More than five months after the parliamentary election, Germany finally has a government as Social Democrats clear the way for **Chancellor Angela Merkel**’s fourth term. Merkel was elected Chancellor by the Parliament on **14 March 2018**, and the new ‘grand coalition’ government in Berlin will be forced to deal with a variety of contentious issues that also include strengthening the stability of the Eurozone. Many scholars have argued that Germany has provided international leadership during the **Eurozone crisis**. An influential strand of the literature has attempted to situate this German behaviour in a more general debate of Germany as a leading or hegemonic power in the **European Union** (EU). Notions such as ‘**leadership**’ or ‘**hegemony**’ suggest that without a strong Germany to enforce the Eurozone’s fiscal restrictions, the implementation of difficult albeit necessary structural reforms would not be successful at preserving the Euro. However, is it justified to view Germany as a leading power during the Eurozone crisis? Moreover, **what does the new German government mean for the Eurozone’s ambitious plans for deeper economic integration?**

Looking to the past, there are good reasons to doubt whether Germany has used its leadership benevolently. Germany’s handling of the Eurozone not only prompted **criticism** in many southern European countries for its tough **austerity measures**, but the German government has also utilised the Eurozone to reshape the EU based on the **German economic model** and interests. To expect or ask for a more ‘benevolent’ Germany under these new circumstances does not seem promising. Even after a new ‘grand coalition’ government was finally agreed upon after a period of difficult coalition negotiations – a situation that has never occurred in **the Federal Republic of Germany’s 70-year history** – placing too much faith in **benevolent German leadership** would not be wise.

Leadership in the EU as an issue of European solidarity

In the public and academic debate, the terms ‘leadership’ and ‘hegemony’ are often used synonymously. One source of this terminological confusion is the concept of leadership developed by **Charles Kindleberger**, who considers the stability of the world economy to be dependent on the existence of state leadership. Kindleberger has defined five public goods that include maintaining a relatively open market for crisis products, the anticyclical provision of long-term credits, a stable exchange rate system, securing macroeconomic coordination, and taking over the role as a lender of last resort in case of an acute economic or debt crisis.

Although the EU has not yet reached the level of a ‘community of emotions’, it has certainly moved away from a mere economic association to a community of rule, with solidarity links among its members

Referring to the **theory of public goods**, Kindleberger has introduced a definition of political leadership that must be categorically distinguished from hegemony. First, whereas **hegemony is necessarily based on coercion and domination**, Kindleberger defines **leadership as a function of willingness**. He has always complained that political science has transmuted the concept of leadership into ‘hegemony’, a word whose overtones of force, threat, and pressure make him uncomfortable. Second, legitimacy is of central importance as it determines whether other states are willing to accept leadership and follow it. Third and contrary to mere influence by power or domination, **leadership is based on mutual recognition**. Material preponderance is, therefore, no *conditio sine qua non* for exercising leadership. Fourth and finally, **leadership relies on specific modes of action**. Hegemonic powers communicate strategically and attempt to impose their preferences via threats and sanctions. The mode of action at a leader’s disposal, by contrast, is compromise-oriented communication based on mutual understanding and coalition building. **A leader’s ability to persuade her or his followers is thereby a crucial element of successful leadership**.

In Europe, however, political leadership is not exercised under a condition of **anarchy** but rather within a **community** environment, which is characterised by a high density of interactions, the lack of a central law formulation and enforcement authority, and a community ethos. The EU is undoubtedly the most developed context for action of a community of states. Although the EU has not yet reached the level of a ‘**community of emotions**’, it has certainly moved away from a mere economic association to a community of rule, with solidarity links among its members. Solidarity describes a relationship between individuals, social groups, or states that is characterised by a special form of togetherness and mutual obligation. **Solidarity is not objectively given** but rather perceived as being meaningful by the actors and must be considered appropriate and legitimate. Therefore, solidarity manifests itself in predictable forms of one-side- or mutual support through the transfer of material resources or behavioural constraints. Understanding the EU as a political community with a moral duty towards solidarity very closely approaches Kindleberger’s idea of 'benevolent' leadership. Insofar as solidarity leadership is thought of as the provision of the public good of responsibility rather than as the exploitation of followers or the private good of prestige, **German leadership is needed to deal with the Eurozone crisis**.

Germany's handling of the Eurozone as a global public good

Germany has certainly played a dominant role in managing the Eurozone crisis since **May 2010**. Although the **EU Commission** initially warned that the **Greek public debt crisis** might easily spread to other Eurozone member states, **Berlin** insisted that this was a 'national problem' that needed to be dealt by the Greek government. At this time, removing Greece from the **Eurozone** was still an option, and '**Grexit**' became a frequently used word. The fact that Berlin repositioned itself and declared its general willingness to lend bilateral support was in part caused by the lack of a legal method of expelling Greece from the common currency area. What's more, **France** and other **Southern European** members of the Eurozone were sharply critical of this early German positioning, arguing for a much less stringent **conditionality** between rule compliance and Eurozone membership. Nevertheless, Berlin confronted its Eurozone partners from the beginning with non-negotiable demands as a requirement for German contributions to any **rescue scheme**.

Timeline: the Greek bailout crisis 2015

To enforce tighter controls on indebted Eurozone countries, Germany almost unilaterally ensured the involvement of the **International Monetary Fund** (**IMF**) not only in bilateral aid packages for Greece but also in the establishment of the **European Financial Stability Facility** (**EFSF**). Moreover, Germany linked the IMF's involvement in the European rescue fund with member countries' individual efforts to consolidate their budgets and with a commitment to a 'culture of stability' within the Eurozone. Concerning the highly disputed issue of the establishment of **Eurobonds**, **Germany acted as a real veto player**. Both German Chancellor Angela Merkel and **Finance Minister Wolfgang Schaeuble** repeatedly stressed the idea that Germany would not accept the **mutualisation of debt** because it would violate German and European rules prohibiting financial bail-outs of individual Eurozone member states.

With Emmanuel Macron’s endeavours to reshape the EU, this situation has since changed; however, it is questionable whether the current German Chancellor’s conservative party will respond to Macron’s desire to forge a Franco-German pact to pursue a large Eurozone reform

Germany promulgated its **rule-based agenda for the Eurozone**, which culminated in the so-called ‘**Fiscal Compact**’. Agreed on in **December 2011**, this **Fiscal Compact** included a debt brake (whose incorporation into national law is subject to scrutiny by the European Court of Justice), a balanced budget (the annual structural deficit may not exceed the threshold of 0.5 percent of GDP), and automatic sanctions (which can only be avoided through a reversed qualified majority in the Council of Ministers) for ‘**budgetary sinners**’. This pact also provided for the strengthening of governance structures within the Eurozone, the enhancement of **Brussels**’ right to shape national budgetary planning, and the transformation of the temporary EFSF rescue fund into the permanent **European Stability Mechanism** (**ESM**). The German government was also the main architect behind the **European banking union**. Under the new **Bank Recovery and Resolution Directive** (**BRRD**) agreed on in **2014**, banks are expected to first turn to private sources for additional capital – including a minimum ‘bail-in’ of 8 percent of a bank’s liabilities – before public capital can be used. However, Berlin rejects plans for a **European Deposit Insurance Scheme** (**EDIS**). Brussels wants the EU bank deposit guarantee scheme to be a ‘third’ pillar of the banking union along with a new system of bank oversight (the so-called ‘Single Supervisory Mechanism’) run by the **European Central Bank** (**ECB**) and the ‘**Single Resolution Mechanism**’, which ensure the efficient resolution of failing banks with minimal costs for taxpayers.

Although Germany’s Eurozone policy has shifted from unilateral hesitation to more collective decisions, not even **Paris** could oppose the German role in Eurozone crisis management. Not only did the **German-French dialogue** come to an end in late **2011** with the establishment of the Fiscal Compact and **François Hollande’s** victory as President of France, but the so-called ‘**Merkozy**’ approach ensured that both sides were divided by deep-seated differences. **The Franco-German divide concerned the extent of necessary solidarity**, the toughness of austerity policy, questions related to the introduction of Eurobonds, and the role of the ECB in Eurozone crisis management. As a consequence, Germany played a proportionally larger role than France. While former President François Hollande spoke of 'friendly tensions' between Berlin and Paris, the French parliamentary president defined these tensions as 'confrontations'. **With Emmanuel Macron's endeavours to reshape the EU, this situation has since changed**; however, it is questionable whether the current German Chancellor's conservative party will respond to Macron's desire to forge a Franco-German pact to pursue a large Eurozone reform.

Germany – a benevolent and solidary power during the Eurozone crisis?

Although Germany has assumed a pivotal role in the Eurozone crisis, it was neither willing nor in a position to assume benevolent, **solidary leadership** within the Eurozone in the sense foremost defined by Kindleberger. First, rather than providing peripheral countries in the Eurozone with a market for their distress goods, the Germans have been selling vast amounts of manufactured goods to the periphery. In 2010, **Germany recorded a surplus of more the 190 billion EUR**; taken together, the smaller and more peripheral Eurozone economies revealed a deficit at the same level. Brussels has repeatedly criticised Germany's trade surplus, which has exceeded the limit of 6 percent permitted within the EU for several years. In **2017**, Germany's trade surplus reached a new record of 8.7 percent of GDP. Although the trade surplus in relation to the Eurozone was brought down by half to around 2 percent of GDP, **Germany's export-oriented economy hardly presents a long-term sustainable model for the Eurozone**.

Second, contrary to what we would expect from a benevolent leadership, **the German economy reacted in a more pro- than anti-cyclical manner with regard to the provision of long-term capital**, which did nothing to calm speculation on the financial and capital markets. Before the outbreak of the sovereign debt crisis, the German banking sector invested massively and bought government bonds in the southern countries of the Eurozone. In late 2010, German bank exposures in Greece, **Ireland**, **Portugal**, and **Spain** – the **PIGS** countries – amounted to around 513 billion USD. Germany's claims were far greater than those of France (409 billion USD) and Italy (76 billion USD). However, with the outbreak of the Eurozone crisis, **the German credit industry sharply decreased its financial engagement within the Eurozone**. While the German credit market's claims on the Eurozone decreased by 17 per cent between 2009 and 2012, the decline was even more drastic in the PIGS countries, which amounted to 281 billion USD in 2012.

Whereas the plan for an EDIS has strong support from France and southern Europe because it would help their banks to continue to reduce their risk levels, EU-level schemes are viewed with deep suspicions in Germany. Again, Berlin is behaving more as a self-interested leader prioritising risk reduction over risk sharing.

Third, **Germany also failed to play a pioneering role when it came to compliance with the Stability and Growth Pact (SGP)** adopted in **1997**, yet it was Germany of all countries that violated the threshold of 3 percent as determined by the SGP and – in coordination with France – blocked the sanction process initiated by the European Commission in **2003**. This effort was particularly significant as the previous German government had pushed for debt thresholds and a sanction process to prevent any softening of Eurozone monetary and financial stability policies. To be sure, Berlin has essentially lobbied for the strengthening of the SGP in light of the Eurozone crisis, calling for tighter sanction mechanisms. Nevertheless, **the German government has not yet ‘led by example’**, and the perils of moral hazard are hardly limited to the Greeks.

Forth, Kindleberger’s idea of benevolent leadership also includes macro-economic coordination and liquidity provision in case of financial crises. With regard to macro-economic coordination within the Eurozone, **Berlin certainly recognises the need to correct its international economic policy positions and strengthen competitiveness within the Eurozon**e. The German government is primarily concerned with fighting inflation and reducing debt. In line with the rule- and stability-based German ordo-liberal model, which had strongly influenced the **European Monetary Union** (**EMU**), the government thus views the EU’s economic policy as being restricted to regulative competencies. The fact that **German Eurozone policy is characterised by the ideas of ordo-liberalism** also becomes evident when we examine the application of the ‘bail-in’ rules established to preserve market discipline in the banking system and plans for a European deposit insurance scheme. In 2017, for example, Germany blamed Brussels with tightening up rules on government support for banks after Italy had been allowed to provide up to 17 billion EUR (approximately 5 billion EUR cash injections and a maximum of 12 billion EUR state guarantees) in state aid to recapitalise at-risk regional banks (i.e. ‘**Banca Popolare di Vicenza**’ and ‘**Veneto Banca**’).

After the Italian bank bailout, Germany wanted to close this ‘EU loophole’, although the Merkel government nonetheless approved more than 200 billion EUR in state aid to rescue its own banking system since 2008. With regard to EU’s bank deposit guarantee plans, Berlin wants Europe’s bank to reduce ‘substantial risks’ before deposit guarantee scheme starts. Whereas **the plan for an EDIS has strong support from France and southern Europe** because it would help their banks to continue to reduce their risk levels, EU-level schemes are viewed with deep suspicions in Germany. Again, Berlin is behaving more as a self-interested leader prioritising risk reduction over risk sharing.

Fifth, while only central bank intervention as a ‘lender of last resort’ can protect against liquidity risks, **Germany has always rejected an active role of the ECB on legal grounds** – beginning with the **Securities Markets Programme** (**SMP**) launched by **Jean-Claude Trichet in 2010** to buy government bonds from struggling Eurozone states on secondary markets. This opposition was evident in the ECB council’s decision to opt for a coordinated purchase of state bonds on the secondary market despite the fact that the **Outright Monetary Transactions** (**OMT**) programme – which **Mario Draghi** introduced in **2012** with his bold claim of needing to do ‘whatever it takes’ to uphold the Euro – had been linked to short-term- and strict conditions and was only available for countries covered by the ESM bailout fund. German political leaders also blamed the ECB for their low interest rates, which hurt savers. **German Finance Minister Schaeuble** has long been a vocal critic of the ECB’s ongoing bond-buying programme (or the so-called **Quantitative Easing**), although low interest rates have helped Germany to save 240 billion EUR since the financial crisis erupted in 2008. Contrary to popular belief, the ECB is not the main driver of the decline in interest rates. Nominal interest rates have been falling for 20 years, and politicians have to deal with ‘secular stagnation’ worldwide. The discussion over German leadership, therefore, has to go beyond blaming the ECB for doing its job. **The ECB has thus not only assumed the role of ‘lender of last resort’ but also succeeded in stopping speculation against the Euro – a problem that the leaders of the Eurozone have failed to resolve**.

Germany’s unwillingness to play a more solidary leadership role also has strong domestic reasons at its roots. While a pro-European orientation is still backed by the German political elite, it does not *reflect German public opinion*

At this point, **it might be legitimate to ask whether it was realistic at all to expect Berlin to bear particularly high burdens in order to stabilise the Eurozone**, especially given that Berlin was not in a position of overwhelming power in 2011 *vis-à-vis* its Eurozone neighbours due to its GPD share of 27 percent of the Eurozone. This argument fails to recognise that benevolent leadership does not necessarily require overwhelming economic power. Chancellor Merkel has nevertheless repeatedly cautioned Germany’s partners, saying that ‘Germany is strong, Germany is the economic motor, and Germany is the anchor of stability in Europe, but Germany’s strength is not infinite’. **However, is Germany’s financial solidarity being overtaxed?**

If we consider absolute figures, **Germany is definitely the most important lending country in the Eurozone**. However, adding relative German bailout costs for bilateral assistance to Greece and the Eurozone rescue funds (EFSM, EFSF, and ESM) and relating them to economic performance reveals that the **German credit share (4.5 percent of GDP) is smaller than the contribution of several smaller Euro states (Estonia, at 5.2 percent; Slovenia, at 5.3 percent; and Slovakia, at 4.9 percent)**. **Even crisis-ridden Spain (at 4.7 percent) and Italy (at 4.8 percent) have contributed more to the bailout costs than Germany in relation to their economic performance**. Even after adding up all state guaranteed loans (from bilateral assistance for Greece to Target-2 balances) and relating them to GDP, in the case of potential payment default by the PIGS-IY countries (the PIGS countries plus Italy and Cyprus), the funds that are made available by the biggest creditors in the Eurozone – Germany and France – only differ in absolute terms but not in relation to GDP.

Germany's thin domestic basis for a benevolent leadership

Germany's unwillingness to play a more solidary **leadership role also has strong domestic reasons at its roots**. While a pro-European orientation is still backed by the German political elite, it does not reflect German public opinion, as the Eurobarometer commissioned by the European Parliament has shown. When asked between August 2010 and September 2012 whether they would be in favour of the common assumption of liabilities for a share of individual member states' public debts, only 56 per cent of Germans favoured the assumption of liability for a share of other members' public debts (EU average: 60 percent), 45 percent believed this 'would strengthen overall financial stability' (EU average: 57 percent), and only 35 percent were of the opinion that it 'would decrease the costs of crisis' (EU average: 50 percent). **Germany thus has relatively low approval rates compared with the European average**, while at least 67 percent of the Dutch and 60 percent of the French supported the assumption of liability for a share of individual members' public debts in the name of solidarity.

As the new German Finance Minister, Social Democrat Olaf Scholz might raise hope about Eurozone periphery as he has said that 'Germany should not *dictate economic policies to its Eurozone partners’. At the same time, however, Scholz has made clear that the SPD will preserve Schaeuble’s balanced budget policy (the so-called Schwarze Null). In a nutshell, Schaeuble may be gone, but the spirit of austerity policy will remain, and a new grand coalition will agree only to the Eurozone reforms that Chancellor Merkel can sell to the conservative part of her own party*

The attitudes towards Eurobonds and financial solidarity in crisis situations are also notable. While 38 per cent of respondents in the Eurozone were in favour of Eurobonds, only 18 per cent of German respondents supported this instrument. 58 per cent of German respondents were against Eurobonds (27 per cent being strictly against them), whereas the Eurozone average was 33 per cent (with 14 per cent strictly opposed to their introduction). **When asking whether the German government should pay more or less for the bailout, only five** per cent **were in favour of increasing payments**, while 65 per cent argued that Germany should reduce its financial engagement. Financial bailouts remain unpopular today among German voters, and **the embrace of solidarity in the German population is below average when compared with other creditor countries in the Eurozone**.

The future of German leadership in the Eurozone

Can and should we expect Germany’s Eurozone policy to become more benevolent in the future? Last October, when Schaeuble attended his final meeting of the Eurogroup finance ministers, he presented **a three-page ‘non-paper’, which laid out Germany’s reform priorities for the Eurozone**. Germany’s former Finance Minister not only rejects a core element of Macron’s Eurozone reform agenda (namely the creation of a Euro area budget to help countries in times of trouble) but also presents a ‘**poisonous gift’ for European democracy** in the eyes of many observers. According to Schaeuble, fiscal responsibilities and control must stay together to avoid a moral hazard. The mutualisation of debt in the form of European safe bonds (some would call them ‘new Eurobonds’) creates bad incentives and would therefore put the stability of the whole Euro area at risk. Moreover, in order to impose stricter fiscal supervision and control on national budgets – possibly also by taking away supranational competencies from the EU Commission – **Schaeuble wants to repurpose the ESM as a European Monetary Fund**.

Schaeuble’s plan is clearly in line with the spirit of austerity policy. To be sure, **the new grand coalition agreement entitled ‘*A new start for Europe*’ goes beyond austerity and is engaged with French President Macron on Eurozone reform**. The agreement declares a readiness to expand the EU budget with a larger German net contribution, and it supports a Eurozone budget to fund macroeconomic stabilisation, social convergence, and structural reforms. For many commentators, it marks the biggest push by Germany towards monetary integration since the **Maastricht treaty** in **1992**. Nevertheless, there are several reasons to be cautious regarding Germany’s leadership under the new grand coalition.

First, the section on Europe in the new grand coalition agreement clearly reveals the hand of **Martin Schulz**. The former German Social Democrat leader and President of the **European Parliament** have called for the creation of a European Monetary Fund that practices solidarity and does not preach austerity. However, Schulz resigned and will not enter a new grand coalition for Merkel’s government. As the new German Finance Minister, Social Democrat **Olaf Scholz** might raise hope about Eurozone periphery as he has said that ‘Germany should not dictate economic policies to its Eurozone partners’. At the same time, however, Scholz has made clear that the SPD will preserve Schaeuble’s balanced budget policy (the so-called *Schwarze Null*). **In a nutshell, Schaeuble may be gone, but the spirit of austerity policy will remain**, and a new grand coalition will agree only to the Eurozone reforms that Chancellor Merkel can sell to the conservative part of her own party.

Second, **whereas European solidarity is steadily drifting away, German Euroscepticism is set to ris**e. Germany long lacked the fertile ground necessary for Euroscepticism, but the Eurozone crisis has equipped it with the necessary tools. The ‘**Alternative for Germany**’ (**AfD**) was founded in 2013 in protest of the Eurozone bailout of Greece. With nearly 13 percent of the vote, Germany’s right-wing AfD party is now the third-largest and biggest opposition force in the ‘Bundestag’. The AfD not only wants Germany to leave the Eurozone (or alternatively, for weak southern Eurozone countries like Italy, Spain, and Portugal to ‘be kicked out’ in order to save the currency) but also rejects all forms of Eurozone governance, especially financial transfers. More **domestic opposition to Merkel’s Eurozone policy will further limit the government’s leeway** in the negotiations for Eurozone reforms and thus pose stronger restrictions to ‘benevolent’ leadership.

Third, **the stunning success of populist and Eurosceptic parties at the Italian election on 4 March could further threaten to undermine the stability of the Eurozone**. Only a few days ago, a group of eight northern EU countries signed a joint statement on the architecture of the EMU that laid out their ‘red lines’ on the Eurozone debate. Led by the Netherlands, the more fiscally conservative northern EU countries are against ‘far-reaching transfers of competence to the EU’ and rejected the idea of fiscal transfers. Their joint statement might be seen as a criticism of France’s desire to form a Franco-German axis to pursue a **less austerity-driven Eurozone**. It is very possible that a new Eurosceptic Italian government could put the brakes on Franco-German talks on Eurozone reform, which, in turn, might have negative repercussions for both the faith in and ability of ‘benevolent’ German leadership.

Fourth and finally, Germany’s economic outlook is gradually weakening – with far-reaching consequences for the EU and the Eurozone. To be sure, Germany still has some apparent advantages compared with many other Eurozone economies. However, **a closer examination reveals that Germany’s economy is unbalanced and lies vulnerable to global economic cycles**. Germans might look at their trade surplus with a sense of pride and as a model for other Eurozone members, but underconsumption and the lack of investment spending on infrastructure is nothing to be proud of. To expect or hope for more German financial assistance for the Eurozone should prove rather fruitless under these circumstances and is politically naïve at best. **Europe should instead prepare itself for a prolonged and more selfish German leadership in the Eurozone**. This position is the opposite of more European solidarity that the crisis-ridden southern Eurozone countries would expect from a new government in Berlin.

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