This paper has two interrelated elements. It provides an examination of the complex discursive structure underpinning and shaping German responses to EMU. It then goes on to investigate the strategic behaviour of German policy makers. This strategic behaviour is informed by the deeper discursive structure. At the same time it is a response to the new paradoxes, uncertainties and contingencies with which EMU faces them. The changes in discursive structure outlined at the beginning are in turn shaped by these contextual changes. What emerges is a picture of complex, interactive changes in which discursive structure, uncertainty and contingency emerge as powerful factors in conditioning German responses to EMU.

EMU raises interesting questions about the forces changing German policies and politics and about the role of discourse in mediating those changes. These forces have in substantial part been common to other European states, notably globalization and fundamental technological changes. One force – German unification – has been specific to Germany, and has been associated with a redefinition of Germany as a ‘burdened’ state. The domestic debate about Standort Deutschland predated German unification in 1990 (Dyson 1999). However, by 1993 sharp, harsh ‘de-industrialization’ in the five new federal states, high unemployment consequent on low productivity and rising costs there, and huge fiscal transfers had given a new focus and impetus, and a specific German dimension, to problems of domestic policy reform. German unification – and the redefinition of Germany that went with it – acted as a new catalyst for domestic reforms.

What is interesting about the German case is the way in which a dominant domestic ideology of Ordo-liberalism conditioned and constrained the way in which key policy makers responded to these forces for change. Specifically, before 1999 this ideology led policy makers to construct Germany’s problems as consequent on globalization, technological change and German unification. They were viewed as creating an inexorable long-term logic of structural supply-side reforms and market liberalization (Bundesministerium für Wirtschaft 1998: 13-16). This logic challenged an outdated ‘Rhineland’ or ‘managed’ capitalism and its norms of consensus and cooperation in managing change. These norms – supported by an ‘enabling’ rather than ‘liberalizing’ state - were seen by Ordo-liberals as hostile to the flexibility and individual initiative required of the German economy. By 1995-96 the German corporate sector was legitimating a wave of rationalization and direct investment

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abroad as making Germany ‘fit for globalization’ and ensuring that Germany was on ‘the winning side’. Corporate pressures – channeled through the Federation of German Industry (BDI) and led by Daimler-Benz - emboldened policy makers in the Chancellor’s Office and the Finance Ministry to adopt a new, tough approach to pushing through Ordo-liberal ideas of supply-side reform.

The result was a changed climate of domestic policy making. Pressures for wage flexibility were reflected in threats of defection from the Federation of German Employers (BDA) which negotiated area wage agreements with the trade unions. Tensions mounted between the BDI, which was most aggressive on globalization, and the other main peak economic associations, which had a stronger interest in the ‘managed’ capitalism model. Conflicts with and within the German Trade Union Federation (DGB) gained momentum following the collapse of the Alliance for Jobs in March 1996. Globalization was associated with a newly assertive Ordo-liberalism, an attempt by the Kohl government to redefine itself as the champion of structural economic reforms, heightened domestic conflict and a ‘reform blockade’ (Reformstau) conducted by the opposition Social Democratic Party (SPD) under Oskar Lafontaine.

But, strikingly, Ordo-liberals were more cautious about attributing significance to EMU as a force for change. Their discourse focused on EMU as a force for structural reforms in other EU states and on the risk that EMU might add to Germany’s problems rather than be a key part of the solution. This discourse was consistent with a preference for a ‘controlled delay’ over strict adherence to the Maastricht timetable. EMU’s significance was only really publicly recognized by Ordo-liberals from 1998, once stage three was a fait accompli. It then began to be seen in more positive terms as a catalyst for necessary domestic structural reforms to labour markets, wages policy and the budget. By institutionalizing fiscal and market discipline, and forcing German policy makers to attend to the new realities, EMU promised to speed up the process of market liberalization.

As this paper stresses, Ordo-liberalism remained dominant but was newly challenged on EMU. The neo-Keynesians around Lafontaine, and – more significantly – the ‘Rhineland’ capitalists, were quicker to recognize that EMU could be a force for change, for opening up what they viewed as a closed, conservative debate in Germany. One construction of EMU gave way to contention amongst three main constructions. Each attributed a different meaning to the euro. This contention was opened up with the election of a SPD/Green coalition government under Gerhard Schröder in 1998. In this respect there were two parallel developments – the transition to stage three on 1 January 1999 and a new party political constellation in power. The change of power was itself a factor in shaping how EMU was constructed in Berlin.

But an examination of the discursive structure underpinning and shaping German responses to EMU tells us only part of the story. Another part is the strategic behaviour of German policy makers in dealing with the paradoxes and uncertainties with which EMU faces them. Five paradoxes are striking:

- between export of the German model of economic stability and a new methodology of benchmarking best practice
- between the Europeanization manifested in programmatic statements and the reticence about Europeanization in ‘framing’ and legitimating particular reforms to the German public
- between the fixed timetable for EMU and strict convergence
• between the Bundesbank as the bank ruling the transition to stage three and the Bundesbank seeking a new role and structure to strengthen its position
• between EMU and the ‘managed’ capitalism model

Hence the transition to EMU threw up a whole complex of interrelated problems with which German politicians and officials had to grapple. Underlying all these problems were the new uncertainties created by EMU and the extent to which outcomes were contingent on factors, many outside the direct control of the German government. Economic growth was a key determinant of whether the fiscal criteria could be met and the timetable adhered to. Another variable outside German control was the behaviour of other EU governments – especially France – in achieving fiscal performances that could be sold to the Bundesbank and the German public as consistent with a ‘stability community’. A third variable was German public opinion and how German politicians chose to use it – whether for instance the SPD might be tempted to oppose the timetable for stage three and how the Bavarian Christian Social Union (CSU) responded to electoral threats from the extreme Right. Hence a key theme is the management of uncertainty and contingency.

Economic Ideology and the Construction of EMU

Ordo-liberalism was the underlying economic ideology which gave direction to, informed, constrained and legitimated German negotiating positions on EMU (Dyson and Featherstone 1999). It was a specifically German product, rooted in the lessons drawn from traumatic experience of two hyperinflations, the failure of the Weimar Republic and the Third Reich (Nicholls 1994). Its heroes were Ludwig Erhard, Walter Eucken and Wilhelm Röpke; its victories, a postwar economic miracle and a strong and stable D-Mark; and its leading combatant on EMU, Hans Tietmeyer. The Bundesbank was Ordo-liberalism’s institutional epicentre and able to count on support from the Economics Ministry, the Finance Ministry and the Council of Economic Advisers (Sachverständigenrat). Ordo-liberalism dominated amongst academic economists and within most of the six main economics research institutes. The history of EMU is one of its continuing impact and resilience in the face of challenge.

Ordo-liberalism was influential in two ways in shaping how German policy makers constructed EMU. Firstly, it argued that EMU must be a ‘stability community’ based on economic convergence, if it was to be sustainable. This meant Europeanizing the German model of economic stability – through absolute priority to the principle of open, competitive markets; an independent ECB pledged exclusively to price stability; rules on ‘no bail outs’ and proscribing monetary financing of budget deficits; and clear, strict and automatically enforceable rules on fiscal discipline. The stress was on strict interpretation of the convergence criteria in the Maastricht Treaty and on rules in the Stability Pact to ensure balanced budgets over the economic cycle.

Secondly, Ordo-liberalism argued against ‘explicit’ policy co-ordination at the EU level. Specific policy problems were to be clearly assigned to different actors who were responsible for solving them. Growth and employment were not seen as the responsibility of the ECB. Equally, governments and social partners were not to interfere in how the ECB discharged its responsibility for price stability. Ordo-liberals were on the whole unhappy with debates about EU-level economic policy ‘co-
ordination’, preferring ‘dialogue’ and ‘co-operation’. Their particular suspicion was
directed at French talk of an ‘economic government’, at references to a more active
exchange rate policy for the euro, and at references to the Euro ‘Council’ rather than
Euro ‘Group’ (implying that it had a formal status as a decision-making body). They
were seen as devices for undermining the independence of the ECB. Hence Ordo-
liberals emphasized the principle of subsidiarity in economic policy, the individual
responsibility of member states for growth and employment, and the competition of
national policies (Bundesministerium für Wirtschaft 1998; Siebert 1998).

Ordo-liberalism’s association with the ‘coronation’ theory – according to
which monetary union would be the final moment of a process of economic and
political union – meant that its exponents had a reserved position on EMU. Strict
convergence came before a fixed timetable; political union must accompany EMU to
ensure sufficient solidarity; and a controlled delay was preferable to a poorly prepared
EMU. In essence, the ‘coronation’ theory served as a critique of the readiness of the
EU rather than of Germany itself, which was presented as the template for EMU. Hence Ordo-liberals were reticent about using EMU as a critique of German policies
and politics. Their critique of Germany was linked to globalization, technological
change and German unification (Bundesministerium für Wirtschaft 1997). The Ordo-
liberal critique focused from the mid-1980s on the single European market
programme as a welcome catalyst for overdue domestic reforms. But EMU was seen
as a potential source of deeper problems for Germany in a global context rather than
as a part of the solution. Hence the tax, social-security, labour-market, privatization
and utilities liberalization reform proposals of the Christian Democratic/Liberal
(CDU/CSU/FDP) coalition from 1996 were framed more in terms of globalization
than of EMU (Banchoff 1999).

This low profile of EMU as a factor in domestic structural reforms came to an
end after 1998 for two main reasons. First, once EMU was a fait accompli, Ordo-
liberals began to redefine it as a catalyst for overdue domestic supply-side reforms by
subjecting the German economy to intensified competition, especially in the banking
and financial sectors. In essence, EMU was redefined as an agency for speeding the
impact of globalization, notably through a greater focus on ‘shareholder’ value
(Siebert 1998). EMU was now valued as an instrument for an Ordo-liberal revolution
in Germany. From this perspective the Schröder government was not ultimately about
correcting Ordo-liberalism in the name of social democratic values. Its role was the
symbolic political management of a necessary market liberalization. Ordo-liberals had
come to terms with EMU, attributing a greater causal significance to it, even if as an
intervening variable. Secondly, the SPD-led government was able to occupy a space
between domestic Ordo-liberal ideology and the positions advocated by other EU
governments of the centre-left within the Euro-Zone. This space was about co-
ordination and social dialogue, new keywords in Berlin, but contested within
Germany.

The key contest within the new government revolved politically around
Schröder and Lafontaine. As new Finance Minister Lafontaine saw an opportunity to
open up German economic debate to new ideas, to use EMU as an instrument to
rescue Germany from unemployment, and to safeguard the European social model
from thesis of globalization as an imperative. This opportunity was provided by the
loss of authority of the Bundesbank over monetary policy and hence a weakening in
the projection of Ordo-liberal policy ideas. Lafontaine sought to Europeanize the
Finance Ministry and make it the powerhouse for new economic ideas (on the British
Treasury and French Tresor models). Above all, he aimed to break the grip of what he
saw as a conservative, inward-looking and bureaucratized economic policy process dominated by the Council of Economic Advisers and the leading economic research institutes (Lafontaine 1999).

Central to this strategy was the transfer of the traditional Ordo-liberal conscience and crown jewel of the Economics Ministry, its economic policy division (Grundsatzabteilung), and of its European division. By this means the Economics Ministry was prevented from acting as an intellectual counterweight on economic and European policies. The rationale was that German credibility and strength depended on a unified EMU policy to which the old checks and balances approach was inimical. A new European division was created to press the case for a co-ordinated EU policy mix involving financial policy, monetary policy and wage policy. It reflected Lafontaine’s view that to be effective SPD policies had to be European. In addition, neo-Keynesians were drafted into key positions, notably Heiner Flassbeck and Claus Noé as State Secretaries, Wolfgang File as head of the money and credit division, and Stefan Collignon into the European division.

Lafontaine had prepared these changes as party chair from 1995. He played a driving role in getting the SPD to see in EMU a catalyst for domestic economic reforms based on social democratic values. Lafontaine worked closely with the French Socialist Party to construct EMU as a project for growth and employment based on close macro-policy co-ordination, the creation of a counterweight to US dominance of globalization, and a European employment pact. These ideas, which were agreed at the special SPD conference in Hanover in December 1997, reflected the thinking of Jacques Delors and Lafontaine’s commitment to using transnational collaboration with the French Socialists to redefine SPD programmatic ideas in a European context.

The most controversial aspect was Lafontaine’s sponsorship of a new neo-Keynesian approach whose intellectual basis was provided by the work of Francesco Modigliani, Robert Solow and James Tobin. Advised by Flassbeck, he focused on the German and Euro-Zone problem as – contrasted with the US - persistent negative output gaps over the previous 20 years (Collignon 1999). Excessively high interest rates had had a detrimental effect on investment, growth and employment. The solution was not so much supply-side reforms as more active demand management, including an expansionary role for wages and a growth-accommodating interest rate policy by the central bank. This policy necessitated strong policy co-ordination at the G-7 and EU levels, breaking the US grip on the key international institutions, and challenging the Bundesbank and the ECB to pursue growth and employment as part of their objectives (Lafontaine and Müller 1998).

Though Lafontaine’s tenure of office was short, his impact outlasted him in the SPD and in the Finance Ministry. Under Schröder German policy drew back from endorsing a neo-Keynesian construction of EMU. But the themes of social justice, macro-co-ordination and demand management endured, albeit with a change of emphasis and style under Hans Eichel. For instance, in the German paper of 10 March 2000 for the Lisbon European Council the SPD’s impact was discernible in two of the four strategic goals: ‘renewal and securing of the European social model’; and ‘macro-economic policy and economic policy co-ordination for sustained growth’. The first goal involved maintaining minimum social standards and top priority to investment in human and social capital; the second, avoidance of unfair tax competition and the pursuit of a macro-economic policy-mix oriented to growth and stability. These Lafontaine-type goals were, however, elaborated in a way that ensured consistency with the two main models – ‘managed’ capitalism and Ordo-
liberalism – and reflected the political victory of Schröder in the contest with Lafontaine.

Notably, under Eichel the Finance Ministry continued to argue the importance of an effective policy-mix that embraced the demand as well as the supply side. It rejected the view of the Council of Economic Advisers that unemployment had its sole roots in supply-side conditions (Bundesministerium der Finanzen 2000: 83). This thinking was reflected in Eichel’s budget consolidation and tax reforms of 2000, which provided a net stimulus to demand. Finally, and informally, the DGB kept alive the ideas of macro-economic co-ordination and active demand management. However, it opted for a strategy of caution and stealth. Thus the DGB instituted new regular private meetings with the incoming president of the Bundesbank, Ernst Welteke. It also used informal meetings, involving the Bundesbank, in preparation for the Macro-Economic Dialogue and organized within the Finance Ministry. The DGB advocated Lafontaine’s thinking but shorn of his confrontational style and Flassbeck’s intellectualism. It preferred discrete, behind-the-scenes influence.

More influential in filling the policy space opened up by EMU was the construction of EMU around the values of ‘managed’ capitalism. Here there was a meeting of minds between Schröder, his economic policy adviser Klaus Gretschmann, Eichel, Finance Minister from April 1999, and Werner Müller, the Economics Minister. Much of this thinking had revolved around the SPD in North-Rhine Westphalia, notably Bodo Hombach (1998), minister in the Chancellor’s Office till summer 1999. The key words were co-operation, dialogue and social consensus in managing supply-side reforms, ensuring that labour-market flexibility took place within a framework of social protection. As with Ordo-liberals the key source of change was seen as globalization. But EMU was more than just a catalyst, forcing the pace of structural reforms. It was an opportunity to regain control over economic policy, to act as a counterweight to the US, to reassert the values of the German consensus model, and to achieve tight co-ordination of economic policy (Gretschmann 1998: 53 and 60-61). In this view, EMU had involved not the export of the German model, only its Ordo-liberal component. Hence EMU needed reform to strengthen social dialogue and co-ordination and achieve a closer fit between the domestic ‘Rhineland’ model of co-operative capitalism and the institutional design of the Euro-Zone. The key was to integrate wage bargaining into the EMU policy mix and to make possible a growth-supporting ECB monetary policy by ensuring that unit labour costs remain consistent with the price stability objective.

This thinking lay behind the German initiative during its EC Presidency of 1999 to establish the Macro-Economic Dialogue – the Cologne process – as a means of promoting a better understanding of how policies interacted. In essence it was modeled on the new Alliance for Jobs (Bündnis für Arbeit) in Germany. The Macro-Economic Dialogue brought together member-state governments, the Commission, the ECB and the social partners, at both political and technical levels, to try to achieve a more compatible policy-mix at the European level and, in particular, to draw wage policy into discussions. Another manifestation was in German ideas, adopted at the Helsinki European Council in December 1999, on strengthening economic policy co-ordination. The aims were to take better account of the interdependencies and spillover effects at work in EMU; to broaden the agenda beyond fiscal discipline; and to toughen up pressure on states to deliver reforms. These measures involved extending the Economic Policy Guidelines to include structural reforms (e.g. wages
and labour markets), recommendations to individual states, and monitoring of their implementation.

From 1998 onwards there were signs of a new German consensus about the emerging Euro-Zone. This consensus involved some Ordo-liberals, notably Horst Köhler (1998: 7) who had negotiated the Maastricht Treaty, accepting that the Euro Group was more than just guardian of the Stability and Growth Pact. It was also an economic policy ‘pole’ in EMU, pursuing a tight co-ordination of economic policies, especially of structural reforms, and engaged in intensive dialogue with the ECB. Another aspect of this consensus, discussed below, was a stronger recognition that domestic economic policies were embedded in EMU. There was, in addition, a new consensus by 2000 on policy ‘benchmarking’ of best practice in economic policy as a method of co-ordination. Benchmarking was useful because of its compatibility with Ordo-liberal premises of subsidiarity and competition of policies. It also promised a technocratic ground of expert determination of what works best as the basis for domestic reforms. Hence Ordo-liberals and ‘Rhineland’ capitalists could rally around it. German negotiators actively promoted benchmarking. Finally, Gretschmann and others promoted the notion of a new phase in European integration after monetary union. This phase involved creating the ‘European innovation and knowledge society’ and drawing the Education, Science, Research and Technology Ministry actively into EU processes of benchmarking best practices. Once again a technocratic basis for a consensual approach to EMU and to domestic policy reform was identified. The Lisbon European Council of March 2000 was seen as marking a better ‘goodness of fit’ between EMU and the German model. In these respects the Schröder government can be said to have moved the centre of gravity of the German consensus. Not least, benchmarking made it respectable to use arguments derived from experience in other states to strengthen domestic political arguments.

But this shift needs qualification. First, tensions and potential for conflict accompanied the consensus. In strict Ordo-liberal terms, the Council of Economic Advisers continued to speak of a readiness for conflict as necessary for a long-term economic policy of supply-side reforms. It expressed scepticism about the value of both the Alliance for Jobs and the Macro-Economic Dialogue, arguing that they threatened to produce a confusion of responsibilities (Sachverständigenrat 1999). There was also disagreement between the federal government, which saw itself as taking a balanced approach to the demand- and supply-sides of economic policy, and Ordo-liberals who stressed supply-side reforms. Another instance (see below) was a difference of view within the Finance Ministry on the scope of Europeanization. Secondly, Ordo-liberalism retained a strong gravitational pull despite the weakening of the Bundesbank and of the Economics Ministry. It continued to define the limits on macro-economic policy co-ordination (see below) and to enforce respect for strict fiscal discipline and supply-side reforms (witness the budget consolidation and tax reforms of 2000). In the preparations for the Cologne European Council Gretschmann ensured that the Finance Ministry’s idea of an optimal macro-economic policy mix was excised from the proposed Macro-Economic Dialogue in favour of stress on its information and communication functions.

The Paradox of Europeanization: From Exporting Model Germany to ‘Benchmarking’ Best Practice
EMU was associated with a seismic shift in German self-perceptions. The Maastricht Treaty had symbolized German monetary power, the successful ‘Europeanization’ of the German model of an independent, powerful central bank. It had been, if not a complete, a substantial vindication of German negotiating strength. The resulting ‘goodness of fit’ between German and EU policy paradigms of ‘sound’ money and finance meant that German policy makers saw little problem in accommodating to EMU. The problem rested with others who were required to undergo drastic domestic transformation. Paradoxically, the transition to stage three revealed the mounting problems of the German political economy, undermined its moral claims to a leadership role, and weakened its negotiating position in 1998-99 compared to 1991. German policy makers began to embrace a more humble outward-looking attitude of learning from others’ better practice in structural economic reforms.

This fundamental ‘goodness of fit’ applied not just to the ECB (the Bundesbank writ large) but also to the earlier ERM (anchored to the D-Mark) and the Stability and Growth Pact (subjecting budgetary policies to clear long-term rules). In each of these cases German domestic preferences had been successfully projected into EU-level agreements. Thus Köhler (1992), State Secretary in the Finance Ministry, spoke of ‘exporting this fine piece of German identity to Europe’. In the Bundestag debate of 23 April 1998 Theo Waigel, the Finance Minister, argued: ‘We are not giving up the D-Mark but continuing its history of success at the European level’. For the CDU/CSU parliamentary party in a statement of September 1997 EMU was not a question of ‘sacrificing’ the D-Mark on the ‘altar’ of Europe but of ‘investing it in the European cause’.

This successful ‘Europeanization’ of the German monetary-policy model was driven by the persuasive ideological conviction of Ordo-liberals. They preached the virtues of price stability and of a predictable, long-term framework of monetary and financial policy as the essential precondition for sustainable growth and employment. Consistent with this credo, the Bundesbank defined its role as the guardian (Wächterrolle) in preparing EMU and as the ‘reliable, well-informed and committed advocate of sustainable monetary stability’ in the Euro-Zone. With the arch Ordo-liberal Tietmeyer as its president (1993-99) the Bundesbank forcefully pursued a pedagogic role on behalf of price stability. EMU was in this respect about a ‘Germanized’ Europe.

But Europeanization of the German monetary policy model had deeper roots than just a strongly articulated, impressively argued and coherent Ordo-liberal theory. The quality and effectiveness of German arguments on EMU rested on strong economic fundamentals, on a powerful historical memory, and on the peculiar symbolic importance that Germans attached to the D-Mark. The strong economic fundamentals were represented by the superior performance of the D-Mark as a ‘hard’ currency, both internally and externally, compared to other EU currencies. In addition to benefiting from association with success, the Bundesbank was able to identify itself with German historical memory of what damage inflation could wreak on economy, society and democracy. The lesson was that the management of money must be depoliticized and conducted in a long-term and consistent framework. Historical memory fused with the postwar performance of the D-Mark to give a degree of political self-confidence to the Bundesbank lacking in other German institutions, except perhaps the Federal Constitutional Court. Above all, it enjoyed a very high level of public support for its mandate (Kaltenthaler 1998).

Hence, politically, the Bundesbank had a powerful institutional veto position on EMU. ‘Binding in’ the Bundesbank was an essential precondition for keeping
German public opinion behind EMU. This strategy was pursued in putting EMU back on the agenda in 1988 (appointing its president Karl-Otto Pöhl to the Delors Committee) and throughout the negotiation of the Maastricht Treaty and the transition to EMU (Dyson and Featherstone 1999). The political damage that could follow when the strategy of ‘binding in’ failed was revealed in 1997. Waigel’s reputation as Finance Minister was seriously damaged by his failed attempt to engineer a premature revaluation of the Bundesbank’s gold reserves as a means of defraying the public debt (Duckenfield 1999). Bundesbank endorsement was the single most important domestic condition for persuading the German public to give up to Europe their most impressive postwar achievement, the D-Mark.

But, paradoxically, this successful Europeanization of German monetary policy – EMU as the projection of German ‘civilian’ power – was accompanied by an eroding credibility of ‘Model Germany’ from 1991 onwards. This eroding credibility reflected underlying structural changes (European Commission 1999; Bundesministerium der Finanzen 2000). From 1993 the annual rate of economic growth fell below that of the EU-11 and EU-15 average. Germany’s annual rate of growth of capital formation amounted to only 2.3 per cent in the 1990s, compared to 5.7 per cent in the United States. Its unemployment rate doubled between 1991 and 1999. Ominously, it scored the second biggest fall in total employment in the EU between 1991 and 1998. Germany suffered from new budgetary problems (especially due to reliance on debt financing of huge fiscal transfers), unprecedentedly high Bundesbank interest rates to fight inflation, and – by 1995-96 – failure to meet the Maastricht deficit criterion.

In short, Germany moved from being the model for fiscal discipline to a problem case. By March 1997 Tietmeyer was confessing that Germany was no longer the model economy for Europe (the Netherlands had a stronger claim) and asking whether EMU might be delayed by German weakness. A statement of the CDU/CSU parliamentary party in September 1997 broke new ground in pointing to the greater success of the Netherlands and other countries in pursuing economic and social reforms, the huge progress in Italy and Spain, and France’s better record than Germany on inflation since 1992. As Germany began to contemplate the ‘long overdue reforms’ necessitated by EMU, a new humility was evident.

Most striking was the lack of initiative before 1996 from the Chancellor’s Office in asking how economic policy needed to be adjusted to prepare for the euro. Kohl’s adoption of a new image as the Chancellor of economic reform was pressed on him by increasingly impatient employers and industry associations, seeking a political ambition to match the scale of rationalization measures being pursued in the corporate sector. Corporate concerns about the euro were expressed in the Petersberg Declaration – ‘Secure into the Future with the Euro’ – of 1996. Here the German employer and industry associations pressed for more flexibility, especially in the labour market and in wage negotiations. But when, in March 1996, the government adopted tough new positions on tax and welfare-state reforms, it drew back from legitimating them by reference to EMU (Banchoff 1999). As in the 1970s and 1980s, reforms were presented as indispensable preconditions for improving international economic competitiveness and restoring credibility to Germany’s economic policies. The urgency was justified by domestic political concerns about rising unemployment and by worries about Germany’s international standing. Germany’s weight at the European level, especially in the transition to stage three of EMU, played more of an internal role within the political elite than in the framing of reforms. Internally, it was recognized that, unless Germany could demonstrate a will to reform, its preaching of
the stability message to others would invite charges of hypocrisy. It would also be
difficult to rebut the claims of Italy and others to join stage three in the first
wave. But reforms were framed for public opinion by reference to the imperatives of
globalization.

Two features characterized the attempted economic reforms of the Kohl
government of 1994-98. They appeared as too little, too late, undertaken by a tired
and fractious coalition of CDU, CSU and FDP. The reforms were trapped politically
between an FDP demanding deep tax cuts and an SPD opposition hostile to major
spending cuts and having a majority in the Bundesrat, the second chamber. More
seriously, by trying to push through reforms in the latter part of the legislative period,
they invited a ‘reform blockade’ by the SPD opposition in the Bundesrat. By 1997
‘Reformstau’ became a keyword to describe the condition of Germany. Against this
background, and fearful of not meeting the Maastricht criteria, Waigel was tempted to
launch his ill-fated proposal to revalue the gold reserves.

Schröder (1998) mounted his political challenge against Kohl in terms of his
superior competence to handle the imperatives of globalization rather than in terms of
EMU. But after 1998 the Schröder government proved unable, for internal political
reasons, to take full advantage of its temporary possession of concurrent majorities in
both Bundestag and Bundesrat. Paradoxically, it was only after it lost its majority in
the Bundesrat that it was at last able to negotiate a radical tax reform (in July 2000),
following a radical budget consolidation programme. Its success in doing so rested on
a greater internal unity and on Schröder’s political strategy of seeking out consensus
with the employer organizations and trade unions as a means of putting the CDU/CSU
opposition and his own Left under pressure to accept reforms. Even so the pace of
reform was slow, with key welfare-state and labour-market reforms still to be tackled.

From 1996 onwards a new modesty crept into German discourse about EMU.
This strain of modesty provided a greater ease of fit between Germany and a larger
rather than small, core EMU. Indeed, there was a striking association between
Germany’s mounting economic and political problems in 1996-98 and the demise of
what had become an informal consensus by 1995 that only a small core of states
would proceed to stage three. The new modesty was also apparent in the spread of the
idea of ‘benchmarking’ best practice elsewhere, deriving in part from the corporate
sector, in part from Brussels and in part from modernizers in the SPD.

The Paradox of Europeanization: The Gap between Programmatic Discourse
and the Framing of Domestic Policy Reforms

Despite a political reluctance to politicize EMU by associating it with increasingly
contentious structural reforms, Europeanization of economic policy through EMU
was invested with new meanings. Policy makers began to see in EMU a catalyst for
domestic transformation rather than as a new reality to which Germany could easily
accommodate. This change of perception was most apparent in programmatic
statements. How Europeanization was understood in Berlin was first made clear in the
Annual Economic Report of 2000. It turned its attention to ‘learning from ‘good
experiences’ in other states’, focusing on Denmark and the Netherlands in labour-
market and wage policy reforms and also the United States (Bundesfinanzministerium
2000: 11-12). These states were seen as offering lessons about the kinds of macro-
economic conditions and micro-structural reforms required to modernize Germany.
This official report also recognized that the euro required a ‘deepening and
strengthening of co-ordination’ of national economic policies, that German autonomy of action was further constrained, and that its economic policies had to be more strongly embedded (eingebettet) in the European macro-framework (ibid: 19). The new European division in the Finance Ministry – Lafontaine’s legacy – advocated the view that all domestic economic policies had a European dimension and the case for tight European co-ordination.

But also striking were the perceived limits on Europeanization. There was a greater readiness to justify structural reforms by international ‘best practice’ or ‘benchmarking’ (horizontal policy transfer) than by reference to the requirements of the euro (vertical policy transfer). ‘Benchmarking’ had two advantages as a concept. Firstly, it situated the debate about domestic reforms in the arena of ‘globalization’ rather than the euro. This construction of reform reduced the association of the euro with negative effects for Germans and hence was politically expedient in protecting the European integration process – in which Germany had a vital national interest – from potential lack of consensus over structural reforms. Secondly, ‘benchmarking’ gave a technocratic rationale to reform. It framed painful reforms in a context of matching ‘best practice’. This form of technocratic discourse also eased problems of gaining acceptance for market liberalization within the SPD and the trade unions.

A further limitation stemmed from the arguments advocated by the economic policy division (Grundsatzabteilung) of the Finance Ministry – transferred from the Economics Ministry in 1998. The Annual Economic Report of 2000 reflected acceptance of its three arguments against the view that German economic policy had been completely Europeanized and hence a measure of continuity. It endorsed the basic principle of subsidiarity, according to which responsibility for growth and employment rested primarily at the national level. It stressed the subsidiary role of European co-ordination to co-ordination and discipline by the market. It also underlined the importance of policy competition for raising economic performance. Though these arguments qualified the new emphasis on Europeanization in the Annual Economic Report, Eichel gave strong internal backing to the European division. This backing focused on two key considerations that favoured the thesis of Europeanization of German economic policy: that policy competition must be fair, notably in tax policy so that tax revenues were stabilized; and that benchmarking ‘best practice’ was a key to expediting structural reforms inside Germany.

Despite this new programmatic emphasis on Europeanization, the crucial budget consolidation programme, tax reform programme and pension reform proposals of the Schröder government were conspicuously not framed in terms of the requirements of EMU. Strict discipline on public expenditure and continuing reduction of the budget deficit were legitimated in German terms. They were justified as essential for regaining domestic room for manoeuvre in financial policy, thereby enabling the government to better deliver on its political priorities. They were also framed as about the principle of intergenerational fairness. The tax reform was about better domestic conditions for investment, growth and jobs, with the EU addressing problems of unfair tax competition. Pension reform was about adapting to negative demographic developments and about intergenerational fairness. In short, domestic political principles and arguments were far more important than EMU. EMU played a background and indirect role.

This background, indirect role was noticeable in the arena of federal-state financial planning. In 1997 Waigel presented proposals for a law on a national stability pact to ensure that state governments and local authorities accepted responsibility for meeting German obligations under the EU’s Stability and Growth
Pact. In doing so he stressed the threat to German credibility from a failure to match EU discipline with a parallel domestic discipline. He also threatened an appeal to the Federal Constitutional Court if Germany should find herself faced with sanctions and without a legal regulation binding the states. But negotiations broke down in the face of disagreement between federal government and states and between rich and poor states about an appropriate formula for distributing deficits. Following rejection by the Financial Planning Council, it was agreed to take the Stability and Growth Pact into account informally.

Hence a gap remained between a new programmatic discourse of Europeanization within governmental circles and official documents and the actual framing of budget, welfare-state and labour-market reforms in public debate. The motives were twofold: a domestic motive of being seen as a government to be pursuing reforms for good German reasons and not because ‘forced’ to do so; and a fear of diverting domestic criticism to the EU. EMU was too new, fragile and important a project to be politically exposed. In so far as one was reforming to ‘make the euro work’ there was an inhibition about making a public admission.

The Paradox of a Firm Deadline and Strict Criteria

The third paradox reflected a deep divide within postwar public opinion between ‘civilian power’ values and ‘stability’ values. On the one hand, there was a great deal of cultural and intellectual support for the idea that German interest was in multilateralism and respect for international institutions and their rules. German interest in a peaceful and prosperous Europe meant meeting the Maastricht timetable with a larger rather than a small ‘core’ EMU around Germany and unqualified respect for the treaty commitment to a clear timetable. On the other hand, German public opinion reflected great pride in the postwar heritage of monetary stability, symbolized by the D-Mark. Respect for this principle meant precedence to a small ‘core’ and an ‘orderly postponement’, if necessary.

The paradox of a firm timetable and strict convergence derived from the treaty itself but was given a specific German definition. Germany was committed both to move to stage three on 1 January 1999 and to ensuring tough convergence criteria were met in order to qualify. By the time that the treaty was signed in February 1992 the issue of which came first – timetable or criteria – was already established as the central domestic political issue about EMU. From December 1991 onwards Kohl and Waigel were on the defensive, operating in a context of multiple uncertainties with an ambiguous political formula designed to offer reassurance to different audiences. Their strategic aim was to avoid a conflict between the timetable and convergence in a domestic context in which a strict interpretation of the criteria became critical. The basic strategic objective was to keep EMU in a framework of consensus defined in terms acceptable to Ordo-liberals.

The federal government was quick to recognize two failures in the Maastricht negotiations. First, not enough had been done to prepare German public opinion, handing the political advantage to those who feared losing a cherished national symbol, the D-Mark. Hence the political and economic case for EMU had still to be made. After Maastricht the agreed formula was to stress four German interests. A stronger EU through EMU would better help the East onto its feet. EMU would reduce the economic risks from a return to currency speculation. It would provide a more predictable environment for German exports and investment. Finally, EMU
would increase the political acceptability of German economic strength to her neighbours. By 1996 Waigel gave increased salience to the economic threat of an over-valued D-Mark to exports, investment and jobs. The risk was a flight of capital into the D-Mark, if EMU should fail or be delayed.

More broadly, there was a shared perception across the political elite that the established political parties risked being out of touch with popular sentiment. This translated into a recognition that political leaders must show themselves to be cautious and responsible in creating a sustainable EMU. It also meant devoting a great deal of attention to ensuring that the leaders of German industry and banking offered active support for EMU. Thus in 1993 the senior German EMU negotiator Horst Köhler took over as president of the association of German savings banks, a key presence in retail banking.

The failure most stressed by the Finance Ministry and the Bundesbank was that Germany had not secured clear enough achievements on European political union. This mattered because - as the Bundesbank argued - EMU could not work in the absence of a political union. The government dealt with this problem by keeping political union at the forefront in the 1990s. It also sought to contain criticism by reminding the Bundesbank that political union negotiations were a matter for the federal government and by stressing that the Bundesbank had a legal responsibility to support the policy of the government. In addition, it pointed out that the Ordo-liberal stress on the principle of subsidiarity in economic policy (e.g. in relation to employment policy) and on safeguarding the independence of the ECB qualified the degree of political union that was desirable to support monetary union. Even so, the federal government had to be able to demonstrate progress on political union with the Amsterdam Treaty in order to insure against negative votes on stage three in the Bundestag and Bundesrat.

The principle of irreversibility left little room for interpretation. There was a fixed, final date for completing EMU. Kohl’s agreement to this commitment at Maastricht was domestically controversial. In particular, Ordo-liberals feared the creation of an unsound EMU, with serious negative effects both on the German economy and on the larger European integration process. They doubted the availability of a ‘stability culture’ outside Germany as an essential underpinning for a sustainable EMU. These doubts and fears were expressed in the manifesto of 60 leading German economists in June 1992 (condemning the undue haste and the laxity of the criteria). They were repeated in the letter of 155 German economists in February 1998, calling for an ‘orderly postponement’ as the deficit and debt criteria had not been adequately met by enough states. They were also shared within the Economics and Finance ministries and the Bundesbank.

‘Irreversibility’ was founded on a political definition of Germany’s vital interests in European integration and on the argument that, following German unification, there was a greater responsibility on Germany to demonstrate its loyalty to this process. Giving up so important a symbol as the D-Mark was the ultimate test of Germany’s trustworthiness as a good European. This political argument – stressing German ‘responsibility’ for Europe - was driven by Chancellor Kohl, shared within the Chancellor’s Office and the Foreign Ministry, and within the leadership of the CDU/CSU parliamentary party. Kohl reiterated that the timetable would be respected. He was also sensitive to the political argument that the original Six (including Belgium and Italy) must march together into stage three. Germany had an interest in EU solidarity. There was also an economic argument for a fixed timetable. A clear date put pressure on all states to pursue convergence, with the threat of exclusion
operating as a preventive sanction against fiscal irresponsibility. In April 1997 Kohl justified his decision to stand again as Chancellor candidate in 1998 by the vital importance of seeing EMU to completion. Crucial here was his perception that Germany might fail to meet the criteria.

Kohl’s technique was to combine assertion of the principle of a firm timetable with the clear message that it was the responsibility of others (the Finance Ministry at home and the French, Italian and Belgian governments) to take the necessary action. In this way Kohl put others – notably Waigel - under pressure to ensure that strict convergence was achieved. In March–April 1997 he took a more public tough line on his determination to meet the deadline, following Germany’s 3.8 per cent deficit in 1996 and the projection of the six leading economics research institutes that Germany would exceed 3 per cent in 1997 (the key final year for assessment). ‘The question is not whether EMU is coming, but what we can and must do to make it begin on time.’ The interpretation of the budget deficit criterion as 3.0 of GDP was defined as Waigel’s problem, not Kohl’s. It was against this background that Waigel launched his proposal for a revaluation of the Bundesbank’s gold reserves. Meeting the deadline was about maintaining Germany’s reputation as a ‘reliable partner’ and Germany’s ‘special responsibility for completing monetary union’.

The principle of strict convergence came to focus on the fiscal criteria (3 per cent deficit and 60 per cent debt), especially the deficit criterion, and was subject to a particular German construction – that the requirement was 3.0 per cent. This requirement was not contained in the treaty. Leading voices warned against an excessively strict interpretation, notably Wolfgang Schäuble, head of the CDU/CSU parliamentary party, Klaus Kinkel, the Foreign Minister, and Welteke, then a member of the Bundesbank council and from 1999 Bundesbank president. Even the Federation of German Banks (BdB) argued against a ‘book-keeping’ approach to the criteria. They spoke of ‘room for interpretation’. The interpretation that ‘three does not mean three plus x’ (Waigel, April 1997) rested on three foundations. Ordo-liberal economists saw the strictest observance of this criterion as the essential safeguard for a ‘stability community’ in which convergence would be ‘sustainable’. In addition, politicians like Edmund Stoiber, Bavaria’s Prime Minister, argued that a stable currency had played a special role in Germany’s postwar democratic stabilization and identity and must not be placed in jeopardy. Stoiber maintained steady pressure on Waigel from within the Bavarian CSU.

The theme of a ‘controlled delay’ of one or more years became a standard argument of Ordo-liberals and was taken up most vocally by Stoiber, especially in summer 1997. The Bavarian CSU was preoccupied with the threat to its absolute majority in the state election in 1998 and the implications for its federal influence. It identified in the loss of the D-Mark a potential mobilizing issue for the extreme Right. Hence Stoiber was keen to identify the CSU with staunch defence of German stability interests in EMU. 3.0 was a totem of stability. For Stoiber EMU was about the image of the governing competence of the established parties and the trust of ordinary Germans in the political establishment. Hence the criteria had to have precedence over the timetable.

In this context Waigel was a critical figure. He was both Finance Minister and chair of the CSU. As Finance Minister he was beleaguered by rising unemployment and deteriorating public finances, especially consequent on German unification and the attendant huge fiscal transfers. As chair of the CSU he was subject to huge pressures from Stoiber, who defeated him in the 1993 contest for the post of Bavarian Prime Minister. This position of weakness was, paradoxically, a source of strength to
Waigel. He was indispensable to Kohl as a means of binding in the fickle CSU to the EMU process and hence a vital political ally. Waigel was also able to argue the need for concessions from EU partners to enable him to carry German public opinion.

But Waigel had to negotiate a very difficult political landscape, in which he was tempted to tailor his message to different audiences. By a series of moves Waigel sought to take the wind out of the sails of those tempted to exploit a D-Mark patriotism. These moves focused on the basic principle of ensuring that the new single currency was ‘at least as stable as the D-Mark’. Though central, this principle was never fully accepted by the large majority of Germans, who continued to be opposed to losing the D-Mark. Waigel’s moves were also designed to bind the Bundesbank into the process, by depriving it of key arguments for a ‘controlled delay’. His strategy was to give credibility to the principle that the single currency would be ‘at least as stable as the D-Mark’, to get the Bundesbank on side in 1998, and to assuage German public opinion and contain domestic dissent.

- In agreement with Kohl, Waigel conceded in 1992 to the political demand of the SPD that the Bundestag and Bundesrat be given the further opportunity – after ratification of the Maastricht Treaty - to make their own political decision on whether the states proposed for stage three had met the strict convergence conditions.
- Again with Kohl, he secured Frankfurt as the site of the European Monetary Institute and future European Central Bank at the Brussels European Council in October 1993.
- He gained a change of name from ECU to euro at the Madrid European Council in December 1995. This change dissociated the new currency from a unit that had depreciated in value and countered talk of exchanging the D-Mark for an ‘Esperanto’ currency.
- In 1995 he proposed the Stability Pact to put in place rules and sanctions to ensure that member-state governments pursued balanced budgets over the cycle, with a stability council to monitor compliance. This countered criticisms of the weakness of the existing convergence procedure and met the Bundesbank’s clarification that by stronger political union it meant tougher budget discipline.
- He adopted the theme of a 3.0 budget deficit to demonstrate his toughness on the fiscal criteria.
- From 1996 he stressed the economic risks to growth and employment in Germany from a delay to stage three in the form of an overvalued D-Mark.
- He conceded an employment chapter in the Amsterdam Treaty in order to insure against the SPD’s rejection of the treaty and to keep the SPD onside in the Bundestag and Bundesrat decision of 1998. At the same time he reassured Ordo-liberals by strict insistence on the principle of subsidiarity and national responsibility in employment policy.
- He engineering the additional ‘stability declaration’ by the York ECOFIN in March 1998 to persuade Bundestag deputies that Belgium and Italy were pledged to undertake additional efforts to tackle their debt problems.
- He took up the principle of subsidiarity in economic policy in response to Stoiber’s argument in 1997-98 that EMU would strengthen
competition for inward investment and lead to a more competitive regionalism in the EU.

- Along with Kohl, he ensured that the Bundesbank’s candidate, Wim Duisenberg, was chosen as president of the ECB, with the Bundesbank’s chief economist and ‘stability’ guru, Otmar Issing, as the ECB’s chief economist.

The political threat was not just from the CSU but also from those in the SPD who, it was feared, might be tempted by a populist campaign against the euro. SPD regional leaders in the Baden-Württemberg and Hamburg elections of 1996 tested the theme of a delay. But in each case it was associated with serious electoral setbacks. Gerhard Schröder took up a ‘structured delay’ up to 2002 as late as December 1997 (The International Economy 1997: 8-9). Schröder’s strategy was to align himself with Tietmeyer’s views and stress the risks to economic stability associated with a fixed timetable. In this way he sought to develop an image of economic competence vis-à-vis Kohl and the CDU/CSU and make himself an electable future Chancellor candidate.

This strategy of calling for a delay was strongly contested within the leadership of the SPD and neutralized by Lafontaine. By December 1996 Lafontaine as party chair was warning against delay, arguing that it would jeopardize convergence and produce crisis in the EU. He led the SPD to embrace EMU as a catalyst to speed domestic economic reform, in alliance with social democratic governments elsewhere in the EU, notably the French Socialists. EMU could be used to engineer an agenda change towards prioritizing co-ordinated European action for growth and employment, notably a European employment pact with binding objectives on member states. For others in the SPD leadership EMU was a matter of demonstrating the SPD’s reliability as a party dedicated to European unification. Hence the SPD held back from mounting a populist campaign on the issue and voted with the government parties in the Bundestag in April 1998 to accept the eleven states as meeting the convergence criteria. But in May 1997 it had threatened to take into account the absence of an employment chapter in the forthcoming Amsterdam Treaty when the Bundestag and Bundesrat considered in 1998 whether the states chosen for stage three met the criteria. This threat, allied to the threat to block ratification of the Amsterdam Treaty, led Waigel to agree to French demands for an employment chapter at Amsterdam.

In consequence, Waigel had to play a tortuous political game in a climate of great uncertainty and subject to contingencies both on political and economic fronts and on domestic and European fronts. He did so in the context of a government strategy that rested deliberately on an ambiguous formula. The formula was that EMU would begin on time, with Germany on the starting line as both a reliable partner and in a ‘flagship’ role, provided that Germany met the criteria and that France was ready. The formula hid a mounting tension between aspiration to a ‘flagship’ role on economic stability and new doubts, first articulated in July 1993 and then again in 1996-97, about whether Germany could qualify by meeting its own tests. Above all, however, it expressed the strategy of avoiding a conflict between timetable and criteria.

Domestically, Waigel’s three most difficult periods coincided with deteriorating economic conditions and political threats, notably from within his own party. The first stretched from Stoiber’s letter to Kohl in September 1993, calling for a delay to EMU as much too ambitious, to the European Parliament elections of June
1994. Stoiber was preoccupied with heading off the extreme Right in the 1994 European and Bavarian state elections. He was also alert to the negative signals from the ERM crisis of July 1993. The second period in early 1996 was associated with uncertainty about the SPD’s position, given remarks by Schröder and by regional leaders in Baden-Württemberg and Hamburg, and also uncertainty about economic prospects, generating perceptions that the timetable was unrealistic. The third period lasted from the gold revaluation proposal of Waigel in May 1997 through Stoiber’s call for a controlled delay in summer 1997 into the late autumn when it was still unclear whether Germany would meet 3.0. As late as September 1997 senior CDU politicians believed that Kohl might be tempted to defer a decision on stage three till after the September 1998 elections.

At the European level, the main source of uncertainty was France. Kohl and Waigel were agreed that EMU did not make sense as a political and economic project unless France qualified. It was as much about strengthening the Franco-German relationship as making European unification irreversible. Hence the whole project was bound up with events and developments in France, which had domestic reverberations in Germany. The reverberations following the problems of the French franc in the ERM crises of 1992-93 were reflected in Stoiber’s call for a delay in September 1993. The election of the ‘unreliable’ Jacques Chirac as President in May 1995 was followed by the Stability Pact proposal in November. The French strikes and demonstrations of November-December 1995 reinforced Kohl’s determination that Germany must be blameless if EMU failed by showing that it had made every effort. The attachment of extra conditions to the transition to stage three by the new French government of Lionel Jospin in May 1997 required a forceful German response. This took the form of a defence of the Stability Pact against French amendments, the stringent application of the subsidiarity principle to the new employment chapter in the Amsterdam Treaty, and toughened resistance to the idea of an ‘economic government’. In 1996 the view in Bonn and amongst employer and industrial associations was that a small ‘core group’, without Italy, was the most realistic option. It was not till late 1997-1998 that the view began to form that a larger group was practical.

Hence the overall impression was one of complex strategy in a context of uncertainty and contingency and of resort to an ambiguous political formula designed to reconcile contending domestic and European interests and responsibilities. Even as late as September 1997 it was not clear whether stage three would go ahead on time and, if so, with whom. Waigel stood at the epicentre of German policy and politics on EMU. That conflict between the timetable and the criteria was finally avoided owed much to his political skills, as well as to a benign configuration of economic data in 1997/98.

The Paradox of Bundesbank Power: Finding a New Role

After 1991 the Bundesbank retained impressive resources of power. But it had to manoeuvre in the narrower policy and political space left by the Maastricht commitment. In doing so it veered between taking up tough positions (e.g. rejecting the Finance Minister’s attempt to bring forward a revaluation of its gold reserves) and more accommodating positions (e.g. in its advice of March 1998 about whether the states selected to form stage three met the convergence criteria). By 1999 it had to grapple with the issue of its own reform to adjust to the new operating conditions of
EMU. Hence the 1990s witnessed tensions and conflicts between the Bundesbank and the Finance Ministry, as well as with the Federal Chancellor’s Office and the Foreign Ministry, followed by new problems of defining the Bundesbank’s role.

The resources of power available to the Bundesbank over EMU were formidable. The Bundesbank Law of 1957 required it to ‘safeguard the currency’. Hence there was a clear legal basis for the Bundesbank to define its role as guardian of the stability foundations of EMU, ensuring that convergence was strict and sustainable. It had a clear, coherent institutional philosophy, grounded in Ordo-liberal economic theory. It had an enormous reputation as Europe’s most successful central bank, grounded in its association with an excellent German record on price stability and with the D-Mark’s position as a ‘hard’ currency and as the anchor of the ERM. The Bundesbank enjoyed the confidence of the global financial markets and was seen as the expert institution on these markets. Above all, the German public trusted it. On EMU matters – especially on ensuring that the euro was ‘at least as stable as the D-Mark’ – the Bundesbank was seen as the authoritative actor by the German economic interest groups and banking associations. Hence, from the outset of EMU negotiations in 1988, the strategy of the federal government was to ‘bind in’ the Bundesbank at all key points. Failure to achieve its compliance – as over the revaluation of its gold reserves in 1997 – was potentially very damaging.

But EMU also revealed the limitations of its power. Once EMU was agreed, the Bundesbank’s role was defined as providing expert advice and criticism in a discrete rather than public manner. This role conception fitted its professional outlook. The law of 1957 enjoined the Bundesbank to respect the general economic policy of the federal government. In consequence it often found itself on the defensive. Its president was overruled over the Delors Committee in June 1988. A fixed, final date was agreed at Maastricht against Bundesbank views. In addition, at critical moments in the 1990s it was reminded that it had a duty of loyalty to the policies of the federal government and to the obligations entered into with the Maastricht Treaty.

At the level of the Chancellor and the Foreign Minister there was a view that the Bundesbank had a limited political and historical perspective. The argument was that EMU was ultimately situated in German external security interests, and that a more activist approach to those interests was required in the post-Cold War, post-German unification period. In particular, a distrust emerged towards Tietmeyer’s motives in taking up an arch-strict interpretation of the convergence criteria, in pressing the theme of an ambitious political union as a necessary accompaniment to EMU, and in his behaviour during the revaluation of gold reserves episode. These positions were seen within the Chancellor’s Office and Foreign Ministry as an attempt to set high hurdles to stop EMU going forward. For Tietmeyer they were designed to ensure that, when launched, it would work in a sustainable manner.

The Maastricht Treaty made a difference to the Bundesbank’s power by submitting it to EU treaty obligations to prepare stage three. Though stage two was essentially an ‘empty shell’, in that no monetary-policy responsibilities were ceded, the Bundesbank’s own interest in actively shaping stage three meant that from 1994 it became thoroughly Europeanized. In addition, the ERM crises of 1992-93 administered a harsh lesson about the risk of the Bundesbank being held responsible for failure to take the European dimension more seriously in its monetary policy decisions. Hence the Bundesbank opted for a more pro-active approach on EMU. The effects were discernible in its internal structural working, notably the new European steering committee of October 1994. This committee represented a new
Europeanization of its official apparatus ‘from below’, with the effect that Bundesbank directors were exposed to European issues in a new way. The effects were also noticeable in its policies e.g. its changed position on money market funds, its change to a two-year money-supply target in 1997, and its (imposed) responsibility for redenominating government debt from D-Mark to euro from 1997.

Stage two, and participation in the European Monetary Institute, had important socialization effects, especially as the Bundesbank was able to have a disproportionate impact on negotiations there. Moreover, the numerous concessions gained by Waigel (and listed above) made the transition to stage three more amenable for the Bundesbank, or at least reduced its capacity to criticize. Another key factor was the absence of any serious ERM crises after 1995. These crises had – notably in 1992/93 – produced a more assertive behaviour by the Bundesbank on behalf of the primacy of its responsibility for domestic monetary stability. In their absence the Bundesbank lacked such opportunities.

Finally, the Bundesbank did not wish to be seen as disloyal to the elected government and as tarnished with the brush of sabotaging the next key step in European integration. It risked being seen as pursuing its own corporate interest in survival and protecting central banking jobs at the expense of Germany’s higher political interests. Here the Bundesbank was influenced by its memory of how Kohl had dismissed its views on the terms of German unification in 1990. Unlike with German unification the Bundesbank could not claim that it had been marginalized over EMU.

In consequence, the Bundesbank’s behaviour was a mixture of assertiveness and conciliation. Tietmeyer’s presence as president guaranteed that it would act as the strong-willed advocate of German stability culture and Ordo-liberal values and arguments. Precisely because this role was facilitated by the federal government – and the Bundesbank’s assertiveness directed outwards to the EU level rather than inwards against Bonn – the Bundesbank’s room for manoeuvre in 1998 was limited. Hence its crucial report of March 1998 on whether the convergence criteria had been met proved accommodating. Another conditioning factor was loyalty to central bank solidarity within the European Monetary Institute. The Bundesbank had participated in agreeing the EMI’s report on whether the convergence criteria had been fulfilled. It could not then be seen to act as an individual critic of its peers. Hence institutional factors are important in explaining why the Bundesbank was conciliatory in 1998.

The transition to stage three was the single most important challenge to the Bundesbank in its history. With the creation of the ECB it lost not just its monetary policy responsibility but also its dominant monetary-policy role in Europe. Its president now made monetary policy as one of 17 members of the ECB’s governing council. The Bundesbank council was responsible for acting in accordance with the guidelines and instructions of the ECB. Otherwise, it could only advise its president. The result was a three- rather than two-level system – ECB, Bundesbank, and state central banks. In consequence, the future functions and structure of the Bundesbank became a key domestic political issue. The rationale for a decentralized structure, with nine state central bank presidents in the Bundesbank council, and for individual responsibilities attached to the state central banks, seemed no longer defensible. Hence the euro was associated with new concerns about the credibility and reputation of the Bundesbank within the ECB. It raised issues of identity, policy responsibilities and structure.

Ernst Welteke, the new president, proposed a centralized, one-level Bundesbank decision structure that would support a unified leadership role in
European monetary policy. He argued that there was no longer a case for independent state central bank presidents in the central decision-making body of the Bundesbank. But the Bundesbank council did not endorse this view and, in 1999, proposed two models – a management board model and a federal model. Welteke also sought full integration of responsibility for banking supervision in the Bundesbank, based on its superior knowledge of market conditions. These proposals met strong resistance. State governments feared erosion of the federal principle, diminished political weight and job losses. The Federation of German Banks (BdB) preferred a unified financial services’ regulator independent of the Bundesbank.

Welteke’s objective was to strengthen his negotiating power within the ECB in the wake of the weakening of the Bundesbank by EMU and a changed operating context. He aimed to better insure against Bundesbank council members undermining his authority by offering their own independent views in public on ECB monetary policy or foreign-exchange market intervention. These comments led to criticisms from partners in the Euro-system. Welteke also wanted to create a German central bank model that others might emulate. The principle around which he sought to manufacture a new consensus was a shared interest in the future credibility and reputation of the Bundesbank within the ECB. This reputation was endangered by a slow, lowest-common-denominator reform of the Bundesbank and by public disputes over monetary policy. Hence Welteke sought an internal decision-making structure more consistent with the new orientation of monetary policy to Euro-Zone-wide data rather than micro-level regional data. He also wanted to carve out new roles to compensate for lost ones, not just banking supervision but ultimately integrated responsibility for financial market supervision. In addition, Welteke saw a new opportunity for the Bundesbank to give greater attention to Germany’s needs as a financial centre, including the competitiveness of the German banking system. This role remained, however, constrained by the principle of neutrality and by the overriding requirement to promote long-term financial stability. Consistent with these views, Welteke also opposed Eichel’s suggestion of February 2000 that management of the federal debt might be transferred from the Bundesbank to a private agency. He opposed any notion of a trade-off between gaining full responsibility for banking supervision in exchange for losing its role as fiscal agent of the federal government. Welteke’s ideas on structure and functions were substantially endorsed in July 2000 by the expert commission under Karl-Otto Pöhl, which proposed replacing the nine state central banks by five regional administrations of the Bundesbank whose heads would form half of a new unified decision structure.

Another change, parallel to the transition to the euro that affected the power of the Bundesbank was the replacement of Tietmeyer by Welteke. In one respect this was a loss of power and status. Tietmeyer had an unrivalled 30-years’ experience of international financial and monetary affairs. Welteke had been a regional politician and for five years a state central bank president. Hence he lacked Tietmeyer’s reputation. On the other hand, Welteke had a less complex relationship to EMU, fully and unequivocally endorsed its political rationale, and had been critical of an overstrict interpretation of the convergence criteria. He was also personally and politically very close to Eichel, with whom he had worked very closely in Hesse. Values of social solidarity and justice were deeply rooted in his SPD background. Welteke was, in addition, knowledgeable through his regional contacts about Frankfurt as a financial centre and receptive to its needs. In essence, his appointment broke with recent practice. He was not a Bundesbank insider as Helmut Schlesinger had been. He was not an international star like Tietmeyer and Pöhl earlier. But, in the
sensitive domestic political context of Bundesbank reform, Welteke enjoyed the confidence of Eichel and could bring a fresh perspective.

**The Paradox of the German Model of ‘Managed’ Capitalism and EMU**

The final paradox was that German politicians and officials were gradually forced to recognize that EMU ‘Europeanized’ the Bundesbank model but not the German model in its larger sense. This issue especially preoccupied the Schröder government. It was reflected in the new emphasis on a dimension of social dialogue to EMU and on the critical role of wage bargaining for price stability. The problem of ‘fit’ with the German model derived from Europeanizing the steering function of the Bundesbank on economic stability without the supportive structure of ‘implicit’ co-ordination found in Germany (Gretschmann 1998: 53). The German political economy rested on an asymmetrical system of ‘implicit’ co-ordination, privileging the central bank as the authoritative ‘signaler’ but recognizing that a mechanism was required to ensure unit labour costs consistent with price stability (Dyson 1999). This mechanism was provided by a model of ‘managed’ capitalism, in which the state played an enabling role in encouraging co-operation within and amongst firms and between employers and labour. Unless the ‘managed’ capitalism model could be both re-dynamized at home and exported to the EU, the prospect was that EMU would undermine it at cost to treasured German values of consensus and social solidarity.

‘Managed’ capitalism had strong historical, cultural and institutional roots. Historically, it formed a continuity with the organized capitalism of cartels, elite networking and regulation that characterized early German industrialization (Dyson 1992). Culturally, it rested on a respect for the principle of consensus. This principle was deeply entrenched in both the political and the economic systems. Hence there was a ‘goodness of fit’ in domestic governance. Schröder was able to use consensus about tax reform in the Alliance for Jobs, notably the support of employers, to lever compliance from the CDU opposition. Institutionally, ‘managed’ capitalism was supported by the German system of corporate governance (especially co-determination), a domestic credit system that encouraged long-term banking finance of industry, the organization of labour-market policy and vocational training, and the management of welfare-state arrangements. Co-determination in corporate governance brought trade unions and bankers into sharing responsibility with employers as stakeholders in industry. In this way the concept of social partnership was deeply embedded in the German economy. From 1995 the vitality of the ‘managed’ capitalism model was manifested in the proliferation of employment pacts – negotiated between individual firms and their works councils and trading off wage restraint for job creation.

Politically, the epicentres of this model were the SPD and the CDU in North-Rhine Westphalia. Its traditional advantages were the encouragement of a corporate- and a macro-level responsibility in wage bargaining, a focus on unit labour costs as a critical issue, ‘long-termism’ in investment, and social and industrial peace through the negotiated management of change. Within North-Rhine Westphalian SPD Bodo Hombach, Klaus Gretschmann and the Prime Minister, Wolfgang Clement, were key advocates of the ‘managed’ economy model. This model was adopted by Schröder, embodied in his political theme of the ‘new centre’ (neue Mitte) and the Alliance for Jobs, and demonstrated in the appointments of Hombach and Gretschmann to the Chancellery in 1998.
Domestic Ordo-liberalism had a complex relationship with ‘managed’ capitalism. Ideologically, its insistence on open, competitive markets put them in conflict. Ordo-liberalism gave primacy to a clear long-term framework of rules for competition, whereas ‘managed’ capitalism took an evolutionary view of competition and focused on the endogenous aspects of the economy. ‘Managed’ capitalism was seen by Ordo-liberals as a system for privileging labour-market ‘insiders’ at the expense of neglecting the unemployed. It was also viewed as threatening to shift blame for problems of growth and unemployment to the central bank, confusing responsibilities rather than clarifying them. On the other hand, pragmatically, many Ordo-liberals recognized that a co-operative approach to wages could induce greater macro-economic responsibility and that consensus about change, by taking into account those affected, could strengthen the market economy. But this same pragmatism created new doubts as the 1990s progressed and globalization was seen as reinvigorating the Ordo-liberal principle of open, free markets. Consensus might be too costly for an economy that required greater flexibility, especially in labour markets and wages. Globalization – its effects hastened by EMU - suggested to Ordo-liberals that the ‘managed’ capitalism model was dated and destined to dissolve.

The Schröder government sought to rehabilitate ‘managed’ capitalism after it had been on the defensive since the early failure of the trade-union inspired Alliance for Jobs in March 1996. The key initiatives were to establish a domestic Alliance for Jobs to seek co-operation on structural economic reforms and to extend this type of thinking to the EU level during the German EU presidency of early 1999. The main proposal agreed at the Cologne European Council was a Macro-Economic Dialogue as one of the three pillars of the European Employment Pact. The other two pillars built on the employment chapter of the Amsterdam Treaty and the procedure for structural reforms. The Macro-Economic Dialogue was designed to prevent macro-economic conflicts between monetary, financial and wage policies by encouraging co-operative behaviour. In so doing, German negotiators were at pains to seek out consensus with Ordo-liberalism. The Macro-Economic Dialogue was about supporting the ECB in pursuing its price stability objective and about achieving trust and reliability in behaviour. Above all, the social partners were drawn into EU-level consultation, but on the model of ‘implicit’ co-ordination and without challenging the privileged position of the ECB.

This very limited institution building at the EU level on the German ‘managed’ capitalism model had weaknesses. The ECB’s monetary policy remained remote from the complex national, regional and local realities of wage bargaining in a way that had not been so true before 1999. The social partners lacked the strength of EU-level organization to match the ECB that had existed at the national level in Germany. The comparison between this very limited institutional development and the forces of market competition unleashed both by EMU and by globalization suggested that these latter two forces were more likely to change Germany than Germany was to change EMU in a way that would protect the ‘managed’ capitalism model.

The question was whether the centrifugal forces outweighed the forces holding together the ‘managed’ capitalism model. One force was the exit of firms and workers from the traditional ‘area-wide’ wage agreements in favour of firm and plant-level bargaining. Here eastern Germany was a model for the rest of Germany. Another centrifugal force was the big private banks like Deutsche and Dresdner. Identifying new market opportunities with globalization and the euro, they pursued two strategies. The first was ‘exit’ from a retail-banking sector that was insufficiently competitive
because of the privileged position for the public savings and the co-operative banks. They sought to carve out a new identity as international investment banks. The second was ‘voice’ in the form of seeking European Commission action against the privileged position of the savings and co-operative banks. The big private banks exhibited a diminished loyalty to the traditional features of the ‘managed’ capitalism model. This diminished loyalty was manifested in their advocacy of an end to capital gains tax on disposal of bank shareholdings in German industry. In this way they sought to mobilize resources for their new corporate strategy. In 2000 the Schröder government conceded this measure to the banks. These changes combined to suggest that the dynamizing of ‘managed’ capitalism by the Schröder government might also be its unraveling. The paradox was that ‘bottom-up’ change from Germany to EMU was giving way to ‘top-down’ changes unleashed by the euro and globalization.

The survival and effectiveness of the Alliance for Jobs became a litmus test for the continuing resilience of the ‘managed’ capitalism model. Its historical, institutional, cultural and political foundations remained in place, though shaken. Schröder’s government acted as one safeguard. But, at a deeper level, the institutional arrangements of co-determination and labour-market policy were more important. What seemed to be happening was a redefinition of the scope of the ‘managed’ capitalism model (Dyson forthcoming). Global financial markets and the euro were weakening one of its pillars – the banking system and industrial financing. Another – ‘area-wide’ wage bargaining – was under acute pressure from German unification and globalization pressures. In the changed circumstances of heightened competition through globalization, technological change and the euro the ‘managed’ capitalism model gained heightened legitimacy from its association with employment, competitiveness and vocational training. Hence its content shifted to the negotiation of employment pacts, tax reforms and welfare-state reforms, involving trade-offs with wage restraint. The German state retained an essentially enabling role in the management of economic change but was redefining this role.

Conclusion

The transition to stage three of EMU has been accompanied by major changes in Germany. At the level of discourse EMU has come to be invested with new meanings by Ordo-liberals, neo-Keynesians and ‘Rhineland’ capitalists. Each has defined EMU as posing a problem of ‘goodness of fit’ and requiring transformation rather than just accommodation by Germany. Where they differ is in their definition of this problem and the nature of the transformation. At the same time, following the departure of Lafontaine, the Schröder government has achieved a new measure of consensus about Germany and EMU.

Structurally too there has been change. The Finance Ministry has been considerably strengthened, whilst the Economics Ministry and the Bundesbank have been weakened. With the Europeanization of the Finance Ministry, and the greater variety of views that it contains, it has taken on a more open character than under Waigel. By strengthening its European co-ordination function the Finance Ministry has gained greater leverage over structural economic reforms, notably as they affect employment. Eichel may lack the political power base of Lafontaine. But he leads a much more powerful ministry than Waigel, and – unlike Lafontaine – he can count on Schröder’s support. Less clear is the position of the Bundesbank. It faces a new problem of projecting a unified coherent image within the ECB consequent on its
federalized structure. The question is whether structural and functional reforms will succeed in strengthening its negotiating power.

In programmatic terms EMU has had a powerful impact, notably within the SPD and within the federal government. In part, this is attributable to Lafontaine’s impact as party chair in seeking to Europeanize SPD policy and use the ideas of other social democratic parties to open up debate and shift the domestic consensus in Germany. It also bears the marks of rethinking within the Chancellor’s Office and the Finance Ministry. The programmatic impact has been associated with a new stress on benchmarking best practice, a technocratic methodology that eases problems of acceptance of structural reforms especially on the Left. This technocratic outlook on reform was further strengthened by the Lisbon European Council’s priority to a European knowledge and innovation society. EMU has been redefined as a technocratic project in a wider sense than just a monetary union of central bankers. In so doing a discourse has been created that expedites structural reforms by objectifying them. But, at the level of specific policies, there remains a reluctance to frame reforms as required by EMU. The preference remains for framing reform as done for good German reasons by reference to domestic political considerations and party principle. At the same time the new centrality of tax, labour-market and welfare-state reforms is bound up with EMU, even if as a mediating variable for the effects of globalization.

These discursive, structural and policy effects cannot, however, be disentangled from the factors of uncertainty and contingency and from how German policy makers have managed the paradoxes with which EMU faced them. The ability of Kohl and Waigel to manoeuvre their way through the economic and political, domestic and European, complexities of the transition to stage three owed a great deal to benign economic circumstances. An upswing in the EU economy relieved national budget problems at the same time as financial crisis in the international economy showed the value of a prospective EMU in providing a shield against the worst effects. But it also demonstrated their strategic and tactical skills in making a series of timely concessions to keep EMU on track and contain domestic dissent. In the end, structure and agency conspired to make EMU possible for Germany. They did so however in a context of uncertainty and contingency that did not make the outcome a foregone conclusion.

Overall, there remains a ‘goodness of fit’ between Germany and EMU. This ‘goodness of fit’ does not mean that Germany has simply accommodated EMU. There is accommodation to the extent that EMU embodies German ideas on economic stability. But the ‘managed’ capitalism model has not been fully exported. More importantly, EMU’s effects are not what many German policy makers anticipated. EMU is changing Germany fast and in complex ways. It is a force for transformation, but constructed in different ways. The Schröder government is the crucial test of the sustainability of ‘managed’ capitalism in this process of transition.
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References


