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Analysing the implications of the contradiction between the German Chancellor and the EU

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The EU financial crisis is an important world economy issue leading to the implementation of bailouts and austerity measures in the GIIPS countries. The business world's and credit agencies' reactions along with political bickering and popular uprisings inside most euro zone governments have substantially postponed and blocked the implementation of solutions. Given Germany's role in the creation of this monetary union, it is relevant to study how Germany has benefited from the creation of the EU, the dilemmas faced by Ms. Merkel as head of the German government and the most important political leader of the EU, and finally how Mr. Draghi's appointment as President of the ECB have affected these predicaments. The conclusion summarizes the author's standpoints among the possible economic, political and social solutions to the current crisis.

JEL Codes: F34, F51 and G01

1. Introduction

From 2008 to the present, the European Union's financial crisis has become an important issue for the world economy. The IMF, the ECB and the European Commission have tried to reduce the budgetary deficits and the governmental debt as percentages of the GDP of the so called GIIPS countries through a combination of bailouts and the enforcement of austerity measures. However, popular uprisings in the GIIPS, the reaction of the European markets to increasing bond yields, the participation of the credit agencies reducing the ratings of most of the EU countries, and political bickering inside most euro zone governments have substantially postponed the implementation of measures meant to solve the problems and making their solutions less effective and harder to achieve. Because Germany is the most powerful member of the EU, as well as one of the main proponents of the EU's creation, it is of scientific interest in the IPE area to study the contradiction existing between the German Chancellor and the EU.

The first section shows how Germany has been the foremost benefactor in the creation of the EU. The second section analyzes the dilemmas faced by Ms. Angela Merkel wearing the hats of the German government as well as the most important political leader of the EU. The third section is dedicated to the contradictions between the German government and the ECB, especially after the appointment of Mario Draghi as its president.

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2. Literature Review

The causes and consequences of global financial crises have been analyzed by renowned economists like Stiglitz (2003) and political economists like Cohn (2011). In particular the financial crisis in the European monetary union has drawn the attention Krugman (2009), and world renowned journalists specializing in International Political Economy issues, from the Financial Times like Wolf (2011, 2012), Münchau (2011, 2012), and The Economist (2011, 2012). The impact of the ratio governmental debt to GDP on growth has been studied in seminal papers by Reinhart (2010) and Reinhart and Rogoff (2009). Given the economic, political and social impacts of the financial crisis in the Southern euro zone countries, in addition to the role that Germany plays in solving this multinational crisis, intense political bickering has overrun the German government, as well as the governments and political parties of the Southern and some of the Northern euro zone countries. The resulting political gridlock has delayed important decisions related to the bailouts.

3. The Methodology and Model

This paper puts forth the following four hypotheses: 1- Germany has considerably benefited from the creation of the EU and the establishment of the euro zone. 2- Angela Merkel's dual roles as both Germany's chancellor and one of the EU's most prominent leaders generates a contradiction reinforced by the euro zone's monetary union, 3- Chancellor Merkel's contradictory position toward the EU is reinforced by the Eurobonds issue, and 4- The change of president of the ECB has diminished the tension in the EU financial crisis.

The author will prove the first hypothesis on the basis of statistics related to current account balances in the euro zone in 2010, the current account balances in Germany and the GIIPS during the period 1995 – 2010, and the bond yields in Germany and the GIIPS countries in the period 1994 – 2011. The second hypothesis will be proven by analyzing economic parameters directly related to the Southern countries' loss of monetary policy before and after the launching of the euro. The third and fourth hypotheses will be proven doing research on the literature of renowned specialists in the EU financial crisis.

4. The Findings

The first hypothesis posits that Germany has been considerably benefited by the creation of the EU, and especially of the euro zone.

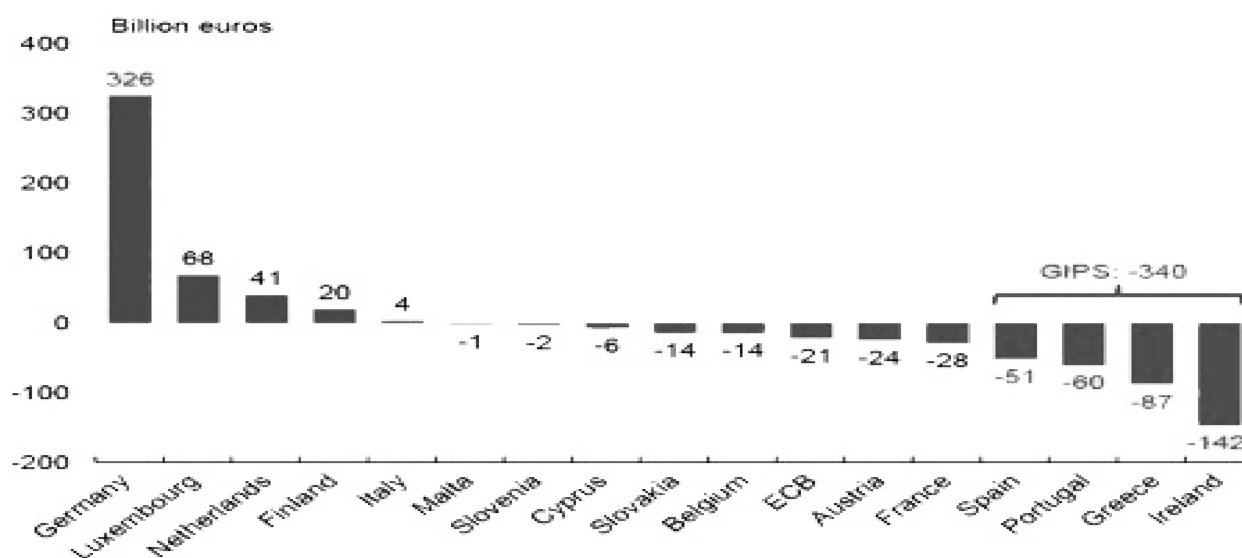
From table 1, it can be seen that most economic indicators show satisfactory results with the exception of the years 2008 and 2009 as a result of the global recession, which affected Germany's exports. Inflation rates were considerably low, in the range 0.3 to 2.6. Average real wages either increased at a maximum rate of 1.8% in 2009, or went decreased in five years after 2004 in the range (-0.1 to -1.1). This indicator very closely relates to Germany's high competitiveness in relation to the EU countries, and in particular to the euro zone. Germany's only indicator with an unfavourable behaviour is the public debt as a percentage of GDP, despite its low budgetary deficit; nonetheless, German's public debt (although higher than the 60% Treaty Maastricht requirement) is considerably less than that of the Southern euro zone members.

Table 1: Germany's main economic parameters in the period 2000 - 2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Real GDP growth %	3.3	1.6	0.0	-0.4	0.7	0.80	3.9	3.4	0.8	-5.1	3.6	3.1
Labor Productivity %	1.6	1.4	0.6	0.5	0.4	1.0	3.3	1.7	-0.4	-5.1	3.1	1.7
Budget balance/GDP. %	1.1	-3.1	-3.8	-4.1	-3.8	-3.3	-1.7	0.2	-0.1	-3.2	-4.3	1.0
Public debt/GDP, %	60.2	59.1	60.7	64.3	66.4	68.6	67.9	65.1	66.7	74.5	83.4	81.7
Inflation, % (Consumer Prices)	1.5	2.0	1.4	1.0	1.7	1.6	1.6	2.3	2.6	0.3	1.1	2.3
Unemploy-ment, %	8.0	7.9	8.7	9.8	10.5	11.2	10.2	8.8	7.6	7.7	7.1	6.0
Real GDP growth/ capita,	3.2	1.4	-0.1	-0.4	0.7	0.9	4.0	3.5	1.1	-4.8	3.7	3.1
Average real wages (% change)	0.7	0.1	1.2	1.0	-0.9	-1.0	-0.9	-1.1	-0.1	1.8	0.4	-0.8

The following figure shows the current account balances in the euro zone after the 2008 crisis.

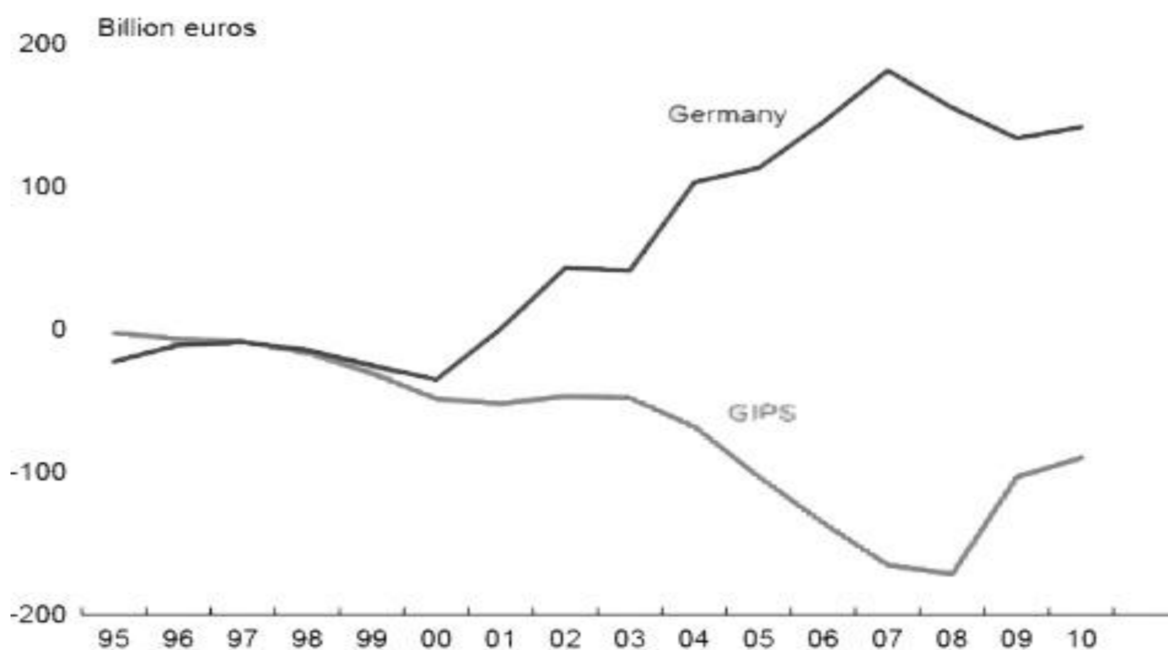
Figure 1: Current account balances in the euro zone in 2010 [2]



Since the creation of the euro in 2002, with the exception of 2008 (as a result of the impact of the US economic slowdown) the German GDP growth has grown steadily[1] – beyond 3% in 2006, 2007, 2010 and 2011 - due to an increase in net exports (between 5 and 7% in the period 2002 to 2011). The proportion (exports/GDP) grew from 0.36 in 2002 to 0.50 in 2011. In the aforementioned period imports from Germany represented more than 15% in the United Kingdom, France, Italy and Spain.

The current account balance between Germany and the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) is shown in the figure below:

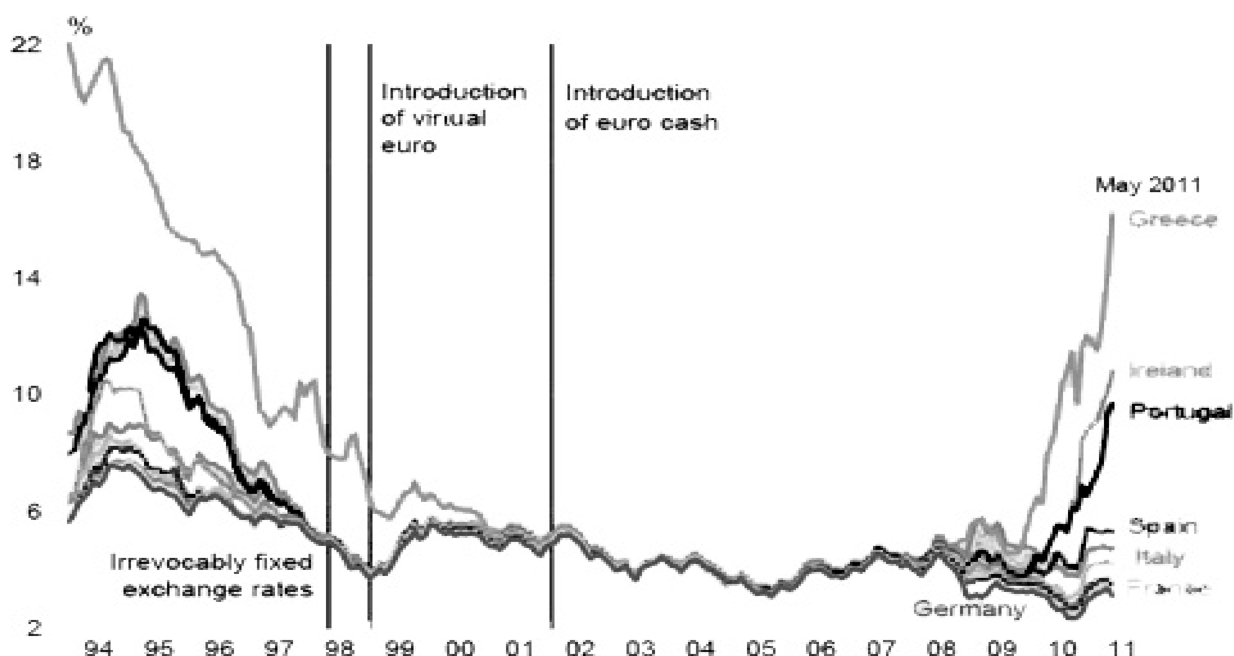
Figure 2: Current account balances in Germany and the GIIPS during the period 1995 - 2010[3]



It is clear that before the creation of the EU there were no differences between the current account balances of Germany and the GIIPS, while after 2001 there was an inversely growing gap between them. Germany's current account surplus coincides with the deficit in the current accounts of the GIIPS.

The borrowing spree and the consequent housing crises created in the GIIPS countries were partially due to the low bond yields resulting from the introduction of the euro zone, as can be seen in the figure # 3 below.

Figure 3: The bond yields in Germany and the GIIPS countries in the period 1994 - 2011 [5]



The creation of the euro zone favorably impressed the markets. As long as the U.S. economy was doing relatively well, there was not impact on the euro zone, and the GIIPS countries could borrow at the same level as Germany. Germany's strength was proven when it was only slightly affected in 2008 by the slowdown in the American economy, while the GIIPS countries started their difficulties in honoring the debts acquired during the borrowing spree.

As a result, with the exception of Spain, all GIIPS countries registered debt as a percentage of GDP > 100% in 2011 [4], widely above the 60% stated in the Maastricht Treaty.

The second hypothesis claims that Chancellor Merkel's dual roles as both Germany's chancellor and one of the EU's most prominent leaders generates a contradiction reinforced by the euro zone's monetary union.

Her main interest as chancellor is to foster German prosperity and to create a solid social trust in her people and the government, while as the EU most powerful political voice, her fundamental task is to attain and to maintain the economic, financial and political stability of the 27 members of the EU, and especially the 17 members of the euro zone, navigating the important financial differences between the Northern and the Southern states.

The contradiction arises from that fact that, on one hand, Germany needs the euro zone members to continue its economic and financial progress and the euro zone members (especially the Southern ones) depend on Germany for their financial health. On the other hand, Germany seeks austerity measures as a condition for bailing out ailing Southern euro zone members, measures which are not welcomed by the governments and peoples of the ailing countries. As a result, important decisions are postponed, hindering any solutions to the crisis.

The euro zone’s monetary union inhibits the implementation of monetary policy by its member states’ central banks. These banks instead must defer to the European Central Bank’s (ECB) decisions. Their lack of individual currencies precludes the possibility of increasing exports by external devaluation. They would have to use internal devaluation to increase competitiveness in a hard way creating adverse reactions from the working class. The only economic stabilizing tool directly available to euro zone members is fiscal policy, which is closely related to their budgetary situation. The implementation of expansionary fiscal policy will be considerably limited by a deficit in the budget amounting to more than 3%, and a governmental debt beyond 60% of the GDP. Therefore, assuming that a government uses its budget in a financially prudent way, chances are that it would not face insurmountable difficulties so long as the economy is growing, the unemployment rate is low, there is little tax evasion and there is an acceptable progressive tax structure. However, no country can avoid the danger of a recession, as it is a necessary stage of the business cycle, but nonetheless a country can weather recession it is in a solid budgetary position. The risk of recession increases with the growth of globalization. In 2008 when the American economy collapsed, the euro zone’s financial crisis began, and has grown especially acute in the GIIPS countries as shown in table # 2.

Table 2: Economic indicators of the Southern euro zone countries from 2002 to 2012 [6]

COUNTRY	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
GREECE											
GDP growth %	3.4	5.9	4.4	2.3	5.2	4.3	1.0	-2.0	-4.5	-6.9	-6.1
Budget balance/GDP%	-4.8	-5.7	-7.4	-5.3	-5.7	-6.4	-9.4	-15.	-10.	-9.2	-7.6
Public debt/GDP,%	117.	112.	114.	114.	105.	104.	109.	125.	142.	165.	161.
Unemployment, %	10.3	9.7	10.5	9.9	8.9	8.3	7.7	9.4	12.5	17.4	24.4
IRELAND											
GDP growth %	6.6	4.4	4.6	6.0	5.3	5.6	-3.6	-7.6	-1.0	1.4	-0.5
Budget balance/GDP%	-0.3	0.4	1.4	1.7	2.9	0.0	-7.3	-14.	-32.	-12.	-9.4
Public debt/GDP,%	32.1	30.9	29.6	27.4	24.8	25.0	44.3	65.5	96.3	108	115.
Unemployment, %	4.4	4.6	4.5	4.4	4.4	4.6	6.3	11.8	13.6	14.4	14.4
PORTUGAL											
GDP growth %	0.7	-0.9	1.6	0.8	1.4	2.4	0.0	-2.5	1.4	-1.7	-3.3
Budget balance/GDP%	-3.0	-3.1	-3.4	-5.9	-4.1	-3.1	-3.5	-10.	-8.6	-4.2	-6.1
Public debt/GDP,%	53.8	55.9	57.7	62.8	63.9	68.5	71.5	83.2	92.4	107.	119.
Unemployment, %	5.1	6.3	6.7	7.6	7.7	8.0	7.6	9.5	10.8	12.7	15.3
SPAIN											
GDP growth %	2.7	3.1	3.3	3.6	4.0	3.6	0.9	-3.7	-0.1	0.4	-1.8
Budget balance/GDP%	-0.5	-0.2	-0.4	1.0	2.0	1.9	-4.2	-11.	-9.2	-8.5	-6.7
Public debt/GDP,%	52.6	48.7	46.2	43.0	39.6	36.1	39.8	53.2	60.1	68.5	83.2
Unemployment, %	11.5	11.5	11.0	9.2	8.5	8.3	11.4	18.0	20.1	21.7	23.7
ITALY											
GDP growth %	0.5	0.1	1.4	0.8	2.1	1.4	-1.3	-5.2	1.2	0.5	-2.3
Budget balance/GDP%	-3.0	-3.5	-3.5	-4.2	-3.3	-1.5	-2.7	-5.4	-4.6	-3.9	-2.8
Public debt/GDP,%	105.	104.	104.	106.	106.	103.	106.	116.	119.	120.	126.
Unemployment, %	8.6	8.5	8.0	7.7	6.8	6.1	6.8	7.8	8.4	8.4	10.9

From the analysis of the table, the following conclusions can be derived:

In the period from 2002 to 2007 (the first six years of the euro's circulation) but prior to the onset of the 2002 US recession, the GDP growth, the budget balance and the public debt as a percentage of the GDP, and unemployment rates reached acceptable levels, with the exception of the public debt in Greece, which showed a decreasing trend from 117% to 104% of the GDP.

As of 2008, GDP growth in Greece turned negative in Greece, and fluctuated negatively in Ireland, Portugal, Spain and Italy, with the exception of some years which registered small increases.

From 2009 until the projection for 2012, the budget balances as percentages of GDP registered deficits in all three years in the five GIIPS countries, reaching minimum levels of 9.2 in Greece, 12.6 in Ireland, 3.5 in Portugal, 8.5 in Spain, and 3.9. in Italy.

All countries experienced growing levels of public debts as percentages of GDP from 2008 to 2011 and the projected figures for 2012. Greece, Ireland, Portugal and Italy far exceeded the 90% level established as the minimum threshold for developed countries to suffer reductions of 1-2 % in the GDP growth according to Reinhart (2010). Meanwhile, Spain's projected debt surpassed 83%.

As a consequence of the decreases in the GDP mentioned above, the unemployment rates in all countries increased dramatically after 2007, especially in Greece (which suffered almost a three-fold increase with a projection of 24%), Ireland, Portugal and Spain (with more than a two-fold increase and a projection of 14%, 15%, and 24% respectively).

The absence of independent monetary policymaking ability combined with the imposition of austerity measures by the troika (the European Commission, the European Central Bank and the International Monetary Fund) along with Chancellor Merkel's explicit support, as a condition for government bailouts, has noticeably worsened the recession in each of these countries Wolf (b, 2012). The financial crises in Latin America in the 1980s, in East Asia in the late1990s, in Russia in 1992, and in the EU in 2010-2012 by Cohn (2011) Stiglitz (2003) and Bootle (2012) show that austerity in times of recession does not lead to growth. Recently, even Christine Lagarde, the current managing director of the IMF, is recommending reducing austerity measures. See Spiegel (2012). Had the GIIPS the capability of devaluing their currencies, a likely increase in exports or tourism might have alleviated the current quagmire in the EU.

Therefore, the ineffectiveness of the austerity measures imposed on the sovereignty of the Southern countries and their prolongation of the economic and financial stagnations of the EU, partially due to the monetary union, presents difficult choices to Chancellor Merkel in soliciting support for further bailouts from the prudent German people, the members of her own Christian Social Democratic party, and other parties of her coalition, the German finance minister, and the troika (especially for Greece, who is in need of a second bailout). Complicating these factors are the governments and peoples of the financially ailing countries, who are unlikely to accept the austerity measures without further uprisings. The consequences of not helping the ailing countries might lead to the exit of Greece from the euro zone, with quantitatively unpredictable economic, financial, political, and social consequences for the remaining euro zone members and the EU as a whole .

From an economic standpoint, the Northern countries are in a far better situation than the Southern ones, specifically Greece, Portugal, Ireland, Italy and Spain. In all the aforementioned countries foreign tourism plays an important role in their economies and a depreciated currency would help them attract this important source of foreign currency. The single currency has closed this alternative for them.

The third hypothesis suggests that Chancellor Merkel's contradictory position is reinforced by the issue of the Eurobonds.

Given the high volatility of governmental bonds in the GIIPS countries, several papers have suggested the idea of creating a European bond, which will placate investors' anxiety about buying governmental bonds in countries with high debts as stated by Münchau (m, 2011), Soros (a, 2011), The Economist (g, and h, 2011). A Eurobond will have much smaller yields for the GIIPS countries, thereby increasing their chances of repaying their debts, and reducing the likelihood of future bail-outs.

The issue of the Eurobonds will exacerbate Mrs. Merkel's contradictory position because it will be favorable for the Southern states, but somewhat unacceptable for the Northern states, especially for Germany, because it is unfair for taxpayers in the financially prudent Northern countries to have to pay higher bond yields to diminish the burden that taxpayers face in the more profligate member states. Additionally it might foster moral hazard in Southern countries, diminishing the impetus to become more austere and financially responsible.

Given the fact that the issue of the European bond would have to be approved unanimously by the 17 euro zone countries, among which there are strongly opposed self-interests, the likelihood of its approval is very small. Soros (b, 2011) states that the political will to solve the euro zone's problems is almost absent, and suggests that the missing ingredient is a common treasury which would imply not only a Eurobond, but also one of the main components of a fiscal union.

The Economist (i, 2011) discusses some measures oriented toward the creation of a fiscal union, and it concretely specifies that these measures lead to a deeper "transfer union" and of issuing joint Eurobonds.

Chancellor Merkel disagrees with the idea of Eurobonds and assigns its responsibility to future generations, who should create a new EU treaty and a new German constitution, but the pressure from governments in the euro zone's weaker countries as well as the Socialist opposition parties might force her to take up this matter sooner rather than later.
The Economist (b, 2012) argues that "Germany will not hear of joint Eurobonds. And France does not want to give Brussels more power to dictate national economic policies. This impasse, in turn, prevents progress on economic and political union. 'There is an unholy alliance between those who refuse to share sovereignty and those who refuse to share risks,' complains one Eurocrat." The same reference asks, "Would the Germans accept such a leap towards a 'transfer union' they have always opposed? Many would worry that such a scheme would be a step toward the French Socialists' long-held dream of harmonizing minimum wages and welfare standards across the EU. Germany, by contrast, wants to make European labor markets more flexible and reform social-security systems."

The Economist (h, 2011) states interesting conclusions about the Eurobond: "a) the ECB purchases of Italian and Spanish government bonds has proven to be a temporary palliative to market tensions and the consequent volatility of bond yields; b) the Eurobonds maybe a means to sever the link between the creditworthiness of a country and its cost of borrowing; c) the Eurobonds will be jointly guaranteed by all euro-zone countries including Germany…" This paper concludes with a succinct diagnosis: "The problem is that most governments have no mandate from voters to move in this direction. Politicians therefore need to start explaining to their electorates the choices they face, and the consequences of those choices. If European leaders sign up for a level of integration deeper than voters want, the backlash could split the EU apart—exactly the outcome they are trying to avoid."

In the international economics literature there is wide support for the Eurobond, although most opinions acknowledge the difficulty in settling political disputes. Münchau (n, 2011) agrees with the premise but argues that it will be hard to achieve due to political gridlock in the EU as well as the inertia of the euro-zone governments' decision-making processes. Some of the main difficulties Münchau outlines are the following: a) the introduction of the Eurobond will take too much time due to changes in national constitutions, European treaties and the creation of new institutions; b) political will and leadership are required first, and they have been absent during the euro crisis; c) Finland, the Netherlands and Slovakia have opposed the Eurobond; d) Chancellor Merkel has shown persistent opposition to the Eurobond; e) Germany's finance minister Wolfgang Schäuble has added fuel to the controversy by stating that a Eurobond would first require the creation of a political union. Münchau finally concludes that the Eurobond may be "the next stage in this game of early denial and ultimate surrender although the approval of the Eurobond might represent a break up of Mrs. Merkel's coalition parties."

The fourth hypothesis states that Mario Draghi, the new president of the ECB, has diminished the tensions between Chancellor Merkel and the EU.

On November 1, 2011, Mr. Mario Draghi took the place of Jean Claude Trichet as President of the ECB, with a different strategy. While Trichet was strongly against any contemplation of Greece defaulting on its debt and supported austerity measures, Draghi has taken a different view and began applying expansionary monetary policy.

Zakaria (2012) briefly explains the impact Draghi had made forty days after taking his new position, which added more flexibility to the political impasse regarding the financial crises in the Southern Euro zone countries, caused by their high governmental bond yields. Zakaria refers to a comment made by Sebastian Mallaby, a scholar at the Council on Foreign Relations, stating that Draghi offered "to lend Europe's banks as much as money as they wanted for three years at the astonishingly low interest rate of 1%."

It is important to note that in his first two months in office Draghi lent to banks three times as much money as Europe and the IMF took in a year. The Bundesbank's and Mr. Trinchet's main objective was to prevent inflation. Mr. Draghi has shown that the danger of inflation is exaggerated in the context of the euro zone, first and foremost because unemployment has been rising; therefore, buying bonds to the ailing banks at 1% will at least temporarily give a break to the GIIPS governments' rising bond yields.

On February 29, 2012, Mario Draghi, as the new ECB president, made a contribution that was otherwise impossible for Europe's governments, as their own central banks have no power over monetary policy in relation to the long term refinancing operations (LTRO) that

usually last for months rather than years and the previous record was just one year. According to The Economist (c, 2012), “The ECB announced that it had lent 530 billion ($710 billion), a bit more than traders had expected. The funding also exceeded the previous LTRO, in late December, which had already provided a massive 489 billion. The number of banks dipping into the honeypot reached 800, well above the 523 that borrowed in the first operation.” This was a timely and convenient move because, on one hand, it is forbidden for the ECB to finance governments; and, on the other hand, the ECB is not in a position to lose money on its bond purchases. It is important to note that Mario avoided being the lender of last resort to the governments and became the lender of first resort to the struggling banks. On top of that Draghi provided funds for longer periods.

This had direct consequences. An imminent bank implosion was avoided; Italian and Spanish bond yields went down considerably. The ECB’s provision of liquidity bought time, but did not solve the euro zone’s deep-seated political and economic problems such as: (a) a pending Irish referendum on the European treaty, (b) downgraded credit ratings for the EU’s troubled economies, especially Greece, (c) entrenched voter opposition in Germany toward a second Greek bailout, (d) the lingering possibility of Greece’s exit from the euro zone; (e) the danger of contagion to other ailing Southern economies that might be unable to recover from their financial crises; (f) popular uprisings in Greece and Spain which might preclude or hinder the austerity programs.

As Wilson (2012) has explained, Bundesbank president Jens Weidmann has confronted Mr. Draghi. Because the Bundesbank is the representative of the euro zone's biggest economy – and incidentally the country with the deepest pockets- keeping Germany on board is essential for Mr. Draghi. “Mr. Weidmann has the task of persuading the German public that the Bundesbank, through the ECB, is acting in its best interests.” Wilson refers to a leaked letter from Weidmann that takes a a swipe at Mr. Draghi. “The leak is seen in some circles as an attempt to undermine the ECB president and his flagship policy of so-called LTROs that have helped ease market tensions.”

Chancellor Merkel, in her annual summer press conference in Berlin according to Peel, (2012) “…reinforced her backing for the European Central Bank and its new bond-buying proposal, underlining a more emollient tone in her approach to the euro zone crisis”. Additionally she, “restated her blessing for Mr Draghi’s plan to intervene in the euro zone sovereign bond markets – under strict conditions – to keep down borrowing costs for the most indebted member states.” Peel emphasizes that “the German government has made it clear it believes that monetary stability issues justify the ECB’s latest decisions,” the chancellor declared. “If the ECB comes to the conclusion that money supply is difficult, then the central bank must take corresponding measures to ensure monetary stability. We don’t lay down limits for that.” Peel adds that Ms. Merkel expressed sympathy for the Greeks and support for the Spaniards.

Nonetheless she insisted that the “euro zone governments must reduce their debts to regain the trust of financial markets.” Most importantly she expressed a belief, contrary to evidence in the ailing euro zone countries that growth and austerity may exist simultaneously.

Venturing deeper into the contradiction Chancellor Merkel faces, this paper concludes that its origin lies in this precise incompatibility, that which exists between austerity (coming from her being German chancellor) and growth (stemming from her role as a EU leader).

One radical way to resolve Chancellor Merkel's dilemma would be Germany's exit from the euro zone. Is this option viable? According to Wolf (a, 2012),"It is, after all, the big country with an obvious exit option. The question becomes more pertinent after the decision by Angela Merkel, Germany's conservative chancellor, to support Mario Draghi, president of the European Central Bank, against Jens Weidmann, her appointee as head of the Bundesbank, over plans to buy bonds of governments in difficulty. The president of the Bundesbank, Germany's most respected institution, has now become a spokesman for conservative German euro skeptics. The ECB, Germans realize, will not remain a reincarnated Bundesbank. Once again, we are reminded that the euro zone is set to be a miserable marriage. Might a separation, however disruptive, be better?"

Wolf explains that Germany's systematic current account surplus is the reason for its accumulated net claims on the euro zone countries and the rest of the world. Since the world economy, and even more the euro zone countries, is immersed in financial quagmire, Germany's risk is increasing. Therefore, it would be advantageous for Germany to reduce its balance of trade surpluses, which would most likely happen if Germany exits the euro zone.

A final element in Angela Merkel's contradiction refers to the increasing risk of moral hazard in the ailing European countries if austerity measures are delayed and they continue receiving bail-outs. However The Economist (a, 2012) argues compellingly that "moral hazard applies to creditors. When the pressure is off, Germany shows little urgency about repairing the euro."

The author agrees with the aforementioned paper when it states that there is a cost to procrastination in taking decisions of paramount importance and that Germany has not shown willingness to act except in the direst moments of the euro crisis. The consequences may be hard even for Mrs. Merkel's political aspiration for re-election next year**.**

5. Summary and Conclusions

I – Germany has benefited from the creation of the EU because: a) after 2002 Germany has become one of the first world's largest exporters with a systematically increasing current account surplus, which is largely the counterpart of the balance of trade deficits of the weaker Southern euro zone countries. b) The proportion of exports in the German GDP structure grew from 0.36 in 2002 to 0.50 in 2011. In the same period imports from Germany represented more than 15% in the United Kingdom, France, Italy and Spain; c) In the period between 2002 - 2011 Germany's bond yields have been the lowest in the EU even when most of the euro zone countries registered higher yields as a result of the world economy slowdown. Germany's sovereign bonds' supremacy in the markets is partially due to being the least risky in the EU; d) Germany's main economic parameters have shown positive trends in the period 2000 – 2011; e) Germany's competitiveness is due to its lower labor costs as a result of the diminishing trend of real wages in the aforementioned period.

II - Between Germany and the EU there exists a contradiction because Germany is tightly linked to, and depends on, the EU; meanwhile the EU could not exist without, and depends on Germany. Germany's dependence on the EU stems from the facts mentioned above. The EU's dependence on Germany comes as a result of the following: a) Germany's Bundesbank's and finance ministry's important roles in approving bailouts to

the weaker euro zone countries, which are supported by German taxpayers although these taxpayers are reluctant to finance the "profligate" Southern countries; b) one of the main reasons for the EU crisis was the lending spree created by the low bond yields of the GIIPS (which were considered to be as risky as Germany in the period 2002 - 2006) after the creation of the euro zone and the circulation of the euro.

The creation of the monetary union, with the loss of monetary independence of the euro zone countries, lies at the core of, and reinforces, this contradiction. Were these ailing countries monetarily independent from Germany, they would be in a position to devalue their currencies to increase their competitiveness, which would be effective considering that foreign tourism is one of their main sources of foreign currency revenues. The story of previous financial crises in countries with full monetary independence shows that the depreciation of their currencies has been one of the most important reasons for their recovery and ulterior growth.

In summary Germany is tightly linked to, and its economic success depends on, the EU; while the EU could not exist without, and depends on Germany, Germany cannot be identified with the EU (neither the Bundesbank with the ECB), and the EU is economically, fiscally, politically and culturally different from Germany. Their main differences stem from their opposing self-interests, emanating from diversity of economic, political, social and even cultural backgrounds.

This contradiction is embodied in the two hats Chancellor Merkel must wear, as both one of the most important leaders of the EU (one of whose main functions is to foster growth in, and to save, the euro and the EU) and as German chancellor (who is forced to impose austerity measures to reduce huge deficits and governmental debts as percentages of the GDP, and to try to guarantee the payment of the bailouts to the ailing countries). In other words, she has to successfully combine growth with austerity when the weak euro zone countries are deprived of monetary policy independence. Chancellor Merkel is in difficult the position of persuading the prudent German people, the members of her own Christian Social Democratic party and other parties of her coalition, the German finance minister, the stronger Northern countries and the troika to support bailouts to the profligate governments of Southern European countries. Additionally she must convince the governments and peoples of the financially ailing countries to peacefully accept the austerity measures. Otherwise, there will be volatility in the market and credit rating agencies may continue downgrading the countries in distress. The consequences of refusing help to the ailing countries might include a Greek exit from the euro zone, with quantitatively unpredictable economic, financial, political, and social consequences for the euro zone and the EU as a whole.

III- The volatility of bond yields, created by the markets' perception of risks in lending money to ailing economies, has inspired the idea of a Eurobond. This bond assumes to be equal to all members of the euro zone (somewhat administratively artificially implying that the risk in all countries is the same). The contradiction is obvious: the strong countries – whose bond yields are much lower than those of the weak countries – will be harmed; while the weak countries will be benefited. Angela Merkel is of course opposed to the idea of Eurobonds. Many other solutions have been brought to the table of discussions, but any discussion of Eurobonds (an idea supported by many specialists and economists) has been postponed, blocked and made secondary to the approval of a fiscal union, a banking union, and other types of union whose creation will be contingent to economic, financial,

political and approval from internal and external institutions like the IMF. In conclusion, the contradiction has been complicated, rather than simplified.

IV – ECB president Mario Draghi has diminished the tension in the contradiction between Chancellor Merkel and the EU by buying bonds from banks at a very low yield in two rounds. The effect on the market is similar to what would have been the creation of the Eurobonds, but without either the opposition from the stronger Northern countries, or the imposition of additional austerity measures. While the issue of Eurobonds would have taken many months of confrontation among governments and the troika, Draghi's action only took two months after starting his presidency as the ECB with little opposition. Chancellor Merkel has publicly approved Draghi's intervention, as a clear sign that the pressure on her has somewhat been reduced. The solution is temporary, not permanent as had been the case for the Eurobonds, but the latter appears to be almost impossible to achieve in a timely way to deter a worsening of the current euro crisis.

End notes

1- All economic parameters related to Germany were taken from the Economist Intelligent Unit.
2- German Bundesbank, "The dynamics of the Bundesbank's TARGET2 balance", Monthly Report 63 (3), 18 March 2011, p. 35; J. Whittaker, "Intra-euro system Debts", Lancaster University Management School, 30 March 2011, p. 1; H.-W. Sinn, "Neue Abgründe", Wirtschaftswoche, No. 8, 21 February 2011, p. 35; calculations by the authors.
3- Eurostat, Wirtschaft und Finanzen, Zahlungsbilanz, Zahlungsbilanzstatistiken nach Land; Ifo Institute calculations
4- Spiegel on line "The most important facts about the global debt crisis"
5- Same as above.
6- Economist Intelligence Unit data base.

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