

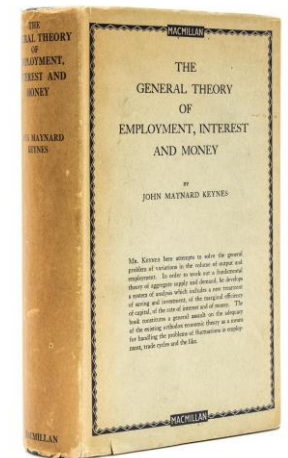


II. JM Keynes and The General Theory (1936)

2. The impact of *The General Theory* on economic policies during the last thirty years (1986-2016)

2. How Germany's anti-Keynesianism has brought Europe to its knees

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Some views on German exceptionalism

- “There is no doubt that the macroeconomic debate and actual macroeconomic policy in Germany differ considerably from other countries” (Peter Bofinger)
- “‘the Swabian housewife represents the starting point’ in German thinking on the euro and fiscal management” (Kretschmann, *Economist* 1 Feb 2014)
- “the wacky economics of Germany’s parallel universe” (Wolfgang Munchau, *FT*, 17 Nov 2014)
 - Schäuble had accused his critics of living in a ‘parallel universe’
- “[Inside Mr Schäuble’s ‘parallel universe’] pursuit of competitiveness is never recognized for the zero-sum game it is if demand is completely ignored” (M. Wolf, *FT* 24 Sep 2013)
- “Germany’s fiscal obsession has a sort of multiplier effect on Europe, and indirectly on the world, that is disproportionate even to Germany’s economic size” (Paul Krugman 26 Aug 2016)
- “German morality play economics” (Krugman 12 Jul 2015).

German economic policy views peculiar indeed

- So it's no secret that there is something peculiar about Germany in matters of economic policy: country seems to be at odds with macroeconomics
 - Pushes austerity in the midst of a slump – as that supposedly boosts confidence and hence growth ('expansionary fiscal contraction', 'the German view')
 - It's also widely held that Germans care more about price stability than anybody else in the world
 - Ghost of Weimar: hyperinflation, printing press & MEFO bills; fear of debt ('Schuld' = guilt); hence German 'stability culture', adoration of deutschmark & Buba
 - 'Not all Germans believe in god, but they all believe in the Bundesbank' (J. Delors)
 - Distinctive 'anti-Keynesian' note in these German peculiarities
- *How did this lead to today's euro crisis & EU's 'existential crisis'?*

German economic history & Buba mythology

- German 20th century economic history 'rich' (mixed) but symmetric
 - But popular & official German historical narrative rather *asymmetric*
 - Buba was key player if not mastermind behind asymmetric narrative
 - As Buba's 'monetary mythology' served its own position & reputation as 'guardian of the currency', guarantor of stability
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- Germany learned wrong lessons from its history, indulged in Buba's mythology – *but somehow it worked just fine for (West) Germany*
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- **Key issue:** why & how did it work for (West) Germany under DM? Why did it stop working under euro? How related to today's crisis?

Example 1: Germany's history of external debt

- Following WWI victors imposed harsh reparations on Germany
 - Subject of severe criticism by JMK ('The economic consequences of the peace') who feared this would prevent Europe from recovering but cause more instability and war
 - Weimar Republic economic & political instability: hyperinflation, banking crises, Great Depression, ... Hitler ... WWII
- Following WWII victors lend supportive hand to West Germany
 - Marshall plan (1948-52), i.e. transfers
 - London debt agreement (1952/53), i.e. debt forgiveness
- How to understand modern Germany's treatment of Greece???
 - What kind of lessons did Germany learn from its own history?

Example 2: History of CBI & monetary stability

- German Reichsbank was independent CB (1922-37) when Germany experienced:
 - Hyperinflation (1922-3)
 - Deflation & Great Depression (1929-33)
- Hans Tietmeyer (Bundesbank president, 1993-99):
 - “The reasons for the success of German monetary policy in defending price stability are in part historical. **The experience gained twice with hyperinflation in the first half of this century has helped to develop a special sensitivity to inflation and has caused the wider public to believe in the critical importance of monetary stability in Germany.** For this reason, the strong position of the Bundesbank is widely accepted by the general public – questioning its independence even seems to be a national taboo. This social consensus has yielded strong support for the policy of the Bundesbank” (1991).
- Wolfgang Schäuble (finance minister, 2009-present):
 - “two different approaches to economic policymaking on each side of the Atlantic. While US policymakers like to focus on short-term corrective measures, **we take the longer view and are, therefore, more preoccupied with the implications of excessive deficits and the dangers of high inflation.** So are German consumers. This aversion to deficits and inflationary fears, which have their roots in German history in the past century, may appear peculiar to **our American friends, whose economic culture is, in part, shaped by deflationary episodes.** Yet these fears are among the most potent factors of consumption and saving rates in our country. Seeking to engineer more domestic demand by raising government borrowing even further would, here at least, be counterproductive. On the contrary, restoring confidence in our ability to cut the deficit is a prerequisite for balanced and sustainable growth. (“Maligned Germany is right to cut spending”, FT, 23 June 2010).

Main message of talk

- Germany has thoroughly misunderstood its own economic history, learned wrong lessons
- Misconstrued true sources of its post-war success
- *GERMAN MODEL* requires others to behave differently: it worked for Germany *because and as long as partners behaved differently*
- ☐ Trouble: euro (EMU) requires partners to *become like Germany*
 - **FALLACY OF COMPOSITION!** JMK would have told you so!
- ❖ Germany's knee-jerk reaction was to 'restore' its competitiveness
- ❖ Doing so under the euro was what brought Europe to its knees



Buba – a central bank better than god



- BdL/Buba was established (by Allies, March 1948) before West Germany and federal government even existed (September 1949)
- Deutschmark was launched ('currency reform', June 1948) before West Germany and federal government even existed
- Deutschmark became associated with 'economic miracle'
- BdL/Buba had head start in establishing its reputation as guarantor of stability & growth
- BdL/Buba was controlled by Allies, but independent of – initially nonexistent – German federal government
- 10 year fight over independence & mandate of Buba (1957)
- Another 40 years to foster 'untouchable' status and monetary mythology
- In Germany, 'inflation nutters' (M. King) are highly respectable, the norm

German monetary mythology: indoctrination

‘Stability culture’ socialization

- Germans constantly inhale Buba mythology
 - Key feature: *asymmetry*! Strong ‘anti-inflationary bias’
 - Two hyperinflations within one generation; must be avoided above all else
 - Debt gets country into trouble; must be avoided above all else
 - We learned our lessons, hence price stability, hence growth (thank you, Buba)
 - We are special, because of our history have every right to be special; also have a lot of wisdom to teach others about our national success ...
- Germany’s economic journalism exceptionally poor
- Germany’s economics profession mediocre
 - Of course socialization of German economists takes place in above national climate of monetary mythology; indoctrination; little room for nonbelievers

Keynesianism vs. Ordoliberalism

- Not true that Keynes & Keynesianism never reached Germany
- Keynes was well-known and respected in Germany ever since 'The economic consequences of the peace'
 - Various visits to Germany
- *Treatise on Money* widely discussed in academia
- *General Theory* published when German economists had either fled the country, got 'gleichgeschaltet', or operated in internal exile
- Ordoliberalism emerged as product of internal exile
 - Walter Eucken (Freiburg School) opposed Nazis
 - But somehow he associated Keynes' GT with interventionism, central planning ('Planwirtschaft') & inflationism; gave anti-Keynesian flavor to Ordoliberalism



Ordoliberalism in a nutshell



- It takes a strong state to establish market order but in general the state should not interfere in market processes
 - Rejection of both laissez-faire (private power abuse) & interventionism/central planning
 - Safeguard competition, offset externalities, some re-distribution
 - Maintain well-functioning price mechanism
- Primacy of currency stability ('Primat der Währungsstabilität') – Keynes' *Tract*
 - Rejection of any central bank discretion; instead: 'rational automatism'
- Eucken's monetary thought was based on primitive (QT) ideas
 - No grasp of Keynes' monetary thought
- Also had no clear concept of fiscal policy; no grasp of macro; pro stimulus in '31
- But Eucken did NOT like CBI! (recognized *symmetry* in Reichsbank's failure)
 - Wanted to implant an 'automatic stabilizer' into monetary order; 'rational automatism'

Keynesianism in (West) Germany

- (Bastard/synthesis) Keynesianism (co-)existed (with Ordoliberalism) in Germany from the beginning
 - Germany was not special for absence of Keynesianism, but for its peculiar home-grown Ordoliberalism (as strong local competitor)
- Ordoliberalism associated with Ludwig Erhard & ‘economic miracle’ & ‘social market economy’; somehow also with CBI & untouchable Buba
 - *PATH DEPENDENCY: Ordo’s initial impact left lasting impression*
- ❖ Heydays of Keynesianism in the 1960s – very brief!
 - Karl Schiller as economic (& finance) minister
 - Sachverständigenrat (‘wise men’), ‘Stabilitäts- und Wachstumsgesetz’, ‘magisches Viereck’, ‘Globalsteuerung’ (= Ordo plus macro)
- Shunned in early 1980s (‘Angebotspolitik’/supply-side economics)



German economic history pre-1980s

- **1950s:** the 'economic miracle' takes off (GDP 8% p.a.)
 - 1950-1: current account deficit, currency crisis
 - Trade surpluses ever since; strong investment, budget surpluses, falling unemployment
- **1960s:** consolidating success (GDP 5% p.a.)
 - Deutschmark revaluation strongly resisted
 - Exports and investment strong, unemployment nonexistent
- As German inflation *lower* than partners', boosting competitiveness, exports act as engine – becomes 'GERMAN MODEL': as stability *causes* growth
- **1970s:** Bretton Woods and German model break down; wages & DM surge, TOT plunge; domestic demand as engine, more active macro policy (G7)
 - Currency appreciation considered 'unfair' as it undermines competitiveness
- ❖ Stability of 1950s/60s vs. instability of 1970s?
- ❖ Blame it on Keynesianism! Rise of monetarism (Buba's M3 magic)

The 1980s: reviving the 'German model'

- Outset & policy turn

- Fairly high inflation & budget deficit, and also current account deficit (oil!)
- Buba runs tight money
- As Schmidt government falls, Kohl government embraces ('expansionary') austerity & single-minded 'Angebotspolitik' (supply-side-only)
- 'Wise Men' had prepared ground for German supply-side revolution by essentially reviving Say's Law that 'supply creates its own demand'

- ❖ Background: European Monetary System

- Regionally reestablishes Bretton Woods conditions, with DM as anchor
- GERMAN MODEL back in business!
- As partners disinflate and EMS 'hardens', intra-regional imbalances soar; Germany runs up large external surpluses, balances its public budget

German unification and the 1990s

- Noninflationary 'unification boom' triggers Buba overkill (1991) and unconditional austerity (1992)
- Buba overkill also kills EMS ('hello' Black Wednesday, ERM crises 1992/93)
 - *Side-effect: German boom & ERM crises actually rebalance Europe*
- Maastricht Treaty requires euro partners to become like Germany
 - Unconditional austerity pursued jointly; more wage-price disinflation
- Begging for trouble! As German model gets undermined when exported!
 - ❖ Macro policy response to unification & Maastricht EMU project turned Germany into 'sick man of the euro'
 - ❖ Germany's fateful response: 'restoring competitiveness' became national agenda

'Sick man of the euro' and the 2000s

- Mindless austerity & 'wage moderation' cause protracted domestic demand stagnation in Germany; *as competitiveness improves*
 - Regarding 'promise of currency union': 'National wage moderation raises international competitiveness, without that currency appreciation against European partners could water down this effect' (Olaf Sievert 1997).
- Common ECB policy plus 'Instability & Stagnation Pact' magnify divergences, bubbles emerge in periphery, imbalances build up
 - While Germany runs up ever larger CA surpluses and acquires foreign assets, its euro partners pile up foreign debts
 - Accident waiting to happen! 'Germany's euro trilemma' in the making
- Ignored – since considered irrelevant inside currency union
- ❖ Recall Wynne Godley's warnings



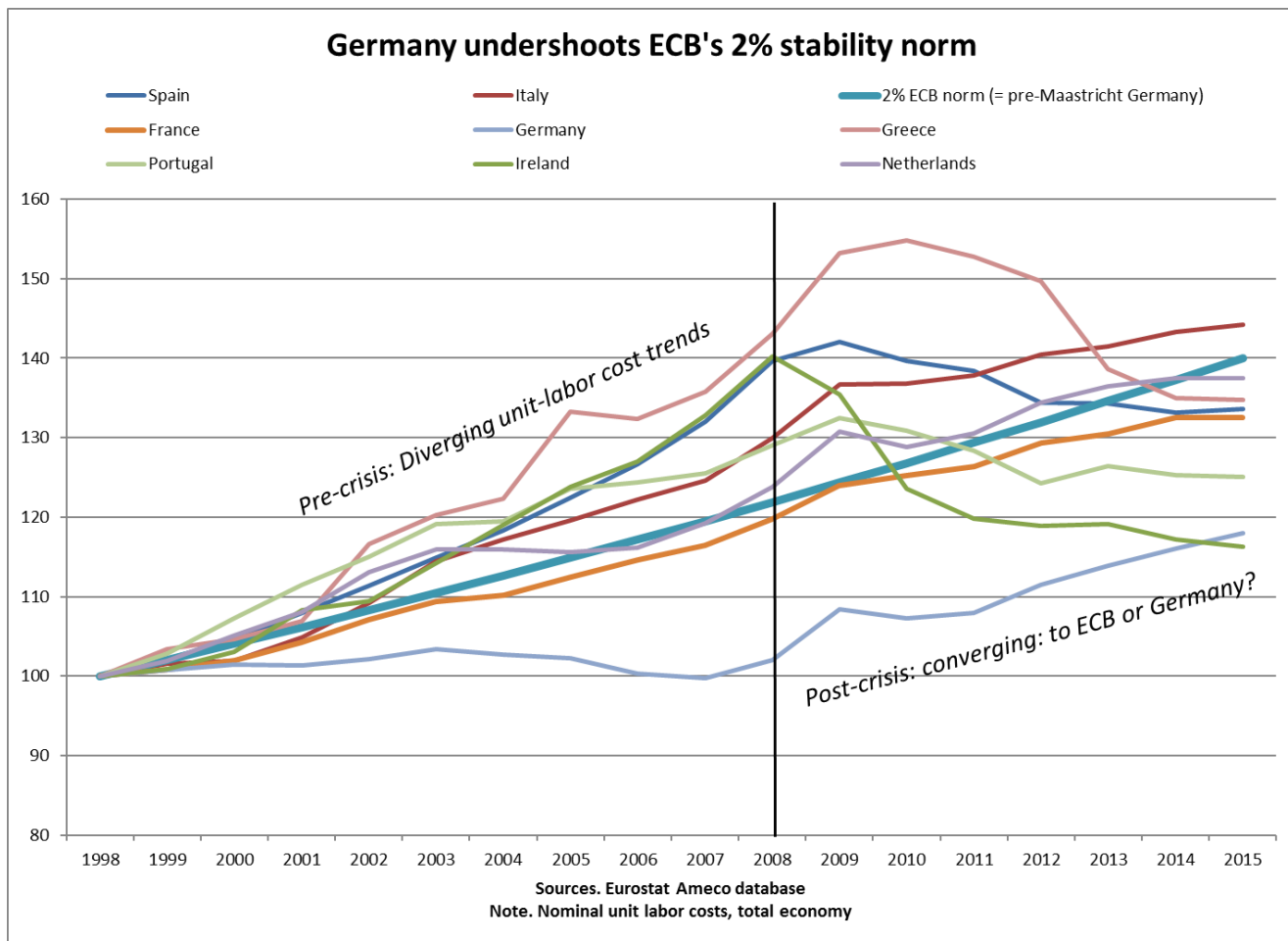
Global crisis & *brief* German 'Keynes moment'

- Apart from recycling & firing up regional imbalances, EZ banks had also undertaken adventurous explorations to other foreign shores
 - US 'subprime' losses provided first trigger of EZ banking crisis
 - Germany bailed out its own banks
 - Germany also implemented quick & sizeable fiscal stimulus (federal election in fall of 2009)
 - Measures proved effective, brisk recovery in 2010
- But then Greek debacle provided welcome excuse to orchestrate 'sovereign debt crisis' and return of unconditional austerity

The euro crisis and German-led EZ response

- Joint pursuit of austerity (boosting confidence & growth of course)
- ECB did bare minimum to prevent meltdown of banking systems, even hiked interest rates in 2011
 - Buba mindset plus German resistance
- Structural reforms to make labor markets more flexible and facilitate ‘internal devaluations’; *essentially: wage deflation ... debt deflation*
- All along Germany refuses ‘internal revaluation’ and boost to domestic demand; as Schäuble’s ‘schwarze Null’ becomes fetish
- Nine years later EZ domestic demand still below pre-crisis level
- While German and EZ current account surpluses soaring

Europe on its knees: at the brink of deflation



•Pre-crisis

- Germany reneges on euro commitment, setting EZ on collision course



•Post-crisis

- Germany resists 'internal revaluation', forces partners into deflation

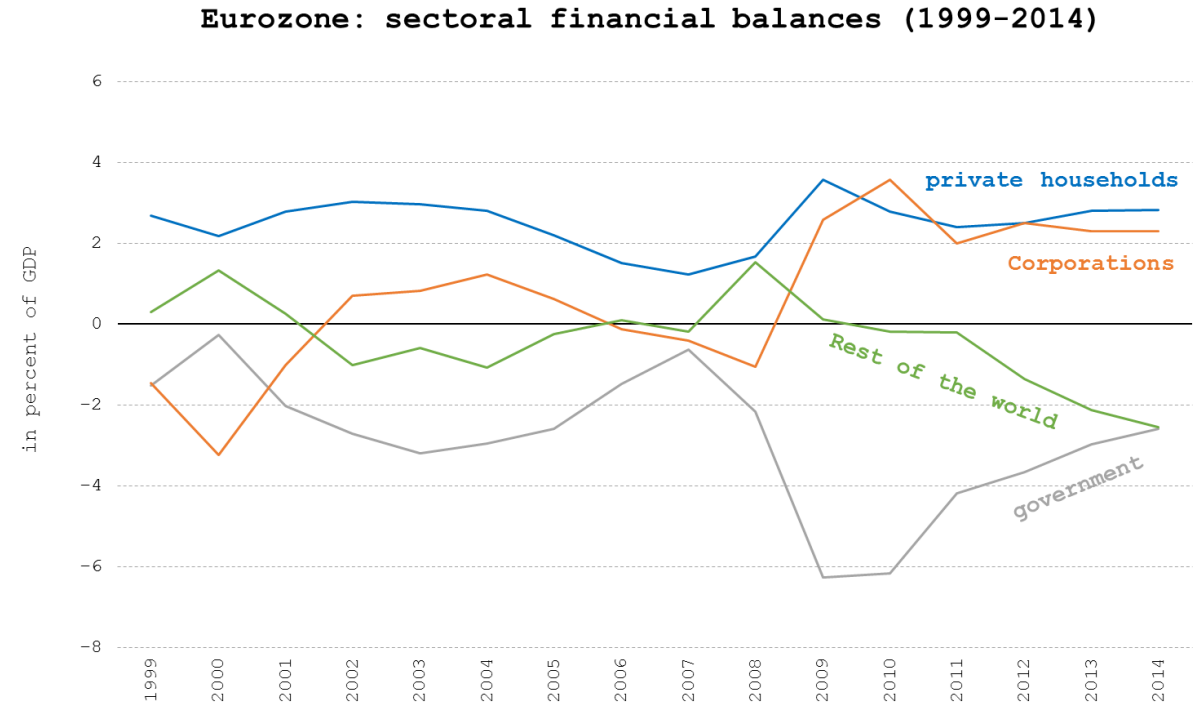
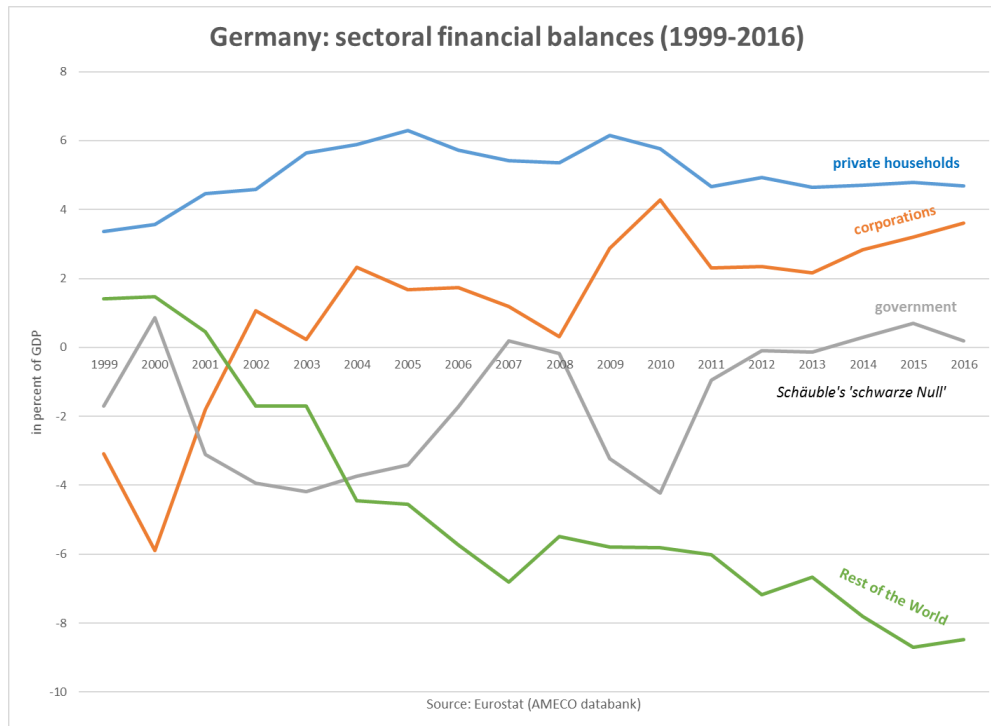


•ECB

- Belatedly turned active since 2014, but in vain
- Attacked in Germany!



The German model from a Godleyan 'financial balances' perspective



- According to Schäuble (and logic of 'Swabian housewife') debt is bad, while growth without debt is possible and virtuous; effectively relies on foreigners piling up *extra* debt
- As private sector (both private households and corporations) are turned into persistent savers, government can only balance its budget if ROW borrows and overspends; = GERMAN MODEL

Summary: no happy ending in sight ...



- Germany took GT's chapter on mercantilism to heart, ignored rest
 - In context of fixed exchange rates, *relatively* low inflation boosts competitiveness; exports then act as engine, allowing lazy macro policy
 - Buba inflation obsession (asymmetry!) enforces budgetary & wage discipline
 - Initial Ordo impact + 'economic miracle' + Buba success ... PATH DEPENDENCY
- Germany failed to appreciate that success of German model actually depends on others behaving differently from itself
 - Fallacy of composition; Swabian housewife vision not sound source of macro wisdom
- Hence exporting German model to Europe was begging for trouble
- Germany's reaction to *underbid its own model* backfired badly
- *Germany's anti-Keynesianism costs Europe (& Germany) very dearly*

Thank you!



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