The Transformation of Germany's Position in the EU through the Crisis

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Introduction

The present Eurozone crisis appears to have divided the member countries within the single currency into three groups: (a) the states uninvolved in the current crisis; (b) the members receiving (or having received) financial aid; (c) the countries financing the latter. Germany as the largest EU economy[1] is the main contributor in the third group; it has been involved from the outset, as the number of countries asking for financial assistance – to varying degrees and with different amounts of assistance involved – grew from one to five.

As a domestic concern with national lending institutions developed into a sovereign-debt calamity, as well as a broader banking predicament, the German government financially contributes to ailing economies primarily through the inception of Eurozone-wide rescue funds, as well as on occasion with bilateral aid. (Continued access to these resources is based upon stringent criteria related to the size of the public sector and the liberalization of state regulations – the term "austerity" has become synonymous for it in public parlance.)[2]

Since the German government is a rare illustration of a Eurozone member state where the *same* chancellor (i.e. the head of government) presides since the inception of the currency crisis, the question arises whether or not a transformation of the country's standpoint throughout the single currency's difficulties has even taken place.

The chapter maintains that such a shift has indeed moderately occurred, particularly on the timeframe permitted by debtor member states to implement the financial measures imposed. Its stance is generally positive toward further institutionalization at the EU level, from the launch of the European Stability Mechanism (ESM) to the contours of a Banking Union, to be administered by the European Central Bank (ECB). Conversely, the government (like the other northern European creditor countries like the Netherlands and Finland) remains firmly opposed to the mutualization of debt through the issuance of so-called Eurobonds.

I hold that this temperate transformation of the German government's position can most plausibly explained by the constraints of domestic public opinion. While some member states, as well as news outlets like the *Economist*, find German leadership in the Eurozone crisis wanting, a large majority of citizens[3] approve of what they regard as the Chancellor's firm position toward debtor countries.

The evolution of the country's position originates in the financial and economic crisis; it would not have occurred in its absence. The ostensible weakening of the single currency has heightened resolve for increased institutionalization, but only on Germany's (and other creditor countries') terms. In this sense, H1 of the book project can be confirmed, but with a considerable caveat: as domestic public opinion, while in principle pro-European, has grown more hostile on further financial bailouts, the policy commitments of Germany will likely remain restrained.

The structure of the analysis is as follows: Before analyzing the German government's change through the Eurozone crisis, the crisis itself needs to be identified briefly to demonstrate the extent of Germany's political and financial participation in the crisis, resulting in a typology; this will be completed in the first section. In the second section, I discuss the methodology with which one could possibly identify the causal relationship of domestic public opinion as constraining the German government's stance in the Eurozone crisis over time. The third section is devoted to the empirical aspects of the country's involvement, and section four subsequently deals with the causality. In the Conclusion, I summarize the findings and speculate on Germany's future position.

1. A Brief History of the Eurozone Crisis

There were two sets of *causes* for the Eurozone crisis: first, the global financial crisis from 2006 until 2008 had begun in the U.S. housing market through the issuance of so-called subprime mortgages. As in the United States, there are also European commercial banks that primarily focus on the mortgage market. These lending institutions, most of them housed in member states of the Eurozone, came under heightened scrutiny, both by credit rating agencies, as well as by the governments.

The second set of causes was European-made, as some home governments began to bail out their own commercial banks, beginning in Ireland and the cascading through a number of Eurozone countries. Thus, what had arisen as a domestic concern for some Eurozone governments with their own main commercial banks spiraled into a sovereign-debt crisis (i.e. several governments spent more money on bank bailouts than their budget could withstand.[4] This being so – and both Ireland and Spain fell into this predicament – the situation in Greece had a different cause. The trigger here was not the banking sector, but the realization of the incoming Papandreou government in September 2009 that previous administrations had disguised the level of borrowing.[5] The size of the budget had to be revised to an annual deficit of 12 percent and an accumulated debt of over 120 percent. Put differently, the country already had a sovereign-debt crisis from the outset.[6]

The *consequence* for countries engulfed in a sovereign-debt crisis (i.e. whether Ireland or Greece) is that the so-called bond yields (i.e. the government financing costs) spread between debtor and creditor member states of the Eurozone. Since governments issue bonds (mostly of a ten-year maturity) in order to raise capital on the financial market, they depend upon these bonds being purchased by investors – equivalent to the concern with stocks dispensed by publicly-traded companies. If a state experiences financial difficulties, bond investors would demand a higher premium to offset their financial risk of, say, buying Greek bonds in the current environment. As a result, state's borrowing cost goes up – bond financing costs of close to seven percent are deemed economically unsustainable.[7]

This means that such a country would need access to loans at a cheaper rate than what it can obtain in the financial market in its situation.[8] In April 2010, the Eurogroup (i.e. the finance ministers of the Eurozone members) established the so-called Troika (comprising the ECB, the European Commission, and the IMF) specifically for dispersing bailout money to Greece.[9] Representatives of the Troika negotiate these bailouts, which are tied to specific conditions related, for instance, to the size of the public sector, the size of pensions, the retirement age, or the liberalization of the labor market. The financial aid is given in installments, each of which is only handed out if the Greek government made agreed-upon progress to implement these conditions.

The German government's financial contribution in the sovereign-debt crisis becomes clear, given the funding the three kinds of sources established for the various bailouts: first, the European Financial Stabilization Mechanism (EFSM) is the only true EU package, and as such it falls into the responsibility of the Commission, which in turn uses its budget as collateral for borrowing up to €60mn. Member states participate according to the capital key weightings by the ECB – for Germany, this means a bit more than 27 percent.[10]

Second, the European Financial Stability Facility (EFSF) is a treaty established outside of the European Union by the Eurozone countries in May 2010 with its headquarters in Luxembourg.[11] The EFSF can issue bonds or other debt instruments on the market with the support of the German Finance Agency[12] to raise the funds for the loans to Eurozone debtor countries. The emission of such bonds is then guaranteed by the Eurozone members again in proportion to their share in the paid-up capital of the ECB[13]. In September 2012, the temporary EFSM and EFSF were rolled into the permanent European Stability Mechanism (ESM), which can raise a capital of up to €700bn – again based upon the ECB-inspired contributions by the Eurozone members.[14] Table 1 depicts a typology of the German institutional and financial links to the Eurozone.[15]

[Table 1 about here – vertical]

There has been quite some variation among the five countries (Greece; Ireland; Spain; Portugal; and Cyprus – which I cover below) that officially had asked for financial assistance through the Troika. Ireland was the first country to leave its bailout program after three years, followed shortly thereafter by Spain (which exited after 1.5 years) in December 2013. Portugal is expected to exit its bailout phase by the middle of 2014. This leaves Greece – where the Eurozone crisis began.[16]

Analytically separate – but empirically overlapping – from the sovereign-debt problem is the banking crisis (i.e. commercial banks do not lend, and/or do not have enough funds to lend, to consumers). There are three aspects to it, all of which have implications for the size of the German government's financial contribution. First, the ECB uses its budget to buy in large measure the bonds of countries with a sovereign-debt crisis from the private investors who hold these bonds. Through this, the European Central Bank attempts to reduce the borrowing costs of said governments, i.e. to effectively narrow the bond yields between Eurozone governments.

Second, the Eurozone member states have charged the ECB with implementing and overseeing a new Banking Union – and it is, at the time of writing, in process of hiring about 1,000 new staff for this very purpose. The ECB's principle role is to apply so-called stress tests on each commercial bank in the Eurozone. These tests could be taking a given bank's balance sheet as the basis to assume, say, a seven percent drop in the home country's gross domestic product (GDP). The question then is how long this commercial bank can withstand such a scenario. The purpose of these stress tests is to determine which commercial banks can be saved, and which ones need to be wound down. Apart from such an initial assessments, these banks require continuous monitoring to ascertain that their financial health remains intact.

And third, there are now new rules in place for bank rescues, identified in a liability cascade of six steps: (1) the shareholders of a bank will receive a lower than expected dividend; (2) the creditors of said bank will have to write of a portion of these demands; (3) deposits of over €100,000 are always unsecured; such savers will lose a part of these deposits; (4) each commercial bank contributes to so-called national resolution funds, which are drawn upon; (5) the respective Eurozone member state; (6) only as a last resort is the ESM (to which Germany contributes about one third) is drawn upon.

This new process is labeled as “bail in” because the first four stages only concern a given commercial bank itself; only in the last two phases would contain tax payer’s money, and even then solely at the domestic level at the outset.[17]

2. Methodology

The Eurozone crisis differs from the two other economic crises covered in this project: unlike the situations in Brazil and in Southeast Asia, the difficulties of the single currency in Europe are ongoing. Consequently, there are no academic sources available to draw on. Instead, the sourcing has to rely exclusively on the portrayal in the media (whether print or visual) or the portrayals by the governments involved – although the latter are typically of less analytical value.

The dependent variable (DV) is the degree of change of Germany’s policy during the “Eurozone crisis.” The most plausible independent variable (IV) is a shifting domestic public opinion about further German bailout funds and the conditions placed upon them on recipient countries. Thus, a decline in domestic public opinion is then expected to constrain the options of the government to approve further bailout funding.

The timeline for this chapter begins prior to the first bailout package for Greece, i.e. with the inception of the Troika in April 2010, and it ends in March 2014 with the ruling of the *Bundesverfassungsgericht* (German Constitutional Court) that upheld the legality under the German constitution of the European Stability Mechanism (which had been established in September 2012).

The sources through which the DV is tracked are the reporting of the five main (in terms of copies sold) national newspapers in Germany: the four dailies are the conservative

Frankfurter Allgemeine Zeitung and *Welt,* as well as the slightly left-of-center *Süddeutsche Zeitung* and the left-of-center *Frankfurter Rundschau;* the chief weekly newspaper is die *Zeit*. Working with Boolean operators (i.e. AND/OR/NOT), the keywords I am looking for to determine whether a given article or editorial qualifies are "Deutschland" AND "Eurozone" OR ”Eurokrise" OR ”Rettungsschirm" OR "ESM." It is conceivable that some reports taken directly from Reuters or the Associated Press in the daily papers may be identical. If this were the case, I would count the keywords in the respective articles only once, but would report the number of articles that fell into these Boolean categories.

The information for the IV comes primarily from the *Allensbach Institut für Demoskopie* (i.e. Allensbach Institute for Public Opinion Research), which is the main German public opinion source since 1947 for a variety of topics, among them work related to European integration in general, and the present Eurozone crisis in particular. This research is chiefly disseminated through monthly full-pages devoted specifically to the Allensbach Institute's scholarship in the *Frankfurter Allgemeine Zeitung* (F.A.Z.). In other words, the Allensbach Institute's researchers write contributions specifically for the newspaper that are then word-for-word published. However, the background documentation frequently contains graphical data, not all of it is contained in the F.A.Z. Therefore, I will utilize these Allensbach background documentations on EU/Eurozone-related topics from 2010 to 2013. Prior to this time, the Allensbach Institute has also published *Kurzberichte* (i.e. brief essays, typically three to five pages each in length) on European matters between 2005 and 2007. Although these reports fall outside of my timeline, I may draw on them as context material.

3. Empirical Information

[N.B.: A delay in the receipt of the above data meant they only arrived on 30 April 2014. As these are well over 1,000 newspaper reports – delivered in a format which did not permit examination with software packages developed for textual analysis (Bei et al. 2008; Cardie and Wilkerson 2008; Monroe and Schrodt 2008; Van Atteveldt et al. 2008; Krippendorff 2013) in the first place; I will now alter the format to do so. While I waited with submitting my draft chapter until the last possibility, I was hence unfortunately unable to report the empirical findings in time for the conference.]

4. Domestic Public Opinion: Causality?

The plausibility of German public opinion demonstrably constraining the ability of the government to take a tough stance on bailout funding and the conditions for it would presume a direction of "cueing." Rather than the government leading public opinion through explanation and actions, public opinion itself can serve as a "scapegoat" for the government.

Preliminary evidence from the results of the Allensbach Institute, an influential public opinion polling firm in Germany, indicates three broad trends: first, a majority of German citizens were hesitant to accept the single currency even several years after it had become legal tender in January 2002 (Allensbach Institute 2005a, 2007). Second, at the height of the public perception of the Eurozone crisis in 2010 and 2011 (Allensbach Institute 2011a, 2011b, 2010), a declining trust in the Euro also led to falling trust in the European project more generally. And third, this has gradually altered by 2013. Trust in the EU is growing in two ways: on the hand, those who have "very high trust" in the EU have passed their low point of 24 percent and have climbed again to above 30 percent. On the other hand, German citizens with low trust in the EU are declining from a high of 68 percent to 60 percent.[18] In other words, both developments are gradual, but these data were compiled almost half a year before Ireland and Spain exited their bailout programs (Allensbach Institute 2013a).

Yet, there are two methodological caveats with these data: first, Allensbach analyzes "trust," while the Eurobarometer opinion polls conducted on behalf of the European Union tend to use the term "support" (e.g. Eurobarometer 2011); the terms may be understood differently by those being polled. Second, the Allensbach Institute collapsed the three categories ("no trust at all," "barely trust," and "not so much trust") into one negative category, with the positive group only being "very big trust." The concern is that the data through this inflate the negative tendencies (Gros and Roth 2011). Thus, I intend to compare Eurobarometer information systematically to the Allensbach surveys to resolve whether or not the trend in both datasets matches.

Conclusion

... [To come]

Notes

[1] In 2012, the country accounted for 20.6% of EU GDP and 26.73% of the Eurozone's GDP.

[2] In addition, several German (and French) commercial banks own the majority of the bonds issued by Greek governments at a time when the country's growth rate was one of the highest in Europe, i.e. prior to the current difficulties.

[3] Chancellor Angela Merkel was re-elected for a third consecutive time in September 2013, for the first time in post-war Germany having a party fall just short of an absolute majority.

[4] The term "bailout" means that public (i.e. taxpayer's) money is being used to come to the rescue of private actors (in this case: commercial banks) in the economy. For instance, General Motors as also was a recipient of U.S. bailout funding during and in the aftermath of the global financial crisis.

[5] To get an idea of how this "cooking the books" process remained undetected for some time, consider the Greek (state) railway. The incoming transport minister discovered that there apparently were more employees than customers. The previous government had the railway issue shares, all of which the government then bought. The losses of the railway through this procedure were a financial transaction, rather than an increase of the budget deficit. It therefore did not appear on the state budget balance sheet; that the Greek statistics office was not independent, but a government agency at the time, aided this disguise.

[6] Among the five so-called Maastricht criteria – based upon which countries ultimately become Eurozone members – are requirements for a deficit/GDP ratio of no more than 3 percent and for debt not exceeding 60 percent of GDP.

[7] Thus, the yields of bonds (i.e. their financing cost) spread between Eurozone countries; Germany could borrow money for about one percent, while the costs for debtor-countries are much higher.

[8] Such financial aid was not immediately forthcoming, as European creditor countries were initially debating whether or not to incorporate the International Monetary Fund (IMF) in such an endeavor.

[9] However, once set up, Troika representatives have also negotiated the conditions for financial aid to the four other countries that had asked for such help: Ireland, Spain, Portugal, and Cyprus.

[10] France is the only other Eurozone country with slightly more than 20%.

[11] The chief executive officer of the EFSF is Klaus Regling, a former Director General of the European Commission's Directorate General for Economic and Financial Affairs, having previously worked at the IMF and the German Ministry of Finance. He continues on with the European Stability Mechanism into which the ESM has turned in September 2012.

[12] The *Deutsche Finanzagentur* (German Finance Agency) is a financial services company owned by the Federal Republic of Germany; it is headquartered near the ECB in Frankfurt.

[13] The €440 billion lending capacity of the Facility may be combined with loans from the EFSM – and with up to €250 bn from the IMF.

[14] The ESM now covers all new bailouts, although the EFSF and EFSM continue to handle money transfers and program monitoring for the previously approved bailout loans to Ireland, Portugal and Greece.

[15] There has been a debate – primarily in the Anglo-Saxon print media – on whether or not Germany has profited from the Eurozone crisis [Das 2013; Reisenbichler and Morgan 2013]. The two sets of positions are inconclusive. I discard them here, as the purpose of this chapter is the extent of change of Germany's position in the Eurozone crisis; not if it benefited from it.

[16] The country also received the largest amounts of financial assistance: a first bailout of €110 bn (including €80 bn in bilateral aid from Eurozone countries – with €23 bn of it from Germany), as well as further loan guaranties through the EFSF. The second bailout amounted to €100 bn through the EFSF. The Greek government in part utilized these amounts to be able to pay its public sector wages, but it created a vicious circle of budget deficits, high unemployment, and low growth.

[17] This cascade has first been used when Cyprus asked the EU for financial assistance for its banking system (which given the size of its economy is large). It is the approach taken to all commercial banks from now on. Note that "small savers" – those with deposits of less than €100,000 – remain protected from any financial contribution to the rescue fund.

[18] This was the case despite the – ultimately not materialized – threat of the anti-Euro party *Alternative für Deutschland* being elected in German parliamentary elections in November 2013 (Allensbach Institute 2013b).

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Appendix

Table 1: Typology of German institutional and financial links to the Eurozone

EU Institution	German Financial Contribution	Voting
ECFIN (Commission)	n/a	Unanimous (1 vote/28 countries)
ECOFIN (EU Council)	n/a	Weighted (28/population size)
Eurogroup (EU Council)	n/a	Unanimous 1 vote/18 countries
ECB	18% capital subscription (i.e. contribution to the ECB budget)	Governing Council: 1 vote/24 members (6 EB+18 countries)
ESM	27% contribution key to authorized bailout of €700 bn	Board of Governors + Board of Directors: 1 vote/18 countries

N.B.: German economy = 20.6% of EU GDP + 26.73% of Eurozone GDP (2012 data).