



**German foreign policy and leadership of
the EU – ‘You can’t always get what you
want ... but you sometimes get what you
need’**

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Abstract

Germany is still in many ways a reluctant leader, even if its economic strength and its increasingly distinctive sets of political interests dictate that, in many areas at least, lead it must. Furthermore, it is not just in Germany's interests to do so, other states in the EU now expect Germany to act decisively not just in times of crisis but also in setting future agendas. Whilst it is self-evidently no longer the case that France and Germany can independently set the pace and tone of European integration, and more voices and interests vie to be heard, it is still to Germany that many states instinctively look when trying to solve many of their EU-related problems.

The reflexive pro-Europeanism of pre-unification Germany has however given way to a more selective and ambiguous approach to European integration. At a time when German leadership in the EU is arguably more in demand than ever, in particular in the current Euro crisis, the willingness and ability of German governments to provide such leadership can subsequently no longer be taken for granted.

The first part of this working paper begins by sketching out the major changes in German European policy, putting them into the broader context of whether German foreign policy in general has 'normalised'. It then analyses the main drivers of these changes: first, a shift in the international and European-level opportunity structures of German policy towards European integration; and second, a tightening of the political constraints and a reappraisal of the standards of appropriateness in the making of German European policy at the domestic level. It then moves on to analysing Germany's recent behaviour in dealing with the Eurozone crisis before concluding with some speculations on the implications that all of the above have for Germany's European Policy in the future.

The second part of the working paper investigates the economic background to German leadership of the EU. In particular, it argues that Germany's swift recovery from the global financial crisis has once more demonstrated that the country is the major economic power in Europe. Given its economic strength, leadership in rescuing the Eurozone has been forced upon a reluctant Germany.

German foreign policy and leadership of the EU – ‘You can’t always get what you want ... but you sometimes get what you need’

Alan Mayhew, Kai Oppermann* and Dan Hough

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Introduction

Mick Jagger and the Rolling Stones may not exactly have been thinking of the future of a post-Credit Crunch European Union when writing their 1969 classic, but the title – and, indeed, the much overlooked second line – seem strangely apt when considering the role of Germany in today’s much changed EU. Germany is still in many ways a reluctant leader, even if its economic strength and its increasingly distinctive sets of political interests dictate that, in many areas at least, lead it must. Furthermore, it is not just in Germany’s interests to do so, other states in the EU now expect Germany to act decisively not just in times of crisis but also in setting future agendas. Whilst it is self-evidently no longer the case that France and Germany can independently set the pace and tone of European integration, and more voices and interests vie to be heard, it is still to Germany that many states instinctively look when trying to solve many of their EU-related problems.

Understanding Germany’s changing role in the EU is not, however, simply about analysing the behaviour of national governments when interacting with each other or indeed with actors within the EU’s institutions. This is in many ways the classic two-level game.¹ Domestic pressures are fundamental in shaping the EU policies of national governments, and balancing these often conflicting sets of interests has been a major challenge for Angela Merkel’s centre-right government since 2009. German European policy has been severely tested by the ongoing Eurozone crisis. Chancellor Merkel’s reluctance to bail out highly indebted Eurozone countries, coupled with demands from Berlin to impose severe fiscal constraints in these debtor states, has called into question not just Germany’s commitment to the single currency, but also the classically integrationist norms and values that (have) underpin(ned) Germany’s EU policy. Instead of being viewed as a leading pro-integrationist state, Angela Merkel’s stance on the EU and to the EU’s flagship policy – Economic and Monetary Union – has signalled that German European policy does indeed appear to be on the move.

These question marks about Germany’s European policy have not, of course, just arisen on Chancellor Merkel’s watch. They date back at least to the Maastricht era and the later years of the Kohl government. The reflexive pro-Europeanism of pre-unification Germany has given way to a more selective and ambiguous approach to European integration. At a time when German leadership in the EU is arguably more

¹ Putnam, Robert D. (1988), ‘Diplomacy and Domestic Politics: The Logic of Two-Level Games’, *International Organization*, 42 (3): 427-461.

in demand than ever, in particular in the current Euro crisis, the willingness and ability of German governments to provide such leadership can subsequently no longer be taken for granted.

The first part of this working paper begins by sketching out the major changes in German European policy, putting them into the broader context of whether German foreign policy in general has ‘normalised’. It then analyses the main drivers of these changes: first, a shift in the international and European-level opportunity structures of German policy towards European integration; and second, a tightening of the political constraints and a reappraisal of the standards of appropriateness in the making of German European policy at the domestic level. It then moves on to analysing Germany’s recent behaviour in dealing with the Eurozone crisis before concluding with some speculations on the implications that all of the above have for Germany’s European Policy in the future.

The ‘normalisation’ of German European policy

Any discussion about Germany’s ‘new’ European policy inevitably links in with broader debates about continuity and change in German foreign policy more generally. This debate has certainly been the most prominent framework for thinking about the foreign policy of post-unification Germany, with the key issue being whether the development of the ‘Berlin Republic’ represents a process of continuity or one characterised more by change in Germany’s foreign policy behaviour. Whereas earlier contributions to the debate have clearly put a premium on patterns of continuity, more recent analyses have tended to emphasise elements of change.²

Siding with the latter, we adopt a holistic perspective on German foreign policy.³ Such a perspective does not really conceive of continuity *or* change as alternative descriptions of Germany’s post-unification foreign policies, but would expect these policies to be characterised by the simultaneous interplay between continuity *and* change. At the same time, a holistic perspective acknowledges that this interplay may have given rise to a qualitatively different ‘whole’ of German foreign policy. In other words, a number of changes in fundamental parameters of German foreign policy constitute a ‘new’ German foreign policy, even if many specific policies and orientations of German governments at the international level remain the same.

The main value of taking a holistic perspective is that it brings to the fore the fundamentally different nature of Germany’s post-unification foreign policy. Traditionally, this change has been analysed as a process of ‘normalisation’ in German foreign policy.⁴ Apart from the use of military force and Germany’s

² In terms of continuity, see for example Hanns W. Maull (2006), ‘Conclusion: Uncertain Power – German Foreign Policy into the Twenty-First Century’, in Hanns W. Maull (ed.): *Germany’s Uncertain Power. Foreign Policy of the Berlin Republic* (Basingstoke: Palgrave), pp. 273-286. For an analysis of perceived changes see, for example, Ulrich Roos (2010), *Deutsche Außenpolitik: Eine Rekonstruktion der grundlegenden Handlungsregeln* (Wiesbaden: VS Verlag).

³ See Gunther Hellmann (2011), ‘Das neue Selbstbewusstsein deutscher Außenpolitik und die veränderten Standards der Angemessenheit’, in Thomas Jäger, Alexander Höse and Kai Oppermann (eds.): *Deutsche Außenpolitik* (Wiesbaden: VS Verlag), pp. 735-757.

⁴ Hanns W. Maull (2004), “‘Normalisierung’ oder Auszehrung? Deutsche Außenpolitik im Wandel”, *Aus Politik und Zeitgeschichte*, 11: 17-23; Marco Overhaus (2004), ‘In Search of a Post-Hegemonic

participation in multilateral military missions, European policy makes for the best example of this process of normalisation.⁵

Although the concept of normalisation is certainly contested, it is generally understood to mean that in the international arena post-unification Germany has begun to act more like a 'normal' middle-sized power. Germany's foreign policy has become less constrained by the country's past, more conscious of its status and power and more willing to use this power in the name of defending German national interests.⁶ At the same time, this 'normalised' German foreign policy is at the receiving end of increasing demands from the international community to shoulder more responsibilities in shaping the international order, most notably with regard to peace-keeping and peace-enforcement. Taken in the round, German foreign policy has become less idiosyncratic, more assertive and much higher profile. It follows that those theoretical frameworks which start out from pre-unification Germany's peculiar and precarious standing at the international level (most notably notions of Germany being a 'civilian power') have lost much of their original appeal.⁷

In terms of Germany's policies on European integration, the normalisation of German foreign policy translates into what has been described as the shrinking of Germany's European vocation.⁸ Germany's reflexive or instinctive support for European integration has been replaced by a more instrumental, hard-headed and (openly) interest-based approach to the EU. In other words, Germany no longer pursues European integration as an end in itself but rather as a means to an end which is defined in terms of the German national interest. What is more, this national interest can no longer be expected to be – almost by default – in line with pro-integrationist objectives.

Along these lines, German support for European integration and German leadership in the EU has become more selective and contingent. In particular, German governments, in their pursuit of the German national interest, have become less inclined to shy away from open conflict with their partners in the EU and more willing to exploit the asymmetric power relations between EU member states.

This has already been felt in a number of different ways. Notably, German European policy has proven to be assertive in demanding stronger German influence within EU decision-making structures, for example with respect to the number of German MEPs or, more importantly, the decision-making rules in the Council. Germany has

Order: Germany, NATO and the European Security and Defence Policy', *German Politics*, 13 (4): 551-568.

⁵ See Martin Wagener (2006), 'Normalization in Security Policy? Deployments of Bundeswehr Forces Abroad in the Era Schröder, 1998-2004', in Hanns W. Maull (ed.), *Germany's Uncertain Power. Foreign Policy of the Berlin Republic* (Basingstoke: Palgrave), pp. 79-92.

⁶ This was very specifically articulated by Gerhard Schröder in 2002 when he developed the notion (not uncontroversially) of a 'German Way' in foreign policy. See Gunther Hellmann (2004), 'Von Gipfelstürmern und Gratwanderern: "Deutsche Wege" in der Außenpolitik', *Aus Politik und Zeitgeschichte*, 11: 32-39.

⁷ See Sebastian Harnisch and Hanns W. Maull (eds.) (2001), *Germany as a Civilian Power? The Foreign Policy of the Berlin Republic* (Manchester: Manchester University Press).

⁸ William E. Paterson (2010), 'Does Germany Still Have a European Vocation?', *German Politics*, 19 (1): 41-52.

also departed from its traditional role as mediator between large and small EU member states and has become altogether less reluctant to pass over the interests and concerns of these states.⁹ Correspondingly, ideas of a ‘hard core’ Europe and a directorate of large member states have again gained currency among German policy-makers, not the least with regard to the governance of the Eurozone or the European Security and Defence Policy (ESDP). What is more, German European policy has also gradually become more intergovernmental and more sceptical of supranational designs. Intergovernmental arenas and procedures have traditionally been the weapons of the strong in the EU and provide the best chances for German governments to make their views count. German support for the strengthening of the European Council in the Lisbon Treaty is one recent case in point. As the example of the Eurozone crisis shows, German governments are apt at using the intergovernmental set-up of the European Council to reinvigorate German leadership in areas of important national interests.

Thus, Germany’s European policy has become ‘normal’ in the sense that it should no longer be expected to be different in kind from the European policies of the other two middle-sized powers in the EU, France and the UK. Indeed, Germany’s new European policy can already be seen to be closer to the characteristic traits of French and British approaches to European integration than in the pre-Maastricht era. While the first high-profile empirical manifestations of Germany’s new approach to European integration – for example in the negotiations on the Amsterdam Treaty in the mid-1990s (under Kohl) or later on in the negotiations on the Nice Treaty (under Schröder) – caused consternation among its European partners, the changes in German European policy are now largely taken for granted – although certainly not universally liked. This again speaks to the extent to which the normalisation of German European policy has already taken place. The next sections will attend to the international and European as well as the domestic drivers of these changes.

International and European drivers of change

The new German approach to European integration reflects changes in the opportunity structures of German governments at the international and European levels. Three changes, in particular, are most pertinent.

Firstly, the EU is no longer the only game in town in terms of German foreign policy. Whereas pre-unification Germany was entirely dependent on European integration as the sole arena in which it could realistically hope to exert legitimate influence on the international stage without antagonising its Western allies, these constraints no longer apply for post-unification Germany. Rather, German governments increasingly look beyond the EU for other arenas to assert their interests. Specifically, we have witnessed both a global and a bilateral turn in German foreign policy. On the one hand, German foreign policy has displayed an increasing activism in global forums like the UN or the G20. One of the best examples for the ambitions of German governments to enhance Germany’s diplomatic clout on the global stage is the ongoing campaign for a permanent seat in the UN Security Council, launched under the late Kohl government and then

⁹ Gisela Müller-Brandeck-Bocquet (2011), ‘Deutschlands bilaterale Beziehungen im Rahmen der EU’, in: Thomas Jäger, Alexander Höse and Kai Oppermann (eds.), *Deutsche Außenpolitik* (Wiesbaden: VS Verlag), pp. 605-629.

pursued with more vigour under the Schröder and Merkel administrations¹⁰ – but seriously damaged for the time being by the decision of the Merkel government to abstain from the UN Security Council vote on imposing a no-fly zone over Libya.¹¹ As another case in point, the Merkel governments have been very active in using the G20 as a high-profile forum to push their global agenda, for example in the field of climate change. Even NATO has become an arena in which German governments have increasingly been seen to push their own national priorities.¹² On the other hand, there has also been a nascent bilateral turn in German foreign policy. Whereas pre-unification German foreign policy was marked by a strong reflex to co-ordinate Germany's bilateral relations within the framework of European integration this reflex has become weaker. Thus, post-unification Germany has become more proactive in conducting independent bilateral relations to different countries and it has been more willing to do so irrespective of the interests of its EU partners. Probably the best example would be the Schröder and Merkel governments' policy towards Russia.¹³ More recently, another strong case in point would again be Germany's refusal to support its Western allies in enforcing a no-fly zone over Libya. While this decision may in part be put down to the – rather desperate – attempt of foreign minister Guido Westerwelle and his beleaguered Free Democrats to reap electoral dividends from playing to the traditional anti-militaristic sentiments of the German public, the government's broader framing of the decision is indicative both of the global and the bilateral turn in German foreign policy: according to what has already been dubbed the 'Westerwelle doctrine'¹⁴, the government's policy on Libya should be seen to show that Germany is prepared to pick and choose its international partners on a global scale depending on the specific issue at hand rather than always being tied to its traditional Western alliance.

Secondly, it has become more difficult for German governments to exert effective leadership within the EU. Most obviously, member state preferences are much more heterogeneous in the EU 27 than they used to be in the EU 15. Viable package deals grow ever more costly and complex. Decision-making power in the Council of Ministers is increasingly dispersed, and Germany's relative standing according to different 'power indices' of decision-making in the Council has become less commanding.¹⁵ As a case in point, the Franco-German tandem was seen as pivotal only for 25 per cent of viable coalitions in the Council already in the EU 25.¹⁶

¹⁰ See Gunther Hellmann and Ulrich Roos (2007), *Das deutsche Streben nach einem ständigen Sitz im UN-Sicherheitsrat. Analyse eines Irrwegs und Skizzen eines Auswegs* (Duisburg: INEF-Report, 92/2007).

¹¹ See Security Council Resolution 1973 (2011), adopted by the Security Council at its 6498th meeting, on 17 March 2011, www.un.org/Docs/sc/unscl_resolutions11.htm (accessed: 5 April 2011).

¹² See Markus Kaim and Pia Niedermeier (2011), 'Das Ende des "multilateralen Reflexes"?' *Deutsche NATO-Politik unter neuen nationalen und internationalen Rahmenbedingungen*, in Thomas Jäger, Alexander Höse and Kai Oppermann (eds.), *Deutsche Außenpolitik* (Wiesbaden: VS Verlag), pp. 105-125.

¹³ See Hans-Joachim Spanger (2011), 'Die deutsche Russlandpolitik', in Thomas Jäger, Alexander Höse and Kai Oppermann (eds.), *Deutsche Außenpolitik* (Wiesbaden: VS Verlag), pp. 648-672.

¹⁴ See Ralf Neukirch (2011): 'Germany's Dangerous New Foreign Policy Doctrine', Spiegel online, www.spiegel.de/international/germany/0,1518,753886,00.html (accessed: 6 April 2011).

¹⁵ For a comparison between different power indices see Antti Pajala and Mika Widgrèn (2004), 'A Priori versus Empirical Voting Power in the EU Council of Ministers', *European Union Politics*, 5 (1): 73-97.

¹⁶ See Simon Hix (2005), *The Political System of the European Union* (Basingstoke: Palgrave).

German governments therefore have a much harder time bringing together winning coalitions to change the status quo and sponsoring compromises which further their European policy agenda. After unification, German European policy has thus experienced a painful paradox. At the very time when Germany began to exercise stronger influence on the broader international level, it became relatively less influential within the EU. The EU decision-making process more than anything worked to constrain the enhanced power that Germany enjoyed in other international fora. German governments thus found it increasingly difficult to upload their preferences and the German institutional model to the European level – something that was very much at the heart of German European policy up until the Maastricht Treaty was signed and the single currency introduced.¹⁷ In consequence, the EU has become an increasingly less attractive arena for German foreign policy. Much of German post-unification European policy from the negotiations on the Treaty of Nice to the Treaty of Lisbon has precisely sought to reverse this development and to bring Germany's relative influence within the EU more in line with its power and status on the international level more generally.

Thirdly, and closely related to this, European integration has less on offer for Germany than it used to have. In particular, post-unification Germany no longer depends on European integration as a means to establish itself as a legitimate international player in its own right. Also, the areas of integration which benefit Germany most and which it was therefore strongest in pushing for – most notably the single market and eastward enlargement – have largely been completed. In other words, most of what Germany hoped to get out of European integration it has actually obtained. Of course, Germany still hugely benefits from the EU and it has thus every incentive to invest resources to defend what has been achieved, not the least regarding the Eurozone. However, there are no large-scale projects on the horizon which are likely to be so much in Germany's interest that it could be expected to take on a consistent leadership role. Germany has thus largely become a status quo power in the EU. It has a huge stake in upholding the *acquis* but it has little to gain from moves towards further integration.

In terms of the international and European-level opportunity structures of German European policy, in summary, German leadership has become more difficult, less rewarding and is no longer 'the only foreign policy game in town'. These drivers for change, in turn, are complemented by the domestic context of Germany's new European policy.

Domestic drivers of change

In terms of domestic politics in Germany, the big post-unification narrative is that the leeway of German governments to provide leadership in the EU has become ever more constrained. This development can be traced on a political, an institutional, an economic and a normative dimension.

As for the politics dimension, first, German public support for European integration has weakened considerably. Much as is the case in many other EU member states,

¹⁷ Kenneth Dyson and Klaus H. Goetz (eds.) (2003), *Germany, Europe and the Politics of Constraint* (Oxford: Oxford University Press).

the traditional “permissive consensus” in public opinion has given way to patterns of a “constraining dissensus”.¹⁸ Eurobarometer data show that the German public is no longer particularly pro-European. Indeed, today it is no more (and on some indicators even less) supportive of the EU than public opinion across other EU states.¹⁹ In addition, public support for the Euro has further suffered in the wake of the current crisis, and clear majorities in public opinion oppose the accession of Turkey to the EU.²⁰

Also, post-unification Germany has its fair share of party-based euroscepticism. Although, the German party system still ranks as a system of “limited contestation”²¹ over Europe, eurosceptic sentiments are now clearly evident, most notably by the Left Party and by the right-of-centre Christian Social Union, the Bavarian sister party of the ruling Christian Democrats. Maybe even more important than this, the two largest German parties – the Christian and Social Democrats – have from time to time given in to the temptation of openly playing to the gallery of public euroscepticism. While the Christian Democrats sought to exploit public misgivings about the prospect of Turkey joining the EU which was supported by the then Red-Green government, the Social Democrats at times tried to play on public anger at bailing out other Eurozone countries with the German taxpayer’s money.²² The two parties are thus sensitive to the changed public mood on European integration. In particular, they are likely to respond to any sign that parties on their right and left are successfully taking up eurosceptic positions.

What has so far limited the impact of party-based euroscepticism in Germany, however, is that European integration is still largely a low-salience issue.²³ At the same time, the Euro crisis – but also the scenario of an eventual conclusion of accession negotiations with Turkey – should serve as reminders that European integration has the potential from time to time to move to the top of the political agenda. It is precisely in such cases that public and party-based euroscepticism are likely to become most constraining for German governments.

On the institutional dimension, domestic constraints on German European policy have become more restrictive. And mainly in two respects. On the one hand, the

¹⁸ Liesbet Hooghe and Gary Marks (2009), ‘A Postfunctionalist Theory of European Integration: From Permissive Consensus to Constraining Dissensus’, *British Journal of Political Science*, 39 (1): 1-23.

¹⁹ See Standard Eurobarometer 73, Spring 2010.

²⁰ See Harald Schoen (2008), ‘Turkey’s Bid for EU Membership, Contrasting Views of Public Opinion, and Vote Choice. Evidence from the 2005 German Federal Election’, *Electoral Studies*, 27 (2): 344-355.

²¹ Paul Taggart and Aleks Szczerbiak (2008), ‘Conclusion: Opposing Europe? Three Patterns of Party Competition over Europe’, in Aleks Szczerbiak and Paul Taggart (eds.): *Opposing Europe? The Comparative Politics of Euroscepticism. Volume 1: Case Studies and Country Surveys* (Oxford: Oxford University Press), pp. 348-363.

²² See ‘Europawahlkampf: Union macht EU-Pläne der Türkei zum Thema’, in *Frankfurter Rundschau*, 8 January 2004, p. 6; Daniela Vates and Damir Fras (2010): ‘Mit hängenden Schultern: In Bundestag und Bundesrat wird das Hilfspaket zum Wahlkampf-Stoff’, in *Frankfurter Rundschau*, 8 May 2010, p. 5.

²³ Kai Oppermann and Henrike Viehrig (2008), ‘Issue Salience and the Domestic Legitimacy Demands of European Integration. The Cases of Britain and Germany’, in *European Integration online Papers*, 12 (2).

German Länder have steadily enhanced their influence over European policy, and the successive revisions of Article 23 of the German Basic Law have given them ever increasing powers in EU matters. Most notably, the ratification of European treaties in Germany requires a two-third majority of votes in the upper chamber of the German parliament (the Bundesrat) which is made up of the governments of Germany's 16 Länder. On the other hand, the overall thrust of the rulings of the German Constitutional Court in the post-Maastricht era has been to curtail the autonomous room for manoeuvre of German governments in European politics. Most recently, for example, the ruling of the Court on the Lisbon Treaty has made it clear that German governments can only agree to simplified treaty revisions if they are explicitly authorised to do so by the German Bundestag.²⁴ The Court has thus significantly weakened the ability of German governments to play a constructive leadership role under these treaty provisions.

Moving on to the economic dimension, post-unification German European policy has become more constrained by the politicisation of the monetary costs of European integration. Given the adverse economic consequences of German unification and the relatively poor performance of the German economy during much of the 1990s, German governments became increasingly reluctant to pay the monetary price of leadership in the EU. Cases in point are the debate about Germany's position as a net contributor to the EU budget and the campaign of the Schröder governments to reduce Germany's financial burden in the EU. This stands in stark contrast to the recurrent practice of the Kohl governments, most notably in Maastricht, to employ financial side-payments to other EU member states in order to facilitate grand bargains on the European level and to buy support for Germany's European policy objectives.²⁵ In post-unification Germany, however, the constraints on governments to employ this traditional tool of German leadership in the EU have successively become more restrictive. The current domestic debate about the financial costs of defending the Eurozone serves to underline the point.

As for the normative dimension, finally, Germany's new European policy is underpinned by a shift in the German elite and public discourse on international affairs in general and on European integration in particular. This shift is marked above all by changed standards of appropriateness, i.e. by changed standards of what is seen as acceptable for German European policy, of how that policy is framed and justified and of what can and cannot be said about it.²⁶

On this normative level we have witnessed a marked reinterpretation of Germany's multilateral engagements from a responsibilities-based to an interest-based discourse.²⁷ Closely related, there has been a shift away from the Kohl-era discourse

²⁴ Jörg-Uwe Hahn (2009), 'Die Mitwirkungsrechte von Bundestag und Bundesrat in EU-Angelegenheiten nach dem neuen Integrationsverantwortungsgesetz', *Europäische Zeitschrift für Wirtschaftsrecht*, 20 (21): 758-763.

²⁵ See Alister Miskimmon, William E. Paterson and James Sloan (2010), 'Germany at a Crossroads: The Gathering Crisis Sharpens', *Comparative European Politics*, 8 (4): 491-504.

²⁶ See Gunther Hellmann (2011), 'Das neue Selbstbewusstsein deutscher Außenpolitik und die veränderten Standards der Angemessenheit', in: Thomas Jäger, Alexander Höse and Kai Oppermann (eds.), *Deutsche Außenpolitik* (Wiesbaden: VS Verlag), pp. 735-757.

²⁷ See Rainer Baumann (2006): *Der Wandel des deutschen Multilateralismus. Eine diskursanalytische Untersuchung deutscher Außenpolitik* (Baden-Baden: Nomos Verlag).

on European integration as a project of peace to a more instrumental discourse on Germany as a 'normal' and self-conscious member of the EU which should stand up for its interests like everybody else. The domestic debates about Germany being underrepresented in European institutions, the country's net contributions to the EU budget, the costs of eastward enlargement and the costs of defending the Eurozone are all indicative of the shift in the standards of appropriateness in German discourse on Europe and work to further entrench this shift. These discursive changes have prepared the normative ground for Germany's new European policy and open up space for further changes in this direction.

Consequences for the Euro crisis

German leadership in the EU has therefore become more selective, reluctant, contingent and instrumental. The 'new' European policy of post-unification Germany can subsequently be accounted for by shifts a) in the international and European opportunity structures of German governments and b) in the domestic constraints on the making of German European policy.

From this perspective, the current crisis of the single currency has brought into sharp focus the potential contradictions between European and domestic demands on German European policy. In European terms, the crisis is clearly a case in which German leadership is absolutely essential for rescuing the Euro. The Merkel government has thus come under extreme pressure from other Eurozone countries to provide such leadership. Stabilising the single currency is also in the strongest national interest of Germany itself. In domestic terms, however, the constraints on the Merkel government to live up to the demands for German leadership were (and are) particularly restrictive. This is true, inter alia, with respect to a sceptical public, the party political contestation over the crisis, the legal challenges to the bailout of Eurozone members at the German Constitutional Court, the monetary costs of defending the Euro as well as a public discourse – prominently led by such newspapers as the *Bild-Zeitung* – in which the crisis was framed in terms of prudent German taxpayers having to pay the bill for the profligate Greek.

Against this background, the Merkel government's response to the crisis was always going to be a delicate balancing act. Although the German government appears to have decided to do everything it takes to rescue the Eurozone, its initial procrastination over the issue clearly reflected domestic constraints. Also, the German government's insistence on a change in the European treaties to allow for a permanent bailout fund and its support for an EU competitiveness pact are not least for domestic political consumption and have to be seen as part of the government's attempt at balancing its constraints on the two levels. Germany's responses to the Euro crisis – and to broader issues of economic policy-making in the EU – are of course shaped by Germany's own economic situation. And it is to this that we subsequently turn to in more detail next.

The economic background to German leadership in the EU

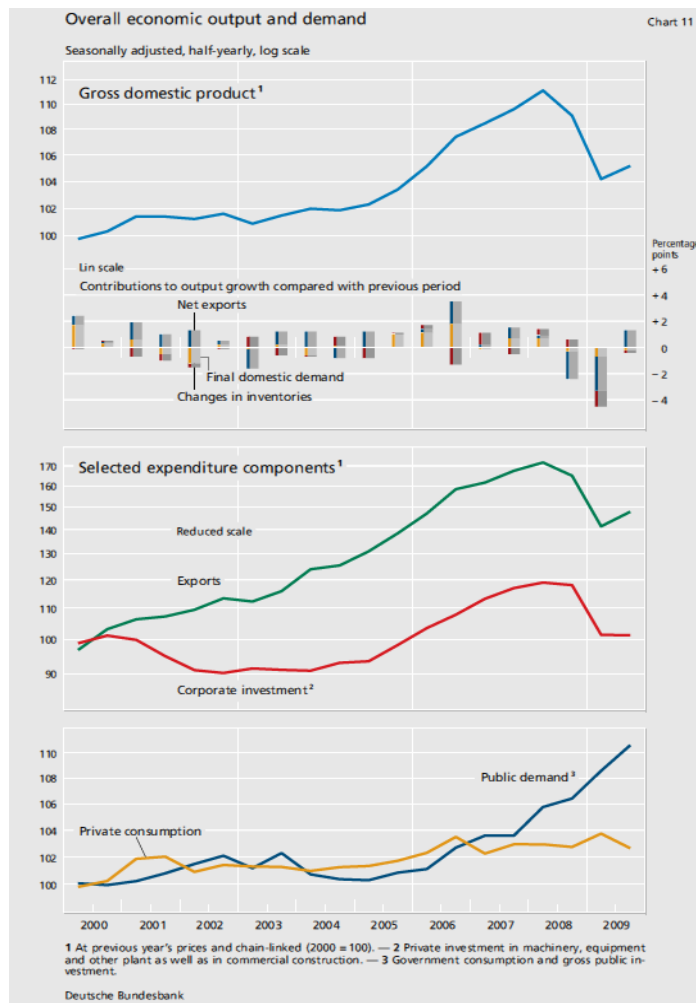
Post-1945 the strength and vitality of the German economy has been the cornerstone on which European growth and prosperity have been built. Successive German leaders were able (and willing) to effectively bankroll the European Union, underwriting many of the financial commitments from which others benefited so

greatly. Post-unification, and particularly over the last decade, this has inevitably changed somewhat. In 2009 the German economy declined at a faster rate than at any time since the Second World War. Real GDP sank by 4.7 per cent. Exports and investment collapsed as the global recession followed the 2008 global financial crisis. This deep recession followed a decade of lower growth in Germany. The post-unification boom had passed by 1995 and from 1995 to 2005 the average rate of real economic growth in Germany was less than 2 per cent annually (1.96 per cent). This poor growth performance was a result of stagnant private consumption and steadily declining investment as a share of GDP (see figure 1). Unemployment rose in the first years of the new century to peak at over 10 per cent of the workforce in 2005. The German model of economic management was not necessarily in trouble, but it was clearly no longer as buoyant as it had been before.

Although it may seem to be but a distant memory now, the mediocre performance of the German economy in the years prior to 2007 contrasted with the stellar performance of other countries in the EU's Monetary Union, notably Ireland, Spain and Greece. Even the performance of the United Kingdom outshone that of Germany. Its rather poor performance in the years prior to the 2008 financial crisis led to a weakening of German leadership in the economic debate in the European Union. This was reinforced when the German and French governments supported a weakening of the Stability and Growth Pact (SGP) in 2005. In fact, public deficit and public debt levels had exceeded those permitted under the Maastricht Treaty in both countries, giving just one clear indication that Germany's position as *Musterknabe* (model pupil) in the European arena was now more dubious.

However, both the German state and German companies reacted reasonably quickly to the challenges posed by rising unemployment and the need to maintain Germany's competitive position. Labour market policy, aimed at liberalising the German labour market, and the strategic management of German companies to bear down on costs, gradually created some of the conditions for stronger economic growth in the future. Indeed, the government fundamentally changed its labour market policies in order to increase their flexibility. The reforms, generally referred to as the *Hartz* reforms, considerably tightened rules on unemployment benefits and 'encouraged' the unemployed to reintegrate in to the labour market by reducing the generous state benefits. Most research suggests that these policies were effective in bringing more people back into the labour market and reducing unemployment, which fell back sharply from its 2005 peak (see figure 2).

Figure 1: GDP and components of GDP 2000-2009
(Source: Deutsche Bundesbank)



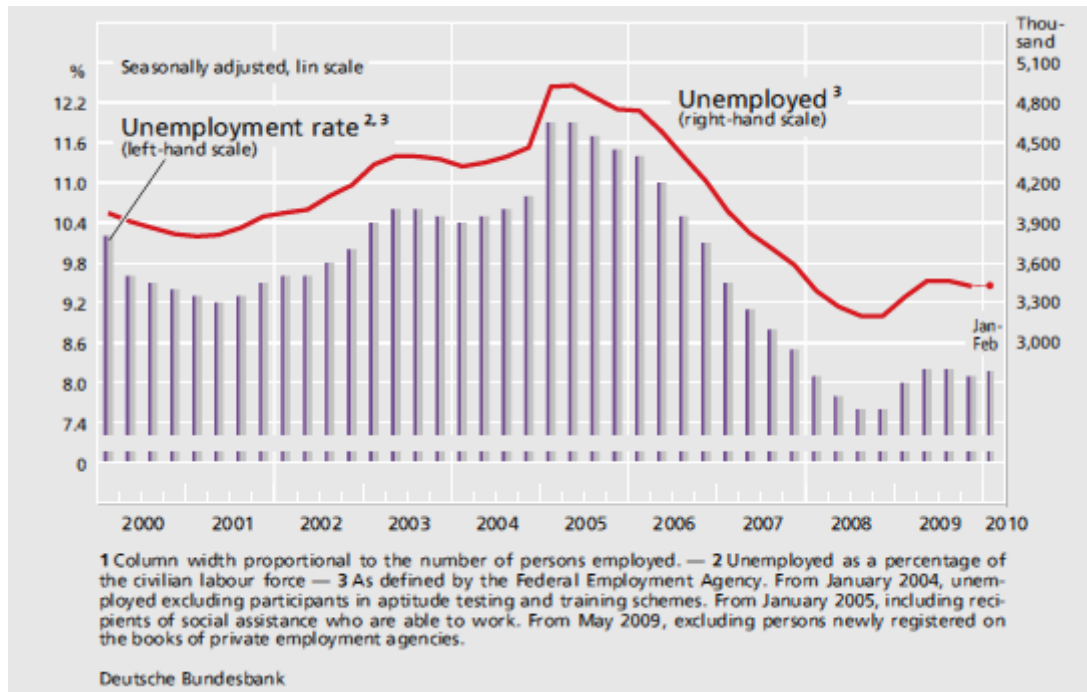
German companies, many of which are very dependent on maintaining export markets, managed to keep unit labour costs roughly constant in nominal terms over a long period from the middle of the 1990s up until 2007. While total unit labour costs fell slightly from 1999 to 2007, unit labour costs in manufacturing fell sharply. They declined by 13 per cent between 2003 and 2007. At the same time German companies, and especially manufacturing ones, outsourced a significant amount of low value processes to countries in Central and Eastern Europe and indeed further afield, thus helping to reduce costs. This not only affected larger companies in Germany, but the proximity to Poland, the Czech Republic, Slovakia and Hungary allowed many small and medium-sized enterprises to move some work abroad.

The decline in the wage share mirrors of course a substantial rise in profits. It is interesting, however, that increased profits did not induce higher overall domestic investment, which as a share of GDP has been falling consistently and has declined from around 25 per cent in 1992 to just 18 per cent in 2009. However, German business investment abroad rose substantially over the first decade of this century.

Whereas national net international investment was of the order of 3 per cent of GDP in 2000 it had risen to 25 per cent by 2008.²⁸ Domestic business investment was also on a slightly rising trend from 2005 until the slump caused by the recession in 2009 (see figure 1). The household savings rate (household savings as a percentage of disposable income) fell from a peak of around 14 per cent in 1992 to just over 9 per cent in 2000 but then rose again steadily to reach almost 12 per cent in 2008 before falling back somewhat during the recession (see figure 3).

Figure 2. Unemployment in Germany

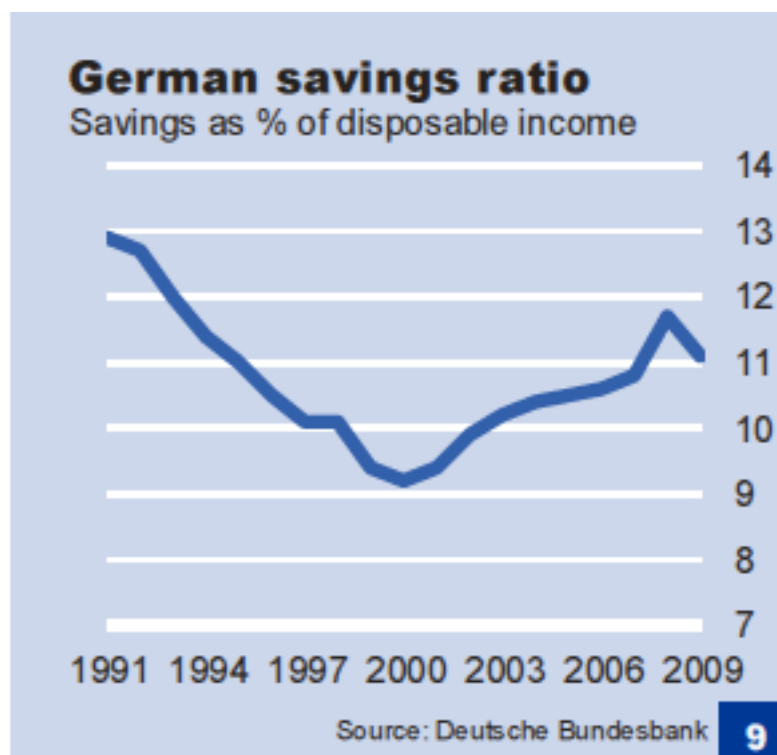
(Source: Deutsche Bundesbank)



The combination of a declining wage share, a rising savings rate, stagnant private consumption and investment with an undervalued exchange rate (the Euro) and strong economic growth in the developing world as well as in much of the rest of Europe meant that German exports soared in the years up to the beginning of the financial crisis (see figure 1). From 2002 Germany had large and growing balance of trade and current account surpluses. The current account surplus reached €185 billion in 2007 or around 7 per cent of GDP.

²⁸ OECD, Economic Survey Germany 2010, Paris. Many companies also used rising profits to pay off debts incurred in the decade before 2000.

Figure 3
The German Savings Ratio
(Source: Deutsche Bundesbank, quoted by Deutsche Bank Research)



By the beginning of the financial crisis, the competitiveness of German companies had improved very considerably compared to their situation in 2000.

The global financial crisis and Germany's swift recovery

The impact of the global financial crisis was particularly serious in the United States and Europe. The German economy plunged in 2009 in GDP terms by roughly the same percentage as the United Kingdom (-4.7 per cent and -4.9 per cent respectively) as its export markets in Europe and the United States contracted rapidly.

Exports and investment both declined sharply, while private consumption remained flat, reflecting the labour market developments and the policy of the German government to provide wage subsidies. The German banking system, as one might expect in a country which is a major exporter of capital, was severely affected. The *Landesbanken* (state banks) and a number of real estate banks (such as Hypo Real Estate, which needed around €100 billion of state support) had invested in extremely risky assets which had to be written down or written off. It was thought that allowing these financial institutions to fail would have been even more costly than the very considerable amount of government assistance which they have received. The total cost of financial assistance to the banks, including bank restructuring, was probably around 25 per cent of German GDP in 2009. The banking sector remains one of the primary risks to the economy partly because of the relatively poor lending portfolio and partly because of its very low capital to asset ratio.

Nevertheless the deep recession persisted for only two quarters – Q4-2008 and Q1-2009. This was followed by a very strong recovery with real GDP growing 3.6 per cent in 2010 and further growth of around 2.5 per cent expected in 2011.

The reasons behind the very rapid recovery from recession include the following:

- The recovery in several key export markets such as China, but also in the European Union
- the competitiveness in terms of products, price and quality of many of Germany's major exporting companies
- the German government's fiscal packages to stimulate the economy
- the German government's use of wage subsidies to keep workers employed even when demand for an enterprise's output temporarily fell away – *Kurzarbeit*
- the undervaluation of the German currency – the Euro
- the inventory cycle.

Germany's stimulatory fiscal package in the period 2009-2010 amounted to approximately 2.5 per cent of 2008 GDP. The aim of these measures taken at the end of 2008 (*Konjunkturpaket I*) and in early 2009 (*Konjunkturpaket II*) was to stimulate demand in the economy and to maintain levels of employment. They consisted of a major investment programme to improve transport infrastructure but also educational infrastructure, specific measures to support small and medium-size companies, measures to reduce the tax burden on families and low income workers as well as very specific measures to support the car industry. Perhaps most important for recovery were however the measures to provide wage subsidies to maintain levels of employment – the *Kurzarbeiterregelung*.

The short time working rules, through which the government pays a proportion of the wages of a worker who might otherwise be made redundant, were adjusted in the recession so that wage subsidies could be paid for a longer period than the normal six months. As a result unemployment barely rose during the recession and, with recovery, companies immediately had adequate labour to cope with increased demand (see figure 4). After peaking at around 1.5 million in 2009, the number of short time workers has fallen back to around 200,000 today.

The competitive position of German businesses which was achieved as a result of flat or falling unit labour costs and a considerable amount of outsourcing was of course also underpinned by the relative weakness of the Euro in relation to the underlying strength of the German recovery.

Figure 4
Short-time working
 (Source: Bundesarbeitsamt, quoted in Deutsche Bank Research)



Figure 5
Real effective exchange rates within the Eurozone (base 1999)
 (Source: Centre for European Reform, London)

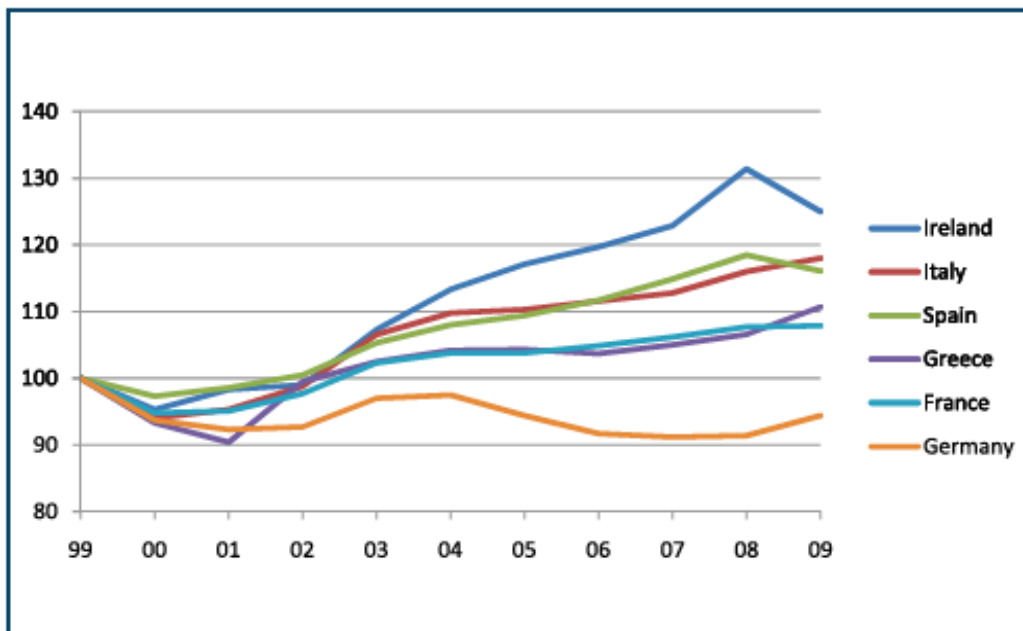


Figure 5 shows real effective exchange rates within the Eurozone for the period 1999 to 2009. Thanks to increasing productivity and low wage settlements Germany's effective exchange rate was lower in 2009 than in 1999. If Germany had

not been in the Eurozone, its currency would have risen strongly against other currencies making its enterprises less competitive on world markets.

Germany and Euro crisis: having leadership forced upon it

This very strong recovery, at a time when much of the rest of the European Union is suffering lower growth, higher unemployment and fiscal retrenchment, has once more demonstrated that Germany is the major economic power of the European Union. Yet, as was illustrated in the first half of this paper, this coincides with a certain German turning away from the whole idea of deeper European integration.

At the same time that Germany has recovered so strongly, German politicians and German citizens have become somewhat more sceptical of the advantages to Germany of deeper European integration. As was illustrated above, deeper European integration, which was one of the key policy planks of all German governments since the Second World War, began to be given a lower priority after 2000, and indeed perhaps after reunification.

In parallel to this development, Germany has become much less prepared to finance further European integration, especially if it means supporting weaker member states financially, when these member states run excessive fiscal deficits or allow the competitiveness of their enterprises to be damaged by excessive wage pressure or financial bubbles in capital markets (often in real estate markets).

To a certain extent Germany now sees itself as a world player in economic terms rather than a medium-sized country, which depends on its membership of the European Union for its influence in the world. This feeling has been underpinned in the economic recovery, in which exports to Asia boomed at a time when exports to the rest of the European Union were only slowly recovering. Whereas in 2007 the rest of the EU accounted for 65 per cent of German exports, in the first 10 months of 2010 this figure had dropped to 60 per cent. However German exports to Asia which were only 11.6 per cent of total exports in 2007 had risen to 15.4 per cent in the first 10 months of 2010. In addition to these changes in trade flows, German foreign direct investment in countries like China were beginning to become far more important for the profitability of German companies.

The generally agreed analysis of the Euro crisis demonstrates that Eurozone member states often acted according to their short-term national and political interests rather than in the interest of stability in the Eurozone. Four main problems can be identified:

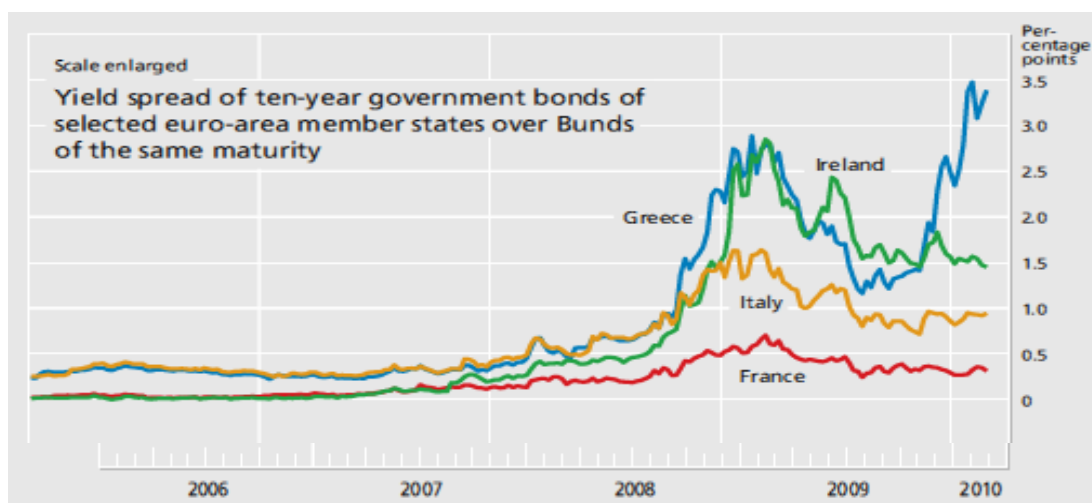
- The falsification of data supplied to the Eurozone authorities and Eurostat (Greece);
- imprudent fiscal policy leading to high deficits and rising debt burdens (Greece, Portugal);
- financial bubbles in the real estate market leading to the state having to support the banks and therefore causing deficits and debt problems even if the government had been running a sensible fiscal policy prior to the global financial crisis (Ireland and Spain);

- competitiveness problems, sometimes but not always resulting from the above-mentioned financial bubbles (Ireland, Spain, Greece).

The introduction of the Euro led to a convergence of bond yields of the Eurozone member states to that of Germany as is clear in figure 6. However these member states were running different fiscal policies and experiencing strong divergences in unit labour costs. It must be assumed therefore that investors did not believe in the ‘no bailout rule’ of the Stability and Growth Pact (article 125 TFEU). With the onset of the global financial crisis, sovereign bond yields began to diverge in a similar pattern to the divergences in bond yields before the introduction of the Euro. In the case of Greece 10 year bond yields have exceeded 14 per cent, and in Ireland they have reached 10 per cent. These developments have made the refinancing of sovereign debt impossible on international capital markets and forced the Eurozone and the European Central Bank to act to provide support both for the indebted sovereigns and European banks.

Figure 6 : Yield spreads in the Eurozone

(Source: Deutsche Bundesbank)



The German view of the crisis however remains essentially that if all the other Eurozone member states had run prudent policies like Germany, there would be no Eurozone crisis. Therefore far from Germany providing financial assistance to the weaker peripheral Eurozone countries, it believes that these countries must regain their competitive edge and reduce their sovereign and private debts by extreme fiscal retrenchment and through a reduction in domestic wages and salaries. In the case of default, bond holders not taxpayers should suffer.

However to a certain extent it has been the performance of Germany in terms of competitiveness which has led to other EU member states being unable to compete in the internal market, where most of the trade of member states takes place. The weakness of domestic demand, especially private consumption and investment, has meant that there was little scope for other EU countries to increase their sales to Germany. Germany's strong performance in terms of the competitiveness of

German enterprises also squeezed other EU states out of European and overseas markets.

The German government faces several domestic constraints on its policy towards solving the Eurocrisis.

- Any solution which might lead to financial transfers from Germany to other Eurozone countries or guarantees to those countries would be extremely unpopular amongst the voters in Germany.
- The Free Democrat (FDP) coalition partner for the Christian Democrats, with very poor results in opinion polls, has seized on this issue in order to try to regain popularity with the voters.
- German public debt and the deficit are well above the criteria laid down in the Maastricht conditions for EMU and the government has promised to bring the levels down to meet the terms of the Stability Pact. In addition a constitutional brake – the *Schuldenbremse* – has been put on public deficits at both the federal and Land levels. This means that fiscal policy is expected to be particularly tight in the coming years.
- In the light of previous decisions on Germany's relationship with the European Union and of the newly established *Schuldenbremse*, the German Constitutional Court might intervene in any government decision regarding the solution to the Euro crisis.

These elements together with the basic belief that the problems of the Eurozone are linked to irresponsible behaviour by governments in certain member states suggest that the German government will remain hard. However the German position has several weaknesses, two of which weigh heavily on actual German policy:

1. Without help, the weakest Eurozone countries may well have to restructure their debts, default or even to consider leaving the Eurozone, which could lead to a breakup of the common currency which, as Frau Merkel has said, would put in danger the whole European project.

While it is true that Germany has become more Eurosceptic, especially as a result of the Euro crisis, responsible politicians still realise that it's position in the world is based heavily on its membership and leadership of the European Union.

2. Should Eurozone countries be forced to default, this would put at risk the German banking system which has very significant exposure to the weakest Eurozone economies - Greece, Ireland, Spain and Portugal.

According to the statistics of the Bank for International Settlements, German bank exposure to these four countries amounts to \$435 billion! This far exceeds the \$331 billion owed to French banks or the \$341 billion exposure of UK banks.

With these sometimes contradictory pressures, the German government has procrastinated on the reform of the Eurozone and these delays have unnerved

markets and made the situation even more difficult. The bond markets expect the German government to show leadership in solving the problems of the Eurozone and without strong German leadership nervousness in the markets will remain.

Germany is therefore being forced into leadership even though it is reluctant to get into this position. It had hoped that the facilities offered to Greece and the establishment of the EFSM and EFSF together with the imposition of very tight fiscal policy in the most affected Eurozone states would reassure the markets and gradually lead to a stabilisation within the Eurozone.

As these hopes were gradually dashed, Germany was forced to take a more proactive role on reform. The proposals of the Task Force established by the European Council were very clearly influenced by German policy. However the decisions on the tightening up of the Stability and Growth Pact and the linking of the SPG to indicators of competitiveness and the perspective of the creation of a permanent European Stability Mechanism has still not convinced the markets that the most endangered Eurozone states will not default.

The German government has decided to take over the reins of leadership in the Eurozone

The German government has obviously decided that the risks of contagion and breakup in the Eurozone outweigh any risks of Germany becoming the source of transfers for weak Eurozone member states.

It launched a 'Pact for Competitiveness' together with the French Government which was aimed at integrating the economies of the Eurozone member states far more deeply than is the case at present. This would entail harmonising certain tax rates, pension systems, wage setting and indexation and labour market rules including retirement and pension entitlement. While there is much opposition from the other Eurozone member states which will all be affected by the German proposals, it is likely that a certain amount of deeper integration survives and is agreed in European Councils later this year.

Agreeing to the establishment of the monetary union with the introduction of the Euro was Germany's great concession to France and other EU member states in the Maastricht Treaty. The re-establishment of Germany as the predominant economic power in Europe, partially through its strong recovery from recession, will also underline German leadership in the Eurozone and perhaps lead to the final emergence of a hard core Eurozone surrounded by rather marginalised non-Eurozone European Union member states. This will have very significant impacts both on the future of the European Union and on its economic development.

Conclusion

The analysis above illustrates that although the Federal Republic is still in many ways a reluctant leader, German political elites realise that it has little choice but to embrace its more expansive role in EU politics. Its interests may not always be in line with those of other states (or indeed those of the EU's institutions) in the way that they once were, and some of Germany's policy preferences will indeed be in direct opposition to those held by some its closest neighbours and allies. But this is a

sign of Germany's increasingly 'normal' position in European politics and not of any willingness to abandon what William Paterson terms its "European vocation".²⁹ For better or worse, Germany remains the only country with the resources to lead the EU; whether these be in times of crisis – and there have been a significant number of these 'times' of late – or through less stormy waters. It is also the only state with the capacity and influence to produce blueprints to push the Union forward in both policy and institutional terms. Germany's economic strength alone ensures that this will remain the case in the future.

Furthermore, it is not just in Germany's interests to take on this leadership role. Other states in the EU may occasionally fret publicly about the German government imposing its will on them, but, as the Rolling Stones said back in 1969, you might not get what you want but you sometimes get what you need. Whilst it is self-evidently no longer the case that France and Germany can independently set the pace and tone of European integration, and more voices and interests vie to be heard, it is still to Germany that many states instinctively look when trying to solve many of their EU-related problems. Germany is now expected to lead, and although this leadership role will naturally involve upsetting some of the people some of the time, there is a widespread consensus that the EU would be a much less efficient and much less dynamic place should Germany choose to shirk this role.

The reflexive integrationist logic of the Cold War era is now subsequently rather passé. Germany's attitude to the EU's myriad of policies has become rather more selective and ambiguous. The old adage that France would lead and Germany would pay is now certainly a topic for historical analyses of the EU rather more than it is a reflection of contemporary reality. The German economy may have had a mixed first decade of the 21st Century, but it has still come out of it (much) stronger than that of any other EU member state. Germany's leadership may subsequently be more contingent on a number of factors, but it remains very much in demand – as the Euro crisis painfully illustrated.

²⁹ William E. Paterson (2010), 'Does Germany still have a European vocation?', *German Politics*, 19 (1): 41-52.

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