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Europe's decline, a German story ?

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Chancellor Olaf Scholz's recent visit to Beijing was the subject of much controversy. Since Xi Jinping's nationalist shift, most Western companies have turned their backs on China. Foreign investment is falling, the stock market is plummeting, and the property crisis continues to spread. To compensate for the contraction of its economy, China has decided to turn to the mass production of electric vehicles and batteries, granting large subsidies, at the risk of increasing global imbalances and leading to a crisis of overproduction, to the detriment of European industry and even China itself. However, among the developed countries, only Germany continues to increase its direct investment in China.

Germany's commitment to economic partnership with China is part of a long-term strategy, dating back to the way Berlin overcame the shock of reunification. Rather than relying on the development of its domestic market, Germany has always favoured a monetary and budgetary policy geared towards the contraction of domestic demand, consumption and investment, so as to generate trade surpluses. This "*mercantilist*" strategy, which was extended across the entire European market during the "*euro area crisis*", has been to blame for Europe's stagnation over the last fifteen years. Europeans therefore need to reassess Germany's strategy and the budgetary and monetary choices that this implies.

THE RENAISSANCE OF THE "GERMAN MODEL

Since the 1990s, Germany's growth has been based essentially on the contraction of domestic demand, i.e. consumption and investment. To deal with the shock of reunification, Germany embarked on a policy known as "*austerity*", based on the forced dismantling of the economy of the former East Germany (GDR), higher interest rates, wage compression and the overhaul of unemployment benefit rules ("Hartz" reforms) to encourage labour "*flexibility*".

These deflationary policies took full effect from the 2000s onwards. German companies benefited from the American recovery and the opening up of China following its accession to the World Trade Organisation (WTO) in December 2001. China has become a leading export market for cars, chemicals and machine tools, which have allowed Beijing to modernise its productive capital and its army. This surge in exports has primarily benefited the major industrial conglomerates (BASF, Siemens, Volkswagen, Mercedes, ThyssenKrupp, etc.), but also the small and medium-sized enterprises of the "*Mittelstand*", whose orientation towards exports has been financed by the network of *Sparkassen*.

Over the years, Germany's trade surplus rose sharply, becoming the largest in the world on the eve of the "*euro area crisis*". This was not due to the otherwise indisputable quality (*Deutsche Qualität*) of '*made in Germany*', but essentially to the fact that German imports had grown much more slowly than exports. The focus of the production system on '*competitiveness*' has led to wage stagnation in a market also characterised by a sharp rise in low-paid, insecure jobs. Over the period, German companies have recorded a sharp increase in their financial surpluses, while public and private investment have fallen.

This phenomenon was accentuated by the fact that Germany, emerging from the shock of reunification, entered the euro zone with a favourable exchange rate compared with that of its European partners, mainly France and Italy, which had imposed high interest rates during the previous period of convergence to the detriment of their productive

capital and, in the case of Italy in particular, an increase in public debt. The advent of the single currency then meant that Germany was able to build up a considerable current account surplus without suffering the appreciation of its national currency, as was the case in previous decades when Germany and France jointly "*revalued*" the Deutsche Mark against the Franc.

Since the euro is essentially a political project, the institutional rules that would have reduced current account divergences within the monetary union have not been implemented, as if building up trade surpluses were a virtue in itself. Germany has thus been able to grow its current account with impunity, benefiting from buoyant consumer spending in France and the countries around the Mediterranean. Since it has maintained a situation of under-investment and reinvested its savings outside the euro area, mainly in the form of purchases of US securities (notably the sadly-titled "*subprimes*") or direct investments in China, Germany has therefore functioned for years as a mercantilist state that has not reinvested its surpluses.

The European elites, particularly the French, failed to perceive the imbalances and risks inherent in the economic strategy pursued by Berlin. On the contrary, economic research institutes and business circles widely promoted the "German model", paving the way for the deflationary policies that were to be pursued during the "*euro area crisis*". The virtuous image of "*Rhenish capitalism*" was constantly put forward to demonstrate the effectiveness of "*supply-side*" policies based on cutting wage costs and reducing public investment. Germany's growth has mainly been linked to high consumption and investment in the other euro area countries, particularly France and the countries around the Mediterranean (whose economies were catching up as a result of joining the single currency); however, Germany's current account surplus was seen as a sign of "*good health*" that it owed solely to "*its efforts*". In reality, it was the German '*ant*' that was living off the European '*cicada*', and the euro area countries that were soon to be reprimanded for the management of their finances could legitimately have asked Germany to account for surpluses that it owed solely to the dynamism of domestic demand in the other euro area members and that it reinvested outside Europe.

Emmanuel Macron, Christine Lagarde (then Managing Director of the IMF) and others tried their hand at this for a while when it came to learning the lessons of the "*euro area crisis*", but without any real success. The Managing Director of the IMF has repeatedly stressed the need for Germany to "*consume and invest more*" to reduce "*global imbalances*", particularly in public infrastructure and digital technology. Similarly, the President of the French Republic has urged Berlin to overcome its perpetual "*obsession*" with budget and trade surpluses, "*because they are achieved at the expense of others*", he added.

THE SELF-INFLICTED EURO AREA CRISIS

It was against this backdrop that the unfortunate and largely self-inflicted '*euro area crisis*' was triggered. After the onset of the subprime crisis and the rescue of most US banks under the aegis of the Fed and the US Treasury, the financial markets focused on the weakest countries in the euro area, with large current account deficits and above-average debt as a percentage of GDP. Greece, whose public accounts Europe had come to terms with so as to meet the convergence criteria, and Ireland, which was bearing the full brunt of the contraction in the property market, were the first targets of this onslaught.

With interest rates in the euro area countries having hovered around the same level for ten years, the markets realised in the space of a few days that the European Central Bank (ECB), unlike the Fed, was not a lender of last resort and had no intention of becoming "*the sewer of bad debts*", to use the vocabulary in vogue in doctrinaire circles. Long-term interest rates in the "*ClubMed*" and "*PIGS*" countries, market acronyms slavishly adopted by the prudential authorities, then rose sharply, leading banks to post heavy losses on the government bonds they held to cover their liabilities. European banks, which had been largely shielded from the subprime crisis by the size of their retail customer base and stricter prudential standards than their US counterparts, found themselves in deep trouble, bringing down whole swathes of the banking sector.

While the Irish banks were being rescued on the sly by the Central Bank of Ireland with the help of the ECB, thereby consolidating the Irish growth '*model*' based on

tax cuts for US multinationals, the '*creditor*' countries were imposing an ironclad regime on Greece, pushing for the resignation of the government, and committing the weakest countries to policies that aimed to reduce domestic demand and restore public finances.

EUROPE IS FALLING BEHIND

Under Germany's influence, the policies pursued a few decades earlier to integrate the territories of Eastern Europe were implemented throughout Europe: lower investment, reduced public spending, higher interest rates and the sale of infrastructure at auction. After Greece, which, with a GDP equal to 2% of that of the euro area, was seen above all as an "*example*", Italy was the main target of the German strategy. Despite a structural primary surplus, Rome had no option but to embark on a policy of "*internal devaluation*", based on a contraction in consumption and investment. Italy, the third largest economy in the euro area and a founding member of the ECSC, became the scapegoat for the sovereign debt crisis for an indefinite period.

While the United States adopted a vast economic recovery plan, accompanied by an accommodating monetary policy and protectionist measures, Europe, in a fascinating repeat of the 1930s, took the path of "*austerity*", in an expiatory logic for which there were uncertain academic justifications. It took the full weight of the US authorities for the ECB to change course under Mario Draghi, proclaiming its commitment to saving the euro "*whatever it takes*" and averting a new sovereign debt crisis.

The attitude of the French elite during these years remains a source of astonishment and sadness. Paris could have brought together a majority of countries to propose a pro-growth economic policy similar to that of the United States. But the discrediting of "*Keynesian recovery policies*" (on which the "*second left*" built a form of moral magisterium), the dogmatic confidence in the effectiveness of "*supply-side policies*", the intellectual comfort of decision-makers, the pathological rejection of Latinity, etc. a whole set of forces worked in the same direction. Concepts from historical anthropology, or even psychoanalysis, would be needed to explain this strange and distressing resignation.

The downward spiral in the euro area, of which European leaders are only now becoming aware, therefore predates the post-Covid recovery. While growth in Europe and the United States had been in line since the post-war period (France even outpaced America in the 1970s), Europe, which was the world's leading economy in 2008, saw its GDP fall sharply from 2010 onwards, finding itself relegated to third place. Public investment has been postponed, research and development budgets have been plummeting, strategic infrastructure has been sold off to Russia and China, and military budgets are becoming the main adjustment variable as a result of the downward rigidity of public spending. Everywhere, economic activity has declined, particularly in the areas hardest hit by austerity: the East German Länder, Italy, Greece and "peripheral" France, which a few years later have now become hotbeds of the vote for extreme parties. The gap is also evident on the capital markets, with European stock markets falling sharply behind Wall Street and international investors withdrawing. Europe, which appeared to be a land of opportunity at the turn of the century following enlargement to include the Baltic States and Central and Eastern Europe, now appears to be a fragmented continent, turned in on itself, with no growth strategy. As Mario Draghi remarked in a speech in Brussels on 16 April 2024, "*we have pursued a deliberate strategy of lowering wage costs relative to each other and combining this with a pro-cyclical fiscal policy, the effect of which has been to weaken our own domestic demand and undermine our social model*"... and it might be added making people more susceptible to Russian propaganda.

BERLIN, THE MAIN BENEFICIARY OF AUSTERITY POLICIES

A champion of "*internal deflation*", Germany was the main beneficiary of the "*euro area crisis*", which helped it rid itself of its European competitors once and for all. Despite its export strengths, Italian industry was hard hit by the slump in orders following the contraction in demand and the uncertainty surrounding the country's political and financial situation. Similarly, Spain, which was one of the '*engines*' of the European economy, witnessed a stagnation in activity. Only France saw a slight increase in its GDP, albeit 50% less than in the

previous decade, and at the cost of continuing the relocation and de-industrialisation strategy begun in the 1990s. The euro area's decline in the global economy has gone hand in hand with an increase in Germany's share of European GDP and an impoverishment of the continent's industrial fabric, now essentially made up of activities linked to the automotive (for how long?) and aeronautical industries.

Against this deteriorating economic backdrop, the onset of the migration crisis following the escalation of the civil war in Syria has served to accentuate European disagreements. Although Germany has a small immigrant population, as a result of a short-lived colonial empire and rather expansionist migration policies pursued since the end of the 19th century, Angela Merkel, in a move where moral narcissism competed with self-interest, declared herself in favour of an almost unconditional welcome for migrants ("*wir schaffen das*"), definitively alienating the British, who were going to vote in favour of Brexit, destabilising the political situation in Italy, which is in the front line because of its geographical location, and weakening the most deprived French populations, who have long been confronted with the failure of integration policies.

COVID-19: A MISSED OPPORTUNITY

With the establishment of a European fund for "*recovery*" and "*resilience*" with almost €700 billion directly financed by the European Commission, the Covid-19 crisis gave rise to new hopes. For the first time in its history, Europe was pooling its financing capacities to ensure the development of long-term projects. However, these expectations were quickly disappointed: On the one hand, the slow release of funds and, above all, their conditionality on the implementation of "*structural reforms*" limited the impact of the plan compared with policies aimed directly at household purchasing power; on the other hand, Germany, through its Chancellor, quickly made it clear that this initiative - which was aimed, although it was not openly stated, at repairing the damage caused to Italy during the previous period - was limited to dealing with the consequences of Covid-19 and in no way constituted a step towards the implementation of a "*European economic strategy*", which the Germans have always mistrusted, seeing in it the shadow of French-style "*Colbertism*" and above all the risk of a "*Europe of transfers*", to which they have always been opposed. Finally, the 'green' orientation of the European plan promoted by the new President of the European Commission, with its accents of climate millenarianism, was going to give Berlin, in addition to a new post-historical legitimacy, new tools to destabilise the French energy model based on the predominance of nuclear power and to justify further tightening of the screws during the inflationary crisis that was to follow.

After two years of lockdown and restrictions, the end of the pandemic was accompanied in Western economies by a strong rebound in consumption. The return to normal life, with a simultaneous recovery in all the developed countries, led to increased tension on production lines, while China was still under a regime of strict confinement. The creation of bottlenecks following the return of demand (while production was still constrained) and then the Russian intervention in Ukraine has mechanically triggered the return of inflation. However, unlike during the subprime crisis, this time Europe, and in particular Germany because of its dependence on Russian gas, was in the front line.

"THE SOLUTION IS RECESSION!"

Faced with this new crisis, Berlin has once again chosen to penalise the population in order to preserve its trade surpluses. At a time when European households has had no share in externally generated inflation (largely the result of Germany's energy choices, which consisted in phasing out nuclear power in favour of coal and Russian gas), Germany has pushed the ECB to hike its key interest rates rapidly, in the biggest monetary tightening in the history of the euro area. Firstly, it was necessary to break with the Draghi era and show *Bild* readers that their "*savings*" would no longer be used by "*Draghila*" to finance the deficits of the "*ClubMed*" countries. The idea was also to rein in domestic demand, to avoid wage increases at all costs with a view to preserving the export competitiveness of Germany's major companies. "*The fear of recession must not stop us*", declared Joachim Nagel, President of the Bundesbank. Isabel Schnabel, Germany's representative on the ECB's Executive

Board, even invoked the need to combat climate change to justify a new agenda for raising interest rates. The credibility and political legitimacy acquired by the Frankfurt-based institution over the years of crisis and pandemic were thus squandered in the space of a few weeks with disconcerting levity and inconsistency.

The effects of the tightening of financial conditions on the economy were soon felt: European growth, which was on the point of returning to a favourable trajectory, close to that of the US recovery, was stopped dead in its tracks. Europe is not enjoying its "*roaring twenties*". The sharp rise in borrowing costs has had a direct impact on young workers, households, the construction sector and industrial investment. With rising interest rates compounded by rising prices, the people of Europe have sharply curtailed their consumption and purchases of durable goods. At a time when America has been reaping the rewards of a growth strategy based on support for investment in new technologies and the maintenance of a monetary policy that supported activity, Europe, ten years on, has once again opted for policies to shrink its economy.

EUROPE, THE SELF-DESIGNATED VICTIM OF THE CHINESE CLIMATE-INDUSTRIAL COMPLEX

This time, however, the environment has changed. The Old Continent can no longer count on the upturn in external demand to pull it through. Hard hit by the collapse of the property sector and overinvestment in infrastructure, the Chinese economy has not transformed into a Western-style consumer economy, as the promoters of its accession to the WTO had hoped. According to a neo-Stalinist logic, Xi Jinping believes that development should be based primarily on investment rather than on the boom in consumption. Unlike during the financial crisis, when the adoption of a vast stimulus plan provided outlets for European industry, China has entered a phase of mass production of state-subsidised manufactured goods (solar panels, batteries, electric vehicles) that it exports to Western countries. Batteries and electric vehicles have replaced buildings and infrastructure. The new face of the "*Chinese dream*" now consists of developing and exporting low-cost manufactured products that will enable Beijing to impose its standards and secure long-term income for its economy. But by exporting its "*technologies*", China is passing on its problems to the whole of the developed world, which has to absorb the surpluses of an economy suffering from a syndrome of over-investment and under-consumption.

Having based its strategy on "*greening*" its economy, Europe appears to be the self-designated victim of the industrial-climate system created by Beijing. Because of its low level of investment in new technologies, Germany is equally affected. Its trade balance with China, which was slightly in deficit, is now in sharp contraction. Exports of luxury vehicles and machine tools are no longer able to balance Chinese exports. Even *Mittelstand SMEs* are demanding protection. Beyond Germany, the entire European automotive industry is being impacted directly.

Against this backdrop, the European Union has revised its approach to China, regarding it as a "*systemic rival*". In practice, however, doctrinaire reluctance to tax Chinese trade remains strong. Above all, Berlin holds back any initiatives in this direction. Rather than boosting the internal market, as European leaders are urging it to do and as the logic of monetary union would dictate, Berlin is stubbornly putting the brakes on any upturn in activity by raising interest rates and calling for budgetary rigour, hoping that a "*just peace*" in Ukraine will once again make it possible to benefit from cheap energy and resume trade... as before.

EXITING EUROPE, THE SUPREME STAGE OF GERMAN MERCANTILISM

Having contributed to the stagnation in demand on which they based the bulk of their '*competitiveness*', Germany's big companies have come to the conclusion that Europe, with its strategy of deflation and '*green*' over-regulation, can no longer be a vector for long-term growth. With this in mind, they have invested massively in the United States, taking advantage of the administration's "*Keynesian*" policy (which the German government and the Bundesbank are constantly challenging when it comes to applying it in Europe, in the name of "*respect for the rules*" and "*ordo-liberalism*"), and secondly, in China, in order to benefit from low labour costs and control over the production of the metals needed to make the battery

cells that power electric vehicles, electronic appliances and most semi-conductors.

Those who were counting on "*derisking*" with China will have paid the price. Between the development of the domestic market and the return on German savings, the authorities have made their choice: "*we need to increase trade with China, taking into account the need for diversification and risk mitigation*", declared one of Olaf Scholz's ministers without any trace of irony. Having worked for monetary, economic, migration, energy and defence policies that have led to the weakening of the European continent, the economic elites on the other side of the Rhine are now considering... pulling Germany out of the EU.

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At the end of this brief retrospective, two questions stand out. Has Europe realised why it is lagging behind? Is it not too late? The "*euro area crisis*" and its unfortunate aftermath may be seen as a "*trick of historical reason*" that will allow the implementation of an economic and monetary policy tailored to the peoples of the Old Continent. Fifteen years of crises and deflationary policies have profoundly damaged Europe's productive capital. The interdependence of European policies obliges us to pursue integration at a time when the outside world is becoming riskier and more uncertain. We tend to think that this is the path that will ultimately be taken when we are up against the wall.

But Germany remains the key to the pursuit of European integration. The medievalist historian Michel Pastoureau recently remarked that our differences in Europe stemmed from the fact that in Germany, the nation had long preceded the State, whereas in France, it was the State that made the nation. Despite its weight in European institutions and its economic power, Germany does not seem to have abandoned the traditional model of a closed national economy that Fichte proposed to it at the end of the Napoleonic Wars. The long history of trading towns that have always been confined to their bourgeois rights still has an influence on the way people think. It is as if Berlin was reluctant to project itself fully into Europe. But with the end of the Cold War and the advent of the euro, Berlin now has a historic responsibility for the future of the continent's peoples. It must abandon its mercantilist ideal and accept its European destiny.

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