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THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

ECONOMIC WINTER

Will Germany Exit the European Monetary Union?

Over the past several years, German Chancellor Angela Merkel has expressed Germany's commitment to the European Union (EU) at every possible opportunity. Whether at a joint news conference in Brussels with the President of France following an EU summit meeting, or on her home turf in a speech to the Bundestag, Ms. Merkel has never been lacking in vows of support and confidence when it comes to the future of the euro zone. Indeed, even during the trials and tribulations of the three year-old European sovereign debt crisis, Chancellor Merkel's ruling centre-right Christian Democratic Union (CDU) has remained steadfast and unswerving in its dedication to the economic outlook for the European Monetary Union (EMU). The above notwithstanding, there are events and pressures presently emerging from several quarters, which suggest that EU solidarity within Germany can by no means be merely taken for granted.

The German Federal Constitutional Court

On September 12th. next, a ruling will be issued by the German Federal Constitutional Court in Karlsruhe, whether to grant a temporary injunction against laws regarding the European Stability Mechanism (ESM) permanent euro rescue fund and the fiscal pact endorsing debt reductions. The Court is hearing a case brought by plaintiffs who argue that by signing on to the 500 billion euro ($610 billion U.S.) ESM and the fiscal pact, Germany will surrender too much sovereignty, undermining the power of its democratically elected parliament which determines how taxpayer money is spent. According to the German newspaper Der Spiegel: "If the Court rejects the injunction, thereby permitting the German president to sign into law the legislation passed by parliament on June 29th., the bills can no longer be revoked, even if the Court were to decide months later that in fact, the laws were in breach of the (German) constitution. That is because the ESM and the fiscal pact comprise a part of international treaties. Once they are ratified, Germany will be bound by international law to adhere to the legislation. The ESM was scheduled to have commenced operations on July 1st. but will be unable to do so until Germany has finally ratified it."

The German Eagle Emblem displayed on a Court wall. Source: Der Spiegel

As reported in the Financial Times, the judges have issued a string of recent decisions reprimanding Chancellor Angela Merkel's government on questions ranging from her euro zone crisis management to the treatment of asylum seekers and the law governing the conduct of future general elections. The question on this occasion is just how far they will seek to tie the hands of the government and the Bundestag in pressing ahead with moves towards a fiscal union. Mrs. Merkel and Wolfgang Schauble, Germany's finance minister, argue that only with a fiscal union – implying a further transfer of national budget sovereignty to EU institutions – can the

EMU be made stable over the long term. The court's ruling is expected to build upon a series of decisions – on the 2009 Lisbon treaty that redesigned EU institutions and in particular, the first bailout for Greece in 2011 – questioning how much further integration would be compatible with Germany's constitution and how far German taxpayers could guarantee the rescue funds.

Christian Calliess of Berlin's Free University has noted: "On Lisbon, the judges ruled that the primacy of European jurisdiction, when exercised in Germany, "only extends as far as the Federal Republic has agreed to this … and was constitutionally entitled to do so. Such national reservations are very sensitive issues from a European perspective, on the basis that there is no unity without primacy. If the 27 constitutional courts of the (EU) member states were to follow the example of the German constitutional court, European law would become a fragmented legal system indeed." Mr. Calliess and other legal experts believe that the Court may use this opportunity to suggest a national referendum be held before further powers – such as budget sovereignty – are transferred to EU institutions. There is little doubt that Ms. Merkel is frustrated by the Court. After a recent judgment that the government was not keeping the Bundestag adequately informed of its moves, in the Euro zone crisis, the Chancellor was reported to have told a meeting of her CDU: "I have reached my limit." Yet, Ms. Merkel would not say it publically. Her complaint is that, in effect, she is required to reveal her negotiating tactics in the Bundestag before applying them in Brussels.

However, the judges are unrepentant. At the core of their concern is the 'eternity clause' in the Grundgesetz (basic law), which states that there shall be 'no amendment' to the principles of inviolable and inalienable human rights. Germany is a 'democratic and social federal state', with its authority derived from the people exercised 'through elections and other votes'. In their ruling on Lisbon, and again on the Greek bailout and the creation of the European Financial Stability Facility (EFSF) – the temporary fund which will be replaced by the ESM if it gets past the Court – the judges expressed concern that an effective transfer of budget sovereignty to EU institutions affected a fundamental pillar of national democracy. In a recent interview with the Frankfurter Allgemeine newspaper, Andreas Vosskuhle, president of the Constitutional Court and chairman of the chamber responsible for the European judgments, revealed: "There is not much scope left for the transfer of further core competences to the EU. If it were thought necessary to cross this borderline – which may certainly be politically acceptable and desirable – then Germany must have a new constitution and for that, a referendum would be necessary." In testing the constitutionality of the ESM and the fiscal pact, the judges have a daunting task.

Four Karlsruhe Court Judges don their crimson caps. Source: Associated Foreign Press

The Fatherland's Rapidly Changing Demographics

In a recent interview with the Globe and Mail, Hans Kundnani, an expert on German generational politics with the European Council on Foreign Relations stated: "In talking to younger Germans, my perception is that they feel a much less consciousness of responsibility for the Nazi past; in the sense that it's something that concerns them, or should determine, in some way, German policy choices. Young people take Europe for granted. There isn't a sense of it having been something that required a struggle to create. This argument about Europe being there to prevent war just doesn't have any more traction. There isn't a sense of (military) crisis among young Germans."

Surveys indicate that it isn't that Germans under the age of 40 are apathetic or apolitical; it's just that they increasingly tend to see the world through a national, rather than a continental lens. Younger Germans just don't feel obligated to help the rest of Europe. A decade ago, Germans were more likely than almost any other nationality to view themselves as 'European' first and as citizens of their country, region or city, second. This is rapidly changing. A 2011 poll taken by Eurobarometer revealed that only 50% of Germans felt that European Union membership was a 'good thing,' compared to 60% in 2010 and even higher percentage numbers earlier. Similarly, only 23% of Germans feel that Germany has a responsibility to bail out Greece; notwithstanding, the majority of Greece's debts and economic relationships are with Germany. Young Germans don't think much about Greece or Spain at all; indeed, they certainly don't feel they have a moral obligation to those countries. Henrik Luechtenborg, a 28 year-old Berlin author recounts: "A lot of young Germans only become seriously involved with Europe today when they profit professionally themselves. They aren't really worried about Greece or Spain."

Germany Vents Its Frustration with Greece

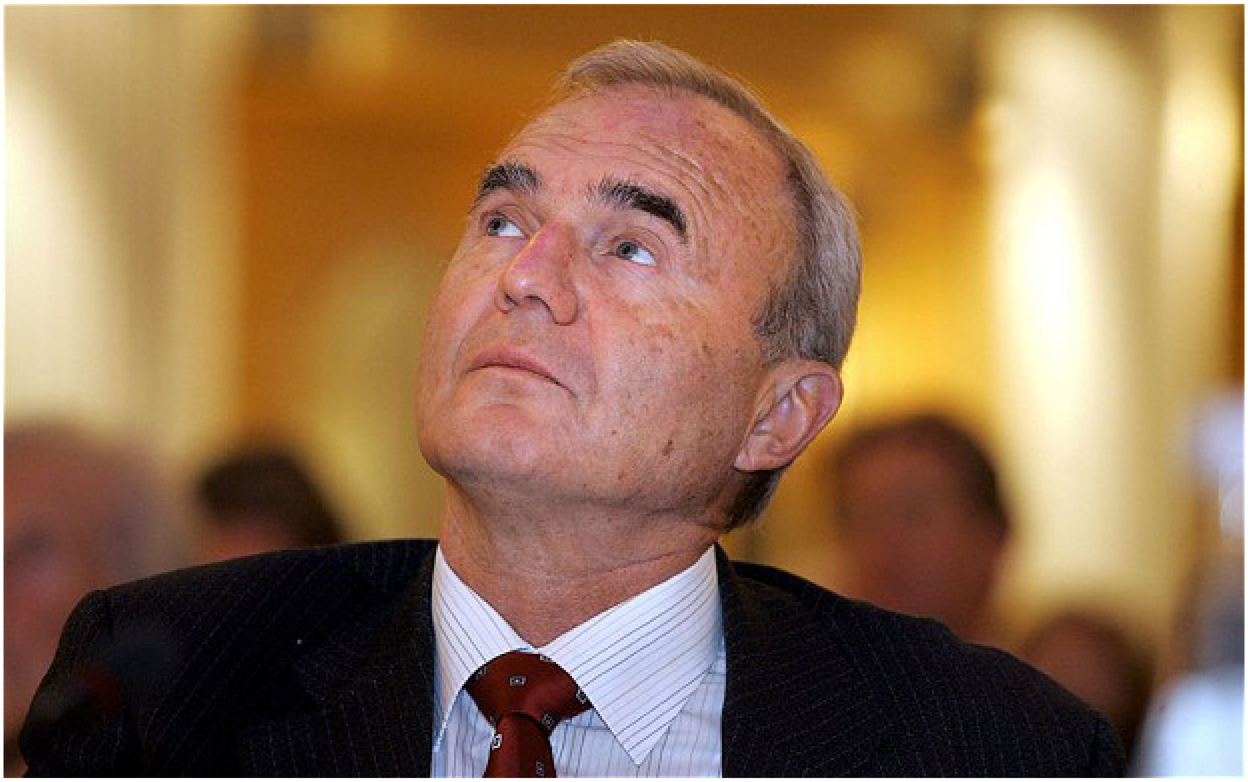
Prior to an interview with the German newspaper Handelsblatt earlier this week, Michael Fuchs, deputy parliamentary leader of Chancellor Merkel's Christian Democrats (CDU) issued a stark warning to Greece that Germany would not hesitate to veto further financial aid to the country, if lawmakers were convinced it was not fulfilling the conditions of its bailout: "We long ago reached the point where the Greeks must show they are capable of delivering a shift. Even if the glass is half full, that won't be sufficient for a new aid package. Germany cannot and will not agree to that. If Greece does not meet the conditions of its bailout, a Greek exit from the European Monetary Union would be inevitable. Post exit, Greece could remain a member of the euro zone and receive a form of Marshall Plan to assist it as it returns to its own currency." The 'troika' of the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) is scheduled to decide on the disbursement of the next tranche of money from Greece's 130 billion euro bailout package in September. During recent weeks, senior members of Ms. Merkel's coalition partners – The Christian Social Union (CSU) and the Free Democrats (FDP) – have stated that a Greek exit from the euro zone would be tolerable. So, when push comes to shove, it is quite evident that German lawmakers have concluded that the European Monetary Union (EMU) can survive without Greece's membership.

Source: Getty Images

European Union Founder Concedes Some Nations May Be Forced to Exit

As reported in the Daily Telegraph U.K., Otmar Issing, a former European Central Bank (ECB) chief economist, warns that the euro zone could be heading towards fracture in his newly published book entitled 'How We Save the Euro and Strengthen Europe.' Mr. Issing is one of the founding fathers of the euro, but who also predicted potential problems with the plan, arguing that political union ought to precede a shared currency to ensure its stability over the long term. Nowadays, Mr. Issing says there is a case for some countries to leave the euro in order to solve their own debt problems. He plays down the role that the ECB could have in solving the debt crisis, suggesting that member countries must fix their own problems.

Mr. Issing observes: "The less politicians address the root of the problems, the more they look with their expectations and demands to the ECB, which was not established for this. It is a central bank and not an institution to rescue governments threatened by bankruptcy. Also, a central bank always acts as a lender of last resort for the banking system, but it does not rescue governments. Exaggerated expectations alone can damage the prestige of the institution. While there is no quick fix (to the European sovereign debt crisis), anything in the direction of euro bonds or something similar, for me would mean the end for the stability-oriented currency union. Even in its short existence, the euro has proved more stable than the deutsche mark."



Former ECB Chief Economist Otmar Issing

Source: Associated Foreign Press

Is the European Union Finished?

In a recent National Post commentary, Lawrence Solomon – founder of Toronto-based Probe International – suggests squabbling euro zone countries, jealous of their own sovereignty, are unlikely able to pull together much longer. "What is no longer unthinkable is a breakup of the European Union itself: even its most ardent supporters fear the EU will meet an unhappy end. Italian Premier Mario Monti recently referred to the growing conflicts as having 'the traits of a psychological dissolution of Europe' and former U.K. Prime Minister Tony Blair admitted to being 'deeply worried' that Britain will leave the EU following a referendum which could be held next year. The referendum, the goal of a wildly popular grass roots movement, could be won by the anti-EU camp should the EU proceed with its plan to save the euro by seizing power from the U.K. and other member states. Confirming Blair's fear is a report from Nomura, Japan's biggest bank, which describes an exit of Britain from the EU – dubbed the BRIXIT – as all too plausible and possibly helpful for Britain's economy. Recent (economic) data revealing that the U.K. no longer depends upon the rest of the EU for the majority of its exports can only add to the 'who needs the EU?' sentiment among many Brits.

The grand experiment called the European Union relied upon the century-old socialist notion that nationalism and nation states are retrograde historical relics, while internationalism is noble. If so, this noble experiment is in for a fall. Luxembourg Prime Minister Jean-Claude Juncker – who is also president of the Euro group of finance ministers – explained it well this week, in warning that nationalism is alive and well in Europe, despite the best efforts of Europe's elites to extinguish it: 'That means what was history and what we thought we had definitely buried, resurges fast. European integration remains a highly fragile undertaking. One must deal carefully with European sentiments and not just think that history is history. No, no – history is the present.' However, the European Union may well be the past."

Il Libero's front-page photo of German Chancellor Merkel headlined Fourth Reich. Source: Getty Images

The Euro Zone System, as Currently Constructed, Is Thoroughly Broken

In a recent report for the Institute for New Economic Thinking, seventeen leading euro specialists – including two members from Germany's Council of Economic Experts and fifteen euro economists at the London School of Economics – as reported in the Daily Telegraph U.K. warned: "As a result of a systemic failure, the European Union is sleepwalking towards disaster. Over the past few weeks, the situation in the euro debtor countries has deteriorated dramatically. This (foreboding) sense of a never ending crisis, with one domino falling after another, must be reversed … It is the responsibility of all European nations, which were parties to the EU's flawed design, construction and implementation, to contribute to a solution. Absent this collective response, the euro will disintegrate. The euro zone's political waters have been muddied by disputes over euro bonds, debt-pooling, subsidies and fiscal union. None of these are necessary to break the log jam.

The euro system could be stabilized immediately (in our opinion), by creating a lender of last resort to support the bond markets either by mobilizing the European Central Bank (ECB), or by giving the European Stability Mechanism (ESM) a banking license to borrow from the ECB. The deeper problem can then be managed through a European Redemption Fund that assumes the legacy debt left by the early errors of the European Monetary Union (EMU). Each country would place all debt above the Maastricht ceiling of 60% of gross domestic product (GDP) into the fund. Each (country) would be responsible for its own debt, but would be able to borrow through joint (euro) bonds. The debt would be paid off over 20 years, with each state anteing up foreign reserves, gold and other collateral to ensure compliance. It is the opposite of fiscal union: the euro zone would return to fiscal sovereignty and since the liabilities would be fixed and the fund self-liquidating, it would comply with Germany's constitution. Such a move would be the game changer missing since the (sovereign debt) crisis began. It would be costly for Germany, but orders of magnitude cheaper than the alternative of 3 trillion euros of damage if the euro breaks apart.

We maintain that the root cause of the euro (debt) crisis has been the boom-bust effect of rampant capital flows over the last decade and not delinquent behavior by feckless nations. The extent to which (bond) markets are currently meting out punishment against specific countries may be a poor reflection of national responsibility. However, the current course has become hopeless. Deepening recession is tearing at the social fabric of the deficit states."

Source: Daily Telegraph U.K.

Summation

In recent weeks, the primary European media focus has centered on Greece and Spain. Assuredly, these two countries have their respective sovereign debt and gross domestic product (GDP) challenges to say the least. However, there is another euro plot inexorably coming to a head under the aforementioned auspices of the German Constitutional Court in Karlsruhe. On September 12th. this Court will issue a ruling regarding the granting, or not, of a temporary injunction against laws enabling the powers of the European Stability Mechanism (ESM) and the fiscal pact endorsing debt reductions, i.e. both measures designed to enable moves towards a euro zone fiscal union.

We believe the Karlsruhe Court will, not only grant the injunction, basically denying any immediate German budgetary sovereignty being transferred to European Union institutions, but also, issue a call for a referendum on the subject of constitutional change. Given the gradual ebbing of German taxpayer support for the weak sisters of the European Monetary Union (EMU) as is evident in domestic polls, it remains an open question whether a German plebiscite would support a constitutional change to accommodate additional transfers of German sovereignty to EU institutions. If such a referendum were called and the result failed to support the agenda of Ms. Merkel's CDU government, then indeed serious debate would likely ensue in parliament regarding a German exit from the EMU and a return to the deutsche mark.

Ian A. Gordon, The Long Wave Analyst, www.longwavegroup.com

"Those who cannot remember the past are condemned to repeat it." Santayana