

Greece, Germany, and the Fate of the EMU

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The stakes are high. Greece's financial malaise poses extraordinary challenges for its political economy, especially for the structures of its social systems. The accumulation of huge public deficits combined with large current account deficits indicate fundamental economic and political problems. A solution can only be found if willing domestic political coalitions receive adequate external assistance (from both the political and financial sectors) to deal with the Herculean task. Since the Socialist government announced in late 2009 that previously published figures of Greece's public deficits needed to be corrected downwards and that its projected deficits would be dramatically higher than previously indicated, financial markets flagged Greece as the weakest candidate out of a group of European economies with similar economic woes. The UK, Ireland, Spain, and Portugal share many of the same economic characteristics – but it is Greece who is in the international limelight.

It can be argued that the Greek crisis indicates more than a crisis of a national regime of accumulation. In a nutshell, the Greek situation refers to a fundamental crisis of the Euro and its institutional and financial architecture. Much ado has been made of the fact that Greece in only two years was able to fulfill the public deficit criteria of the

Stability and Growth Pact (SGP) after entering the Euro zone in 2001. Financial markets, at least from the theoretical perspective of rational expectations, should have been long aware of Greece's problems, and priced-in this risk for Greek public debts. However, financial markets seemed to have nearly entirely neglected the flagrant violation of the Stability and Growth Pact. As a matter of fact, the risk price (the spread compared to German public debt) only very recently increased. It did so, however with vertiginous speed, reaching hitherto unknown levels for the Euro zone.

Though Greece represents only a tiny share of the overall GDP for Euro zone economies, a sovereign default in Greece would have repercussions throughout the common currency zone. Financial markets may be encouraged to turn their attention to other ailing economies of the Euro zone and start speculative attacks by pushing the price for Credit Default Swaps (CDSs) to new heights. Lower sovereign ratings on a broader scale would then undermine the reputation of the Euro, and endanger the stabilizing anchor function of the Euro zone. On a financial industry level, a default in Greece would generate significant costs for banks that are relatively strongly engaged with Greek public debts. This is particularly the case for some German banks that have invested 30–38bn Euro in the markets for Greek public debt.

In this context of dramatic financial stress from one of its member

economies, political actors of the various institutions of the Euro area and the EU as well as of national governments responded with astonishing cacophony. Opinions ranged from letting Greece default and leave the Euro zone on a Euro holiday, to fully supporting the financial needs of the ailing country by offering various forms of bailouts. In some instances, identical national political camps supported opposing policy options, and in some cases politicians changed their minds on a daily basis. Confusion seemed to reign in Europe.

This confusion reflects the unpreparedness of the politico-economic elite in Europe, who until the last minute were strong believers of the practicality of the SGP on the one side and of the disciplinary effects of untamed international financial markets on the other side. Much of the confusion, however, is directly related to national interests and preferences. This is particular true in the case of Germany where Chancellor Angela Merkel used the Greek crisis to position herself as the new “Mrs. No’ who firmly rejects any action that can be interpreted as a bailout. At the same time, Finance Minister Schäuble was pondering the creation of a European Monetary Fund to act as supervisory agency and as well as a rescue institution, arguing that the solution to the crisis should come from within the EU and not include the assistance of the International Monetary Fund. Merkel never expressed her open support for such a new agency but saw the inclusion of the IMF as critical – if only

to jab President Sarkozy who, for domestic political reasons, didn’t want so see the IMF and its director Strauss-Kahn, a potential rival for the next French presidential election, on board. At the end of the day, Merkel had to compromise and to accept a proposal for emergency funding to which her government would have to contribute about 8bn Euro. Since signing this agreement, the German government has portrayed this plan as everything but a bailout program to make sure that it does not violate the bailout clause of the Maastricht Treaty (article 103, section 1). This effort is mainly as a political maneuver to prepare for a showdown at the Supreme Court where adversaries of the compromise will soon look for a overarching final verdict.

National agendas have been the traditional driving force in EU politics. This tradition has held in the political reaction to the Greek financial malaise. This time, though, the muddling through may not have been enough to prepare the Euro zone for the storms and severe weather brewing on the horizon.

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