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12. The EMS and the Bundesbank in Europe

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I INTRODUCTION

This essay deals with the financial position of Germany in Europe and the role of Europe in Germany's economic strategy. The central argument of the paper is that the German orientation is structurally, institutionally, as well as philosophically, anti-Keynesian orientated, so that the Federal Republic[1] has become the source of strong deflationary impulses for Europe as a whole. Germany conquered the role of being Europe's deflationary factor in the course of a long historical process from which Bonn emerged not just as the largest economy of the continent but also as the political hegemon. Except in the 1990s, German hegemony has been explicitly used to strengthen the economic position of German capital in Europe.

The present essay intends to highlight the mechanisms and the factors which, in historical time, transformed Germany from a force of economic growth into a force of economic deflation.

Section II sets out the conceptual framework forming the basis of the study, along with the description of the main phases and of the central institutional features of postwar German capitalism. The postwar period will be divided into three main phases. The first, from the reconstruction years till the very beginning of the 1960s, is characterized by a process of cumulative causation for Europe as a whole. The second phase, lasting until the second half of the 1960s, is described as an interlude period, in which the political economy of the EEC is dominated by the interaction between the balance of payments constraint and export-led growth. Finally, the third phase, starting with the revaluation of the Deutschmark in 1969, covers the 1970–90 period during which Germany emerged as a deflationary factor for Europe as a whole.

Section III analyses the financial and real aspects of the first phase of accumulation. It is argued that in this phase Germany's economic growth acted

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favourably on the economic expansion of the rest of Europe in spite of the highly oligopolistic nature of industry in the Federal Republic.

The subsequent phases are analysed in the remaining sections. The fourth one attempts to show how the export bias of the Federal Republic is tied to the role played by the large industrial groups and to the functioning of the Bundesbank. The fifth section argues that Bonn's hegemonic tendencies surfaced particularly during the stagnation of the 1970s. Finally, in the sixth section it is maintained that during the 1980s the EMS has become the institution of Germany's hegemony. Conclusions are drawn in the seventh and last section, where it is argued that German capitalism is now facing the prospects of stretching beyond Europe while having to confront the impact of the economic crisis.

II THE CONCEPTUAL FRAMEWORK IN HISTORICAL PERSPECTIVE

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For nearly the entire period from the 1950s to 1990 Germany's position in Europe is characterized by its balance of payments surpluses, the most important component of which is net manufacturing exports.[2] Such a situation justifies taking a Keynesian perspective, which consists in viewing the accumulation of current account surpluses as deflationary and inimical to full employment. At Bretton Woods, Keynes argued against the imposition of the burden of adjustment on the deficit countries, since this would cumulatively move the international economy away from full employment. Analytically, Keynes's position has been lucidly demonstrated in a little-quoted paper by Kalecki (1946), where it is shown that automatic flexibility in exchange rates cannot be relied upon to restore balance-of-payments equilibrium simultaneously with full employment. Kalecki's approach makes the whole adjustment process dependent upon the willingness of the strong countries to dispose of the surplus by means of lower interest rates and of a higher propensity to import. Methodologically, the novelty in the Keynes–Kalecki approach lies in having tied the question of possible balance of payments disequilibria to the issue of how not to sacrifice full-employment objectives.

In the economic and political literature, the problem of Germany's persistent surpluses has been treated mostly as a policy issue rather than as a specific dimension of the process of capital accumulation (in the Marxian and Classical sense). It is here that a second perspective – represented by the works of Kalecki, Sylos-Labini and Sweezy – may be brought in. It is well known that for this group of authors the consolidation of oligopolistic formations implies, at the macroeconomic level, the weakening of the endogenous impulses to investment. Throughout the essay the German economy will be portrayed as the most coherent oligopolistic unit among the Continental economies. Sporadic references to the oligopolistic nature of the FRG's economy can be found also in mainstream literature. For instance, Steinherr and Morel (1979) attempted a formal explanation of the ability of German industry to expand exports in the wake of substantial appreciations of the Deutschmark. The authors assumed exporting firms to be pricemakers operating with a given mark-up. In this way, exporters would not be compelled to bear the full brunt of a revaluation because of the lower prices of imported inputs. By contrast, competitive producers, by being pricetakers, would become more exposed to international competition, thereby witnessing a decline in the profitability of their own operations. Consequently, resources would be shifted to the oligopolistic, export-orientated sectors.

This approach, with its emphasis on large firms, can be combined with an institutional characterization of the hierarchical relations underlying the working of the German economy. Institutionally, the focus of attention becomes the ownership structure of German industry centred around the links between the large companies and the banking system. Until now, the ownership structure of the big companies has not been much affected by the instability of financial markets, since:

> Its essential point of reference lies in a delicate balance between foundations, institutions linked to company employees, and public agencies, all of which are coordinated by the all-powerful and ubiquitous presence of the large banks. (Prodi, 1990, p. 147)

In this way, the distribution of resources needed to feed the process of accumulation is not determined exclusively by the pricing policies of individual units, but by a whole network of institutional relations. Historically, the integration between banks and industry was not due to purely institutional factors; rather, it was connected to the fact that Germany's industrialization followed the pattern of investment priority in the capital goods sectors and in heavy industry, all being projects where large start-up capital is needed.

In the postwar period, the heavy industry and the capital goods sectors continued to play the most important role both in the growth process and in the accumulation of external surpluses. The FRG receives the bulk of its surpluses through manufacturing exports. In this context, during each of the four decades from 1950 to 1988, the investment goods sector always grew more than the other industrial branches of the economy (Schneilin and Schumacher, 1992).[3] This structural evolution – which enabled Germany systematically to accumulate surpluses – has been sustained by a banking system characterized by the universal bank, whose role is to provide firms with a whole range of financial services. In practice, the German economy is governed by the level of integration between the large industrial groups, which are also the main exporters, and the three largest banks.

The institutional links between the banking system and industrial enterprises imply that the latter tend to use bank credits rather than going directly to the 'public'. Firms are therefore sensitive to the recommendations made by the banks, which have also a virtual monopoly of the operations of the stock exchange. In turn, banks take a keen interest in the objectives pursued by firms. The preoccupation with price stability is rooted in the above institutional nature of the German financial–industrial complex.

The universal bank borrows funds on a short- and medium-term basis and supplies long-term financing to firms, including participation in share ownership, which, beyond the threshold of a 'blocking minority', is legally treated as a form of credit. In this context, inflationary conditions would tend to shorten the term structure of borrowed funds, thereby compelling the universal bank to shift to more conservative policies. Hence, a firm stance against inflation by the Bundesbank constitutes a guarantee of the stability of Germany's financial–industrial complex. Thus, monetary policies orientated towards price stability become an inherent feature of the system (Nardozzi, 1983). The nature of the ownership structure of German capitalism implies that there has to be a consistent relation between the policies of the universal banks and the large companies grouped around them. This consistency depends upon the position of the Bundesbank. The latter acts as the body *de facto* entrusted to safeguard the relations between banks and big industrial concerns, which are also the major exporters.

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A clear example of how the Bundesbank safeguarded the stability and credibility of the financial–industrial complex is given by the events of the 1970s. After 1972, the Bundesbank sustained – following the revaluation of the DM – the structural transformation of the pattern of accumulation from an extensive to an intensive one. The economy moved from a pattern based on exports of industrial goods and imports of labour and money capital into one based on exporting advanced industrial goods and money capital while importing industrial goods.

The importance of the Bundesbank's rôle in those years can be summarized as follows. During the phases of restrictive monetary policies, firms were induced to acquire external financing, thereby reducing the pressure on domestic financial markets.[4] The inducement to use the external channel came from the universal banks, whose bodies participate directly in the decision-making process of firms. The action of the universal bank implied that the large firms were in the best position to use the external channel, since the minimum size of each single operation is quite large relative to the operations of the small firms. Furthermore, restrictive monetary policies, when interpreted as a credible stance against inflation, were meant to modify the liability structure of the banking

sector from short- to longer-term denominations. This is precisely what the universal banks need in order to keep financing the investment projects of firms. As Nardozzi has pointed out, the objective of monetary stability and the pragmatic character of monetary policies – which took into account the profitability of banks – contributes 'to explain the connections between the monetary behaviour and the structural features of the German economy'. Consequently, the possible weaknesses of the economy are located 'not so much in the financial system but rather in the pattern of industrial growth based on high levels of concentration' (Nardozzi, 1983, p. 119; my translation from Italian).

The connection between banks and industry worked very well during the growth years following the reconstruction process up to the formation of the EEC, as well as during the last two decades, which have been characterized by persistent unemployment. Thus, it would be misleading to associate the integration between the two main components of modern capitalism, industry and finance, with the maintenance of a stable level of activity relative to the requirements of full employment. In the past, the mistake of confusing the productive power of German capitalism with a normative evaluation about its inherent stability has been made by the Marxist thinker Rudolf Hilferding, author of *Das Finanzkapital*, who was the first to develop a theory of the relations between banks and industry in a cartelized economy. Impressed by the degree of integration between those two elements of economic activity, Hilferding argued – shortly before the outbreak of the Great Depression – that financial capitalism would by now be crisis-free. The same attitude was expressed also by Schumpeter (1928). Their thesis is that large industrial concerns, by controlling their markets, can plan and stabilize production at the desired level, while integration with the banking system frees large industries from liquidity crises as well as from monetary fluctuations.

It is not difficult to see that this very specific German economic culture also found its way into the theories of the social market economy propounded by the ruling Christian Democratic party. In the Hilferding–Schumpeter conception, the relation between large industrial groups and finance are put explicitly at the very heart of the behaviour of what Schumpeter called trustified capitalism; whereas in the social market conception the links between industry and finance are hidden behind the institutionalist and unanalytical form of reasoning adopted by that school. Both approaches, however, view the integration between finance and industry as yielding economic stability, which, in the social market approach, is ensured by a corporatist social hierarchy.

In the interwar period, contrary to the Hilferding–Schumpeter view, the system of trustified capitalism did not shelter the economy from the Great Depression, which in fact, hit Germany particularly hard. By the same token, the system of universal banks and high capital concentration did not save the FRG from the regime of low growth rates and high unemployment of the last two decades.

However, the institutional structure of West Germany did enable its economy to strengthen its position amidst growing stagnation in Europe. Exports surpluses, heavily orientated towards capital goods, were the factors which enhanced the position of the FRG over the last twenty years. Yet, before reaching a situation in which the relative power of West German capitalism could benefit from stagnation, the economic relations between the FRG and the rest of Europe went through a phase of positive cumulative causation, followed by a short interlude before the beginning of a long and drastic process of structural change.

After the Second World War, Germany's economy acted dynamically for the whole of Europe till the early 1960s. As will be argued in the next section, this positive cumulative causation was made possible by the existence, at the European level, of US-sponsored institutions which mitigated the cleavage between industry and finance by keeping interest rates low and by softening the balance of payments constraint. In this framework, Germany's economic expansion and Europe's growth were not mutually inconsistent, although Bonn established, right from the early 1950s, a systemic trade surplus with its European partners.

It was during the 1960s that the regime of high accumulation of the 1950s started to break down, rather than being transformed into a regime of permanent full employment. At the roots of the change lay the emergence of the balance-of-payments constraint as an instrument with which to enforce wage policies in order to obtain export-led growth. For a while, this policy orientation implied a *de facto* tug-of-war with the FRG, whose surpluses declined substantially from 1960 to 1966.

The German counter-offensive came in the late 1960s. It was propelled by a sharp change in the pattern of accumulation based on the combination of export growth with the outflow of direct investment. This change was inaugurated by the 1969 revaluation of the DM and continued during the 1970s through successive revaluations. The remarkable feature of the FRG's economy after 1969 lies in the ability to transform the appreciation of the currency into an active instrument of industrial restructuring. Hence, while the balances of the other European countries were burdened by the increase in oil prices, Germany maintained and even increased its own surpluses till the very end of the decade.

The reason for this behaviour is not political but purely economic, and can be explained in Kaleckian terms. For Kalecki, a mature capitalist economy would tend towards stagnation without exogenous increases in demand. Such increases would have to come from public expenditure, from military expenditure and finally from exports.[5] The avenue represented by military expenditure was not of economic interest to Germany because of the changes – to be discussed in the next section – in Europe's political economy engendered by the United States. Thus, exports became the main instrument for the profitable absorption of the surplus.

In the course of time, German industry has achieved an oligopolistic position throughout the Continent. This can be explained by the fact that the corporatist character of German capitalism is connected to its specific sectoral coherence. Sectors are not allowed to decay, those in decline are themselves subjected to modernization policies, so that they do not lead to the formation of industrial wastelands with negative effects on the other branches as well (Katzenstein, 1989). In this manner, the industrial prowess of German industry is kept up relative to that of the rest of Europe. Because this process occurred in the 1970s and 1980s, under conditions of stagnant growth, the maintenance of trade surpluses was a crucial factor in the profitability of German firms.

Western Europe is the heart of Germany's effective-demand space. Europe's high growth rates, following the reconstruction period, enabled German industry to fan out over the whole network of Europe's intersectorial relations. In this respect, Germany's trade surplus with the EEC is particularly illuminating. The US$50 billion of net exports obtained in 1989 were formed by a $13 billion deficit in agricultural products, by a $15 billion surplus in intermediate industrial goods and by a $48 billion surplus in investment goods (Dal Bosco, 1992). Only a long historical process, in which priority is given to the capital-goods sectors, can explain the overwhelming role of investment goods in the FRG's exports. This also means that German industrial goods are necessary inputs in just about every branch of Europe's productive apparatus. The transformation of Europe into the area of profitable effective demand for German production is the result of strategic decisions concerning sectorial developments, rather than the outcome of competitive tendencies.

Today the role of Western Europe in Bonn's political economy is strengthened by the need to compete internationally against Japan and the United States, while it is rendered more problematical by the opening up of Eastern Europe.

Until 1990, Germany's strategy was to accumulate surpluses – mostly from its trade with the rest of Europe – regardless of the economic needs of the other European countries. This was necessary in order to finance exports and direct investment abroad, especially since Germany has been experiencing a growing deficit with Japan and the industrializing countries of the Far East, that is not offset by the (declining) surplus with the United States. To become active in that part of the world, Germany has to invest a large amount of financial capital, but Bonn's financial institutions and monetary authorities are extremely reluctant to see Germany's international position change by issuing liabilities against Germany itself. Therefore, trade surpluses become the key to Bonn's international strategy. Given that at present Germany cannot reverse the negative trade balances with Japan and East Asia, Bonn's surpluses must come from its trade with the rest of Europe. In other words, the competition between Japan and Germany pushed Bonn to augment its hegemonic position within Europe.

After 1990, the annexation of East Germany and the prospects of expanding into Eastern Europe have altered the dimension of the strategic choices facing the German authorities. This will be discussed in greater detail in the last section of the paper. Here, suffice it to say that neither East Germany nor Eastern Europe are strong sources of profitable effective demand. There are, however, important areas for the development of productive activities which, on the one hand, are not profitable in West Germany, and, on the other hand, can compete against the exports coming from the newly industrialized countries of the Far East. Yet, as the East German case has shown, the costs of operating in the East have caused the loss of the surplus position enjoyed by the FRG. As trade with Europe is no longer sufficient to generate the desired financial flows, Germany must resort to the financial markets in order to pursue its objectives. The implementation of such a strategy from a position of strength requires the defence of the confidence in the value of the currency bestowed by the international financial institutions. This is achieved by means of a new spate of restrictive monetary policies based on relatively high rates of interest.

In practice, Germany is not interested in putting forward a Keynesian-type solution to Europe's rising rate of unemployment. It follows that Europe has to bear the burden of financial adjustment in a negative way, thereby sharpening the deflationary bias which has been sealing the whole Continent in a situation of rising unemployment for well over a decade.

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III THE FINANCIAL AND REAL CHARACTER OF THE FIRST PHASE OF ACCUMULATION

The first phase of accumulation in postwar Europe can be looked at as a period in which the real dynamics of output had priority over financial interests, in the sense that the latter were subjected to the former. This period, although stretching into the early 1960s, goes from 1946 to 1958, which are also the years during which currencies were not convertible. With the return to convertibility after 1958, balance-of-payments relations began to govern the growth pattern of EEC countries.

For Germany's position in Europe, the importance of those 12 years consists in the fact that the economic dominance acquired by its industry did not come about through the link between industry and imperialism which marked the previous phases of German capitalism. The possibility of moving away from the imperialist connection between markets and raw materials, which defined so strongly the political economy of Europe right up to the Second World War, was a direct result of the financial and monetary decisions taken for strictly political reasons by the US authorities (Marshall Plan, government aid and relief in

occupied areas (GARIOA) and the European Payment Union (EPU)). The role played by these institutions in removing the traditional economic sources of inter-capitalist conflict in Europe hastened a crucial transformation in the technological basis of the Continental economies. Now that the control and acquisition of areas producing steel and raw material was no longer critical to the process of accumulation, growth could be obtained through the extension of the scale of output by adopting mass-production techniques on a wide variety of consumption and intermediate goods. Such a process required a considerable period of retooling, in order to proceed to the construction of altogether new productive facilities.

The nation state in each of the European countries was given the responsibility of providing the structural framework for the reconstruction programmes, which, meanwhile, were unwittingly transformed into programmes of long-term structural change. The domestic role of the state did not clash with its European role, because the financial institutions which they had to manage in common (with the assistance of the United States) were orientated towards the expansion and restructuring of production rather than towards the acquisition of profits from purely financial transactions.[6] As Milward (1984, 1992) has shown, the hallmark of the 1950s was the organization of European institutions around the productive role of the nation state. This required devising a system of international relations limiting the autonomy of finance and allowing the easy transformation of export surpluses into commercial credits. Thus, the growth objectives pursued by the governments and the industrialists in each nation state were not in conflict with the expansion of intra-European trade on a completely different basis from the imperialist one of the pre-1939 period. The interplay between the institutional and the structural role of the state was made possible by the pre-eminently functional tasks assigned to financial agencies.[7] This in turn permitted the implementation of policies in which domestic wage deflation did not contradict domestic expansion based on retooling and restructuring, nor did the latter contradict export and import expansion.

German economists do recognize the role played by the American-sponsored institutions in the creation of favourable financial conditions for development. Yet the institutions of the reconstruction period are often seen as extraordinary steps, justified only by the need to create a new non-conflicting form of economic relations in Europe, the implicit assumption being that after a certain period things would proceed smoothly in a world of free multilateral trade and of equally free financial flows.[8] In reality, shortly after the return to convertibility in 1958 and the freezing out of most of the safeguards of the 1950s, the policy preoccupations of EEC countries were increasingly centred on how to control domestic demand in relation to perceived current account constraints. By contrast, the main feature of the 1946–58 period lies in the intensity of the structural transformations and their relative consistency at the Continental level. This process would have been impossible without accommodating financial institutions, in ciation of the US dollar tended to reduce the cost of oil imports, but it also exposed those countries to the American drive aimed at regaining international competitiveness. Given the weakness in their balance of payments position, countries like France and Italy could not eschew the issue of whether or not to devalue also their own currencies. Now, Europe's external trade has a marked intra-European dimension in which Germany is by far the largest importer of the products of each single country. In these circumstances, the option to devalue depended on the probability of succeeding in outcompeting Germany. The type of policies involved is well represented by the Italian case. The Bank of Italy favoured a revaluation of the lira against the dollar, thereby reducing the cost of oil, and a devaluation against the other European currencies, thereby enhancing Italy's exports *vis à-vis* Germany's. This strategy was indeed successful as it allowed Rome to achieve a balance of trade surplus with Bonn (Parboni, 1981).

The tendency towards a form of competitive devaluation did not escape the attention of the SPD-led government and, especially, of Helmut Schmidt. Faced with the multifaceted effects of the devaluation of the US dollar under the Carter Administration, the SPD government began to worry about how to link European currencies together in order to prevent the creation of a monetary front in Europe. Schmidt's advocacy of a European monetary system, although cast in the grand vision of a unified Europe centred on Franco-German co-operation, is a testimony to the faith that successive German leaders had in the role of industry in maintaining hegemony. They did think that with controlled exchange rates, the productive, non-price efficiency of German industry would eventually carry the day, leaving the others to undertake the required adjustments. With the EMS, Germany acquired the freedom to fight the fluctuations of the dollar through internally co-ordinated restructuring. At the same time, Bonn prevented the other European countries from using the exchange rate instrument to undercut its policies.

Conceived in a period in which the dollar was depreciating, the European Monetary System served Germany well during the phase of the appreciation of the US currency (1980–5). Thanks to the restructuring and foreign investment policies adopted in the preceding decade, the FRG very quickly overcame the current account deficit caused by the second oil shock in 1979. By 1982 Bonn re-established its trade surplus with the oil-producing countries, while the rise of the dollar and the American recovery generated an expansion of the surplus with North America, safeguarding, at the same time, the surplus with the rest of Europe. The majority of the other European countries, by contrast, benefited chiefly from the surplus obtained from the United States. The external position of the rest of Europe, measured in terms of the surplus of current transactions over GDP, did become positive, but only briefly. After 1985, conjointly with the resumption of the downward trend of the dollar, the rest of Europe began to lose the surplus with the United States, while the deficit with Germany

stayed, along with a growing deficit *vis-à-vis* Japan and the Far East. During the second half of the 1980s, Europe became even more important as a terrain for the implementation of the FRG's export-orientated strategies, because of the decline in Bonn's surplus with the USA and the expanding deficit with Japan and the Far East.

On the whole, the two phases of the 1980s augmented Europe's dependency on Germany. In the first phase, the improvement in Europe's external position was due mostly to the purely contingent factor represented by the policies of the Reagan Administration. No significant amelioration took place on the German front. Furthermore, the negative effects on investment caused by the American policy of high interest rates, leading to the revaluation of the dollar, necessarily had a more detrimental effect on the weaker countries than on Germany. The weaker countries would have needed a comparatively greater dose of investment in order to undertake the restructuring necessary to face up to German competition. In the second phase, those countries found themselves with at least one hand tied behind their back by the EMS, thereby failing to identify a favourable terrain on which to compete against Bonn.

German economists have praised the EMS on the ground that it showed greater flexibility than the Bretton Woods system (Giersh *et al.*, 1992). A closer look at their arguments reveals that their preference for the EMS is based on the fact that it preserved the Bundesbank's freedom of movement in a context in which the other countries 'did more or less adopt the anti-inflationary stance of West Germany's central bank' (Giersh *et al.*, 1992, p. 254). The EMS in fact magnified the limitations of the European Snake by tilting the system of payments in a very anti-Keynesian direction (Parboni, 1981; Samuelson, 1991). This is because the technical innovation brought about by the EMS, the ECU, does not constitute the creation of an international currency. Interventions are based on EEC currencies and on the dollar; external deficits are largely financed by borrowing dollars. Countries can avail themselves of substantial intra-EMS credit facilities, but the amounts borrowed have to be repaid within a very short period of time, thereby putting on the deficit country the pressure of adjustment. Within the EMS there is no institutional mechanism by which the weak countries can compel the strong ones to weaken their position, which is precisely what Keynes attempted to avoid at Bretton Woods. A weak currency country must deflate and/or strengthen its currency relative to those of the other members of the system.

The convergence towards the Bundesbank's monetary policies is, therefore, a built-in characteristic of the system in the light of the inflexibility of Bonn's attitude, which, as argued earlier, stems from a structural conception of the international position of the German economy. On the other side of the fence separating Germany from the rest of Europe, economists have tried to rationalize the asymmetric balance of power by means of the hypothetical advantages which would be earned by pegging one's currency to the DM (Giavazzi and Pagano, 1988). The argument runs entirely in terms of the credibility to be gained in terms of future inflation rates, relative to a long-run position characterized by the so-called natural level of unemployment. Even leaving aside the dubious notion of a natural level of unemployment, the credibility approach does not allow any room for a discussion of the implications of such an exchange rate regime for countries having an economic structure and financial organization vastly different from the German one.

The institutionalization of the FRG's degree of freedom through the EMS had, for some major countries, either a straight deflationary effect or a perverse one. France falls within the former category while Italy belongs to the latter case. The impact of the EMS regime on these two countries is important in order to grasp the ramifications of Germany hegemony within the EEC. Together, France and Italy represented by the end of the 1980s 22 per cent of the FRG's world trade and 41 per cent of its EEC trade. Moreover, in the light of the de-industrialization of Great Britain and of the still-wide gap separating Spain from the other large economies of Europe, France and Italy are the only two large countries with the potential to challenge Germany in a relevant range of industrial products. The argument which follows will maintain that the EMS regime has actually weakened such a potential.

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As is well known, in the early 1980s the French socialist government was faced with the conflict between the social objective of reducing mass unemployment and the altogether different orientations of financial institutions, which were more concerned with inflation and the preservation of the value of the currency. The government opted for the second approach by means of a policy based on fiscal restriction and on the defence of the exchange rate of the French franc *vis-à-vis* the DM. The level of the exchange rate turned out to be the most important cause of the growing trade deficit, in a phase when the overall growth rate of the economy began to slow down towards that of Germany (Parguez, 1992). Slow growth in Germany and slow growth in France meant, however, two different things. The privileged position enjoyed in Germany by the capital-goods industry (Harrigel, 1989) allowed the FRG to attain large export surpluses. By contrast, the picture that emerged in France is that of a stalled economy with unemployment hovering around 10 per cent from 1985 till the eruption of the present crisis (Cotta, 1991). Indeed, while Germany during the 1980s increased its dominant role in Europe as a producer and exporter of capital goods, France lost ground to countries like Italy in many consumption goods, as well as in investment goods servicing directly the consumption-goods industries. The growth of services and of electronic industries could not offset the negative impact of the relative decline of the core industrial sectors.

On the opposite side of the spectrum, Italy represents a case of perverse adjustment to the exchange rate mechanism inaugurated by the EMS. Italy's

growth rate remained during the 1979–90 period significantly above that of the other large European economies, although it declined more sharply than in the rest of Europe, if measured against the 1973–9 period. The country's participation in the EMS involved a process in which the devaluation of the lira, relative to the ECU, was less than the inflation differential *vis-à-vis* the other countries, thereby causing a real appreciation of the currency. Recalling now that the EMS regime compels the weak countries to strengthen their own currency, Italy's way of adjusting to the EMS seemed reasonable to avoid a harsh disinflation, because the economy was coming from much higher inflation rates than the rest of the EEC.

The real appreciation of the currency compelled Italian firms to undertake a radical restructuring in technological terms. Yet, given that Italy's industrial structure is very different from Germany's, the real appreciation of the lira, taking place under conditions of relatively high growth rates, led to persistent external deficits. Italy's growth benefited the FRG more than any other European country, as Bonn's trade surpluses with Rome showed a strong expansion throughout the 1980s.

As noted by Graziani (1991), the Bank of Italy confronted this situation by means of capital inflows attracted by a policy of high interest rates. As a consequence, the ratio between the external debt and GDP rose from 8.7 per cent in 1982 to 15.19 per cent in 1990. Furthermore, since Italy did not enjoy German-type export surpluses (which represent an essential source of profits for German companies), restructuring alone was not a sufficient condition for restoring the profitability of firms, which had been dented by the crisis of the 1970s and the recession of the early 1980s. The crucial factor which brought profitability back was the flow of transfer payments by the public sector to firms (Graziani, 1991; Bank of Italy, 1988). Italy's monetary authorities fostered restructuring by combining fixed exchange rates with inflation, while using public expenditure to help the profitability of firms. In this context, the country's macro-economy was locked into a situation of high interest rates and rising foreign and public debt.

For both France and Italy, the end result of tying their monetary policies to the stability of the exchange rate system had negative effects. In France, these effects manifested themselves chiefly through the weakening of its industrial structure and the persistence of a high rate of unemployment hovering around 10 per cent. In Italy, as argued by Graziani, the effects have been felt mostly by the public sector through its transfers to firms, in order to finance restructuring, and to individuals, in order to mitigate the impact of unemployment. The combination of high interest rates with a rising foreign debt, while imposing on the public sector the task of restoring the profitability of firms, has led to an intractable situation in Italy's public finances. By the end of the 1980s, both

Italy and France found themselves with a much reduced degree of manoeuvrability relative to Germany.

VII THE NEW POSITION OF GERMANY

The acceptance of the EMS by countries like Italy and France represented an institutionalized acceptance of the hierarchical relations which characterize Europe's political economy. During the last decade Europe has had to comply with Bonn's use of the EMS according to Bonn's priorities (Kennedy, 1991). Europe, by being the FRG's main area of effective demand, became also the periphery of German capitalism. The share of the FRG's surpluses obtained within the EEC increased from about 44 per cent in 1985 to more than 62 per cent in 1989, a period in which governments strengthened their resolve to adhere to the EMS. The peripheral character of Europe manifests itself in that, if any of the large countries reflates, its impact on the rest of the EEC will be limited, while German industry, present in the whole spectrum of Europe's interindustry matrix and capable of quickly generating commercial credits, is poised to benefit significantly.

The acceptance of this state of affairs led to the formation of two myths within business and dominant political circles in the rest of Europe. The first concerns the expansionary effect of a speedy institutional unification of the EEC. The second relates to the supposedly beneficial, but longer-term, impact of the collapse of the political regimes in Eastern Europe and in the former Soviet Union.

As to the expansionary impact of European unification, it is important to remember that virtually identical arguments were voiced during the phases leading to the formation of the Common Market in 1957. Those expectations turned out to be correct because industries were then operating mostly from and within a domestic framework. Furthermore, the high growth rates and the correspondingly high levels of capacity utilization prevailing at the end of the 1950s meant that national industries had to plan for further expansion in order to be able to operate at the level of the newly born Common Market. In fact, industries had ten years to adjust their productive capacities, since barriers to movements of industrial goods were formally abolished in 1968.

A totally different situation prevailed in the mid-1980s. Export and direct investment networks had already been in place for nearly 20 years. Productive capacities were, by and large, already adjusted to the size of the, much larger, EEC market. In this context, the decline of the growth rates of the economies forming the EEC implied that the European productive apparatus tended to display not insufficient, but excess, capacity. As such, the prospect of European unity was unlikely to stimulate a significant expansion in overall investment. Only a common reflationary policy could have initiated a new investment wave. Yet,

with the FRG sitting right on its surpluses and with currencies pegged to the DM, the process towards European unity was taking place within an unambiguous scenario marked by real deflation.

The truly novel element of the post-1985 situation has been the liberalization of capital movements. Given the autonomy conquered by the FRG's monetary authorities, financial liberalization implied adopting a policy of high interest rates in order to maintain the exchange rate with the ECU.

At the same time, it should be pointed out that the pressure towards financial liberalization was an objective one, rooted in the financial aspects of the process of capital accumulation at the European level. The 1980s have been marked by a very rapid increase in the number and size of acquisitions across Europe. Germany was at the very centre of the process. Unlike elsewhere in Europe, the strategy followed by German companies has been orientated more towards acquisitions which enhanced their market share than to short-term financial gains (Prodi, 1990). German companies benefited from three factors: the accumulation of external surpluses by the banking system; industrial strength; and ownership structure. The latter factor introduces a crucial asymmetry in the mechanism of acquisitions and mergers. The close interconnection between banks and industries makes it very difficult for foreign companies to acquire a German one, whereas no parallel obstacles exist for German companies investing abroad.

Thus, the expectations generated by the goal of European unity were, as far as the rest of European capitalism is concerned, largely mythical in nature. The existence of unused capacity ruled out an investment boom, the monetary arrangements ruled out a common reflationary policy, capital mobility expanded the sphere of action of German firms in a context of a slow growth in aggregate European demand.

A similar fate awaited the expectations raised by the end of the previous regimes in Eastern Europe and in the former USSR. In the wake of the dissolution of East Germany, many European companies thought that the former German Democratic Republic (GDR) could be used as a means to penetrate more decisively into the German market. This possibility vanished within a very short period of time as the space of the GDR was quickly taken by German companies. As for the rest of the Eastern European and Russian front, suffice it to say that Germany now provides nearly 50 per cent of total exports to the former Comecon countries as against 41 per cent in 1980. The increase in the FRG's export to Eastern Europe and Russia is, however, taking place under conditions of negative growth in that part of the world. Therefore, very little room is left for the rest of Europe which, by and large, does not possess the financial means to meet the German hegemony in the East.

By the end of the 1980s, the two myths ended up mutually reinforcing each other, only to unravel together at the onset of the new decade. The systematic decline in the consensus sustaining the identity between European integration and European monetary union originates in large part from within business circles. This is particularly true of France. One source of the political crisis lies in the fact that, faced with the profound transformation undertaken by the German economy from the early 1970s onward, large segments of Europe's industrial and financial groups accepted German hegemony, hoping to join forces with the FRG and its institutions. In reality, they had to confront German competition in an environment of low growth rates in Western Europe and of economic implosion in the East.

The situation which matured at the very end of the 1980s also generated for Germany a different set of objectives relatively to the other components of European capitalism. These objectives relate to competition with Japan and the Far East and to the issue of the annexation of the GDR.

By 1990, the Federal Republic was the only European economy with a productive capacity able to function at the world level. On the basis of the IMF classification, Bonn had 17 per cent of the total value of exports of the industrial countries, far above Japan's (8.5 per cent). The model of accumulation followed by Bonn, led by exports and direct investment, looked to the EEC as its main area of effective demand. In 1970 the FRG's trade with the rest of the EEC was nearly balanced. Twenty years later, in spite of steadily declining growth rates, the EEC provided the vast majority of the FRG surpluses, the main source of which are net exports of investment and capital goods. During the same period the United States, due to the heavy fluctuations of the dollar, proved to be a rather volatile area in which to obtain surpluses. In particular, the export surplus with the USA shrank from 1985 onward, while the overall share of the surplus on current transactions over GDP jumped from 2.4 per cent in 1985 to a peak of 4.9 per cent in 1989. The institutionalized nature of the relations linking Germany to the EEC through the EMS, sheltered Bonn from the effects of the devaluation of the US currency.

Japan, by contrast, bore the brunt of Washington's exchange rate policies, which are usually accompanied by direct political pressures. The share of Japan's surplus relatively to GDP peaked in 1986 at 4.3 per cent, only to descend to 1.3 per cent in 1990 (the German share was then 3.2 per cent). This factor, coupled with fresh pressures by the United States on other East Asian countries as well, compelled Japan and the East Asian economies to accelerate the expansion of exports and direct investment towards Western Europe. In this context Germany, while deriving its strength from Western Europe and the EEC, showed, like the rest of the Continent's economies, a growing deficit with Japan, the Far East and China. Thus, by the end of the 1980s the necessity to confront the Far Eastern competition, coupled with the need to counter further fluctuations in the US dollar, became more urgent. Other European countries also faced this problem, but their weaker situation has brought them to see the

EEC as a place of safety. This explains the opposition by Italy, France and Spain to the imports of Japanese cars, even when produced in the UK.

Germany, on the other hand, had, as in part still has, a wider set of instruments at its disposal. The accumulation of surpluses, the ensuing strength of its currency, the world-wide nature of its productive capacity, allow the FRG to confront the matter differently. In a situation of stagnant demand, expansion into the Far East is becoming absolutely essential for Germany, especially in the light of China's high growth rate, the only significant bright spot in the present situation. The penetration into the Far East, China included, imposes a form of managed trade and investment relations with Japan, for whom this area is becoming the major source of net exports. Germany, therefore, is not as adamantly opposed to Far Eastern exports as are France, Italy and Spain. The FRG's strategy appears to be more orientated towards a form of economic diplomacy based on reciprocity and on mutual links between German and Japanese firms. In the final analysis, however, the capacity to expand into the Far East will depend on the flows of direct investment and commercial credits that Bonn can generate. Yet the financial means to undertake this strategy must come from a continuing German hegemony in Western Europe, because the latter provides the overwhelming majority of the surpluses from which Bonn's financial institutions derive their leverage over international capital markets.

Western Europe and the EEC, now the EU, must play an even greater role in financing the FRG's efforts in the Eastern part of Europe. The opening up of an Eastern European sphere of influence has been the decisive factor which has pushed Bonn to firm up and even increase its degree of freedom within the EEC, in consequence scuttling the process towards European monetary union. This problem, with its multifaceted aspects, is worth considering in some detail.

The type of German hegemony prevailing in Europe till 1989–90 was predicated upon Adenauer's conception of ensconcing the FRG firmly within Western European polity. Having obtained through the EMS a degree of freedom not available to the other European countries, Bonn could deal more effectively with the fluctuations of the US dollar. Consequently, it also found itself better endowed to meet the competition coming from Japan and the Far East. This deeply asymmetrical situation brought other European countries to express concern as well as political dissent. The rest of Europe is, however, too weak to negotiate a change in the rules of the game, so that the manifestations of dissent became a major factor in the internal political crisis of the countries concerned (France, Britain). The change in the rules of the game came from Germany itself; that is, from the body that shaped them in the first place.

The opening up of the East gave rise to an ambiguous attitude on the part of Bonn's authorities. German industrialists, bankers and policymakers knew very well that the East is not a wasteland. In terms of technical capabilities, of the level of scientific and technical education of its population, Eastern Europe is far from being underdeveloped. It is its internal division of labour, the composition and specification of its output, which does not, as yet, suit the requirements of capitalist competition. The new situation in Eastern Europe made it possible to envisage, in the longer run, the creation of a German economic zone dependent on the FRG in relation to the transfer of technology and capital goods, but also capable of acting as a recipient of the restructuring processes taking place in Germany itself.

The creation of such an area would also be consistent with the need to compete against the Far East. Once restructured under German technical, managerial and financial supervision, large parts of Eastern European industry could, in fact, become exporters of products which are not the dominant ones in the FRG and which compete directly with those of Far Eastern countries. According to this scenario, Eastern Europe would have a persistent current account deficit with Germany that would have to be financed by means of export earnings with the rest of the world. The strong interest shown by Germany towards Eastern Europe is proved by the favourable attitude adopted by Bonn in relation to Eastern European exports to the EEC. By contrast, Italy, France and Spain have shown much greater caution on this issue.

The Eastern European pull has changed in a very complex way the role played by Western Europe in Germany's political economy. The formulation of a long-term strategy towards the East imposes an inward-looking approach on Bonn's authorities. The destructuring of the old economic and social system, a necessary political condition in order to open up that part of the world, has brought about a process of economic implosion in those countries. This means that whichever of the present forces happens to hold political power there, it will not be able to devise a meaningful strategy of integration into the world capitalist economy. Such a strategy will have to come from external interests, with the local power groups operating in a satellite fashion. Germany is the only European country which has a global interest in redesigning the position of the East. This interest has been vastly augmented by the annexation of the former GDR. The annexation could have allowed for the full exploitation of the channels linking the former GDR to the rest of Eastern Europe. However, the process of destructuring has tended to undo the aforementioned links. It follows that, in order to take advantage of its privileged position in Eastern Europe, the FRG must concentrate on a comprehensive strategy of restructuring, beginning with East Germany and moving outward to the former Czechoslovakia, Hungary, Poland, the Baltic states, Slovenia, Croatia and also Ukraine. Over these countries – but not over Russia – Bonn can expect to exercise strong political influence.

The costs of the Eastern pull – highlighted by the East German case – involve a prolonged loss of the current account surpluses which Bonn has so painstakingly accumulated, to the point of dragging the whole of Europe on to a

deflationary path. It is at this point that the relations between Germany and the rest of the EEC take on an altogether new dimension. The EEC must remain the FRG's dominant area of profitable effective demand. Yet the surpluses obtained from the EEC and the rest of Western Europe are not enough to finance the multiple objectives of Germany's institutions and corporations. The financing of these objectives must come, therefore, also from the financial markets. In the absence of the previous surpluses, Bonn's leverage over financial markets depends on the stability of the real value of its currency. Restrictive monetary policies under recessionary conditions (1992) mean that Western Europe is being called upon to finance Germany's way out of the balance of payments difficulties caused by the Eastern factor, presently embodied in the problems caused by the annexation of East Germany.

The formation of 'Great Germany' and the necessity to intervene in Eastern Europe has led Bonn's authorities to defend at all costs their degree of freedom in matters of monetary policies. This is the source of the ambiguity in relation to the now defunct process towards a European monetary union. Even the minimal requirement of a voluntary transfer of international reserves to a common European body became a matter of disagreement between the Bundesbank and the European Community, in spite of the fact that the EMU project has been largely structured around Bonn's needs.

Bonn's determination to shift the burden of adjustment on to the other European countries is based on the implicit assumption – strengthened by the experience of 20 years of monetary policies accompanied by economic restructuring – that German industry has the technical capacity to undertake a new wave of transformations under the severity of high interest rates.

However, the present situation is very different from that of the 1980s, when, along with mass unemployment, there existed significant, albeit contradictory, elements of dynamic change. The early 1990s, when all the contradictory aspects of the previous decade came to a head, were characterized by a rise in the degree of unused capacity and by falling profitability. As shown by the crisis of Japan, the growth rates of the East Asian and the Chinese economies, although impressive, are not sufficient to act as a strong counterweight to the recession in the rest of the industrialized world. In these circumstances, it is much more difficult to rationalize production, since the persistent downward tendencies leads to the appearance of new and undesired excess capacities. Therefore, it is by no means certain that Germany can use restructuring as in the past. Thus, Germany's attempt to maintain its hegemony under much-deteriorated conditions, rather than leading to a new set of rules, may simply mean a new step in the evolution of the crisis with its long-term negative consequences on employment.

NOTES

1. Since our period ends in 1990, we should use the terms 'Germany' and 'Federal Republic' interchangeably. For the same reason, the European Union will be referred to as the EEC.
2. It is true that Bonn has lost such a surplus in 1991. However, this was neither due to a spontaneous adjustment, nor to a policy-induced correction inspired by the need to help European recovery programmes. The German deficit was, rather, caused by the virtual impossibility of achieving simultaneously the objective of incorporating a formerly independent state and holding onto current account surpluses.
3. Taking 1970 = 100, the production index for the main industrial sectors of the FRG was:

	1950	1960	1980	1988
Mining	80	106	82	65
Basic industries	21	54	117	123
Investment goods	18	58	122	149
Durable consumption goods	28	65	114	115
Food industries	29	64	121	129

Source: Schneilin and Schumacher (1992, p. 123)

4. As Nardozzi (1983) shows, this was achieved by means of restrictive policies which created an interest rate differential between the Euromarket rate and the domestic rate. With the former lower than the latter, firms were pushed by the banks themselves to obtain credits on the Euromarket.
5. According to Kalecki, 'The export surplus enables profits to increase above the level which would be determined by capitalists' investment and consumption. It is from this point of view that the fight for foreign markets may be viewed. The capitalists of a country which manages to capture foreign markets from other countries are able to increase their profits at the expense of the capitalists of the other countries' (Kalecki, 1971, p. 85).
6. In the above context the function performed by the European Payments Union (EPU), can be taken as an example. It allowed the European economies, and Germany in particular, to take full advantage of the expansion of effective demand for capital goods created by the Korean war. In fact, while the Korean war generated a capital-goods boom for the Germany economy (Carlin and Jacob, 1989), it also caused, initially, a severe balance of payments crisis for Bonn. The balance of payments constraint was then relieved by a US loan especially approved by EPU.
7. The structural role of the state consisted in that it acted directly on the creation of positive long-term expectations (in the sense of chapter 12 of Keynes's *General Theory*).
8. This view is still presented today without the benefit of historical hindsight (Nolling, 1993).
9. Milward (1992) has shown that Europe's exports to West Germany increased during the 1950–8 period more than Europe's total exports. In the same years, the FRG exports to Western Europe expanded less than total German exports.

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