

---

 Special report:  
**Germany**


---

## Germany and Europe

# The Merkel plan

**Germany's vision for Europe is all about making the continent more competitive**

Jun 15th 2013 | From the print edition

ANGELA MERKEL DOES not often muse publicly about the European project. A physicist by training, she prefers solving concrete problems to holding forth about abstract ideas. A sunny morning in late April



this year was a rare exception. At an event to mark the publication of a new book on her foreign policy by Stefan Kornelius, a journalist at a German daily, the *Süddeutsche Zeitung*, Mrs Merkel debated the future of Europe with Donald Tusk, Poland's prime minister.

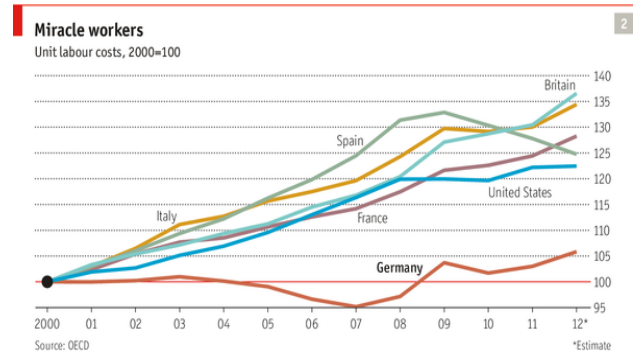
Mr Tusk began with soaring rhetoric. Europe, he said, was about freedom, about ensuring that the horrors of history would never be repeated. Mrs Merkel concurred that freedom was an essential part of Europe's values, but argued that on its own it was not enough. The European project was to secure the continent's prosperity in the 21st century, when emerging economies were rising fast. Having seen one system collapse in her lifetime, added the chancellor (who grew up in East Germany), she did not want to go through it again.

If Mrs Merkel's vision is pragmatic, so too is her plan for implementing it. It can be boiled down to three statistics, a few charts and some facts on an A4 sheet of paper. The three figures are 7%, 25%

Merkel lays down the law

and 50%. Mrs Merkel never tires of saying that Europe has 7% of the world's population, 25% of its GDP and 50% of its social spending. If the region is to prosper in competition with emerging countries, it cannot continue to be so generous.

Mrs Merkel's charts show various measures of competitiveness, an obsession of hers. She produces graphs of unit labour costs (see chart 2) at EU meetings in much the same way that the late Margaret Thatcher used to pull passages from Friedrich Hayek's "Road to Serfdom" from her handbag.



The A4 sheet of paper maps the political route Europe must take to become more competitive. In his book Mr Kornelius describes how in 2011 Nikolaus Meyer-Landrut, the chancellor's powerful adviser on Europe, plotted European policy along two axes—the bits that worked and those that didn't, those where power was devolved to Brussels and where it remained with national governments. He found that all the problems that had led to the euro crisis (such as lack of budget discipline and extravagant welfare states) had arisen in areas where control remained at national level, so either these policies had to be federalised by creating a European "superstate", or Europe would have to acquire a parallel architecture of rules to bind nation states.

Mrs Merkel went for the second option. At Germany's behest, the EU treaties were amended in March 2012 to introduce new fiscal rules for euro members, known as the "fiscal compact". Among other things, this required all euro members to amend their constitutions to install a "debt brake", as Germany did in 2009, prohibiting them from running structural budget deficits. The chancellor wants to introduce more such rules to force Europe's economies to become more competitive.

Mrs Merkel is quite willing to change Europe's treaties, as was necessary for the fiscal compact, but for the sake of greater competitiveness rather than for political integration in its own right. Her instinct is that agreements between governments will be more effective than federalism in achieving the changes Europe needs. But unlike the French, who have always preferred a Europe steered by national governments, she wants such agreements to limit individual countries' scope for discretion.

"Solidarity" (ie, German cash) does play a role, but mainly as a means of buying time and encouraging reform. That is the idea behind the existing euro rescue funds, which lend money to cash-strapped governments in exchange for commitments to cut their budget deficits and pursue structural reforms. Germany has proposed "contracts" under which countries in southern Europe

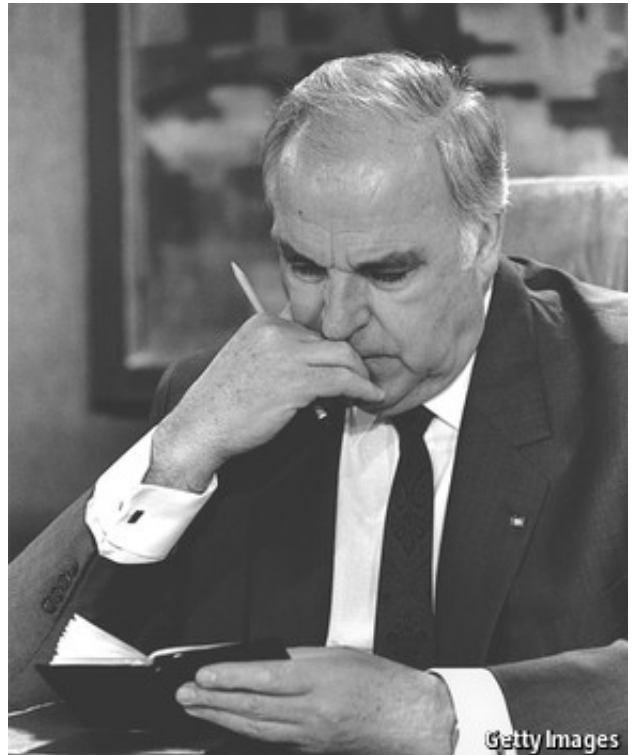
get help in exchange for specific reforms, say, to tackle youth unemployment. In recent weeks it has offered bilateral help. Germany's state development bank, for instance, may help finance Spanish firms. But Mrs Merkel has no truck with Keynesian deficit spending, and her government stands firm against Eurobonds or any other explicit mutualisation of debts. Though officially committed to a banking union, it is sceptical of elements, such as common deposit insurance, that imply mutual guarantees.

This vision of Europe is quite different from the emotional European fealty that dominated much of post-war German politics, reaching its zenith with the introduction of the euro itself. The chief aim of Helmut Kohl, the chancellor who presided over German unification and the creation of the single currency, had been to draw a line under Europe's fractured history politically, with economics playing a much lesser role.

Mrs Merkel works hard on her European politics: no other EU leader spends as much time cultivating relations with colleagues across the continent. But her approach is practical rather than emotional. For instance, she wants Poland to join the euro because it is a successful, competitive economy and a useful counterweight to statist France. Her attitude is not as utilitarian as Britain's, where the argument for European integration boils down to weighing up economic costs and benefits. But like David Cameron, Britain's prime minister, Mrs Merkel is concerned mainly with winning in the global economic race, which is one reason why Germany wants to keep Britain in the EU.

Mrs Merkel's pragmatic approach is often attributed to her background. As post-war Germany's first chancellor hailing from the east, she is said to lack the attachment to the EU felt by west Germans. There may be something to that. But an upset in September's elections will not send Germany on a radically different European course, for the broad strokes of her economic analysis are widely shared. And in truth few German politicians (except those in the European Parliament) put a high priority on a push for European federalism.

Officially, all German parties, including Mrs Merkel's CDU/CSU, are still committed to greater political union. The finance minister, Wolfgang Schäuble, is a long-standing advocate of a federal



Europe. The parties' election manifestos all include federalist pledges, but they seem increasingly formulaic.

Do as we do

With the exception of the Alternative für Deutschland, the new fringe party, all the parties agree that the euro must be preserved, but that Germany's liabilities within the club must be limited and uncompetitive economies need to be cajoled towards reform. If there are differences between the Merkel government and other mainstream politicians, they are about the pace of moving towards a banking union and the balance between "adjustment" in southern Europe and "solidarity" from Germany and other creditors. The SPD and the Greens might be less hesitant than Mrs Merkel to create a common resolution scheme for European banks. Peer Steinbrück, the SPD's candidate for chancellor, frets about the "dangerous spiral of austerity" and says Germany needs to spend more money on Europe, though he does not say how much or how.

The chief aim of Helmut Kohl had been to draw a line under Europe's fractured history

If the crisis intensifies, the SPD might be more willing to consider a "debt redemption fund". First proposed in 2011 by the German Council of Economic Advisers, such a fund would reduce borrowing costs in southern Europe by replacing all euro-zone government debts above 60% of GDP with new bonds carrying a joint guarantee, along with strict rules to ensure this excess debt would be paid off over the next two decades. Mrs Merkel's government immediately shot down the idea, arguing that it was too similar to Eurobonds and would create unlimited German liabilities. The SPD and Greens sounded more positive, and the SPD says in its election manifesto that such a fund should be considered. But with financial markets now calmer, thanks to the European Central Bank, no one talks about it much.

Whoever wins the election will face the same constraints: the German public is firmly opposed to large cash transfers to southern Europe. Germany is hemmed in by its own rules. In particular, because of the constitutional debt brake more money spent on rescue funds necessarily means higher taxes or less spending at home. Perhaps most important, the Constitutional Court is strongly opposed to anything that might oblige German taxpayers to assume unlimited liability for other countries' debts. The red-robed judges in Karlsruhe have become assertive protectors of German sovereignty.

All mainstream German politicians share Mrs Merkel's broad strategy because they interpret recent German history in much the same way that she does. As they see it, the key to economic success is export prowess, achieved by keeping budgets tight and wages competitive. In short, the rest of

Europe needs to become more like Germany. Some politicians have said this in so many words. Volker Kauder, a prominent CDU politician, caused a fuss when he said that “Europe now speaks German.” Others are more subtle, pointing to the virtues of Germany’s fiscal probity, praising the country’s tough labour-market reforms and lamenting southern Europe’s lack of manufacturing clout.

A plan that does not add up

To Mrs Merkel and much of Germany’s elite, making Europe more prosperous by promoting competitiveness is strategy enough. But putting all the onus on Europe’s debtors does not make sense. The more that wages and prices in southern Europe are squeezed, the less people and businesses there will be able to pay back their debts, including those owed to Germany. The euro zone will recover faster and more easily if Germany spends more at home. Otherwise it will have to provide correspondingly more financial help to keep the euro together.

Many German economists acknowledge these trade-offs, but Germany’s euro policy is driven by lawyers and rules, not economists. German politicians tend not to think broadly about Germany’s role in the euro in relation to other countries, but only about its own successful policies, which they insist others must adopt. That is quite different from formulating a strategy which can work for the region as a whole. Paradoxically, the country that abhors nationalism is oddly national in its focus.

But Germany’s recipe for economic success falls short even in its own terms because it is based on a selective analysis of the country’s recent history. Germany has indeed become much more competitive over the past decade, but not solely because of tough reforms and tight budgets, as the [next section](http://www.economist.com/news/special-report/21579145-ingredients-german-economic-success-are-more-complex-they-seem-dissecting) (http://www.economist.com/news/special-report/21579145-ingredients-german-economic-success-are-more-complex-they-seem-dissecting) will show.

From the print edition: Special report



Explore our [interactive guide](http://www.economist.com/euroguide12) (http://www.economist.com/euroguide12) to Europe's troubled economies