exports as a source of profits, but the association should not be overrated. Kalecki's concern with the external trade surplus was related to realisation of a domestic surplus, so that net exports were a determinant of profits (e.g. Kalecki 1971). Only a few mercantilists, however, clearly related the possibility of a trade surplus to the existence of a domestic surplus, namely a social product above what is necessary to reproduce the system on the same scale, let alone the absence of much concern with problems of aggregate demand in typical mercantilist literature. A mercantilist flavour can nonetheless be read in Kalecki: net export as way to get rid of domestic surplus and to make profits, and source of the credit capacity necessary to finance the trade deficit of dependent 'external markets'.

Although with less theoretical depth than Kalecki, Joan Robinson (1966: 10) also regarded 'new mercantilist' competition as a natural state in a world in which 'the total market does not grow fast enough to make room for all' so that 'each government feels it a worthy and commendable aim to increase its own share in world activity for the benefit of its own people'. The drama is that some 'can win only if others lose'. Moreover, success breeds success: 'The most important benefit from a surplus … is that … it permits home investment to go full steam ahead, while a deficit country is nervously pulling on the brake for fear of excessive imports. Investment in the strong country brings technical progress which improves its competitive position and makes its balance of trade all the stronger, while the weak country slips into stagnation or suffers distressing spasms of stop and go.'

Of course the capitalist ruling class does not deliberately pursue a mercantilist strategy from reading Kalecki. It can, however, have in mind an economic self-sustaining model like this: a disciplined and well-trained labour force creates the basis of foreign trade leadership; wage moderation (relative to average productivity) assures capital profitability;[8] foreign markets offset repression of the domestic consumption market due to low wages, the external penetration of firms is encouraged while foreign investment in the home market is discouraged (Guerrieri and Padoan 1986: 30-3); successful exports and depressed imports (due to restrained domestic consumption) lead to a trade surplus that becomes the icon of the success of the model and the morning star of social and economic policy, in particular labour market discipline; a stable real exchange rate, preserved through a low domestic inflation rate (again a result of labour market discipline) preserves competitiveness of exports on one hand and attainment of necessary imports of wage and production goods at stable costs; external success also drives home investment and productivity; in addition, the trade surplus allows the country to finance decentralisation of the less sophisticated parts of production in ancillary countries with lower labour costs, to finance the current account deficit of trade partners, and acquire foreign financial and real assets; the political power derived from this strong financial position consents the country to resist external pressure to change its policies and to create an international economic context favourable for their continuation (e.g. the EMS and the EMU in the case of Germany).

In synthesis, external success brings domestic discipline and efficiency that in turn assure foreign competitiveness and profits (this is what the capitalist elite perceives and pursues); profits are realised through net exports (this is the Kaleckian hidden part).

3.4. Mercantilism and the international context

It has been argued that there is no discontinuity between the two kinds of mercantilism and that the more or less benign nature of mercantilist policies depends on the international context rather than on states' subjective aims (Guerrieri and Padoan 1986). The international context may doubtless accommodate different degrees of mercantilism. Typically, the political and economic interests of the hegemonic power (in the sense of Kindleberger 1981) may tolerate doses of mercantilist policies by weaker allies, as the US did with Western Europe and Japan in the Bretton Woods era, or later with regard to East Asian countries including China (Medeiros 1997), in what has been named the Bretton Woods II system (Dooley et al. 2003). As observed by Guerrieri and Padoan (1986: 33): 'Successful pursuit of a neomercantilist policy rests on the ex ante structure of international relations and in particular on some countries' acceptance of the fact that others pursue such a policy. In the hegemonic system, one country (the United States) must agree to act as a "residual economy".' The very success of export-led growth may, however, ultimately shake the economic fundamentals of international equilibria, and mercantilist policies may become less tolerable and a source of international instability.

What is weird in the case of Germany is that this country seems to have become progressively more mercantilist in the 1970s, precisely when the international context required her to share economic leadership and coordination with the enervated hegemonic power. The designation of malevolent or aggressive mercantilism therefore appears to suit Germany: pursuit of a trade surplus and a repeated lack of international cooperation.

4. GERMANY AS A MERCANTILE ECONOMY

Since unification, Germany has been an example of benign mercantilist in the sense of state building, industrializing and creating welfare institutions to sustain social cohesion. As in Japan, the people are trained in discipline and community concern and this is a decisive asset for Germany, though it should not be forgotten that she suffered traumatic social and ideological conflicts last century. German national assets remerged in a more peaceful context in the post WW II reconstruction period, followed by the German economic miracle. As argued at the end of section 3.3, the external whip may be regarded as functional for internal discipline and efficiency. An export-oriented economy was a deliberate decision of the German elite after WW II. In 1953, for instance, Ludwig Erhard stated that ‘foreign trade is not a specialized activity for a few who might engage in it, but the very core and even precondition of our economic and social order.’ In this regard, it is worth mentioning the traditional German concept of *Ordnung*:

> which can be directly translated to mean order but which really means an economy, society, and polity that are structured but not dictatorial. The founders of the social market economy insisted that *Denken in Ordnungen* - to think in terms of systems of order- was essential. They also spoke of *Ordo-Liberalismus* because the essence of the concept is that this must be a freely chosen order, not a command order.[9]

It is generally maintained that although already an export-led country, after the first oil shock Germany became a malevolent mercantilist country (e.g. Ciocca and Vito Colonna 1981: 109).[10] The reaction of Germany to the economic turmoil of the 1970s featured many of the traditional components of malevolent mercantilism: wage moderation, fiscal restraint, a resulting favourable inflation rate differential, such as to compensate any appreciation of the nominal exchange rate and preserve competitiveness, as well as little concern for international reflationary action. Izzo and Spaventa (1981: 77) criticise the argument that Germany’s specialisation in export goods, typically machinery, would make support of domestic demand ineffective in stimulating domestic output. Even admitting the validity of the premise, the two authors object that this support would in any case stimulate imports, and thus recovery of partner countries, and therefore lead to larger German exports. Kindleberger (1976: 126-7) listed a number of structural reasons for the German trade surplus that included moderate inflation, industrial competitiveness and high propensity to save, so that disequilibrium was ‘in the nature of things’, although he no longer rejected, as he did in an early paper, a ‘beggar-thy-neighbour’ policy, for instance, by revaluations of the nominal exchange rate insufficient to compensate the inflation differential between Germany and her competitors (ibid: 130). According to Ciocca and Vito Colonna (1981: 133) and Riccardo Parboni (1980: 105) German mercantilism or German imperialism had the aim, through direct investment and foreign credit, both permitted by the trade surplus, of creating a wide German-dominated area that would included south and eastern Europe. This behaviour aggravated the international deflationary cycle (e.g. Valli 1981: 10; Ciocca and Vito Colonna 1981: 135) and low European growth (Guerrieri and Padoan 1986: 40).

In 1975-1978 the OECD sponsored the so-called ‘locomotive theory’ of coordinated international recovery led by the main countries. The international pressure on Germany was eventually successful, so that in 1978 this country approved a successful fiscal stimulus that also led to a current balance deficit (Ciocca and Vito Colonna 1981: 117). However in 1979, as a consequence of the second oil shock, the German policy stance was soon reversed and the expansion judged ephemeral, a ‘straw fire’ according to Otmar Issing, ‘an experience never to be repeated’ (Bibow 2009b:15).[11] A widely held fear of inflation is the standard justification for German caution. Bibow (ibid.:13, cf. also Dal Bosco 1987: 88-89) regards this interpretation, however, as a social image aptly fabricated, not least by the Bundesbank: it was high unemployment that opened the way to Nazism, not hyper-inflation, as ordinary people in Germany and abroad are led to believe (hyper-inflation took place much earlier, in 1918-1924).

Since Germany refused to cooperate in an international effort to reflate, competitive devaluation by the European partners could be expected. Creation of the EMS (and later the EMU) could thus be interpreted as preventive moves by Germany to impede this retaliation (Ciocca and Vito Colonna 1981: 127). It is noteworthy that on one hand, these partners willingly condescended to the competitive deflation framework imposed by Germany in order to destroy trade union power (Parboni 1985: 233), possibly hoping, on the other hand, that the prospect of a monetary union would enhance their say. They only succeeded in the first aim. The EMS and later the EMU were tailored to the German model, though not without incongruities. Let us reconsider the three pillars of European economic policy sketched in section 1.

The ECB is often seen as heir to the Bundesbank in the role of watchdog of the German labour market, while the strong Euro is heir to strong DM policy. As already mentioned, Germany had her cake and ate it too with the EMS and later the EMU, refusing to sustain domestic demand and hindering her European partners from devaluing their currencies in retaliation. On the other hand, Euroland internal imbalances have increased since the EMU. Wage stagnation and productivity growth permitted Germany to gain in competitiveness with respect to her European competitors, while an interest rate policy tailored to German necessities has also contributed to the emergence of European imbalances in a non coordinated EMU context. Namely, low interest rates suited to the deflationary German context have induced housing-bubble-led growth elsewhere in Europe. Tellingly enough, the German export economy has benefitted hugely from these bubbles, perhaps unexpectedly. With little regard to signs that the bubbles were about to burst, in early summer 2008 the ECB raised the interest rate to intimidate German trade union wage claims.

Similar incongruence can be seen with regard to European fiscal policy. As noted by Bibow (2009a p.5), Germany benefited from her partners' profligacy, especially in the 1980s: 'The point is that the German model worked for Germany precisely because and as long as others behaved differently.' However in the 1990s, once German rigour had been exported through the Maastricht regime, this backfired on Germany through lower demand. The German interest in fiscal severity may be justified by her concern about the strength of the Euro, as part of her strategy of containing the cost of imported inputs. Finally, the European employment strategy based on national labour market flexibility has been called 'competitive deflation': it is clearly a zero-sum strategy, or perhaps a Pyrrhic victory for Germany.

Summing up, the German export economy model is a well-ordered model which by definition imposes social responsibility and discipline on German society, especially Trade Unions, since its very continuation depends on foreign competitiveness that depends on productivity growth and wage moderation.[12] Exports, being concentrated on capital goods, do non require an internal consumption market. The foreign exchange policy preserves a constant real exchange rate, so that on the export side firms must rely on technical change to gain competitiveness, and on the import side the cost of imported wage and production goods is contained. Monetary institutions, first the Bundesbank and later the ECB, are watchdogs of wage responsibility, the so-called natural unemployment rate being defined in order to obtain labour discipline. The trade surplus serves the dual purpose of creating a regional German economic area in which to decentralise production and acquire activities, and of financing foreign demand for German goods, at least until debtor countries' own imbalances become unbearable. The threat of off shoring production has been used to bully the German labour force, even by big companies, as in the Siemens case in 2004. Economic and political power are associated with the German trade surplus, allowing her to have the final word in European institutions and to resist pressures from other global giants that could upset an international context functional to her mercantilist stance. This power has been evident in the definition of European economic policies and in German behaviour in the current and past crises. This model is not, however, without contradictions at global and European level.

CONCLUSIONS

German mercantilism has been indicated as a co-factor in triggering and perpetuating the current crisis. This paper found that a rationale of the German model was presumably maintenance of an efficient, disciplined and profitable national economy associated with international economic and political power. A French commentator, aptly reported by Dal Bosco (1987: 10, my translation), provides a historical perspective for this interpretation:

> The economic policy choices of Federal Germany in the post-war period – parity choice and price stability – reiterated and widened the outward orientation of the German economy, a historical legacy of the German Reich (…). The external successes of the Federal Republic of Germany had a positive effect on domestic social and economic relations, recalling the interpretation advanced by historians of Imperial Germany, that domestic order was a necessary condition for external projects that in turn reinforced internal order.

Yet as we noted above, all participants of the EMS and EMU were willing to create some order in their own labour market relations (this was clear in the case of Italian participation in the EMS in 1979). This suggests that in capitalism, malevolent mercantilist behaviour is generally not specific to some bad guy, but is more of a natural course for the ruling class, as envisaged by Kalecki and Joan Robinson (and Rosa Luxemburg), since it couples labour market discipline and foreign market realisation of the surplus. Moreover, in an international market where the harmony of relative advantages is theoretically and practically flawed, countries strive to get as many absolute advantages as they can. So they would all actually like to be Germany, the 'successful' mercantilist country; unfortunately, this is not possible by definition. As Joan Robinson pointed out: 'All industrial countries want a surplus on income account. "Export-led growth" is the most convenient way of running modern capitalism. Whoever succeeds at any moment is accidental, largely depending on historical circumstances and political and psychological influences. Success leads to success and failure engenders failure' (quoted by Burbidge 1978: 42). In addition, obtainment of persistent trade surpluses by the successful mercantilist giant contributes to the creation of regional and global imbalances that may periodically boomerang on the temporary winner (Bibow 2006: 26). Unfortunately, the opposite policy framework, international Keynesism, has been more of an accident of history associated with the Cold War, than a rule. It is capitalism that is malevolent, not a single country.

One hope for Europe is that the contrast between the humiliating role played by the EU at the Copenhagen meeting on global warming and the European economic imbalances revealed by the Greek crisis, on one hand, and Chinese political and economic ambitions on the other, will induce at least a moderate change in European political stance with Germany accepting some degree of economic policy co-ordination and some form of federal fiscal policy at continental level. The most recent developments (May 2010), however, suggest that the German interpretation of fiscal coordination consists just of a more restrictive European policy stance without assailing the fundamental causes of the regional imbalances. The European perspectives appear therefore rather bleak (see Cesaratto 2010).

Notes and references

[1] Forthcoming with minor differences in Brancaccio E., Fontana G. (2011). I thank, without implications, Franklin Serrano, Sergio Parrinello and Massimo Pivetti for valuable suggestions.

[2] For a critical comparison of the two views see Palley (2009).

[3] See for example Paul Krugman in the *New York Times*, Wolfgang Munchau in the *Financial Times*, Marcello De Cecco in *La Repubblica.*

[4] Exchange rate policy is discussed by the *Eurogroup*.

[5] Pundits hinted at the German model as the long-run cause of European troubles (Martin Woolf, *Financial Times*, 9 February 2010). The present Greek, Portuguese, and Spanish troubles - as well as those of the Baltic and eastern European nations - suggest the fragile nature of the catching-up process of these countries in the EMU era, disproving the optimistic view of Blanchard and Giavazzi (2002). The EMU certainly facilitated sustaining of persistent current account deficits of these countries by financing the housing-bubbles and/or deficit spending growth at the origin of those deficits. According to the conventional economists cited, this is a natural process, whereby rich countries, in which capital is abundant, finance fellow countries that are catching up. However, this course of events seems much more similar to the Kaleckian view of developed countries financing their external markets by lending money to developing countries (Kalecki 1971). The same developed countries cannot avoid rescuing indebted countries from time to time, as Germany will possibly do in the present case.

[6] As pointed out by Parrinello (2009a, 2009b), the standard presentation of Ricardian theory hastily assumes an exogenously given amount of fully employed labour in the two trading countries,

whereas Ricardo conceived the labour supply as an endogenous variable that adapts itself to the vagaries of capital accumulation in the long run. Parrinello also shows that in a post-Keynesian model in which effective demand determines unemployment equilibria, absolute advantages may prevail over comparative advantages.

[7] A number of studies by Sraffian authors have used the results of the capital theory controversy to demolish neoclassical harmonic theorems of international trade (cf. Parrinello 2009a).

[8] Note that although wage moderation is a component of mercantilism, real wages would generally rise faster in the successful mercantilist economy, as Joan Robinson (1966: 17) remarked: 'Industrial countries have been experiencing a continuous process of rising money-wage rate. In the stagnant country, costs are pushed-up, making its competitive position all the weaker, while the strong country can afford a greater rise, because output per head is increasing faster and yet subject to less pressure, because its workers' real earnings are visibly growing.'

[9] From the *US Library of Congress Country Studies.*

[10] A standard neoclassical explanation justifies German surplus in view of the ageing process: mature German generations save a lot and accumulate foreign assets now, in order to be able to finance their retirement. From a practical point of view, this does not explain why the trade surplus policy began in the seventies, or earlier. The analytical problems of the conventional view of pensions in open economies are shown by Cesaratto 2005: 212-20.

[11] When Germany abandoned the idea of coordinated fiscal recovery, this led to failure of Mitterrand's famous adoption of Keynesian policies in 1981. This was a genuine straw fire.

[12] 'La croissance économique de la RFA, orientée vers l'exportation, a été entretenue par une véritable 'mistique' qu'aucun groupe social n'a réellement remise en question' (Le Gloannec 1980: 291). In February 2010, no concern about weak domestic consumption prevented Ig-Metall from giving up any real wage claim in the bargaining season in order to preserve employment levels and the national industrial apparatus.

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