The shapeshifting hegemon: Germany and EMU dynamics

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The candidate confirms that the work submitted is her own and that appropriate credit has been given where reference has been made to the work of others.

To the memory of my grandfather, the best storyteller I have known

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Abstract

This thesis addresses the controversy currently at the heart of debates over the future of the Eurozone, between those who argue Germany is insufficiently hegemonic, versus those who believe it is excessively so. To make sense of this, we begin with a conceptual analysis, highlighting the different versions of the term and subsequently classifying them as either problem-solving or critical theories of hegemony (based on Cox, 1981). Problem-solving theories are ahistorical, concerned with how hegemony *functions* to preserve an existing world order (with hegemony defined through imageries of stability based exclusively on the case of the US at a fixed point in time). By contrast, critical theories examine the *nature* of hegemony in historical perspective, questioning the existing world order and highlighting its inequalities.

The theoretical contribution of this thesis is that we use the critical versus problem-solving distinction to explain the aforementioned controversy in the applied literature on German hegemony. On the other hand, we show also that the fixity bias – the tendency to treat states as unitary (homogeneous) and unchanging – typical of problem-solving theories has nevertheless permeated more critical literature as well. Our empirical contribution is that we overcome this limitation by analysing the *nature* of German hegemony in the EMU in a way that is sensitive to change and heterogeneity. We focus on change by examining Germany-EMU interactions as a two-way relationship, with Germany both shaping, and being shaped by, monetary integration. We emphasise heterogeneity by questioning whose interests are being served by the present configuration of the Eurozone. We conclude that Germany as a hegemon is not homogeneous but serves the interests of German industrial capitalists and European financial capitalists, which makes its hegemony more diffuse, and simultaneously, more entrenched. Change at the domestic and supranational level has made Germany a shapeshifting hegemon, characterised by an elusiveness that likely strengthens Germany's position for the time being, by obscuring the source of German power. These conclusions are drawn via a research strategy that has not been used before in analyses of German hegemony: a case study approach which included collection of new primary data (interviews with German elites). This thesis thereby also makes a methodological contribution.

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List of abbreviations

ARD	Arbeitsgemeinschaft der öffentlich-rechtlichen Rundfunkanstalten der Bundesrepublik Deutschland (Consortium of public broadcasters in Germany)
BBC	British Broadcasting Corporation
BC	Before Christ
BMWi	Bundesministerium für Wirtschaft und Energie (German Ministry of Economics)
CDU	Christlich Demokratische Union Deutschlands (Christian Democratic Union of Germany-political party)
CME	Coordinated Market Economy
CSU	Christlich-Soziale Union in Bayern (Christian Social Union in Bavaria-political party)
DGB	Deutscher Gewerkschaftsbund (German Trade Union Confederation)
DM	Deutschmark
EC	European Community
ECB	European Central Bank
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EMS	European Monetary System
EMU	European Economic and Monetary Union
ERM	European Exchange Rate Mechanism
ETUC	European Trade Union Confederation
EU	European Union
FAZ	Frankfurter Allgemeine Zeitung (newspaper)
FDI	Foreign Direct Investment
FT	Financial Times
GDP	Gross Domestic Product
HR	Human Resources
HST	Hegemonic Stability Theory
ILO	International Labour Organisation
IMF	International Monetary Fund
IPE	International Political Economy
IR	International Relations
LME	Liberal Market Economy
LOLR	Lender of Last Resort
OCA	Optimum Currency Area
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PPP	Purchasing Power Parity
PSI	Private Sector Involvement
RS	Regulation School
SEA	Single European Act
SGP	Stability and Growth Pact
SPD	Sozialdemokratische Partei Deutschlands (Social Democratic Party of Germany)
UK	United Kingdom
US	United States
VoC	Varieties of Capitalism

Chapter one: Introduction

1.1. Analytical framework

a. Background

> 'The problem today is not German strength but German weakness – a reluctance to take up its hegemonic role' (Matthijs and Blyth, 2011 [no pagination]).

> 'The cost of adjustment to the economic crisis as well as the cost of making the eurozone more credible is being shouldered by those most acutely affected by the current economic turmoil. (…) Germany has acted as a coercive hegemon' (Currie and Teague, 2017, p 159).

> 'Europe's future will continue to be disproportionately "Made in Germany" (…) The "German question" – about the role of a country too big for Europe and too small for the world, as Henry Kissinger famously put it – is back on the agenda' (The Economist, 2013a [no pagination]).

The quotes above reflect several important aspects of contemporary European political economy. One is that, while reforms have been undertaken post-2008 to alter the architecture of the Eurozone, in many ways the crisis of the euro is still ongoing, on a background of power asymmetries. Secondly, the crisis itself has led to a revival of scholarly interest in the concept of hegemony and its practical implications, as well as to a renewed concern about the role of Germany in the European Union (EU). In this context, two opposite camps have emerged, with some commentators asserting that the way out of the European crisis fundamentally hinges on Germany's willingness to play a hegemonic role, while others maintain that German hegemony is a current problem in the European Economic and Monetary Union (EMU), instead of a panacea (with some observers additionally attempting to reconcile the two sides to some extent). Thus, while Germany is seen to occupy a central role in contemporary European political economy, this role is also ambiguous and contested. Ambiguity is further increased by the fact that neither side seems to be particularly mindful of the complexities and contradictions subsumed under the term 'hegemony'.

This apparent controversy currently at the heart of debates over the future of the Eurozone represents the original source of inspiration and motivation behind this thesis. This research started out as intellectual curiosity vis–à-vis the origins of the contradiction between those who see Germany as insufficiently hegemonic, versus those who see it as overly so. Once we had delved deeper into this topic, it has nevertheless extended beyond that, raising more questions about the meaning of hegemony in general, about the evolution of the Eurozone, about the evolution of the German model, and about how these themes are interconnected. This thesis therefore addresses EMU dynamics from the perspective of power asymmetries, with a focus on the nature of German hegemony within the monetary union.

As such, it belongs to the domain of International Political Economy (IPE). While there is no consensus on how to do research in IPE, or even what kind of questions IPE analysis should pose, given that IPE encompasses divergent paradigms, with roots in older political economy, as well as International Relations (IR), traditions, there does exist a generally agreed upon definition of IPE. For Robert Gilpin (1975, p 43), the object of study of IPE is 'the reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power'. This continues to be broadly accepted today: 'IPE is bounded by the exploration of the relationship between power and wealth' (Higgott and Watson, 2008, p 10). Hegemony, in its broadest sense defined as 'a relationship between the dominant and the dominated' (Worth, 2015, p 17), has always been a key concept in IPE (Odell, 2001), albeit, as will be shown in chapter two, also an underdeveloped one. Nowadays the term is most often used to describe power relations *between* nations, but in this thesis, we are concerned also with power relations *within* nations, in particular the relationship between capital and labour.

b. Objectives, research questions and contributions

The main objective of this thesis is to identify the ways in which Germany is hegemonic in the EMU, and the ensuing repercussions, at both the Eurozone level, and the domestic level in Germany. We take the conflict of views introduced above (between those who think Germany is overly hegemonic, and those who believe it is insufficiently so), to mean that there is at least one sense in which Germany *is* hegemonic in the EMU. Asking *whether* Germany is hegemonic in the EMU would lead us to simply go around in circles in this debate; the main aim is not merely to side with one group or the other, but to discover first of all the basis upon which each side draws its conclusions.

To explain the conflict of views vis-à-vis German hegemony, the first step in our exploration is to ask whether there exists a comprehensive, all-encompassing theory of hegemony, and if not, what alternative meanings of 'hegemony' can be identified. We begin, therefore, with a conceptual analysis of hegemony, which will then serve as an overarching framework to help us make sense of the applied literature on German hegemony. We identify three distinct versions of hegemony: Ancient Greek, Gramscian, and Hegemonic Stability Theory (HST). The first two can be classified as critical theories of hegemony, the latter as a problem-solving theory, if we apply the classification developed by Robert Cox (1981) to the topic of hegemony. Problem-solving theories are ahistorical, concerned with how hegemony functions to preserve an existing world order, whereas critical theories question the existing order and its inequalities, concerned with the nature of, and conditions behind, hegemony in historical perspective. The HST (problem-solving) version, which has come to dominate the literature, is highly problematic in the sense that it defines hegemony through imageries of stability based exclusively on the case of the US in the Bretton Woods system in the early 1960s. This understanding of hegemony through the symbol of the US at a fixed point in time creates a fixity bias in the literature: states are treated as unitary (homogeneous) and unchanging (continuous models).

Going further, the next research question addressed here is then how the concept of hegemony has been applied to the case of Germany in the EMU. We find that the conflict of views that initially inspired this thesis is the result of an application of problem-solving, versus more critical, theories of hegemony, respectively, to the German case. The main theoretical contribution of this thesis, therefore, is that we bring together sources that explicitly refer to German hegemony in the EMU, published between German reunification and the present day, in view of identifying the hegemonic theory (or theories) such sources are implicitly based on, to shed light on the source of the contradiction that originally inspired this research.

This examination of the literature not only allows us to explain the conflict of views vis-à-vis German hegemony, but also acts as a stepping stone for us to develop our own analysis of Germany's role in the EMU. We build on a commonality found within the applied literature, namely the notion that the supremacy of Germany's political economy model within the monetary union constitutes an important aspect of German hegemony. However, we challenge another commonality in the literature: the fixity bias that originates from problem-solving theories but has permeated more critical approaches as well. Incorporating this bias, literature on the German model sees it as a continuous, homogeneous arrangement, which affects intra-EMU relations, but is itself immune to change. By contrast, we make the case for a return to critical theory, by analysing Germany-EMU interactions as a two-way relationship, focusing on heterogeneity and change. The questions we raise, to overcome the fixity bias in the existing literature, are the following: What are the features and origins of the German model? How has Germany shaped monetary integration? How has monetary integration shaped Germany? Which societal factions stand to gain or lose the most from the existing EMU order? Answering these questions enables us to draw conclusions about the nature and implications of German hegemony in the EMU, as well as about the evolution of the German model. This analysis which emphasises change and heterogeneity constitutes the main empirical contribution of this thesis.

Finally, this thesis also contributes to methodology in the field. We view reality, and by extension, hegemony, as multi-faceted, stratified, and shifting, encompassing both material and ideational, subjective and objective, publicly-recorded and tacit elements. This complexity, we believe, is best encapsulated using a multiplicity of methods. Consequently, we build our analysis as a narrative which combines insights from eclectic academic literature (on hegemony, the German model, German modern history, the design of the EMU, the management of the euro crisis), official policy documents, public discourse, media outputs, official published statistics, as well as new primary data collected as part of this research in the form of semi-structured interviews with German elites (policymakers, labour representatives and industrialists) who describe 'their world'. This particular research strategy has not been used before on the topic of German hegemony in the EMU. Our approach is a case study in political economy, as explained in more detail in section 1.2 below: we analyse Germany's role in the EMU as a particular case of hegemony. Therefore, beyond the specific research questions introduced above, we answer also a more general question of the type 'how might we understand and do research on hegemony?'.

1.2. Methodology

This section discusses the methodology adopted in this thesis, moving from general to particular. We start by aligning the general approach taken in this thesis with pragmatist philosophy in the context of broader debates in the philosophy of science. In terms of research design *per se*, we then classify our approach as a case study in political economy, which includes one particular method that has never been used before in analyses of German hegemony, namely interviews with German elites: policymakers, industry representatives, and trade unionists. Elites have been defined in the literature as those who 'hold positions of power within organizations such as corporations, governments, or (…) trade unions' (Herod, 1999, p 313), 'those with close proximity to power or policymaking' (Lilleker, 2003, p 207), 'individuals or groups who ostensibly have closer proximity to power or particular professional expertise' (Lancaster, 2017, p 93). As a final step in this section, we provide details of how fieldwork was conducted.

a. Philosophy of science and research design

Debates in the philosophy of science have long centred around the divide between two main paradigms: positivism and interpretivism, with the former invoked in support of quantitative research, and the latter, of qualitative research. The key differences between the two paradigms are summarised in Table 1.1. below, adapted from Tashakkori and Teddlie (1998).

Table 1.1: Paradigms in the philosophy of science: positivism versus interpretivism

	Positivism	**Interpretivism**
Ontology (theory of being)	Single reality, mind-independent	Multiple, constructed realities
Epistemology (theory of knowledge)	The knower and the known are independent	Knowledge is mind-dependent, therefore the knower and the known are inseparable
Axiology (role of personal values in inquiry)	Inquiry is value-free	Inquiry is value-bound
Generalisability	Time- and context-free generalisations are possible	Time and context specific
Causal linkages	Causes precedent to, or simultaneous with, effects can be identified	Sometimes it is impossible to distinguish between cause and effect
Type of logic	Deductive: the argument runs from general to particular; emphasis on *a priori* hypotheses or theories	Inductive: argument from particular to general, emphasis on 'grounded theory'

Per the positivist paradigm, the world consists of observable facts and event regularities (Olsen, 2004) which may be isolated from their wider environment and tested in experimental fashion. Knowledge is therefore to be obtained using sense experience and deduction, via experiments on observable facts, which generate results that can be formulated into covering laws subsequently used to predict future events. Positivism considers non-scientific, and hence inadequate for research purposes, any statement that expresses a value judgement, an opinion, an intuition or a feeling rather than an objective fact (McCloskey, 1986). Methodology is thus viewed as an instrument of demarcation between scientific and non-scientific research, with positivist methodology promising knowledge free from doubt.

Conversely, interpretivism views reality as entirely subjective, determined by individual concepts and meanings. Knowledge thus reflects an inextricable link between the researcher and the researched, with reality created and transformed through people's experiences (Sale et al., 2002). Taken *ad extremum*, the assumption that no mind-independent reality or structure exists beyond our cognitive choices can make interpretivism slip into relativism or nihilism, leading to situations where either any statement is characterised as scientific knowledge, or where, alternatively, knowledge is altogether denied. Thus, while the positivist approach to science is too rigid, the interpretivist approach may be overly loose.

Philosophers in the pragmatist tradition occupy a middle ground between positivism and interpretivism, and have thus been described as 'pacifists' in the 'paradigm war' (Tashakkori and Teddlie, 1998). Pragmatism supports 'the use of whatever philosophical and/or methodological approach works for the particular research problem under study' (ibid., p 5), so it is often invoked to resolve methodological conflicts; yet it is erroneous to reduce it to an epistemological dimension when it is actually based on a detailed open ontology (Frankel Pratt, 2016). Pragmatist philosopher John Dewey (1958 [1929], p xi) argued that the human need for security makes us seek 'unity, permanence, universals, over plurality, change, and particulars', when, in fact, social reality consists of all of these aspects:

> 'We live in a world which is an impressive and irresistible mixture of sufficiencies, tight completeness, order, recurrences which make possible prediction and control, and singularities, ambiguities, uncertain possibilities, processes going on to consequences as yet indeterminate. They are mixed not mechanically but vitally (…) change gives meaning to permanence and recurrence makes novelty possible.' (Dewey, 1958 [1925], p 47).

In this thesis, we share the main ontological tenets of pragmatism: the notion that reality is complex and stratified instead of strictly unitary (Feilzer, 2010; Creswell, 2014), comprising some layers that are objective, others that are subjective, some 'stable', some 'precarious' (Dewey, 1958 [1925]), as well as the emphasis on change as a result of dialectical interactions - itself a corollary of the view that agency and structure are co-determined (Frankel Pratt, 2016). This pragmatist worldview determines also our understanding of hegemony as multi-faceted, stratified, and shifting.

It is these ontological premises that then carry implications for epistemology and method. Pragmatists agree on the value-ladenness of inquiry, the theory-ladenness of facts, the importance of empirical evidence, and the fallibility of knowledge (Reichardt and Rallis, 1994). A view of reality as complex, stratified, and encapsulating both mind-independent layers as well as elements 'lodged in the mind' (Creswell, 2014), calls for theoretical and methodological pluralism in order to derive knowledge. Pragmatism incorporates the notion of a dialectic of learning, according to which the tensions and contested arguments that may result from the mixing of paradigms reveal more about a topic than strict adherence to one paradigm (Greene and Caracelli, 2004). A pluralist approach with regards to data and method provides opportunities for triangulation: cross-checking the 'accuracy, validity, relevance and completeness' of insights coming from different sources and approaches (Starr, 2014), shedding light on the various aspects of the same broad phenomenon. The type of logic supported by pragmatism is abductive: instead of employing *a priori* theoretical assumptions as a template (deduction), as in positivism, or using empirical findings to build theory from scratch (induction), as in interpretivism, 'we start reasoning at an intermediate level' (Friedrichs and Kratochwil, 2009, p 709). Once we have found a phenomenon of interest, we 'start collecting pertinent observations and, at the same time, applying concepts from existing fields of our knowledge' (ibid.), allowing theory and practice to shape each other.

b. The case study approach

A pragmatist philosophical angle (advocating for plurality in terms of theory and method) applied to the study of Germany's role in the EMU as a contemporary case of hegemony has led us to adopt a case study approach as our research strategy. Stake (1995, p xi) defines a case study as 'the study of the particularity and complexity of a single case, coming to understand its activity within important circumstances', whereas for Yin (1981, p 98) it denotes an empirical inquiry which examines 'a contemporary phenomenon in its real-life context, especially when the boundaries between phenomenon and context are not clearly evident'. Both definitions emphasise complexity and interactions, which are paramount in the pragmatist worldview. The case study method is particularly relevant in situations where a topic is undertheorised, as it most often serves an exploratory purpose, aiming to generate a better understanding of an emerging phenomenon or to propose new insights into a phenomenon. It is most useful where research questions begin with 'how…?', 'why…?', or 'what kind of…?', where the phenomenon of interest is contemporary, and where the researcher has little or no control over events; where a phenomenon also has noncontemporary aspects, the case study method is often intermixed with historical analysis (Yin, 1994.).

In methodological terms, complexity leads to a situation where 'the number of variables of interest will inevitably be an order of magnitude greater than the number of data points (i.e., the number of cases)' (Yin, 1981, p 98). The implication of this technical aspect is that the case study then 'relies on multiple sources of evidence, with data needing to converge in a triangulating fashion', and 'benefits from the prior development of theoretical propositions' (Yin, 1994., p 11) to guide data collection and analysis. The case study approach is therefore compatible with pragmatist epistemology in the sense that both stress the need for pluralism in studying complex phenomena. Also in line with pragmatism, case studies generally apply abductive logic: researchers begin with some theoretical propositions, conduct empirical analysis, and then revise the initial theoretical propositions, essentially elaborating upon, or modifying, extant theories (Yin, 1981).

In this thesis we study hegemony as a complex, undertheorised phenomenon by taking contemporary Germany as a case within the context of the EMU, and analysing Germany-EMU interactions as a two-way relationship which blurs the demarcation line between phenomenon and context. The case study approach is particularly applicable to our research because our primary research question, 'what are the ways in which Germany is hegemonic in the EMU?' is simultaneously a 'how?', 'why?' and 'what kind of?' type of question. Since we aim to shatter the 'holistic illusion' (Yin, 1994) in the literature on German hegemony by considering heterogeneity and subnational dynamics, this is an embedded rather than a single case study. In pragmatist fashion, we rely on multiple sources of evidence (historical analysis, interviews, policy documents and media sources analysis, quantitative data) to overcome the limitations of existing literature on German hegemony in the EMU and generate new insights into the topic.

In the context of the euro crisis, Bonatti and Fracasso (2013, p 1024) have pointed out that ‘the German point of view deserves greater scrutiny’ if we want to understand the political economy of EU crisis management, which, in turn, is a ‘first condition for its improvement’. Yet, to the best of our knowledge, no major academic work has so far employed interviews to examine the German perspective and thus shed new light on Germany-EMU interactions. In this sense, the fieldwork conducted as part of this thesis constitutes a key element of novelty in our research area.

Researchers in political economy have highlighted the importance of interviews in case study analysis by arguing that respondents often are ‘both extremely good informants as well as interesting and intelligent commentators on ‘their’ world’ (Cawthorne, 2001, p 85), providing information that is unobtainable through other methods (Stevis, 2017) – expert information, in the case of elite interviewing (Herod, 1999). Critical political economists in particular, who study the evolution of capitalism, consider relationships between states, businesses and unions to be central to ‘processes and power structures within capitalism’ (Montgomerie, 2017, Chapter 5, location 3293/4461). Therefore, they make the case for interviewing elites (policymakers, business representatives, and labour representatives) to shed light on these relationships and gather insights into the evolution of capitalism (see e.g. Bruff, 2017; Stevis, 2017). These authors, however, also emphasise the need to corroborate interviews with other sources, given the complexity of social reality, which implies there will be aspects ‘about which informants may be ignorant or simply unconcerned’ (Cawthorne, 2001); as such, they use case study approaches which combine interview findings with policy documents and historical analysis as well as statistics (Cawthorne, 2001; Bruff, 2017, Stevis, 2017). In this context, interviews are treated not as ‘observations’ in the conventional sense, but as pieces used to build up a narrative, depending on the researcher’s ‘ability to draw out of the interview some material that is interesting and meaningful’, on his or her capacity ‘to recognize patterns, and to organize those patterns to form a theory’ (Piore, 2006, p 18). Interviews contribute to abductive reasoning in the sense that the researcher has a clear picture of the phenomenon she or he wants to examine and how, but revises these guidelines based on what is encountered during fieldwork, given that it is impossible to anticipate in advance all details that will prove to be important; talking to people 'not engaged in theorising' also prompts the researcher to challenge pre-conceived theoretical assumptions more readily (Cawthorne, 2001; Piore, 2006; Starr, 2014).

The original purpose of the interviews conducted as part of this thesis (containing questions that relate to domestic and Eurozone policy) was threefold: to unveil beliefs and ideas about Germany-EMU interactions, on the assumption that policymakers, industry representatives and trade unionists are a good representation of the (non-homogeneous) state (Bruff, 2017); to ascertain whether there are any differences between views expressed by policy actors in official documents and discourse, versus situations where they are guaranteed anonymity; and to reveal differences between the three groups of interviewees as an indicator of internal heterogeneity. But, as Montgomerie (2017, Chapter 5, location 3189/4461), implicitly referring to abductive reasoning, notes, 'the very act of going out into the world to collect empirical evidence unsettles (…) the original research design'. Ultimately, the way we used our interviews matches Piore's (2006) vision, that they should be utilised to identify meaningful patterns and to subsequently build a narrative around these. Going over interview transcripts has enabled us to 'get a sense of the whole' (Creswell, 2014), helping us decide which aspects of Germany-EMU relations to focus on, and what additional literature, policy documents and data to look for. We then combined these sources to build a narrative around those patterns, contributing to a more comprehensive understanding of our phenomenon of interest.

c. Description of fieldwork

This section addresses the specifics involved in our fieldwork. New primary data was collected as part of this research project, using qualitative methods in the form of semi-structured interviews (mostly in person, but a few over the phone as well) with German industry representatives, labour representatives, and policymakers and policy advisors, representing different facets of German society. Fifteen interviews were carried out during spring-early summer 2016, in Germany and Belgium (Brussels), under conditions of anonymity and confidentiality.

Table 1.2. below provides a list of the ten primary interview questions; these were frequently followed by secondary questions, depending on the flow of the conversation.

Table 1.2.: Main interview questions

1. In your view, what defines Germany's national interest? 2. What would you say are the key characteristics of Germany's domestic economic policy? 3. What role does competitiveness play in the German economic model? 4. In your view, what is the role of labour market policy? 5. How do you think the Euro project is unfolding? 6. How would you describe Germany's current role in the Eurozone? 7. What would you identify as the main gains and losses for Germany from the EMU project in its present form? 8. Do you think Germany's national interest has an impact on Eurozone developments? 9. How do you see the future of the Eurozone/European Union? Are there any reforms you would like to see applied? 10. What do you think Germany's role should be in this reformed Europe?

In line with ethical and unbiasedness requirements, the interviews began with general, open-ended questions that avoid suggesting specific ideas or terminology, to diminish the risk of altering beliefs (Bruine de Bruin and Bostrom, 2014), whereas follow-up questions became more directive. Also in order to avoid bias, questions pertaining to aspects of Germany's domestic economy were asked ahead of those relating to Germany-Eurozone interactions, and we did not explicitly refer to 'hegemony' or 'power'; given this, the choice of respondents to openly talk about power (as we shall see in chapter five) constitutes a significant finding. A semi-structured format was chosen, because semi-structured interviews are simultaneously useful for revealing common understandings or misunderstandings of a particular phenomenon, while retaining enough structure for comparability (Bruine de Bruin and Bostrom, 2014; Starr, 2014). They are also 'the best way of obtaining focused responses in a short time frame' (Harvey, 2011, p 434), particularly when we do not know in advance all the details that will prove to be important (Piore, 2006).

As per the usual conventions (Leuffen, 2006; Lilleker, 2003), participants were initially contacted in writing, on email addresses provided on their respective workplaces' websites, in correspondence that described the topic in broad terms, listed the main interview questions, and explained why the particular person was chosen and what information we were hoping to retrieve from them. We made use of institutional affiliations to gain access, referring to our status as visiting researcher at the Macroeconomic Policy Institute (IMK) of the Hans Böckler Foundation in Düsseldorf, Germany, in correspondence with potential participants. Purposive (rather than random) sampling was applied: familiarity with German and EU policy, as well as a good command of English, were important pre-requisites; participants were thus chosen based on their expertise and position rather than randomly, in order to provide relevant answers. Purposive sampling, combined with the sensitive nature of the topic, limited sample size. Snowball sampling was also used as fieldwork progressed.

Interviews lasted between 45 minutes and two hours, and the conversations were recorded, with the interviewee's permission, in order to ensure full retention of information. Informed written consent was obtained prior to the commencement of the interview process. Participants could decline to answer specific questions and had the right to withdraw up to one month after the interview had taken place. Anonymity was guaranteed by avoiding the use of names or any other personal information that could make respondents identifiable on recordings or transcripts, as well as in any other parts of this research. Where direct quotations are reproduced, permission has been obtained from interviewees, who were given the opportunity to review selected quotes; this restricts confidentiality, but anonymity is still maintained. All this meant that the risks involved in participation were minimal; no benefits were offered either.

Literature on the challenges involved in elite interviewing generally emphasises the outsider-insider divide, as well as power imbalances, suggesting that the researcher, as an outsider, will automatically be at a disadvantage when interviewing (especially foreign) elites, and assuming that elites will be the disproportionately powerful party (Drew, 2014; Lancaster, 2017). Yet, like Herod (1999), we realised that it is possible in practice to make use of an 'elasticity of positionality', downplaying or accentuating differences depending on the situation, instead of being 100% outsider or insider. Our experience matches Herod's in the sense that our status as a foreign researcher (an 'outsider'), 'something of a novelty, a harmless ''foreign'' academic rather than, say, a threatening ''domestic'' investigator' (Herod, 1999, p 322), made it easier to ask thorny questions in a disarming way. On the other hand, what also helped was an element of ‘insiderness’: people holding doctorates themselves were ‘more sympathetic to academic endeavours’ (ibid., p 317) and therefore more open to the interview.

Like ‘outsider’ and ‘insider’, ‘powerful’ and ‘vulnerable’ proved to be fluid, non-homogeneous categories as well. As a young, female doctoral researcher we were sometimes underestimated, but this enabled us to then ask more controversial questions. A particular difficulty arose when trying to decide how to report findings in such a way that protects respondents, but does not conceal contentious information, which ‘may have implications for maintaining or perpetuating troubling power dynamics’ (Lancaster, 2017, p 102). We managed this dilemma by mixing direct anonymous quotations with a more general narrative summarising the most important findings. As mentioned above, where direct quotes are used, these were first sent to participants for approval. In each case, we checked what the participant has modified – in many instances, it was just a matter of making statements sound more erudite; on a few occasions, respondents modified their statements to refer to an institution rather than a particular person representing that institution. Neither of these represent a significant altering in terms of content. The challenges involved in elite interviewing have therefore been mitigated as far as possible.

1.3. Thesis structure

This thesis is divided into seven chapters. This introduction is followed by a conceptual analysis of hegemony in chapter two, which shows that instead of an all-encompassing theory of hegemony, there exist at least three distinct theoretical strands that understand hegemony in different ways: in chronological order, the Ancient Greek, Gramscian, and HST in IPE variants. Further, based on Robert Cox’s distinction between critical and problem-solving theories, the first two variants are classified as critical theories of hegemony, whereas the latter represents a problem-solving theory. As such, the evolution of hegemonic theory as a whole is described as a shift from critical to problem-solving theory, with the caveat that a significant critical edge can be found in critiques against HST as well as neo-Gramscian literature (of which Cox’s work is an important part). Nonetheless, the problem-solving approach remains dominant, to such an extent that its fixity bias – the tendency to treat states as unitary (homogeneous) and unchanging – has come to permeate more critical sources as well. Overall, chapter two provides a framework within which to assess extant literature on German hegemony, as well as to subsequently develop our own analysis, in the spirit of critical theory.

Chapter three provides an overview of contemporary theorising of German hegemony in Europe, which started soon after German reunification. Nominally, this literature discusses German hegemony using the EMU as a point of reference, but is, in fact, insufficiently concerned with the evolution of the EMU as such; in view of this, we begin chapter three with a critical overview of the EMU integration process. We then proceed to evaluate existing literature on German hegemony, separating sources chronologically depending on whether they have been published before, or during, the euro crisis. The main finding of chapter three is that the conflict of views in the applied literature on German hegemony can be explained by applying Cox's distinction between critical and problem-solving theories to the issue of German hegemony. On the other hand, as is the case with the general literature on hegemony, discussed in chapter two, even more critical sources carry over some of the limitations of HST as a problem-solving theory of hegemony, in particular its fixity bias – the tendency to treat Germany as a unitary (homogeneous) and unchanging actor. Another commonality in the literature is the emphasis on the German model of political economy as a key facet of hegemony. This discussion is also affected by fixity bias: the German model is discussed as a continuous arrangement, which affects intra-EMU relations, but is itself immune to change. The assessment in chapter three overall sets the direction for our own approach in subsequent chapters, where we account for change in terms of both how Germany shapes, and is shaped by, monetary integration, and highlight heterogeneity by questioning whose interests are being served by the present EMU configuration.

In chapter four, we examine more closely the features and origins of the German model as a key aspect of hegemony. We begin by presenting the (perceived) features of the model, as highlighted in the French Regulation School (RS) and Varieties of Capitalism (VoC) literatures. We show that both of these approaches centre around the notion of institutional complementarity: how micro, meso and macro features support each other to deliver a coherent economic system. Devotion to the concept of institutional complementarity makes both the RS and VoC approaches ill-suited to account for change, as well as functionalist, in the sense that they focus on the functions performed by individual elements of the German model rather than asking where they originate from. A complementary line of discourse, which does attempt to answer the question of how the model arose, is then assessed. This line of discourse, emanating predominantly from Germany, asserts that the German model represents an incarnation of ordoliberal ideology. Contra this literature, we argue that ordoliberalism is neither uniquely German, nor compatible with all model features. We propose instead to search for the origins of the model in ideas (rather than ideologies) associated with defining episodes in German modern history: the industrialisation process, the Weimar years, the Nazi era, and Germany's postwar 'economic miracle'. The main finding of this analysis is that individual elements of the German model have their origins in ideas that are, for the most part, either selective memory, or a deliberate retelling of history. This makes the supremacy of the German model at the EMU level highly problematic and contestable.

Chapter five explores the ways in which Germany has shaped monetary integration, from the Maastricht Treaty to present-day crisis management policies. We show that Germany exerted great influence over the final form of the Maastricht Treaty, which set the basis for the EMU, and characterise this as hegemony by design. However, we challenge homogeneity assumptions by highlighting that the German delegation at Maastricht had not been serving some sort of general interest, but representing the interests of German industrial and European financial capitalists. In terms of crisis management, we argue that, in the short-term, German elites had been engaged in portraying the crisis as one of competitiveness, which simultaneously masks the culpability of European financial capitalists while praising German industrial capitalists. This turned the 'competitive' German model into a yardstick for success at the European level, fortifying German hegemony over Eurozone policy design in the long-run. This more complex nexus indicates that German hegemony is more diffuse, and simultaneously more deeply rooted, than is commonly understood. At the same time, it is also unsustainable: it will be shown that power is not wielded by any particular German politician; rather, they are aware of the faulty architecture of the EMU, but incapable of correcting it because they are constrained by the powerful interests they are representing.

Chapter six considers the reverse perspective: the impact of monetary integration on Germany. We show that existing literature on change in the German model, along with policy documents and interview responses, implicitly suggests that, while export focus – and thereby competitiveness – at the macroeconomic level remains a dominant feature of the German model, the way competitiveness is achieved in practice has nonetheless changed, following the Hartz labour market reforms of the early 2000s. The shift from a phase of quality competitiveness when export gains were shared between employers and employees, to price competitiveness at the expense of labour, implies an upheaval in micro- and meso-economic relationships in the German model, despite the continuity on the macro side. We find that this shift has been made possible through the depiction of monetary integration as a challenge to the German economy, in a wider process to discipline Germany's labour force, which had started soon after German reunification. The precarisation of employment within Germany since the Hartz reforms means that the benefits Germany derives from its hegemonic position in the EMU are inequitably filtered throughout German society, which explains the ordinary German's opposition to redistributive policies at the European level, highlighting heterogeneity. Domestic change suggests that the German model is not time-invariant, but shifting terrain, which makes Germany's hegemony all the more elusive.

Finally, chapter seven concludes by providing a summary of findings, as well as a reflection upon policy implications and possibilities for developing this research in the future. The main findings of this thesis are synthesised under the phrase 'shapeshifting hegemon'. This captures the key difference between the analysis undertaken in this thesis and existing literature on German hegemony in the EMU – namely, the fact that we take into account, and emphasise, change and heterogeneity, which likely strengthen Germany's position for the time being, by obscuring the source of German power and diminishing the replicability of Germany's model of political economy.

Chapter two: Hegemony – a conceptual analysis

2.1. Introduction

As mentioned in the previous chapter, the apparent contradiction in recent debates over the future of the Eurozone, between those who argue Germany is too hegemonic, versus those who insist it is not hegemonic enough, is what originally inspired this thesis. Any attempt to make sense of this controversy needs to start from a wider, historically-embedded and nuanced analysis elucidating the meanings of the concept of 'hegemony'. The purpose of this chapter is to undertake such an analysis.

Rather than a coherent, all-encompassing theory of hegemony, we identify, and present linearly, three main theoretical strands that define hegemony in different ways: Ancient Greek, Gramscian, and Hegemonic Stability Theory (HST) in International Political Economy (IPE). We start by tracing the origins of the term back to its Ancient Greek roots, in section 2.2. Section 2.3 then discusses Gramsci's (1971[1929]) modern reconceptualization of the term, as well as applications of Gramsci's work onto the study of IPE. In section 2.4., we analyse the 'hybrid' neorealist-neoliberal institutionalist theory of hegemonic stability (*Routledge Encyclopedia of International Political Economy*, 2002a; *Oxford Companion to Politics of the World*, 2004), a development on the work of Charles Kindleberger (1973). We examine HST from a critical standpoint, arguing that it links hegemony with stability axiomatically, without having previously developed a concept of hegemony to underpin the theory. It defines hegemony *ex post* instead, through imageries of stability based exclusively on the case of the US during the Bretton Woods years. This produced a version of hegemony that continues to dominate IPE and set the terms of reference in global governance debates, which focuses on the state as some sort of 'ideal type' and thereby unitary and unchanging. Endeavours to grasp the different strands generally rely on the distinction drawn by Robert Cox (1981) between critical and problem-solving theories. This distinction is introduced in section 2.5, where we argue that the evolution of the concept of hegemony can be understood as a shift from critical to problem-solving theory, especially since the critical edge in Cox's own (neo-Gramscian) approach to IPE is diluted to some extent by implicit assumptions of fixity, shared with, and much more apparent in, HST as a problem-solving theory. Section 2.6 concludes.

2.2. The Ancient Greek version of hegemony

The term *hegemon* has Ancient Greek roots, the first documented source to mention it being Thucydides' *History of the Peloponnesian War*, fifth century B.C., which recounts the conflict between the Delian League, led by Athens, and the Peloponnesian League, led by Sparta, spanning over the years 431 - 404 B.C. (*Oxford Companion to Politics of the World*, 2004). Thucydides and other Greek historians, such as Herodotus or Xenophon, analysed hegemony in the context of leadership of (military) alliances between Greek city-states. In his narrative, describing the change in the nature of Athenian leadership of the Delian League during the Peloponnesian War, Thucydides makes a distinction between *hegemonia* and *arkhe*, both translated into English as *hegemony*, using the first to denote legitimated leadership, and the latter to mean political control, with *hegemonia* a precondition for long-term *arkhe* (Lebow and Kelly, 2001). Athens is described as having shifted away from *hegemonia* to a failed *arkhe*, at first successful in balancing self-interest against justice for its allies as well as adversaries, but gradually relying increasingly on coercion alone (Lebow and Kelly, 2001). In this sense, hegemony is understood as both a potential source of empire, as well as something to contrast empire with (Wickersham, 1994).

Hegemonia itself was a matter of entitlement. As summarised by Wickersham (1994, p 23), 'in claiming hegemony (…) the first point one makes is that another arrangement would be an insult; one demonstrates an insultingness by recounting everything that gives one's city a claim to glory and honor'. For Herodotus in particular, hegemony encompasses prestige and the escape from subordination, which are to be attained by reference to past achievements of a city-state, derived mostly from history and myth, but sometimes also by underlining present capabilities, strategies or resource base. Thucydides emphasises material capability and ideational factors in equal measure, associating *hegemonia* with the 'gift of honour' bestowed upon Athens by other city-states in the Delian League, proud to be allied with Athens, for the following reasons: a recognition of the decisive role played by Athens in ultimately achieving victory in the Greek-Persian Wars (499 - 449 B.C.); the expectation of benefits to be gained as a result of being granted access to the vast and expanding Athenian market; as well as admiration and respect for the intellectual and artistic accomplishments of Athens (Lebow and Kelly, 2001).

During the Peloponnesian War, Athenian military strategy shifted from defensive to offensive, with the city-state seeking imperial expansion, which required more resources and therefore led to a more coercive attitude vis-à-vis allies. The extraction of higher tributes, the response to resistance with higher fines, exile, or invasion, and the use of allied lands for Athenian interests turned its allies into mere 'subjects'. For Thucydides, this was illustrative of a deep decay of Athenian leadership, abandoning notions of morality and honour (Lebow and Kelly, 2001). Both Thucydides and Xenophon underline the ethical treatment of military allies as a decisive factor in the continuation of hegemony, pointing out that violence, coercion and exploitation lead either to the transformation of hegemony into empire or the breakdown of the initial alliance altogether (Wickersham, 1994).

Hegemony in the Ancient Greek variant, therefore, denotes a combination of military and economic power with moral leadership, ethics and honour; the abandonment of the latter elements leads to unsustainable imperialism, with 'hegemonic mistreatment' of allies creating 'memories that inhibit future attempts at empire building' (Lebow and Kelly, 2001, p 601).

2.3. The Gramscian variant

a. Gramsci's reconceptualization of hegemony

A significant modern reconceptualization of the term is attributed to Antonio Gramsci (1971 [1929]), who used it to refer to politics within well-defined, coherent nation-states. The fragmentary character of his writing and the difficulty in ascertaining a precise intention behind his *Prison Notebooks* shroud the concept in ambiguity, as noted by the translators of his work into English (ibid., p xiv):

> 'The term ''hegemony'' in Gramsci itself has two faces. On the one hand it is contrasted with ''domination'' (and as such bound up with the opposition State/Civil Society) and on the other hand ''hegemonic'' is sometimes used as an opposite of ''corporate'' or ''economic-corporate'' to designate an historical phase in which a given group moves beyond a position of corporate existence and defence of its economic position and aspires to a position of leadership in the political and social arena.'

Gramsci's understanding of hegemony focuses on a class-level analysis, developing Marx's idea that political institutions and practices are established by the bourgeoisie to consolidate and legitimise its social position and sustain the capitalist mode of production (Worth, 2015). While acknowledging the role of coercion in cementing class relations, Gramsci sees hegemony as going beyond mere dominance, asserting that it also involves leadership, implying a dimension of shared interests and consent; when a group leads others, it means 'to concord their interests and aspirations with the interests and aspirations of other groups' (Gramsci, 1971 [1929], p 104). Hegemony thus appears to be a compromise between social classes that acquiesce to a particular social order under the leadership of the dominant class, which must manage to present its interests as natural and ground them in institutions, ideas and morals. Leadership and dominance are not mutually exclusive, but rather reinforce each other:

> 'A social group dominates antagonistic groups, which it tends to ''liquidate'', or to subjugate perhaps even by armed force; it leads kindred and allied groups. A social group can, and indeed must, already exercise ''leadership'' before winning governmental power (this indeed is one of the principal conditions for the winning of such power); it subsequently becomes dominant when it exercises power, but even if it holds it firmly in its grasp, it must continue to ''lead'' as well' (ibid., pp. 57-58).

Consent, Gramsci (ibid.) argues, is constructed by intellectuals and civil agency (education, religion, media, popular culture, folklore, etc.), which help materialise certain ideas and mentalities into a working social order, a 'hegemonic bloc', and also help reproduce this social order. He also speaks of a 'crisis of hegemony'; this occurs when the hegemonic class fails to secure a goal for which it had previously gathered or 'forcibly extracted' consent from subordinate groups, or alternatively, when subordinate classes awaken from passivity and build a counterhegemony to challenge the dominant class and bring about systemic transformation (ibid.).

Given that hegemony is not reserved solely to the material sphere, but is embedded in institutions, mentalities, relationships, etc., a working class counterhegemony relying on economic factors alone presents little chance of realisation. Rather, once working-class consciousness has developed, it needs to be geared towards challenging the prevailing order at all levels of society, combining a war of movement (a direct assault on the capitalist mode of production through mass protests and strike action) with a war of position (a reconstruction of civil agency to be compatible with a new social order, addressing 'the needs and interests of a larger number of groups' in society and creating 'an even greater basis of consent' [*Columbia Dictionary of Modern Literary and Cultural Criticism*, 1995, no pagination] compared to the prevailing hegemony).

Gramsci's idea of hegemony is therefore subtler than notions of mere 'domination', and includes a strong critical component, challenging the fabric of capitalist society, with the ultimate purpose of systemic transformation. According to David McLellan, 'hegemony' in its Gramscian guise is 'one of the most important, if elusive, concepts in contemporary social theory' (*Oxford Companion to Philosophy*, 2005, p 110).

b. Gramsci's concept of hegemony applied to interstate relations

Gramsci's notion of hegemony, originally describing class dynamics, has been extrapolated to the level of interstate relations by scholars nowadays referred to as neo-Gramscians. A seminal paper in this sense is Robert Cox's 'Gramsci, Hegemony and International Relations: An Essay in Method' (Cox, 1983), where the author attempts to create a framework for adapting Gramsci's ideas to the study of international relations. Cox (ibid.) takes as starting point a short passage in Gramsci that seems to suggest that changes in domestic social relations will always precede changes in international relations:

> 'Do international relations precede or follow (logically) fundamental social relations? There can be no doubt that they follow. Any organic innovation in the social structure, through its technical-military expressions, modifies organically absolute and relative relations in the international field too' (Gramsci, 1971 [1929], p 176).

Cox's reading of Gramsci takes the state, 'where social conflicts take place' and 'where hegemonies of social classes can be built' (Cox, 1983, p 169) as the key unit in international relations. The state in this approach is not only a bureaucratic entity or the enactor of foreign policy, but the reflection of a unique combination of domestic social relations, as well as the propagator of such social relations, by maintaining cohesion, identity, and a common culture (Cox, 1983). Cox defines a hegemonic state, and a hegemonic world order, as follows:

> 'Historically, to become hegemonic, a state would have to found and protect a world order which was universal in conception, i.e., not an order in which one state directly exploits others but an order which most other states (or at least those within reach of the hegemony) could find compatible with their interests. Such an order would hardly be conceived in inter-state terms alone (…) A world hegemony is (…) an outward expansion of the internal (national)

> hegemony established by a dominant social class. The economic and social institutions, the culture, the technology associated with this national hegemony become patterns for emulation abroad. (…) While peripheral countries may adopt some economic and cultural aspects of the hegemonic core, they are less well able to adopt its political models' (ibid., p. 171).

Relying on the above paragraph from Gramsci (1971 [1929]), Cox (1983) argues that change at the international level must necessarily follow changes within national boundaries – a war of position within the hegemonic nation.

Given the ambiguity that characterises Gramsci's work, it has been pointed out that Cox's approach is only one – yet by far the most influential – of the possible ways of applying Gramsci's concept of hegemony to the study of IPE (Agnew and Corbridge, 1994; Worth, 2015). As an alternative, Agnew and Corbridge (1994) raise the possibility of hegemony in the international arena 'without an identifiable territorial hegemon'. While individual states may act as 'agents of hegemony', there can be hegemony without the dominance of a single state over all others, in the sense of 'competing hegemonies'. These are based on dominant historic blocs of elites in different states which 'tacitly accept the same assumptions about the nature of statehood and the rules of international behaviour', such that 'there is always hegemony, but there are not always hegemons' (Agnew and Corbridge, 1997, p 17).

Cox's version of state-level hegemony runs parallel to the more conventional version of hegemony in IPE, which we discuss below. As we shall see in section 2.5, although Cox applied Gramsci to interstate relations with the purpose to challenge conventional IPE, the two approaches nevertheless share some common implicit assumptions.

2.4. The conventional IPE version of hegemony: hegemony defined through Hegemonic Stability Theory

This section starts by providing an overview of neorealism and neoliberal institutionalism as paradigms in IPE. We then discuss how these theoretical perspectives converged into HST under the influence of Kindleberger's *The World in Depression*, and how they subsequently defined hegemony through HST. Finally, we bring together some of the major critiques of HST which are, therefore, also critiques of the HST variant of hegemony.

a. The road to HST: neorealism and neoliberal institutionalism

To understand the HST version of hegemony, the intellectual product of IPE scholars Robert Gilpin and Robert Keohane, it is necessary first to set out the theoretical perspectives these two authors represent: neorealism, and neoliberal institutionalism, respectively. These, in turn, are modifications upon the realist and liberal paradigms, which, along with Marxism, form the core of IPE (Gilpin, 1981, 1987; Crane and Amawi, 1997; Frieden and Lake, 2003). Table 2.1 below summarises the key assumptions behind realism, liberalism and Marxism in the context of IPE. These paradigms differ substantially in terms of ontology, and in particular in terms of what they deem to be the appropriate level of analysis.

Table 2.1: Main paradigms in IPE and their key assumptions

Realism	Liberalism	Marxism
• States are the proper unit of analysis. • States are unitary, rational actors. • States are power maximisers. • The international system is anarchic.	• Individuals (plus households and firms) are the proper unit of analysis. • Individuals are rational (and obviously unitary) actors. • Individuals maximise their utility by trading goods. • Free trade is a powerful mutual interest that guarantees peace at the international level.	• Social classes are the proper unit of analysis. • Exploitation of labour by capital forms the basis of capitalism; the expropriation of surplus value is exploitation. • Classes act in their own material interests, to maximise class well-being. • The capitalist system is inherently conflictual, and hierarchical, not anarchic.

Information in the table adapted from Brawley, 1998; Crane and Amawi, 1997; Frieden and Lake, 2003.

The emergence of neorealism and neoliberal institutionalism should be understood in the context of the evolution from classical liberalism to neoclassical economics (Watson, 2014). Whereas classical liberalism does incorporate a theory of politics in the sense that it sees a role for the government (to intervene for market-making or market-correcting purposes, but a role nevertheless [Frieden and Lake, 2003]), neoclassical economics maintains an analytical separation between politics and economics, dismissing political intervention in markets as irrational, which means it ‘fails as an IPE theory because it ignores questions of power’ (Crane and Amawi, 1997, p 27). In an attempt to bring liberalism back into IPE, the methodological individualism and focus on utility maximisation typical of neoclassical economics began to be applied to nation states.

Neorealism is based on the same ontology as realism, taking the (assumed to be rational and unitary) state as unit of analysis, part of an international system believed to be anarchic. Robert Gilpin, considered the prime exponent of this tradition (Crane and Amawi, 1997) summarises its ontology as follows:

> 'Through calculations of power and national interest statesmen can create order out of anarchy and thereby moderate the inevitable conflicts of autonomous, self-centred, and competitive states (…) Realism is based on practices of states, and it seeks to understand how states have always behaved and presumably will always behave. It does not believe that the condition of anarchy can be transcended except through a universal imperium' (Gilpin, 1981, p 226).

This view embodies a cyclical understanding of time and thereby an assumption of spatiotemporal continuity: 'the nature of international relations has not changed fundamentally over the millennia' (ibid., p 211). In *War and Change in World Politics,* Gilpin deals with a typical realist topic – the causes of war (Crane and Amawi, 1997). He argues that states have always acted as egotistic individuals in an anarchic world, and will continue to do so unless disciplined by 'rational constraints' aiming for world order. One of these constraints, as mentioned in the quote above, is the dominance of one state over the others in 'a universal imperium'. By contrast, bipolarity and multipolarity are assumed to lead to instability: 'efforts by one or more states to improve their relative positions can trigger an uncontrollable train of events that can lead to international conflict and war' (Gilpin, 1981, p 93).

The key difference between postwar realism and neorealism is epistemological: neorealism replaces the realist notion of power maximisation with the liberal notion of utility maximisation (Crane and Amawi, 1997; Brawley, 1998) and adopts a positivist epistemology (*Oxford companion to Politics of the World,* 2004), applying rational choice methodology to the study of interstate relations. Gilpin (1981) acknowledges that the economy is embedded in social and political relations, but quickly abandons this notion in favour of neoclassical modelling to show the conditions under which the international economy reaches a cooperative equilibrium. Realists assume states will use their power to alter the international distribution of costs and benefits, prioritising self-help over cooperation. Neorealists use cost-benefit calculations to predict interactions between states, generally assuming that states will choose cooperation when it maximises their utility (when gains unavailable independently can be accessed jointly), leading to equilibrium. Once the marginal cost of changing this equilibrium becomes equal to the marginal benefit, the assumption is that states will attempt to alter the status quo.

Neoliberal institutionalism is also based on methodological individualism, assuming rationality and utility maximisation (which can apply to a variety of actors in theory, but is in practice most commonly applied to states assumed to be unitary, like in the realist tradition). In fact, despite being widely regarded as a neoliberal institutionalist (*Routledge Encyclopedia of International Political Economy*, 2002a), Robert Keohane (1984) describes his own analysis of the conditions for international cooperation as starting from a realist standpoint. What he adds to neorealism is the notion that institutions can influence behaviour by reducing uncertainty and information asymmetries. Institutions are thus treated in a mechanistic way, as means through which rational actors (predominantly states) can maximise utility, rather than in socio-historical perspective (Brawley, 1998).

An important point to retain from this discussion is that both neorealism and neoliberal institutionalism treat the state as a key unit of analysis, and see it as rational, indivisible, and spatiotemporally stable. We shall see in chapter three that the applied literature on German hegemony embodies precisely this view (fixity bias); what has been lost in conventional IPE is a 'sense of the state in its 'state-society' aspect or of the political and economic processes within state borders that shape state policies' (Agnew and Corbridge, 1994, p 82).

Also germane is the tendency of neorealist/neoliberal institutionalist authors to treat 1970 as 'a year zero' as far as the discipline is concerned (on this point see also Watson, 2014). For instance, Keohane (2009, p 35) writes: 'when Susan Strange, Joseph Nye, Peter Katzenstein, Stephen Krasner, John Ruggie, and I started to explore IPE – Susan in the 1960s, Joe and Steve and I around 1970, Peter and John a few years later – there was no field'. We consider this to be misleading, given the legacy of realism, liberalism and Marxism, which go back much further than the 1970s.

It is precisely the treatment of 1970 as 'year zero' that made HST a centrepiece of IPE. The origins of IPE thusly delineated coincide with the collapse of the dollar-backed, US-led Bretton Woods system of international economic management, which was commonly understood to have brought unparalleled stability and prosperity to participating nations. Widespread perceptions of US decline and foregone stability, along with anxiety over what would emerge out of the ashes of the Bretton Woods system, gave rise to an 'originating bias' in IPE, with many of the early IPE scholars engaged in efforts to establish the conditions needed for renewed systemic stability (Watson, 2014). In this context, Keohane (2009, p 35) mentions the influence exerted by the work of economic historian Charles Kindleberger: 'in 1973 Kindleberger published *The World in Depression*, which made a great impact on all of us'. This represented the original source of inspiration behind conventional IPE definitions of hegemony which inexorably link hegemony with stability, as described below.

b. Kindleberger's influence on IPE and the formulation of HST

The topic of Kindleberger's (1973) book was the Great Depression and its causes, but it implicitly also reflected concerns vis-à-vis instability prevalent at the time of its writing and publication. *The World in Depression* was set out as a critique of arguments espoused by both Milton Friedman, who explained the Great Depression as a consequence of flawed US monetary policy, and Paul Samuelson, who saw it as a result of historical accidents. Kindleberger's aim was to discover an alternative explanation, which he established as a lack of leadership in the world economy, at a time when Britain was too weak to lead, and the US unwilling. His argument is rooted in the neoclassical theory of public goods: international stability represents the ultimate collective good in the world economy, whose existence depends on the provision of second-order collective goods: counter-cyclical long-term lending, discounting in crisis, and an open market for distress goods, to which he subsequently (Kindleberger, 1986) added coordination of macroeconomic policies and a stable exchange rate system.

A pure public good is defined as one fulfilling both the criterion of non-excludability (no individual or group can be prevented from consuming it) and that of non-rivalry or jointness (consumption by one agent does not preclude simultaneous consumption by another). Because of these characteristics, agents have the incentive to free-ride, relying on someone else to provide the good. This leads to a problem of collective action, whereby the public good may be underprovided, not provided at all, or provided only after a significant delay (Drazen, 2000). For Kindleberger, stability is a pure public good, underprovided because of free-ridership, not exploitation: ‘the danger we face is not too much power in the international economy, but too little, not an excess of domination, but a superfluity of would-be free riders’ (Kindleberger, 1981, p 253). While every country has an interest in stability, Kindleberger argues that each prefers another state to provide it, in effect behaving in a way that is ‘individually rational, though collectively disastrous’ (Drazen, 2000, p 385). In game theoretic language, this translates into Prisoner’s Dilemma payoffs: each country has the choice to either cooperate (provide the public good) or defect (free-ride). With non-cooperation as a dominant strategy, the Nash equilibrium is established where both countries defect, and find themselves worse off than if they had cooperated.

This collective action problem can be solved, according to Kindleberger (1986, p 845), if a country is willing to step up as a leader, motivated by ‘conscience, duty, obligation, or […] noblesse oblige’, prepared ‘to set standards of conduct for other countries’, ‘to seek to get others to follow’, and ‘to take on an undue share of the burdens of the system’ (Kindleberger, 1973, p 28), shifting the system away from non-cooperative equilibrium. Since small countries ‘lack the power to affect the outcome of great events and are therefore privileged to look after the private national interest rather than concern themselves with the public good of stability’ (ibid., p 301) it is up to bigger countries to provide crisis resolution mechanisms and maintain the world economic system afloat. Swiftly dismissing any idea of joint leadership as unstable, he concludes that ‘the main lesson of the inter-war years’ is that ‘for the world economy to be stabilized, there has to be a stabilizer, **one** stabilizer’ (Kindleberger, 1973, p 305, emphasis added).

This conclusion had influenced Gilpin (1981) in his analysis of the causes of war, mentioned in section 2.4a above, which takes unipolarity as an important constraint on the assumed to be anarchic international system. Keohane (1984) cites inspiration from both Kindleberger (1973) and Gilpin (1981) in his development of what is now known as Hegemonic Stability Theory

(HST). The theory is centred around two main propositions: that ‘order in world politics is typically created by a single dominant power’, and ‘the maintenance of order requires continued hegemony’ (Keohane, 1984, p 31). Kindleberger’s conclusion thusly reinterpreted by a neoliberal institutionalist via the work of a neorealist has therefore led to a theory which ‘asserts that a single element of international structure – the presence or absence of a predominant state or hegemon – is the primary determinant of collective political-economic outcomes at the international level’ (*Routledge Encyclopedia of International Political Economy*, 2002a, p 664). Nonetheless, in line with his view that institutions once created reduce uncertainty and information costs, Keohane (1984) insists that the second premise of HST (‘the maintenance of order requires continued hegemony’) does not hold, in the sense that institutions created by a hegemonic nation can facilitate cooperation even ‘After hegemony’ (the title of his book, written in the context of widespread concerns vis-à-vis US decline).

This reinterpretation of Kindleberger’s work met with a negative response from the original author, who never actually used the word *hegemon*. Kindleberger admits discontent with Keohane’s transformation of his concept of leadership into hegemony:

> ‘a word that makes me uncomfortable because of its overtones of force, threat, pressure. I think it is possible to lead without arm-twisting, to act responsibly without pushing and shoving other countries. The word hegemon means leadership in Greek, to be sure, but my Columbia Encyclopaedia associates it with the Peloponnesian Wars and the struggle for dominance between Athens and Sparta’ (Kindleberger, 1986, pp. 841-42).

Yet upon closer inspection, Kindleberger’s own definition of leadership is not much different from that which he claims to oppose:

> ‘Leadership may be thought of at first blush as persuading others to follow a given course of action which might not be in the follower's short-run interest if it were truly independent (…) it has strong elements of both arm-twisting and bribery. Without it, however, there may be an inadequate amount of public goods produced’ (Kindleberger, 1981, p 243).

This contradiction indicates an important problem with HST: it is a theory that links hegemony with stability without having developed a concept of hegemony beforehand. Michael Cox (2015, p xi) even hypothesises that the term ‘hegemon’ in HST may have been chosen by a process of elimination, when ‘superpower’ did not sufficiently ‘capture the essence of American power under conditions of unipolarity’ and ‘empire’ ‘appeared to carry far too much political baggage’.

Indeed, Keohane (1984) defines hegemony *ex post*, in light of HST, with the particular case of the US during Bretton Woods in mind (Strange, 1996), in terms of four pillars of structural power:

> 'The theory of hegemonic stability, as applied to the world political economy, defines hegemony as a preponderance of material resources. Four sets of resources are especially important. Hegemonic powers must have control over raw materials, control over sources of capital, control over markets, and competitive advantages in the production of highly valued goods' (Keohane, 1984, p 32).

Gilpin, whose earlier work served as a source of inspiration for Keohane, more recently defined a hegemon as 'the leader of an alliance like that organized by Sparta to defeat the Persian invaders in ancient Greece or by the United States to defeat the Soviets' (Gilpin, 2001, p 99). This reflects the neorealist assumption that 'the nature of international relations has not changed fundamentally over the millennia' (Gilpin, 1981, p 211), which results in the conflation of two distinct issues (Lentner, 2005): the alliances in Ancient Greece were formed between city-states that do not constitute an exact equivalent of nation-states today, whereas the Cold War involved politics between well-defined states of the 20th century. Furthermore, this interpretation of hegemony fails to account for Cold War bipolarity, confusingly referring to the Soviet Union as hegemonism/a darker side of hegemony (Grunberg, 1990); also, it is unclear whether the US did 'defeat' the Soviets, or the collapse was, in fact, generated internally. Such a definition further mystifies rather than aids our understanding of the concept.

c. Critiques of HST

According to Worth (2015, p 171), HST is at best an 'underdeveloped theory of hegemony', which bases its understanding of hegemony exclusively on the fate of the US throughout the Bretton Woods period. Several authors had made the argument that HST reflects the 'originating bias' in IPE/an ethnocentric bias in favour of the US, as in the examples below:

> 'Proponents of hegemonic stability theory implicitly introduce it as part of a more general lament or ''nostalgia'' for a perceived decline of American hegemony in recent years. Viewing the postwar period of American leadership as beneficial to Western interests more generally, they associate the decline in American strength with increased disorder in the international system' (Snidal, 1985, p 580, first footnote).

> 'The theory of hegemonic stability is of American origin and is quite strongly biased in favor of the United States. (…) Many proponents of the theory are deeply convinced that the United States differs fundamentally from other countries. It is profoundly a moral nation. Kindleberger's discourse is outright moralistic and perhaps refreshing in its sincerity' (Grunberg, 1990, p 444).

> ‘Keohane’s book was prompted by growing discussion of the ‘relative decline’ of the United States and what might replace the ‘hegemonic stability’ the United States had brought to the world economy. His concern with hegemonic stability is very much of a piece with the ideological geopolitical discourse of the Cold War period’ (Agnew and Corbridge, 1994, p 82).

Grunberg (1990, p 471) goes on to argue that it is common for people to ‘assign their country the ‘’good part’’ in a preordained narrative’. She suggests that HST might be very different, or not exist at all, had its formulation been left, for example, to scholars in developing countries in the Global South. Such authors, writing during Latin America’s ‘lost decade’, were much less likely to speak of American benevolence. Agnew and Corbridge (1994, p 105) argue that HST satisfies an intellectual need ‘to tie together the fates of the US and world economies in a seamless web of mutual necessity’.

Susan Strange (1987) was among the first scholars to criticise HST for implicitly decrying US decline prematurely. She underlines the continued world supremacy of the US in four pillars of structural power (production, finance, security, knowledge), and, as a corollary, the fact that the country’s switch to unilateralism, causing global instability, is therefore symptomatic of an increase, not a reduction, in power. Strange (1996) takes issue with Keohane’s (1984) definition of hegemony, which suggests that the US post-Bretton Woods is less hegemonic on account of the country’s switch from trade surpluses to deficits, reflective of a loss in foreign markets and competitive advantage. She argues instead that trade deficits merely signify a shift in US priorities, a change in the nature of US hegemony. She writes also that relative global stability during the Bretton Woods era under US hegemony was the result of a ‘happy coincidence’ of national and systemic interests, converging to create a ‘rare window of opportunity’:

> ‘Having just fought a war to stop Europe falling under German domination, the United States government was not likely to let it fall under the domination of the Soviet Union. At the same time, the memory of 13 million Americans out of work in 1940 was still fresh, and the risks to American business of a postwar recession were being openly discussed. Reviving and at the same time opening the European economy to American enterprise was the solution in the American economic interest, just as offering military guarantees against further Soviet expansion westwards was the solution to American geopolitical interests (…) To hope for another such happy coincidence in the 1970s or the 1990s – or indeed at any other time in the foreseeable future – would be over-optimistic. The reversion of US policy to a more self-serving, unilateralist use of hegemonic structural power (…) is (…) only to be expected.’ (Strange, 1996, p 195).

In other words, for Strange HST is guilty of linking stability with hegemony axiomatically, when in fact trade-offs between the interests of the hegemonic nation and systemic interests are more common. Moreover, there exist significant trade-offs even between the various interests of the hegemonic (as well as any other) nation itself. More recently, Goodhart (2007) observed that in the context of national monetary policy it is possible to distinguish between internal, external and systemic stability, where the first refers to domestic prices, the second to the external value of the currency, and the third to the financial system. These dimensions are interlinked, but also irreconcilable in the context of short-term interest rates as the sole policy instrument, which allows policymakers to focus on either internal or external stability, but not both. Taken together, Strange and Goodhart's arguments suggest that stability may not necessarily be a public good, that it is not a homogeneous whole but rather there are different aspects or dimensions to it.

This line of argument is explicitly taken up by Snidal (1985). He criticises hegemonic stability theorists for mistaking joint gains at a point in time for jointness – for assuming, on the basis of the fact that more than one country can derive gains at the same time from being part of an international system, that the system itself will always exhibit public good characteristics. Taking the public good aspect for granted, HST advocates the establishment of an international system led by a hegemon to govern interstate relations, but remains largely unconcerned with the features of such a system. As such, it associates order/stability with the existence of hegemony, and chaos with a lack thereof. A benevolent hegemon guarantees stability and derives benefits, but smaller countries benefit even more, as they do not have to bear the costs of providing this public good. In practice, however, chaos and order are not the only possible alternatives: rather, the hegemonic nation can use its power to underwrite various types of international systems, i.e. various orders. In this sense, hegemony may even be associated with 'public bads' instead of public goods, if the system is based on conventions that apply to all member states alike simultaneously but go against the interests of some countries which lack the power to alter the system (although they do have the ultimate option to reject the hegemon/the conventions of the system, thereby triggering an unravelling of the system). As Grunberg (1990, p 442) put it, 'a large discrepancy in the distribution of power is likely to be reflected in an unequal distribution of welfare.' HST, however, remains focused on pure efficiency considerations in terms of the provision of an allegedly collective good, ignoring questions of distribution, choosing 'any order rather than chaos' instead of asking 'which order?' (Snidal, 1985).

One of the earliest empirical tests of HST, in terms of both range of applicability and mode of implementation, was undertaken by Barry Eichengreen (1987). He uses a mix of game theory and historical analysis of the creation, functioning, and decline of international monetary regimes. Making an analogy between dominant countries and dominant firms, Eichengreen (1987) defines a hegemon as a country whose market power exceeds that of its rivals by a significant margin; he then distinguishes between carrot and stick variants of HST (a categorisation also made by Snidal [1985], using the terms 'benevolent' and 'coercive', respectively):

> 'In the carrot variant, the hegemon, like a dominant firm in an oligopolistic market, maintains the cohesion of the cartel by making equivalent side payments to members of the fringe. In the stick variant, the hegemon, like a dominant firm, deters defection from the international monetary cartel by using its economic policies to threaten retaliation against renegades' (Eichengreen, 1987, p 2).

Eichengreen's game theoretic exercise is devised in simpler terms, however. It moves away from the original setting envisioned by Kindleberger – a world without a hegemon where non-cooperation is a dominant strategy because of the alleged public goods characteristics of international systems – to a situation where there already exists an established international monetary system akin to the Bretton Woods system. In this context, the model includes two countries, each with the choice to maintain parity (cooperate), thereby continuing to adhere to the system, or devalue (defect), taking the policies of its counterpart as fixed. A central assumption is that countries generally derive benefits from participating in the monetary system and incur costs upon abandoning fixed parity, such that they will choose to defect only if the benefits of adjustment via devaluation exceed the costs of defection. These costs are further assumed to be constant over time, with both countries incurring them when either abandons fixed parity.

Since this context involves prices (exchange rates), it is modelled as a Bertrand game, with upward sloping reaction functions, considering that countries' decisions on whether to devalue are strategic complements (they mutually reinforce one another). This is depicted in Figure 2.1. below, where e and e* are the domestic and foreign currency prices of gold, respectively, such that an increase in e or e* implies devaluation; R and R* are domestic and foreign reaction functions. Countries have an incentive to change e/e* away from the initial Nash equilibrium (where R crosses R*) only if the benefits of adjustment exceed the costs of abandoning fixed parity. Otherwise, each country will maintain parity irrespective of what its counterpart does, as illustrated in Figure 2.1. by the vertical portion on R and the horizontal portion on R*, respectively. If the foreign country devalues, its reaction function shifts upwards to R*' as in Figure 2.2. below. If devaluation is sufficiently small (R*' still crosses R within the latter's vertical portion), then the home country chooses to maintain parity regardless of the costs incurred when the other country abandons it.

Figures 2.1-2.3: Participation in an international monetary system as a Bertrand Game

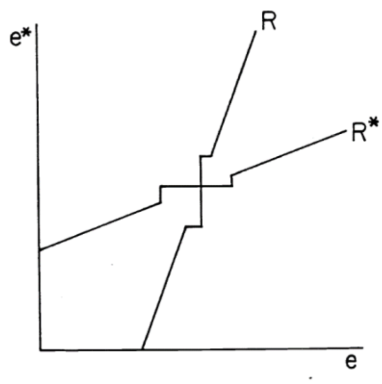


Figure 2.1

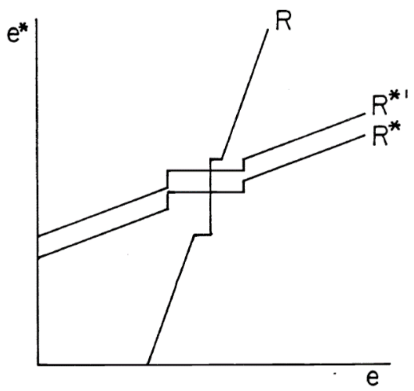


Figure 2.2

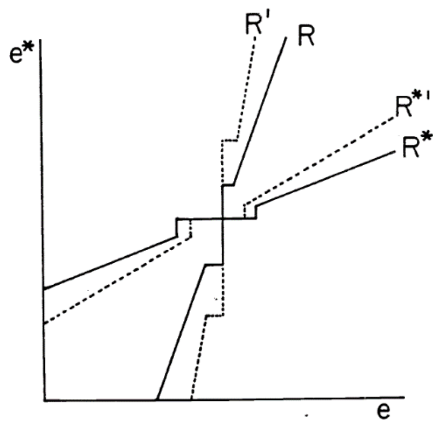


Figure 2.3

Source: Eichengreen, 1987

So far, the two countries were assumed to be equal. If we assume that the home country is hegemonic (which for Eichengreen means more influential on, and at the same time, less sensitive to, the policies of its counterpart), the gains from devaluation diminish; in graphical terms, reaction functions become steeper with the vertical part on R longer, and the horizontal part on R* shorter, as in Figure 2.3 above. This means that the hegemonic country will be less likely to devalue regardless of the choice made by its counterpart, because the cost of changing the exchange rate is assumed constant, whereas the benefits of devaluation are assumed to decline once a country's power increases; by contrast, the non-hegemonic country is likely to retaliate to a devaluation by the home country. Consequently, HST is supported by this setting only in a weak sense: the hegemon is unlikely to abandon fixed parity, but cannot prevent other countries from doing so, which leads to inconclusiveness as to whether the end result is stability or instability.

Therefore, even with strong assumptions vis-à-vis costs and benefits of being part of an international system, plus an understanding of stability exclusively as maintaining parity, and little attention paid to the differences between countries and to the features of the system, 'the results are difficult to reconcile with hegemonic stability theory' (Eichengreen, 1987, p 12). Relaxing the assumption about taking the policies of the counterpart as fixed, to consider instead a sequential game, further undermines the conclusions of HST, as does the consideration of sanctions and bribes (Eichengreen, 1987).

Historical analysis also challenges the conclusions of HST. Generally, attempts to test the theory empirically face difficulties in terms of the practical cases to take as instances of hegemony, given the lack of a comprehensive definition of hegemony in IPE (*Routledge Encyclopedia of International Political Economy*, 2002a); most scholars agree, however, that Britain during the Gold Standard and the US during Bretton Woods represent pertinent examples. Examining archived documents on major international conference proceedings, Eichengreen (1987) finds that Britain and the US did significantly influence the design of the international monetary system under the Gold Standard and Bretton Woods, respectively, but other countries still managed to include important modifications, whereas in terms of stability and adjustment mechanisms, collective (e.g.: of the European centre), rather than singular, hegemony proved more effective. As such, HST is supported, at best, by 'casual empiricism' (Grunberg, 1990).

In spite of the significant shortcomings of HST, which are also weaknesses of the HST version of hegemony, given that hegemony was defined *ex post* through HST, it has nevertheless 'come to dominate the literature' (Strange, 1996, p 194). Susan Strange had made this comment in the 1990s, but it loses none of its relevance today. The 2007-2008 financial crisis and ensuing global instability led to renewed scholarly interest in HST, with hegemony viewed as a solution to large-scale crises. Although, as we have seen in this chapter, hegemony is a concept that long predates HST, with the link between hegemony and stability having only been drawn in the context of the collapse of the Bretton Woods system in the early 1970s, it has become commonplace to define hegemony through stability. In other words, the axiomatic link in HST between hegemony and stability, without a clear concept of hegemony, has led to reductionist interpretations of hegemony. A recent example in this sense is reflected in the following definition: 'they [hegemons] represent the existence of cooperation, in which a powerful actor in the world economy emerges to provide a 'public good' in an effort to overcome collective action problems' (Fields and Vernengo, 2013, p 742).

2.5. The evolution of the concept of hegemony, from critical to problem-solving theories

This overview of the literature has so far revealed that, instead of a comprehensive theory of hegemony, there exist various theoretical strands. Attempts to make sense of these in a holistic way generally make use of the distinction between problem-solving and critical theories, introduced by Robert Cox (1981).

Cox (1981, pp. 128-9) describes a problem-solving theory as one which 'takes the world as it finds it, with the prevailing social and power relationships and the institutions into which they are organised, as the given framework for action', with the purpose 'to make these relationships and institutions work smoothly by dealing effectively with particular sources of trouble'. Such theories isolate particular problems, without calling into question 'the general pattern of institutions and relationships', to which a *ceteris paribus* assumption is applied. By contrast, critical theory 'is critical in the sense that it stands apart from the prevailing order of the world and asks how that order came about' and 'does not take institutions and social and power relations for granted but calls them into question by concerning itself with their origins and how and whether they might be in the process of changing', thus challenging the very framework to which problem-solving theories are applied (ibid., p. 129).

As such, whereas critical theory is 'a theory of history' which aims to situate a particular problem in its wider context, accounting for change, problem-solving theory is 'non-historical or ahistorical' by studying the problem within fixed parameters (ibid., p 129). Given that critical theory accounts for change, it must adjust its concepts and methods frequently, which makes it less precise compared to problem-solving theories; however, precision in the latter is based on a problematic understanding of social and political relations as fixed in the first place. As Cox (1981, p 129) put it, fixity assumptions are 'not merely a convenience of method', but also carry an ideological bias, conservatively defending a given order, and the interests of those comfortable with that order. From the perspective of problem-solving theory, critical theory is written off as unscientific, yet its aims are no less practical than those of problem-solving theory. The difference is that critical theory 'approaches practice from a perspective which transcends that of the existing order' (ibid., p 130), by also considering feasible alternative orders, whereas problem-solving theory focuses on tactical actions that can sustain the existing order.

Based on this distinction, the *Oxford Companion to Politics of the World* (2004) classifies HST as a problem-solving theory of hegemony, and the Ancient Greek and Gramscian variants as critical theories of hegemony. HST looks at hegemony as a way of solving problems of global instability in the aftermath of the collapse of the Bretton Woods system. On the other hand, Greek philosophers and Gramsci were more concerned with analysing the 'nature of and conditions for' hegemony, paying attention to history, ideational factors, inequality and exploitation, as well as notions of morality and consent, while also considering the possibilities for systemic transformation (counterhegemonic forces in Gramsci's formulation, the changing nature of Athenian hegemony in the Greek variant).

The *Routledge Encyclopedia of International Political Economy* (2002b), in defining hegemony, separates problem-solving 'realist' views of hegemony, which emphasise the stabilising capacities of the hegemon, giving the term positive connotations, from critical, 'far less benign Marxist views of hegemony' which are more concerned with the exploitative position enjoyed by dominant classes or dominant states. Yet we believe the critical versus problem-solving divide is not reducible to a contra/pro hegemony divide. It is overly simplistic to equate critical theories with a negative view of hegemony and problem-solving theories with a positive view; while it is a critical theory, the Ancient Greek version of hegemony nonetheless describes Athenian hegemony as largely positive (it is the transformation of hegemony into empire that is viewed negatively in this context). Rather, the Ancient Greek and Gramscian versions are critical because they are mostly concerned with the *nature* of hegemony in a context of change, whereas the HST variant is problem-solving, as it claims knowledge of how hegemony *functions* to preserve an existing world order. In theory, this could be any order at any time, but in practice hegemonic stability theorists write with 1960s' US in mind, defining hegemony *ex post* based on this individual case of the US at a fixed point in time. This is not to say that hegemonic stability theorists view US hegemony as an endpoint history has reached, but rather a desirable state of affairs which should be revived.

In this sense, it can be argued that the evolution of the term is characterised by a shift from critical to problem-solving theories, with the caveat that an important critical edge can be found in the critiques against HST, summarised in section 2.4c, which challenge the nature of US hegemony and the link between hegemony and stability, as well as the public good character of stability, highlighting problems of distribution and raising the possibility of multiple world orders.

Cox (1981) himself had drawn this distinction between critical and problem-solving theories in order to set up his own 'critical' framework for IPE analysis (the neo-Gramscian approach outlined in section 2.3b) in contradistinction to neorealist theories prevailing at the time. He argues that, while realism had started out as a critical theory, 'trying to understand institutions, theories and events within their historical contexts', it was transformed into a problem-solving theory after World War II, by scholars engaged in ahistorical assessments and mainly concerned with ‘the defence of American power as a bulwark of the maintenance of order’ (Cox, 1981, p 131). Cox (1981) criticises neorealism for reducing the state to a few dimensions of material force, for undervaluing the normative and institutional aspects of world order (critique mirrored in e.g. Snidal’s assessment of HST summarised in section 2.4c above), and for failing to differentiate between various forms of state and to acknowledge the importance of non-state actors. His observation that ‘the prospect that there exists a plurality of forms of state, expressing different configurations of state/society complexes, remains very largely unexplored’ (ibid., p 127), paved the way for his own approach to IPE applying Gramsci’s theory to interstate relations (Cox, 1983).

Since the neorealist conception of the state as a rational unitary unchanging actor continues to dominate IPE, the problems highlighted by Cox (1981) also persist. The majority of IPE theorists continue to treat the state as one homogeneous unit, an ideal type, and at the same as the only unit worthy of analysis, reflecting a severe lack of sensitivity regarding internal processes and dynamics. They ignore that hegemons ‘differ widely in the domestic structures of their polities and economies’ (*Routledge Encyclopedia of International Political Economy*, 2002a, p 664), while also overlooking the various interactions between states and non-state actors, both at the subnational and supranational/ transnational level (Agnew and Corbridge, 1994). Even Keohane (2009, p 34) confesses dissatisfaction with the evolution of IPE (including the direction taken by some of his former doctoral students), with the dominant approach paying ‘too little attention both to how interests are constructed and how policies are subject to processes of international diffusion’, ‘remarkably reluctant to focus on major changes taking place in world politics’, while at the same time admitting that this is, strictly speaking, not incompatible with his own rationalist arguments in *After hegemony* (Keohane, 1984).

Yet Cox’s own theory, which applies Gramsci’s concept of hegemony to the study of international relations (Cox, 1983), remains susceptible to some of these critiques. While neorealism does indeed embody an assumption of fixity typical of problem-solving theories in Cox’s formulation, by treating time as cyclical and adopting a reductionist view of the state, an aspect of fixity is nevertheless also apparent in Cox’s conception of interstate relations. As mentioned in section 2.3b, his reading of Gramsci makes Cox maintain that domestic change must always precede change at the international level; this overlooks the possibility of a two-way relationship between states and their international environment. Once a state becomes hegemonic, it sets the direction in international relations as a model which other countries seek to emulate. Cox's formulation therefore allows for change only until hegemony is established within a state, afterwards treating the state as a fixed unit unless counterhegemonic forces operate domestically. We agree with Cox's criticism of neorealism for its failure to acknowledge that reality consists of a plurality of state forms, but what also needs to be acknowledged are differences *within* states through time, as well as the plurality of interactions between states as well as between states and non-state actors at different levels, also subject to change. These latter two points are insufficiently addressed by Cox, which dilutes the critical aspect of his theory. Overall, we agree with Agnew and Corbridge (1994, p i) that 'the dynamism of the international political economy has been obscured through excessive attention to the state as an unchanging actor' – with some theories however employing assumptions of fixity more widely than others.

2.6. Conclusions

The broadest conclusion to emerge from this foray into the relevant literature is that hegemony is a core concept in IPE, yet also a multi-layered and contested term. It has developed very differently within distinct theoretical strands, which precludes the existence of an all-encompassing theory of hegemony and, by extension, of a comprehensive framework for assessing hegemony and its repercussions. Instead, even before we examine the application of the concept to the case of Germany, we can reasonably conclude that the different connotations given to the word generate controversy in identifying pertinent instances of hegemony, leading also to diverging practical implications in terms of policy proposals. Divergence over where the concept fits in between notions of dominance and leadership further mystifies our understanding of it.

This notwithstanding, attempts at a common definition generally emphasise that 'all [versions] point to the fact that hegemony is comprised of a relationship between the dominant and the dominated' (Worth, 2015, p 17). The *Columbia Dictionary of Modern Literary and Cultural Criticism* (1995) states that 'in its most common sense, hegemony refers to the dominance of one group, nation, or culture over another', whereas the *Routledge Encyclopedia of International*

Political Economy (2002b, p 669) defines hegemony as ‘the occupation of a dominant position within any system’. In a broad sense then, hegemony denotes an attitude and intent to control (the global economy, a monetary system, other social classes, etc.), supported by the ability to control, encompassing both material and ideological dimensions.

Beyond this, a popular way to then separate the various strands analytically is the application of the distinction between problem-solving and critical theories based on the purpose they serve, following Cox (1981). The Ancient Greek and Gramscian versions of hegemony are critical in the sense that they ‘identify the nature of and conditions for hegemony, highlighting the inequalities and subordinations of a given order’ (*Oxford Companion to Politics of the World*, 2004) whereas HST is a problem-solving theory, as it accepts the world order as it is, looking at the conditions under which hegemony can help this order run smoothly. The evolution of the term can therefore be described as a shift from critical to problem-solving theory, especially since the fixity bias of HST, which treats the state as unitary and unchanging, in neorealist fashion, has permeated critical literature as well.

The assessment in this chapter – in particular the distinction between problem-solving and critical theories of hegemony – will be used as a basis upon which to evaluate existing literature on German hegemony, in chapter three, as well as to subsequently develop our own analysis of the role of Germany in the EMU, in chapters four-six. This analysis will be done in the spirit of critical theory, which, as shown above, has been marginalised in contemporary IPE. We discuss power relations in the EMU by considering a two-way relationship between Germany and the EMU framework, simultaneously highlighting supranational and subnational dynamics. Our emphasis is on heterogeneity and change, in view of challenging the fixity bias in dominant, HST-inspired (neorealist) theories of German hegemony.

Chapter three: Framing Germany as a hegemon

3.1. Introduction

Hegemony discussions in IPE had long been extended to include regional hegemons as well as global, with some scholars insisting that even Britain during the Gold Standard or the US during the Bretton Woods years had been no more than regional hegemons themselves (on this last point, see, for instance, Bulmer and Paterson, 2013). Historically, discussions of German hegemony started soon after the unification of Germanic lands into an integrated nation state in 1871, followed by rapid industrialisation and militarisation. 'Hegemony' was initially used to reflect the country's growing economic prosperity and military might, combined with a growing imperialist drive (see e.g. Colquhoun, 1909). In the context of the two world wars, it became simply a euphemism for 'empire' – e.g. *Manchester Guardian* (1938, p 12): 'there is nothing in the way of Germany enjoying a position of hegemony on the Continent'. The defeat of Nazi Germany in World War II led to a reconfiguration of European geopolitics, with the containment of German power as a priority in the aftermath of the war. The solution adopted was the fragmentation of the German state, and the inclusion of West Germany into a project of European integration that aimed to link together European countries in a way that enables common interests to prevail over conflict, preventing future wars.

German reunification discussions in the late 1980s meant that 'the equilibrium of the past 30 years is coming to an end' (The Times, 1989, p 1), reopening questions about the role of Germany in Europe. It was at this juncture that political elites in Europe embarked upon a journey to establish the EMU. In the context of German reunification, some feared the possibility of renewed German domination, whereas others were speaking of a 'renewed commitment to the West' on the part of Germany, emerging out of 'Germany's own understanding of its position', which precludes any exercise of force (The Independent, 1990, p 15). Commentators belonging to the former group assumed that Germany was interested in EMU integration as a strategy to secure European hegemony, whereas those belonging to the latter viewed Germany's EMU integration as a deliberate and carefully considered subordination of its own strength to supranational constraints in order to maintain cooperative relationships with its neighbours (The Times, 1990).

These discussions had largely been muted in the run-up to, and the immediate aftermath of, euro adoption, most likely because the euro project had no real precedent, so it was unclear to observers where it was heading, and what this meant in terms of Germany's position. German hegemony discussions re-emerged full-force, however, following the 2007-2008 financial crisis, with perceptions that the management of the Greek debt crisis is largely orchestrated from Berlin. Has Germany become hegemonic in the EMU during the crisis? Has it actually been hegemonic in the EMU from the start? Mirroring earlier debates, answers to these questions reflect a deep conflict of views: on the one hand, there are people who answer in the negative, asserting that Germany is not hegemonic, but that it should assume that role, in order to stabilise the EMU (e.g. Matthijs and Blyth, 2011); other commentators, on the contrary, maintain that German hegemony is a destabilising factor for the EMU (e.g. Bischoff and Detje, 2012). Additionally, there are also those who seek to reconcile the two opposite camps to some extent, classifying Germany as a 'reluctant hegemon' (Paterson, 2011; The Economist, 2013a). Meanwhile, the majority of German political elites vehemently deny German pursuit of hegemony: for instance, in a debate hosted by Deutsche Bank in 2013, German Chancellor Angela Merkel, asked whether Germany is hegemonic in Europe, responded that the concept is 'completely foreign' to her (EU Observer, 2013).

The overall aim of this chapter is to make sense of this conflict of views, while outlining the limitations of existing literature on German hegemony, in view of developing our own assessment of the role of Germany in the EMU. We adapt the distinction between problem-solving and critical theories of hegemony (Cox, 1981), introduced in the previous chapter for the case of global hegemony, to the case of regional (European) hegemony considered here. As a reminder, problem-solving theories look at hegemony as a solution to instability, defending the (social, economic, political) order of which the hegemon is part, while critical theories are more concerned with the nature of hegemony and of the hegemonic order, as well as with possibilities for change. Our main finding is that much of the applied literature on Germany reflects the intellectual dominance of the HST (problem-solving) version of hegemony, replicating rather than challenging the conventional IPE perspective which we critiqued in chapter two. The contradiction between those who maintain Germany is too hegemonic, versus those who think it is not hegemonic enough, arises because of the application of critical, versus problem-solving theories of hegemony, respectively. Nonetheless, as is the case with the general literature on hegemony, even those sources that adopt a more critical perspective carry some of the biases of problem-solving theories, by depicting the hegemonic state (in this case, Germany) as a unitary, unchanged actor.

For the study of German hegemony, we take the EMU framework to represent ‘existing order’. The features of this order are summarised in section 3.2 below, which provides a critical overview of the European integration process. Section 3.3. then analyses the ways in which general literature on hegemony, explored in chapter two, has been applied to the case of contemporary Germany, to account for the power relations behind this order. We group sources chronologically into two broad categories, depending on whether they explicitly refer to German hegemony in the EMU prior to, or during, the euro crisis. The main findings from this exercise are summarised in section 3.4.

Before moving on to the next section, it is important to note that there exists an adjoined line of discourse that concerns itself with the role of Germany vis-à-vis Central and Eastern European countries. German hegemony in the East has been analysed through the prism of very diverse elements: medieval settlements of Germanic peoples in Eastern Europe, establishing a distinct culture, as well as German language education; positions of leadership occupied in Eastern European countries by descendants of the Germanic Hohenzollern and Habsburg dynasties; commercial ties and joint business ventures between Germany and the East; Chancellor Brandt’s Ostpolitik in the Cold War era which aimed to improve East-West relations, etc.(see, for example, Markovits and Reich, 1991). An important development in terms of Germany’s relationship with the East, worthy of future exploration, is eastward enlargement of the EU since 2004. We do not, however, pursue this line of analysis here, as our concern is primarily with the monetary integration aspect of the EU, not enlargement *per se*.

3.2. An overview of the EMU

In the introduction above, we mentioned that German reunification, in reviving questions about how to set up an institutional framework in Europe that limits coercive power, acted as a catalyst for monetary integration. German hegemony is now being debated using the EMU as a point of reference. Below, we provide a general overview of the EMU setting, which is important to contextualise our analysis going forward; section 3.3 then discusses literature that analyses Germany's role within this setting. Our own view on Germany's influence on EMU dynamics is explicitly developed as part of the empirical analysis in chapter five.

a. Early stages

The European Union (EU), formerly European Community (EC), started as an institutional construction to prevent a repetition of World War II and promote peace in Europe, in the form of the European Coal and Steel Community (ECSC), established in 1951, the aim of which was to regulate member states' heavy industry. Early attempts to broaden the scope of the ECSC beyond the economic sphere were rejected in favour of preserving national sovereignty, setting a precedent for the prioritisation of economic considerations in the integration process for decades to come (Huffschmid, 2005). The idea to further bind the EC together in a monetary union had been vehiculated since the 1950s, but the first official plan to this end was laid out in the 1970 Werner Report (Council of the EC, 1970), following a request made by EC heads of state at a summit in the Hague one year prior. However, this plan, aiming to complete monetary integration in stages by 1980 (Council of the EC, 1970), had been disrupted by the collapse of the Bretton Woods system of fixed exchange rates in 1973, which led to a climate wherein EMU was deemed unrealistic (Huffschmid, 2005).

Combined with the OPEC oil shocks of 1973-4, the end of Bretton Woods ushered in a decade of great instability and stagflation, a setting which provided fertile ground for those of a free-market bent to discredit state intervention. Since then, we have witnessed the ascendance of laissez-faire doctrines; as pertains to monetary integration in Europe, the free market began to be viewed as ‘the only sensible political objective’ (Huffschmid, 2005, p 13). This shift to market solutions had profound implications for the design of the EMU – a point we shall return to shortly.

In the context of exchange rate instability, European elites recommenced the process of monetary integration in the hope that it would dampen fluctuations (Huffschmid, 2005). Consequently, the European Monetary System (EMS), based on the European Exchange Rate Mechanism (ERM), was established in 1979. This involved the creation of a European currency unit (ECU) – a unit of account, whose value was calculated as a weighted average of the currencies of EC member states, the latter then being fixed at adjustable rates against the ECU, and allowed a fluctuation band. Critiques of the EMS focused on its asymmetric character, given that in practice the German Bundesbank, intent on inflation control, never intervened against Deutschmark (DM) appreciations, forcing other countries to devalue their currencies instead (Huffschmid, 2005). A series of speculative attacks on currencies in the EMS following the liberalisation of capital through the Single European Act (SEA) of 1986 raised new questions about the sustainability of monetary integration, bringing the Mundell-Fleming trilemma, as well as optimum currency area debates, back into the spotlight (Singh, 2000).

b. Europe as an optimum currency area?

Also known as the impossible trinity in macroeconomics, the Mundell-Fleming trilemma is named after Robert Mundell and J. Marcus Fleming, who had formulated it, concomitantly but independently, in the early 1960s, when the sustainability of the Bretton Woods system first began to be doubted (Singh, 2000). The trilemma states that financial openness restricts policy choices, given that, at any point in time, any economy will only be able to have two of the following three elements: fixed exchange rates, monetary autonomy, free capital flows (Dymski, 2013). Fleming’s (1963) example to illustrate this incompatibility starts from a deterioration in a country’s balance of payments as a result of changing conditions in international markets, potentially leading to recession and unemployment domestically. Recession may be prevented through credit policy that stimulates domestic demand, but a decrease in interest rates for this purpose would, in the context of full capital mobility, lead to an outflow of funds and thereby a decrease in the demand for domestic currency. If the exchange rate is fixed, reserves must be used to maintain parity, but the usage of reserves increases the likelihood of speculative attacks on the domestic currency and therefore, of a deeper crisis than the initial recession. Mundell (1961) and Fleming (1963) agreed on the problem, but disagreed on the solution. For Fleming, capital controls would lead to an optimal resolution of the trilemma. Mundell, on the other hand, argued that countries that form an optimum currency area (OCA) within which there exists high factor mobility should keep fixed exchange rates and free capital flows, surrendering monetary autonomy, but the region as a whole should then have a flexible exchange rate with the rest of the world.

This seminal paper by Mundell (1961) spurred a vast literature exploring conditions under which a monetary union (involving individual member states' simultaneous renouncement of monetary and nominal exchange rate policy) is feasible. Symmetry of shocks is the most obvious: common supranational monetary policy is effective for all countries in the group if they are affected by external shocks in the same way. If shocks are asymmetrical and nominal exchange rates cannot be altered, trade imbalances would soon accrue, but not if prices and wages were sufficiently flexible such that the real exchange rate adjusted easily even while the nominal was fixed. An example of an asymmetrical shock provided by Mundell (1961) is a shift in demand from one country to another within a monetary union. In the absence of price and wage flexibility, a third condition is that emphasised early on by Mundell (ibid.): high factor mobility within the currency zone. For more left-leaning theorists, an OCA is one that 'can maintain external balance without causing unemployment' (Kenen, 1969, p 41); consequently, they place great importance on the role of fiscal transfers to compensate for income and employment divergence between regions and countries in a monetary union.

These conditions are, however, normative rather than positive statements; as a result, different people can reach different conclusions as to whether any given group of countries forms an OCA or not, depending also on their wider theoretical perspective in political economy, as Mundell (1961) himself had been well aware of, early on. Among other things, he paused to contrast the views of Meade (1957) and Scitovsky (1958) on the feasibility of a monetary union in Europe. Meade was arguing that due to a lack of factor mobility between European countries these would be better off retaining flexible exchange rates to enable adjustment, and Scitovsky on the other hand asserted that a common currency would automatically increase capital mobility, thereby facilitating adjustment. At first, Mundell's (1961) own view was closer to Meade's, but a decade later (Mundell, 1973), he was arguing in favour of a single currency in Europe on assumptions similar to those held by Scitovsky.

Fleming (1963) had been sceptical about the EMU from the start, concluding, with what can only be described, in light of the Eurozone crisis, as remarkable foresight, that:

> 'such a system […] could hardly hope to ensure full employment to all the countries of the group unless the members were prepared to submit to a thoroughgoing coordination not only of monetary, but also of fiscal and possibly wage, policies; unless they were imbued with a solidarity sufficient to induce those with favorable balances of payments to endure some degree of inflationary pressure for the sake of the others; and unless a high degree of mobility of labor prevailed within the group' (Fleming, 1963, p 481).

Nonetheless, such considerations had been set aside in the late 1980s, when European leaders decided to establish a single currency in view of overcoming the growing weaknesses of the EMS.

c. Setting up the EMU on the basis of the endogeneity hypothesis

Monetary integration following the SEA became 'a project mainly expressed in terms of market liberalization' (Huffschmid, 2005, p 11). Mundell (1961) was writing that the Common Market should not be viewed as an end in itself, but as a means to political union; this goal, much discussed since the early days of the EC, was nonetheless abandoned in the 1990s. Integration proceeded on the basis of arguments similar to those expressed by Scitovsky (1958) and Mundell (1973). While OCA theory *per se* remains silent on financial factors, Mundell (1973) reconciled the idea of an OCA with neoclassical financial theories. According to these theories, the removal of country-specific currency risks would increase allocative efficiency: it would lead to capital flowing from richer to poorer countries, where it would be more productive, conducing to greater growth and development, triggering a catching-up process and ultimately resulting in convergence (Chen et al., 2012). This, in conjunction with OCA criteria, later became known as the endogeneity or convergence hypothesis (Frankel and Rose, 1998), which posits that, by adopting a common currency in the context of unrestrained financial flows, initially structurally divergent countries can form an optimum currency area *ex post.* This implies that OCA criteria are self-fulfilling.

Contra Kenen (1969), who had insisted on the need for fiscal transfers in a monetary union to tackle structural divergence, a theoretical argument has been made that fully integrated capital markets can substitute for fiscal transfers. The logic is the following: firms in countries affected by negative shocks make losses and drive stock prices down, whereas stock prices in countries experiencing a boom will rise; residents in the recessionary country are, however, free to hold stocks in any other member state, so their income might actually increase despite the recession (de Grauwe, 2012). This argument ignores the fact that stockholders in both countries are bound to be wealthy residents anyway, so capital market adjustments are unlikely to benefit the working class, the people most likely to lose their jobs as a result of the recession! The assumption that financial liberalisation and integration leads to convergence also misses the changes in finance since 1970 (Dymski, 2013), namely the turn to 'casino capitalism' (Singh, 2000) and the growing power of financial capitalists over the real economy (Dymski, 2013). Capital has been shifting away from investment in production to speculation in financial markets, where profits could be made easily and quickly, and banks had ceased to be mere financial intermediaries, becoming profit-seekers themselves. Therefore, funds had actually been diverted away from the real economy instead of providing the means to bridge the gap between richer and poorer countries by matching savings with investment opportunities, as expected by neoclassical theorists (Singh, 2000).

Denying that financial repression can actually support growth in the real economy and ensure stability (Singh, 2000), European elites had decided to lift all capital restrictions, inscribing this decision in the 1986 SEA. Consequently, in the context of the Mundell-Fleming trilemma, the policy choices going forward were either full exchange rate flexibility plus monetary autonomy, or monetary union. In practice, intermediary or mixed systems had also been considered, such as the proposal of using a common currency only in transactions with the rest of the world while retaining domestic currencies, or using a common currency in parallel with domestic currencies, but these were abandoned on the grounds that they would be too complex to implement in practice

(Huffschmid, 2005). Monetary union was chosen because of its numerous theoretical benefits: the elimination of foreign exchange rate risk and transaction costs, ease of cross-country price and wage comparisons leading to greater efficiency, and greater opportunity for production concentration in view of achieving economies of scale at the microeconomic level (Carlin and Soskice, 2015); the reduction of structural divergences as a result of capital flowing where it is most productive, plus intensified trade, greater investment, reduced speculation and uncertainty, and greater policy credibility at the macroeconomic level (Drazen, 2000).

European elites backed the endogeneity hypothesis (de Grauwe, 2012). During the June 1989 European Council meeting in Madrid, EC heads of state entrusted the then Commission President Jacques Delors with the task of heading a committee to identify the necessary steps towards achieving monetary union. The Delors Report (European Council, 1989, pp. 16-17) concluded that the integration process should be based on 'a large degree of freedom for market behaviour'. It became the blueprint for the Maastricht Treaty, signed in 1991, formally replacing the term EC with EU, and laying the foundations for the Eurozone as a large-scale experiment in irrevocably fixed exchange rates. The EMU came into being in 1999, when the euro was officially introduced.

d. The structural lock-in of the Eurozone

The consequences of this choice are far-reaching. Euro adoption on a background of free capital flows has not led to convergence. On the contrary, the Eurozone today still does not meet any of the OCA criteria, and divergence has rather increased, due to the unequal distribution of costs and benefits of EMU membership (Huffschmid, 2005). This suggests that structural divergences are actually deep-seated differences with institutional, political, cultural and historical roots, which cannot be transcended as easily as endogeneity theorists had assumed. What is worse, most policy instruments that could be used to tackle these differences had been disabled by the EMU design.

With the introduction of the euro in 1999, Eurozone member states had deprived themselves of monetary autonomy. Structural divergence means that common monetary policy conducted by the European Central Bank (ECB) is not fit for all Eurozone countries simultaneously, but rather too restrictive for some countries and too expansionary for others; this is known as the 'one-size-fits-all' problem (Huffschmid, 2005). Moreover, the sole objective of the ECB, as outlined in the Maastricht Treaty, is price stability, to be achieved via the effect of interest rates on aggregate demand. This exposes the implicit assumption that inflation is demand-pull, and ignores the possibility of cost-push inflation. The ECB's role to maintain inflation close to, but below 2%, carries a deflationary bias (Carlin and Soskice, 2015). The political independence of the ECB precludes Lender-of-Last-Resort (LOLR) activity, as well as monetary and fiscal policy coordination.

Fiscal policy is also severely constrained. At the national level, the Maastricht Treaty had set convergence criteria – requirements for countries wishing to join the EMU – among which, a limit of 3% of GDP for budget deficits and 60% of GDP for public debt. These later became permanent fiscal rules, introduced in the Stability and Growth Pact (SGP), adopted in 1997, which also requires the overall EU budget to be close to balance (Huffschmid, 2005). Accordingly, fiscal policy is also 'one-size-fits-all'; in practice, there is little reason to believe that the aforementioned limits are compatible with any possible level of growth (ibid.). The Maastricht Treaty also included a 'no bailout' clause, specifying that no member state should be liable for, or assume the debts of, another.

Back in 1977, a report requested by the Commission of the EC (1977), on 'the role of public finance in European integration', known as the MacDougall Report, argued that the EC budget would have to be increased from 1% of EC GDP to at least 5-7% of GDP to 'provide sufficient geographical equalisation of productivity, living standards and cushioning of temporary fluctuations to support a monetary union' (Commission of the EC, 1977, p 14). The 5-7% range had been proposed on the assumption that member states would retain full room for manoeuvre in national fiscal policy to support welfare, which is not the case under SGP conditions; moreover, the EU is much more structurally diverse now, following successive rounds of enlargement, than it had been in 1977. Considering this, the current size of the EU budget, at 1% of EU GNP (Europa website, 2017a) – with past values never having exceeded 2% – is clearly inadequate to support the EMU.

In the absence of fiscal transfers, an economic downturn in a member state will lower tax receipts and increase public spending, leading to a budget deficit, which cannot be financed by the country's Central Bank because of the loss of monetary independence, nor by the ECB, which lacks LOLR capacity. This predicament explains the limits on public spending imposed in the SGP and the 'no bailout' clause, but does not excuse the whole setting of the EMU which causes this predicament – the vulnerability of a country borrowing in a currency it does not issue, upon which financial markets can force default (de Grauwe, 2012) – in the first place.

Beyond a relinquishment of control over credit growth and allocation, the surrender of independent monetary policy in conjunction with capital account liberalisation posed further problems in terms of bank regulation and bank behaviour (Dymski, 2013). It limited the powers of regulatory authorities vis-à-vis finance that has been freed from accountability to any individual nation state. Ideally, effective bank regulation should have control over domestic banks, as well as over foreign banks operating domestically, while retaining LOLR capacity to supply liquidity during crises. This regulatory framework should, in turn, support bank behaviour that results in the provision of productive credit to finance economic and social projects while maintaining systemic safety and soundness (Dymski, 2013). Financial liberalisation since the SEA meant a loss of control over foreign banks; national regulators could still control domestic banks, but had little incentive to do so in the context of increased financial competition from abroad. The loss of LOLR capacity by joining the EMU meant, under these conditions, that, by the early 2000s, all three pillars of effective bank regulation had been immobilised. The ensuing culture of permissiveness shifted bank behaviour into hypercompetitiveness, greater risk-taking, and speculation, and therefore away from systemic stability and meeting the demands of European citizens (Dymski, 2013). This change in bank behaviour caused the financial crisis, the costs of which were then passed on to nation states, generating a situation where, instead of providing funds to support national development programmes, banks drained governments of funds for their own survival. This triggered sovereign debt crises across the Eurozone, bringing to the fore the problem mentioned above – the vulnerability of governments that borrow in a currency they do not issue.

As Dymski (2013, p 12) put it, ‘adopting a common currency without political consensus and without a solid fiscal transfer mechanism’ – based on ‘pre-determined rules for government behavior and a wide scope for market forces, disciplined by financial flows’ – was ‘an invitation to disaster’. He describes the loss of monetary and exchange rate policy, coupled with financial permissiveness and the limitations imposed on fiscal policy, as a ‘structural lock-in’ (Dymski, 2013). This lock-in puts tremendous pressure on wage and labour market policy as the only remaining adjustment mechanisms at the Eurozone level. If there is one OCA criterion European elites had paid attention to, however inadvertently and devoid of other considerations, that would be wage flexibility. To solve the Eurozone crisis, they prescribed austerity and wage cuts; thus, the faulty institutional structure of the EMU on a background of heterogeneity carries grave distributional implications.

3.3. Framing Germany as a hegemon in the EMU: an evaluation of the literature

As noted in section 3.1. above, references to German hegemony in Europe long predate European monetary integration, with ‘hegemony’ in the past most frequently used as a synonym for Germany’s imperialist drive, the trigger of two world wars. A sensitive topic during the country’s East-West divide, notions of German hegemony resurfaced after reunification, with contemporary theorising of German hegemony in Europe using the EMU as point of reference. Below, we evaluate scholarly literature on German hegemony in the EMU, grouped chronologically into two categories: sources analysing German hegemony before, and during the euro crisis, respectively.

a. Pre-crisis literature on German hegemony

The formal outline of the EMU institutional framework in the Maastricht Treaty, following German reunification, spurred theories of German hegemony in the EMU almost immediately, years ahead of the official launch of the euro in 1999. However, on the whole, there had been very few mentions of German hegemony before the euro crisis. The earliest source to refer to reunified Germany as a regional hegemon is a paper by Markovits and Reich (1991; updated in Markovits et al., 1996). They begin by contrasting the views of an ‘optimist majority’, that the monetary integration project underway would be beneficial to Germany and its European partners alike, with those of a 'pessimist minority', that a revived Germany would eventually repeat mistakes of the past, with monetary integration essentially a German stratagem to dominate the rest of Europe (Markovits and Reich, 1991). The authors contend that any factors that could lead to totalitarianism had been successfully eradicated by Germany, but that it is precisely the country's new commercialised and democratic nature that makes it a hegemon in Europe.

To assess German hegemony in the EC, they argue it is important to 'challenge the theoretical and methodological dominance of mainstream structural approaches in IPE' (ibid., p 2) i.e. those inspired by HST. Yet in practice they largely follow the dominant IPE approach, applying Keohane's definition of hegemony (Keohane, 1984), which reduces the state to four pillars of structural power, based on the case of the US during the Bretton Woods years (see previous chapter, section 2.4b). Using data on trade patterns from 1970 onwards, Markovits and Reich (1991) conclude that a high absolute level of German exports to the EC, a high market share, plus a growth rate of exports far exceeding that of its rivals (France, Italy, the UK) make Germany hegemonic in a sense compatible with definitions of hegemony 'used by hegemonic stability theorists on a broader scale' (ibid., p 20). From this perspective, not only did Germany appear as the main beneficiary of the EC, but also more hegemonic in the EC than the US ever was under the Bretton Woods system, as the US never accounted for more than 25% of world market share, whereas Germany's export market share in the EC had been 27.8% at the time of reunification.

Markovits and Reich (1991) then go on to argue that the nature of German hegemony is benign, because it 'pays the bill', as the main net contributor to the EU budget. The idea of benign hegemony is reinforced in Markovits et al. (1996), not just in the sense of budget contributions, but also more direct benefits accruing to smaller EC states through export spillovers. A Granger causality vector-autoregression test among variables capturing German export growth, export growth in the Benelux countries (as small countries in the EC), and export growth in Britain (as Germany's main rival, disadvantaged by the economic setting of the EC), using annual export data for the period 1960-1992, shows positive spillover effects on Benelux exports 3-6 years after an initial increase in German exports, and no significant effect on UK exports. The explanation provided for this finding is the difference in exchange rate regime, with the UK maintaining a floating rate with Germany and the Benelux countries a fixed rate, which meant a closer coordination between the economic cycles of Germany and the Benelux states (ibid.). These two aspects (payments into the EC budget, and economic cycle coordination between Germany and countries maintaining fixed exchange rates with it) led Markovits et al. (1996) to believe that the EMU, once launched, would be beneficial to Germany and other European countries alike. This conclusion is reminiscent of HST as a problem-solving theory in that it focuses exclusively on the *functions* to be performed by Germany in the future EMU system (assuming they will remain the same as in the EC), paying insufficient attention to the *features* of the system itself. It overlooks the extra costs of adjustment involved in giving up domestic currencies, further exacerbated by the particular EMU set-up, as discussed in section 3.2. above. It also ignores the findings of the MacDougall Report (Commission of the EC, 1977), that the EC budget (regardless of who is paying the most into it) is too small to support monetary integration.

Markovits and Reich (1991) nonetheless claim to depart from HST notions of hegemony, by also integrating into their analysis the Gramscian aspect of ideational hegemony, following Cox (1983). Their application of Gramsci consists of an argument that, while in the early stages of European integration, France had provided ideological leadership, with Germany merely seeking acceptance from its former adversaries, in time German ideas and values became 'attractive' to other European countries, as a result of its postwar economic success and new economic model (*Modell Deutschland*), at a time when France's economy was continuously worsening. The German model is therefore taken as an emblem of ideological hegemony, with Germany as an exporter not only of goods, but also ideas, which influenced the design of the EMU. The updated version of the paper (Markovits et al., 1996), suggests that the authors' consideration of more Gramscian theories of hegemony is instrumental rather than reflective of genuine affinity for such theories, however. After the publication of their original analysis (Markovits and Reich, 1991), they had to grapple with a significant change in the German economy, which shifted from trade surpluses to deficits after reunification, with an increasing current account deficit. This posed problems for their classification of Germany as a hegemon, since they had used Keohane's definition of hegemony which refers to export market shares and comparative advantage.

Versions of hegemony that are less specific and, by implication, more open to a variety of interpretations, could, however, compensate for this. Indeed, Markovits et al. (1996) explain Germany's rising current account deficits as a result of a substantial tourism deficit, which they take as an indicator of ideational hegemony, arguing that it reflects extensive foreign travel due to an interest in exchanging ideas across the continent! Such a statement was made possible by ambiguity surrounding the concept of hegemony in IPE in general, as well as surrounding the applicability of Gramsci's notion of hegemony to interstate relations. This aside, the overall conclusion, reached in both versions of the paper (Markovits and Reich, 1991; Markovits et al., 1996) is that Germany is indeed a regional hegemon, whose power continues to expand, and manifests itself in both material and ideological forms (largely separate from one another).

The argument that Germany is a regional hegemon resurfaces in Beverly Crawford's (2007) book on foreign policy. This time gap in the literature, as suggested in the introduction of this chapter, can be explained by the fact that it would have been very difficult to theorise the interactions between Germany and the EMU framework in the early years of the euro – a unique experiment in monetary integration without real precedent. Like Markovits et al. (1996), Crawford (2007) uses Keohane's definition of hegemony, and concludes that Germany exhibits three of the four components of material hegemony underlined by Keohane: control over markets (data on EU exports for the period 1992-2002 show that Germany had been consistently surpassing its rivals), control over capital (as the principal supplier of intra-EU FDI), and comparative advantage in the production of highly-valued goods (as evidenced by the share of manufacturing production in GDP, larger than in other European countries); the one component that Crawford argues is missing is control over raw materials. She goes on to argue that these pillars of structural power give Germany the capacity to lead. This is combined with a willingness to lead, given Germany's voluntary integration in the EMU to 'soften perceptions of dominance', as well as its significant role in EMU negotiations in terms of shaping new institutions, which 'embedded' its hegemony into those institutions. Contributions to the EU budget are again used as 'proof' of benign hegemony. The book's main argument is that as long as the German economy is robust, the country uses its power to underwrite cooperation in Europe, but shifts back to self-interest when the economic outlook worsens, as evidenced by Germany's breach of the SGP rules when its economy turned recessionary, in spite of it having been the driving force behind the design of these rules. This argument is compatible with HST-inspired definitions of hegemony, which see unilateralism as evidence of hegemonic decline, criticised by, e.g. Susan Strange (1987), who argued that US unilateralism post-1970 reflected a change in the nature of US hegemony rather than hegemonic decline.

On the whole then, scholarly interest in the notion of German hegemony prior to the crisis had been very limited. The early research by Markovits and Reich (1991) had also inspired Crawford (2007) to analyse the role of Germany in the EMU through the prism of HST – in particular by applying Keohane's definition of hegemony. With little attention paid to the nature of the monetary system under development, these sources refer to German hegemony as benign, with, however, an increasing tendency towards unilateralism, used, in line of HST, to suggest gradual hegemonic decline (Crawford, 2007).

b. Literature on German hegemony in the context of the euro crisis

The Eurozone crisis in the aftermath of the 2007-8 financial crisis revived the debate on German hegemony, giving rise to two apparently contradictory theoretical strands. One argues that the problem in the EMU is a lack of hegemony, and that Germany should take up a hegemonic role, whereas the other views coercive German hegemony as the fundamental problem in the Eurozone.

Matthijs and Blyth's (2011) assessment of the Eurozone crisis is representative of the first perspective. They begin by stating that 'to solve the European crisis and avoid repeating the mistakes of the late 1920s and the 1930s, those sitting in Berlin and Brussels should (…) read Charles Kindleberger' (ibid., no pagination). Drawing a parallel with the failure of the US to provide leadership during the Great Depression, they argue that, likewise, Germany is presently not hegemonic in Europe because it has failed to provide during the crisis the five public goods enumerated by Kindleberger (1973). Instead of creating a market for distress goods where crisis countries could sell their products, 'Germans have been enthusiastically selling their manufactured goods to the periphery' (Matthijs and Blyth, 2011). Lending from Germany to

Southern Europe has been pro-cyclical rather than counter-cyclical. The Eurozone construction assumes that exchange rate stability can be maintained if countries follow rules to keep their 'fundamentals' sound, so in this respect Germany has also fallen short, by breaking the rules of the SGP. Instead of providing macroeconomic policy coordination, Germany has become an economic benchmark for other countries, despite the fallacy of composition in a collective pursuit of export growth. Finally, it has not had the capacity to act as lender-of-last resort either.

The conclusion that Germany is not hegemonic because it does not provide stability in the Eurozone embodies the reductionist HST definition of hegemony through an axiomatic link with stability. A defence of the existing order, typical of problem-solving theories, is obvious in the emphasis on the fact that Germany is not hegemonic because it had broken some of the rules of the EMU system; the appropriateness of those rules is not called into question. Moreover, Germany had broken the SGP rules *before* the crisis, reverting to the position of the European country with the best fundamentals post-2008, which, in Matthijs and Blyth's (2011) analysis should then mean that Germany is hegemonic in at least one respect. The fact that they use the notion of a German model given as an example to other countries as evidence of a lack of hegemony is perplexing at first, but explicable if we remember that they implicitly define hegemony exclusively through stability (recall that hegemonic countries are understood as models for other states in Cox's [1983] version of neo-Gramscianism).

Using a wider timeframe, Melanie Morisse-Schilbach, a lecturer at the University of Dresden in Germany, argues that Germany has been a benign hegemon before the crisis, but this changed afterwards (Morisse-Schilbach, 2011, p 27), with Germany now 'a major player in this gamble of antagonizing Europe', acting unilaterally. Like hegemonic stability theorists, Morisse-Schilbach interprets unilateralism as lack of hegemony, leading to instability.

Another source associating instability with a lack of German hegemony, albeit from a somewhat different angle, is a paper by Hampl (2012), vice-governor of the Czech Central Bank. His main argument is that, while Germany had been a hegemon under the EMS, it had the most to lose from the EMU, as 'Eurozone membership turned Germany from a hegemon into just one of the key players in rule making and practical policy making' (Hampl, 2012, pp 3-4), which lacks the strength to change the conditions as it likes. The euro is described as a project of the 'weaker' European countries wanting to put an end to constantly having to devalue their currencies against the Deutschmark, which turned the German currency into 'a public good' no longer controllable by German elites. Additionally, according to Hampl (2012), once in the monetary union, 'weaker' European countries broke the EMU rules for stable money, bearing German imprint, and they thereby triggered instability and jeopardised the system as a whole, causing the Eurozone crisis. In other words, while Matthijs and Blyth (2011) are concerned with Germany breaking the rules of the EMU, Hampl takes issue with *other countries* breaking the rules for stability laid out by 'the former hegemon'; the validity of those rules is never questioned in either case. A key problem with Hampl's narrative in particular is that it fails to explain how other member states in the Eurozone, repeatedly described by the author as 'weak', succeeded in imposing their preferences onto the 'former hegemon'.

A diametrically opposed view – that the introduction of the euro marked the inception, not the demise, of German hegemony – can be found in the work of German researchers Bischoff and Detje (2012). They emphasise the competitive advantage gained by Germany with the introduction of the common currency, akin to a devaluation of the strong Deutschmark, permitting the country's exports to increase. This increase in German competitiveness, in conjunction with the Lisbon Strategy, adopted by EU leaders in 2000, which aimed to turn the EU into 'the most competitive economy in the world' (Europa website, 2017b), made Germany a model for the rest of the Eurozone, thus adding an ideological dimension to Germany's position. Contrary to Hampl (2012), Bischoff and Detje conclude that 'Germany is today stronger than it ever has been in the history of European unity', and that it largely uses this strength to impose sweeping austerity measures onto crisis countries, suggesting that German hegemony is of a coercive nature. This perspective embodies a more critical approach, since it considers the wider context that made Germany hegemonic: as opposed to HST inspired theories, which merely take exports as an indicator of hegemony, Bischoff and Detje (2012) look also at the *conditions* that allowed Germany to increase its exports (a weak euro), and the institutional framework that turned Germany into a benchmark for other countries (the Lisbon Strategy).

A similar argument about the imposition of the German model onto southern European countries plus Ireland was made more recently by Currie and Teague (2017). They explicitly describe German hegemony in the EMU as 'coercive', on account of Germany's refusal to 'allow European developments to call into question Germany's own socioeconomic system' on an ideological level, which leads to material costs of post-crisis adjustment being shifted onto other countries (ibid., p 159). They then assess the extent to which industrial relations have changed within crisis countries as a result of German hegemony. Despite adopting a more critical perspective by considering the conditions that make the German model hegemonic at the Eurozone level, there is nevertheless a tendency in the paper by Currie and Teague (2017), as well as the earlier one, by Bischoff and Detje (2012), to assume a *fixed* German model, in spite of change at the European level. This is reminiscent of Cox's (1983) more general application of Gramsci to interstate relations, critiqued in section 2.5 in the previous chapter.

The conclusions drawn by Matthijs and Blyth's (2011), Morisse-Schilbach (2011) and Hampl (2012) on the one hand, and Bischoff and Detje (2012) and Currie and Teague (2017) on the other, may be radically different, but are nonetheless equally categorical. Other narratives are more equivocal, perhaps also in an attempt to reconcile opposing views.

Possibly the most popular phrase associated with Germany during the euro crisis is the notion of 'reluctant hegemon', first used by Paterson (2011), developed in Bulmer and Paterson (2013) and Bulmer (2014), borrowed also by the Economist (2013a). Paterson (2011) writes that, prior to the crisis, European integration had been characterised by a dual Franco-German hegemony. In the early postwar years, West Germany participated in the creation of supranational institutions whilst accepting French leadership, in order to mend its international reputation and at the same time resume access to export markets necessary to revitalise its economy. As such, France was a political leader, Germany increasingly an economic one, predominantly in the realm of exports. In time, however, the power of Germany continued to increase, bolstered by the euro, while that of France simultaneously declined. The Franco-German balance changed in the sense that 'Germany needed France to disguise its strength and France needed Germany to disguise its weakness' (Paterson, 2011, p 61). An early version of this argument was made by Markovits and

Reich (1991; see section 3.3a above). The Eurozone crisis is described by Paterson (2011) as the final tipping point towards German hegemony, because the emergence of Germany out of the crisis as a creditor country with a strong, competitive economy bestowed upon it a role of leadership in the political domain as well, on top of the economic supremacy it had traditionally enjoyed. Nevertheless, Paterson argues Germany had not sought this role, hence the term 'reluctant hegemon'. Susan Watkins's concept of 'crimped hegemony' introduced in an editorial for *New Left Review* (Watkins, 2014) echoes a similar idea. She discusses the trajectory of European integration more generally, but pauses to emphasise that 'German ascendancy was not the outcome of a unilateral power grab' (ibid., p 13), but emerged out of the European debt crisis, when investors, especially in the US, started to see Germany as the *de facto* leader of Europe, a state of affairs then begrudgingly accepted by other European countries. Not a sovereign decision on Germany's part, this crimped hegemony nonetheless represents 'the very outcome that integration was designed to prevent' (ibid., p 25).

The phrase 'reluctant hegemon' as introduced by Paterson (2011) has since been borrowed by the Economist (2013a). According to them, Germany is a hegemon in economic terms: a country with high export market shares, the largest creditor in the Eurozone with excellent fundamentals (low unemployment, balanced budget, falling debt, lowest bond yields in Europe) and the home of firms (big businesses as well as SMEs) that continue to be global champions, in contradistinction with France, whose economy is described as 'stagnant, statist and uncompetitive'. Germany's reluctance in the political field is explained by reference to the negative historical connotations surrounding German leadership in Europe, which allegedly create uneasiness within German policymaking.

The 'reluctant' epithet is explained further in Bulmer and Paterson (2013). There, Germany is described as a hegemon 'whose economic leadership is recognized but politically contested' (Bulmer and Paterson, 2013, p 1387). Political hegemony is assumed to be limited by three sets of constraints: domestic politics, legitimacy issues, and the failure to provide the public goods highlighted by Kindleberger (1973). This latter constraint once again reflects an understanding of hegemony through HST; the fact that Germany is not providing the public goods enumerated by

Kindleberger means only that it is HST that fails, not the concept of hegemony itself. This equation of hegemony with stability is implicit in the discussion of other constraints too, which are actually subsumed to it. Generational change, in the sense that younger generations, raised under conditions of prosperity, allegedly see less and less of a need for a hegemon to provide stability, is listed as a domestic constraint on hegemony, along with the strain on public finances exerted by Germany's ageing population. Legitimacy issues are thought to arise precisely because Germany is not providing stability. The same argument that Germany is not (fully) hegemonic because it is 'scarcely characterised by a determination to offer stability through leadership', is replicated in Bulmer (2014, p 1253). At the same time, Bulmer also brings in notions of ideational hegemony, specifically the idea, encountered in earlier sources too, that Germany has managed to transfer its economic model onto the EU level, and that the same model is now used as an example to other countries, clashing with their own policy models and therefore conflicting with European integration goals more widely (Bulmer, 2014).

This narrative of the reluctant hegemon has therefore had an interesting evolution. Paterson's original article on 'reluctant' hegemony (as well as Watkins's, on 'crimped hegemony') was critical in the sense that he analysed the historical evolution of Germany-EMU relations, identifying the turning point that made Germany hegemonic. Subsequent literature, however, developed this concept by reverting to HST, and thereby to conclusions that Germany is insufficiently hegemonic in the EMU. This, in itself, is further evidence of the dominance of HST.

Based on this overview of the literature, the crisis can be seen as a turning point in the theorising of German hegemony. First of all, it revived interest in the topic, which had been dormant in the early years of the euro. Secondly, while the pre-crisis literature describes German hegemony as exclusively benign, literature post-2008 departs from this: it swings between absence of hegemony, coercive hegemony, or reluctant hegemony, but there is implicit agreement that the policies adopted by Germany are not beneficial to the rest of the Eurozone. From a slightly different angle still, it can be argued also that the crisis prompted some questioning of the nature of German leadership and the nature of the EMU, vindicating Cox's prediction that 'a condition of uncertainty (…) beckons to critical theory as people seek to understand the opportunities and risks of change' (Cox, 1981, p 130) to some extent. Nonetheless, the intellectual dominance of HST remains obvious; those sources that focus exclusively on crisis management policies rather than also on the build up to the crisis are more likely to conclude that Germany is not hegemonic in the EMU because it fails to provide stability, reflecting an embodiment of the problem-solving approach.

The sources above have been organised according to the conclusions they draw vis-à-vis German hegemony in the EMU, conclusions which represented the primary source of inspiration behind this thesis. We started with literature that concludes Germany is not hegemonic in the EMU, then contrasted these sources with literature that argues the opposite, and then discussed literature that attempts to reconcile the first two camps to some extent, which mainly revolves around Paterson's notion of a 'reluctant hegemon' (Paterson, 2011).If we were to organise these sources strictly chronologically instead, an interesting point to note is that the literature overall seems to have evolved from notions that Germany is not hegemonic (Matthijs and Blyth, 2011; Morisse-Schilbach, 2011) to the idea that it is a 'reluctant hegemon' (Paterson, 2011; The Economist, 2013a; Bulmer and Paterson, 2013) to the conclusion that Germany is a coercive hegemon (Currie and Teague, 2017). This temporal aspect suggests that, as the euro crisis deepened, Germany's position of power within the EMU system became more visible, and therefore more difficult to ignore or deny.

3.4. Conclusions

Benign. Coercive. Embedded. Reluctant. Crimped. Non-existent. All these terms have been used to describe German hegemony in the EMU. From the outset, it should be mentioned that this is not because of cross-country differences of opinion, between German and non-German observers; opinions vary within Germany as well (e.g. Morisse-Schilbach [2011] versus Bischoff and Detje [2012]). Rather, controversy is due to the definition of hegemony used in the analysis, as well as the timing of the analysis. Timing matters in terms of whether the source was published before or during the Eurozone crisis, and, if the latter, whether in the early phases of the crisis or in more recent years, as German power in the EMU is becoming increasingly difficult to ignore.

Whether Germany is hegemonic in the EMU depends on what we mean by 'hegemonic'; this sounds obvious, but is surprisingly rarely acknowledged in practice. The previous chapter has shown that, rather than a comprehensive theory of hegemony, there exist various theoretical strands; in the conclusion of that chapter, we used Cox's distinction between critical and problem-solving theories (Cox, 1981) to describe the evolution of the term. Like wider IPE literature more generally, most of the applied literature on Germany encapsulates the dominant problem-solving approach of HST. If we define a hegemon in a reductionist manner (omitting that the notion of hegemon existed long before HST) to mean 'stabiliser', thereby reducing HST itself to nothing more than a tautology, then Germany cannot be described as hegemonic in the EMU in the present context of instability, but could have been a hegemon before the crisis. This, indeed, is the conclusion reached by most of the sources included in this chapter. Pre-crisis sources classify Germany as a hegemon on the basis of Keohane's definition of (material) hegemony in terms of structural power, combined with the fact that the EMU had been characterised by relative stability prior to 2008. Many post-crisis sources conclude Germany is not hegemonic because it fails to provide stability. Literature guided by HST generally pays little attention to the features of EMU, which we summarised in section 3.2. Other sources, which apply more critical definitions of hegemony, agree with the basic observation of HST-inspired theories that Germany does not provide stability in the EMU, but take this, in conjunction with Germany's economic and political strength during the crisis and the policies it is presently promoting, on an already faulty institutional background, to mean that the country is a coercive hegemon. The distinction between problem-solving and critical theories can therefore adequately explain the conflict of views in the literature.

On the other hand, what problem-solving as well as more critical theories of German hegemony have in common is that they overarchingly refer to the notion of a German model, which other countries wanted to emulate in the early 1990s, and which is now being forcefully imposed on them, as an important aspect of German hegemony in the EMU. Literature influenced by HST theorises this separately as a form of ideological hegemony (especially when Keohane-inspired definitions of material hegemony do not seem to apply sufficiently well to the case of Germany), whereas critical theories analyse ideological and material dominance implicitly in conjunction with each other, suggesting that the euro boosted Germany's economic strength, such that while other countries had been affected by the crisis the German model emerged as a benchmark for the rest of the EMU. Nevertheless, all of these sources suggest the German model is a key facet of German hegemony in the EMU. This commonality in the literature is valuable in that it provides a building block on our way to evaluate Germany-EMU interactions.

Yet what the applied literature on Germany also has in common is that problem-solving (HST-inspired) and more critical sources alike largely treat Germany as a unitary, unchanging actor, taking its interests as given. HST-inspired approaches use Keohane's definition of hegemony (which summarises the US position during Bretton Woods) as a sort of index by which to assess whether Germany is hegemonic or not, and then on this basis proceeds to describe how German hegemony *should* work within the EMU system, again drawing an implicit parallel with the US during the Bretton Woods years. This, in effect, creates analyses that are fixated on the US circa 1960 as an ideal type, instead of looking deeper into how German hegemony actually works in a contemporary setting. Keohane's definition is popular because it makes it easy to measure and quantify hegemony, and even to compare degrees of hegemony; this fits in with Cox's (1981, p 129) statement that problem-solving approaches are 'a convenience of method'. This advantage of simplicity can provide an explanation as to why the fixity biases of HST have percolated through critical approaches as well. Even those parts of the applied literature on German hegemony that are more critical nevertheless discuss the German model as a continuous arrangement, which affects intra-EMU relations, but is itself immune to change, with the domestic level in Germany left unexplored (HST-inspired assessments take the domestic level into account only as far as including it as a 'constraint' on the provision of systemic stability).

The aforementioned limitations, together with the suggestion in the applied literature that the German model is an important clue into German hegemony, and our commitment to critical theory, helped shape the perspective we adopt over the next three chapters. Rather than speculating about the *functions* of German hegemony in view of preserving the existing EMU setting, as HST-inspired literature does, we believe it is crucial to examine the *nature* of German hegemony in evolutionary perspective. As pertains to the German model as a facet of hegemony, genuinely critical theory would demand an analysis of how the model arose, as well as its nature and evolution towards becoming the 'winning' model at the Eurozone level. Critical theory would also need to consider a dialectic relationship between the hegemonic model and the system it is part of, instead of simply assuming the model shapes the system but not vice-versa. The fixity bias in the literature can be transcended by considering change and heterogeneity; the prominent role we give to these aspects represents the main contribution made by this thesis to the applied literature on German hegemony. Over the following chapters, we focus on change in terms of both how Germany shapes, and is shaped by, monetary integration, and on heterogeneity by questioning whose interests are being served by this configuration.

Chapter four: Germany as the 'German model': features and origins

4.1. Introduction

The exploration of recent literature on German hegemony in the EMU in the previous chapter revealed that a significant aspect of this hegemony is deemed to be the German model. The majority of sources, inspired by HST, treat the German model as ideological hegemony, fundamentally distinct from material hegemony, while more critical sources view hegemony as an encapsulation of both material and ideological elements to begin with, but all point to the importance of the model. To be sure, contemporary European history is awash with economic models that have risen to success only to fade back into obscurity, such as the Swedish model, the Dutch 'Polder model', or the Italian 'economic miracle' of the 1960s. What is different in the German case is the supranational dimension added to the model by virtue of Germany's EMU membership (Schmitter and Todor, 2015).

An implication of this is that, especially since the beginning of the Eurozone crisis, 'Germany' has been equated with 'the German model', praised and criticised in equal measure in current debates about the EU. 'German model dominates Eurozone', Hofmann (2012) was stating in the title of an article for *Investors Chronicle*, observing that policymakers across Europe are looking to emulate the German model. In 2013, a policy brief by the European Council on Foreign Relations (Dullien, 2013) questioned whether there can be 'a German model for Europe' and replied in the negative. French economists (Blot et al, 2015) asked in 2015 '*Faut-il suivre le modèle allemand?*' ('Ought we to follow the German model'?) and left the answer open.

The German model is known as *Modell Deutschland* in German discourse, Rhenish or Rhine capitalism in Michel Albert's (1993) formulation, and coordinated market economy in the Varieties of Capitalism (VoC) literature (Hall and Soskice, 2001). Its macroeconomic characteristics are described as export focus, tight monetary policy to underpin a strong currency through price stability, and fiscal conservatism. At the micro-and meso-economic level, its features are conventionally assumed to be close, cooperative relationships between firms and financiers on the one hand, resulting in long-term financing, and between firms and employees on the other, to their mutual advantage, resulting in job security, high pay, and high-quality production. This latter underlying assumption that Germany competes on quality, not price, ensures congruence at the macroeconomic level between a strong currency and export focus.

The phrase *Modell Deutschland* was first popularised by social-democrat Chancellor Helmut Schmidt (Streeck, 2009) in the early 1970s, to refer to German policy from 1945 onwards, but it actually cuts across political divisions. Schmidt's political opponents, such as CDU's Kohl, had also incorporated the phrase into their discourse as early as 1976, thus cementing the notion (Soell, 2014). Preserving the German model remains an oft-cited national objective in Germany (Schissler, 2001). On the other hand, since it is neither a concept of the Left nor of the Right, it attracts criticism from both sides, with the Left reproaching its fiscal and monetary conservatism while the Right attacks the German collective bargaining model and the limitations it imposes on firms in terms of remuneration and hiring and firing decisions (Hallett, 2014).

Literature that sees the German model as a facet of hegemony is in line with neo-Gramscian conceptions of hegemony, which predict that 'the economic and social institutions, the culture, the technology associated with (…) national hegemony become patterns for emulation abroad' (Cox, 1983, p 171). Existing literature on German hegemony, discussed in chapter three, does not, however, develop a deeper inquiry into the origins and evolution of the German model, as would be demanded by true critical theory in Cox's formulation (ibid.). Rather, it treats the German model as a homogeneous continuity, indicating that the fixity assumptions typical of conventional IPE literature filtered from HST through to otherwise more critical theories of hegemony.

In what follows, we aim to overcome these limitations. This chapter traces the origins of the model, whereas chapter six then discusses its evolution. Together, they contribute to critical analysis in the sense that they highlight change and heterogeneity in the model, while emphasising the importance of history.

To answer the question of how the German model arose, we first examine, in section 4.2 below, the wider theoretical framework which discusses the German model (without references to hegemony): the French Regulation School (RS) and Varieties of Capitalism (VoC) literatures.

We show that these approaches view the German model as a particular form of institutional complementarity, often presented as superior to other models, in analyses that focus on dualisms (Germany versus France in the RS, Germany versus the US in the VoC approach). The notion of institutional complementarity refers to the way in which institutions fit together to deliver a coherent and relatively stable national system. Devotion to this concept means that both literatures adopt a functionalist approach in explaining the features of the German model: they describe how these features function together to deliver policy coherence, rather than where they originate from and how they evolve. Our question about the origins of the model therefore remains unanswered in this literature. Instead, the literature shares the problem-solving characteristics of hegemonic stability theory: both literatures make assumptions about how Germany functions, and treat the German model as unitary and unchanging (continuous), incorporating a fixity bias. The RS defence of the German model as an 'ideal' form of regulation is particularly reminiscent of the nostalgia felt by IPE theorists about 1960s' US as an 'ideal type' of leader, which led them to formulate HST. The shared perception of model continuity, resulting from fixity assumptions, will be challenged empirically in chapter six.

Here, we continue our quest to explain the origins of the model by considering next, in section 4.3, a complementary line of discourse, emanating predominantly from within Germany. This posits that the features of the model originate from German ordoliberal ideology, which continues to have a strong hold on German policy today. We argue, however, that ordoliberalism is neither uniquely German, nor compatible with all model features. This then leads us, in section 4.4, to search, in German modern history, for individual ideas (instead of a comprehensive, continuous German ideology) associated with defining historical episodes, that could explain the (perceived) features of the German model. The episodes considered are (late) German industrialisation, the Weimar Republic years, the Nazi regime, and Germany's postwar economic boom. We find that the features of the German model, which sets the parameters of German hegemony in the EMU, emerged out of distorted interpretations of history. We conclude, in section 4.5, that this makes the dominance of the model at the Eurozone level highly problematic.

4.2. Theorising the German model: a form of institutional complementarity?

In section 4.1 above, we introduced the German model as a juxtaposition between micro-meso and macro elements, yet it would be misleading to suggest that consensus exists on all of those elements. While there is broad consensus on the macro elements of the model, the micro-meso dimension is wrought with contentions, as evidenced, *inter alia*, by the various collaborations to a recent edited book on the German model (Unger, 2015). The one uncontested feature of German political economy through the past decades, that all collaborators agree upon, is the country's macroeconomic focus on exports; there is also broad agreement that fiscal and monetary conservatism constitute features of the model. By contrast, the micro-meso elements, especially employer-employee relations, are thought by some contributors to have changed significantly since 1990 (ibid.). The editor concludes that 'the existence, desirability, exportability and sustainability of the German model' are interpreted differently across disciplines, with 'economists hav[ing] less problems accepting a model than (…) political scientists and sociologists', because the former largely focus on export performance, while the latter pay more attention to labour conditions and industrial relations (ibid., p 12).

We believe, however, that divergence arises not across disciplines *per se*, but depending on the *theoretical approach* adopted by each contributor. More specifically, those who 'have less problems accepting a [continuous] model' are those who focus on the notion of *institutional complementarity*: theorists belonging to the French Regulation School (RS) or those adopting the Varieties of Capitalism (VoC) approach. Institutional complementarity denotes the way in which micro, meso, and macro elements enhance each other long-term. The quote below, which refers to German political economy today from a VoC perspective, exemplifies this concept:

> 'The macroeconomic elements of the model deliver the type of socioeconomic stability that provides a sound basis for economic activity. The microeconomic features support a strong manufacturing sector characterized by the presence of numerous medium-sized firms, a preference for business strategies focused on high quality production, and a thriving innovation system that underpins the sustainability of the model' (Calvo, 2015, p 336).

In this section, we explore the German model via this literature. It will be shown that the RS and VoC approaches, like problem-solving theories of hegemony, explain the features of the model via the functions they perform rather than through an exploration of their origins, embodying a fixity bias that sustains the perception of model continuity.

a. The German model through the French Regulation School

The publication of Michel Aglietta's *A Theory of Capitalist Regulation* in 1976 marks the beginnings of the French RS; more recent editions contain a postface wherein Aglietta reflects upon the evolution of this approach since then (e.g., Aglietta, 2000). According to him, the basic premise of the RS is that 'capitalism has the inherent ability to mobilize human energy and transform it into growth, but it does not have the capacity to convert the clash of individual interests into a coherent global system' (ibid., p 397). Devoid of self-correcting mechanisms, capitalism must be reined in by constraining structures.

These structures, however, vary across countries; regulation theory differentiates countries on the basis of interactions between 'mode of production' and 'mode of regulation' (Boyer, 2015). The 'mode of production or 'accumulation regime' refers to the way in which production is organised and surplus value is distributed. A 'mode of regulation' is defined as 'a set of mediations which ensure that the distortions created by the accumulation of capital are kept within limits which are compatible with social cohesion within each nation' (Aglietta, 2000, p 391). It encapsulates norms, practices and institutions across five dimensions (wage relation, form of enterprise, monetary regime, state intervention forms, international regimes) that aim to ensure the reproducibility of a particular 'mode of production' (Unger, 2015).

The effectiveness of a particular 'mode of regulation' relies on the compatibility between the institutions that form it. Regulation theory focuses on ways in which institutions in some spheres of the political economy can enhance the operation of institutions in other spheres, on 'the passage from the microeconomy to the macroeconomy' (Aglietta, 2000), therefore on the notion of institutional complementarity introduced above. Complementarity, and by extension the features of national models themselves, is described as the result of state-level compromises, involving ‘mediation’ and the ‘pursuit of collective interests’ (ibid.). Compatibility is ‘always observable in specific contexts at specific historical moments’ (ibid., p 391), and the breakdown of complementarity is understood to lead to a new mode of regulation.

A recent RS take on the German model can be found in Boyer, 2015. He reminds readers that the RS explains diversity within capitalism as a result of different institutional complementarities specific to each nation, and proceeds to contrast the German model with the French economy. For Boyer, Germany and France differ first and foremost in terms of their education systems, with Germany’s vocational training leading to more cooperative relationships between employers and employees compared to the hierarchical employment system in France, which reflects more generalist educational aims. This, in turn, leads to different product strategies, with Germany specialising in high-quality production and France in standardised production, which gives German exporters greater command over their prices compared to French producers (Boyer, 2015). The German model, with its export focus, is thus described as an ‘original form of complementarity’ between product strategy and HR management:

> ‘The financing and, to a certain extent, the control of companies were the responsibility of banks, while rates of pay were as a rule established by collective bargaining. Capital was patient, enabling a compromise to be struck between the management of companies and the trade unions to which their workers belonged. At company level, versatility in the organisation of work encouraged specialisation that favoured sophisticated products distinguished by quality and service’ (ibid., p 213).

The description is in the past tense because Boyer writes that there have been changes within Germany after 1990: German reunification, coupled with intensified international competition hampered Germany’s export performance for a while, before labour market deregulation restored competitiveness, at the expense of pay, employment quality, welfare payments, and domestic consumption. While this observation seems to invalidate the notion of a continuous model, Boyer (2015, p 202) nonetheless concludes that the German model ‘derives its resilience from an ability to reform without sacrificing its logic’, while France ‘is suffering from an exhausted model unable to reform’. Boyer adds that ‘Germany’s success (…) is due to the reforms which successfully adapted Rhenish capitalism to the new international and European context, while still preserving or even reinforcing mechanisms that ensure the specialisation in high-end goods for many industrial products’ (ibid., p 219). He concludes that ‘this model can function as long as there are waves of industrialisation in new countries that require capital goods made in Germany to help them ramp up' (ibid., p 217). The features of the model are discussed from the perspective of how they impact on one another, not where they originate from.

Boyer's understanding of German political economy incorporates a common problem for the RS more widely, resulting from the emphasis on mediation and collective interests: 'harmonicism' (Husson, 2007). This denotes a standpoint that loses sight of the conflictual nature of capitalism, exploitation, and power. According to Husson (2007), harmonicism manifests itself in practice as a tendency to focus on what are perceived as 'good, stable, coherent and legitimate forms of regulation', to the detriment of explaining what is actually going on. This focus reminds us of IPE theorists writing in the aftermath of the collapse of the Bretton Woods system, who, as argued in chapter two, formulated HST as a result of feeling nostalgic about the quality of leadership that the US had provided under that system. Therefore, the RS understanding of the German model, and the HST version of hegemony are compatible with each other in the sense that they share a tendency to treat states as 'ideal types', which leads to fixity biases.

The RS, through its focus on institutional complementarity, risks perpetuating a belief in a continuous (or at least long-lasting) existence of modes of regulation it perceives as desirable, often in spite of mounting evidence that points to change, thus abandoning its own notion of breakdown and transition in modes of regulation. Boyer's narrative summarised above clearly presents the German mode of regulation as superior to the French one. His view regarding the resilience of the German model can therefore be understood as an implicit defence of 'good', 'desirable' regulation. The overall contradiction in Boyer's formulation suggests a conflict between an earnest attempt to consider change, and the devotion to the concept of institutional complementarity, ultimately won by the latter.

b. Germany as a coordinated market economy in the Varieties of Capitalism literature

Another theoretical approach, besides the RS (which it partly draws upon), that has been analysing Germany as a model in contradistinction to other national models, is the VoC approach. Outlined in *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Hall and

Soskice, 2001), it has proven very popular within academia over the last fifteen years. While the RS mainly presents the German model as an alternative to the French way of organising production, in the VoC literature the key distinction is between the German model of a coordinated market economy (CME) and the Anglo-Saxon model of a liberal market economy (LME). This distinction between CMEs and LMEs, in turn, was inspired by earlier work: most notably, by Michel Albert's *Capitalism versus Capitalism* (Albert, 1993). Hall and Soskice (2001, p 4, footnote 4) acknowledge Albert in a footnote: 'One of the pioneering works that some will want to compare is Albert (1993) who develops a contrast between the models of the Rhine and America that parallels ours in some respects'.

The context behind Albert's book was the collapse of the Soviet Union, perceived as a decisive victory of capitalism over communism. As a consequence of this, Albert (1993) predicted that new battle lines would be drawn *within* capitalism, chiefly between 'American' capitalism and 'Rhine' capitalism (the latter encompassing Germany, as well as most of continental Europe, plus Japan). In Albert's formulation, 'American' capitalism was tantamount to 'capitalism as a threat', reliant on market forces, short-term profits, and individualism. In contradistinction, 'Rhine' capitalism was based on a more cooperative approach to production and distribution, with firms engaged in long-term strategies fully supported by the domestic banking sector, whose *raison d'être* is company financing, as well as by employees who share both responsibilities and gains with employers. Hall and Soskice (2001) preserve this distinction between Germany and continental Europe plus Japan on the one hand, and the US (as well as Britain, Canada, Australia) on the other. They remove, however, the normative edge in Albert's work, which openly favoured a triumph of Rhine capitalism over the American version. Hall and Soskice (ibid.) present CMEs and LMEs not as rival models of which only one can win, but models that can coexist.

In their quest 'to elaborate a new framework for understanding the institutional similarities and differences among the developed economies', Hall and Soskice (ibid., p 1) emphasise that the existence or efficiency of a specific institution enhances the returns from, or efficiency of, another institution, thereby borrowing the notion of institutional complementarity from the RS. On the other hand, Hall and Soskice (ibid., p 6) claim they are setting up a framework that 'bring[s] firms back into the center of the analysis', in order to overcome a weakness, as they see it, of regulation theory, namely the latter's overemphasis on the role of the state and what it can achieve. This is, however, a contentious point within regulation theory itself, with Boyer (2015) emphasising the role of the state in mediation, while Aglietta (2000), by contrast, describes the mode of regulation as something 'beyond state and market'.

For VoC theorists, the RS is also guilty of overlooking strategic interaction between the various actors in political economy 'each of whom seeks to advance his interests in a rational way' (Hall and Soskice, 2001, p 6). The apparent difference, then, between the RS and VoC is that the former differentiates countries on the basis of interactions between 'mode of production' and 'mode of regulation', while the latter, based on the results of strategic firm interactions. In other words, institutional complementarities, and model features, emerge as a result of state-level compromises in the RS, and of rational choices, in VoC.

Hall and Soskice (2001, pp. 8-9) claim to take a 'relational approach' to the firm as 'key agent of adjustment', by considering the relations established by firms with employees, unions, suppliers, financiers, other firms, the government, etc. In the VoC approach, the quality of these relationships is seen as the basis for success in any given political economy. Quality is given by the ability of firms to coordinate their interests with those of other actors, across five spheres (which seem to parallel, but not exactly match, the five dimensions of RS 'mode of regulation'): raising finance (corporate governance), employer-employee relations, industrial relations, inter-firm relations, vocational training and education. At the same time, it is assumed that firms choose the mode of coordination that has the most institutional support in a specific country; this calls into question the claim made by Hall and Soskice (ibid.) that their analysis centres on the firm. In simple terms, in a political economy characterised by fluid and competitive markets, firms will more likely rely on market coordination, their behaviour depending primarily on supply and demand conditions and the functioning of the price mechanism. In case of imperfect markets plus institutional support for credible commitment and effective information-sharing, they will rely mostly on strategic coordination, depending more heavily on non-market relationships with employees, financiers, and other firms. The first case denotes a LME, characterised by competitive relationships; the second, a CME, characterised by more collaborative relationships. The two cases reflect different types of 'comparative institutional advantage' (ibid.).

Germany is, in the VoC literature, the CME *par excellence*. The complementarity at the heart of the German model is described as follows:

> 'Many firms pursue production strategies that depend on workers with specific skills and high levels of corporate commitment that are secured by offering them long employment tenures, industry-based wages, and protective works councils. But these practices are feasible only because a corporate governance system replete with mechanisms for network monitoring provides firms with access to capital on terms that are relatively independent of fluctuations in profitability' (ibid., p 27).

More recently, Hall (2015, p 46) reinforced this image of the German model as 'a form of stakeholder capitalism in which firms are responsive to the concerns of their employees and other firms as well as shareholders'. Despite pointing out changes on the German labour market, Hall ultimately believes that there still is a German model to speak of, still centred on manufacturing and rather immune from financialisation. This replicates an earlier argument made in Hall and Soskice (2001), that Germany would continue to oppose financial deregulation at the macro level in order to preserve its existing micro model wherein finance is made available to domestic firms pursuing long-term strategies. Hall (ibid, p 49) concedes that Germany is now perhaps 'a less egalitarian society', 'but there are many people elsewhere in Europe who would trade their life circumstances for those of the average German'.

Hall's insistence on continuity in spite of change perfectly mirrors Boyer's (2015) point of view summarised above, replicating the problems of the RS's focus on institutional complementarity. Devotion to the concept of institutional complementarity, central to both the RS and VoC literatures, is what makes these authors see Germany as a continuous model, and therefore reluctant to acknowledge change. Hall and Soskice (2001, p 54) declared that theirs is not a static conception of political economy, but Hall's assessment of Germany points to the contrary. The features of the model are taken as given, replicated from RS to VoC also via Michel Albert, of interest exclusively through the functions they perform, with limited attention paid to where they come from and how they evolve. This, like problem-solving theories of hegemony, carries an implicit fixity bias.

A complementary line of discourse, mainly developed by German authors, which is less functionalist, but still views the German model as continuous, is that which describes the German model as an incarnation of German ordoliberal ideology. It is this perspective that we now turn to.

4.3. *Modell Deutschland* as an incarnation of ordoliberal ideology?

A common perception within Germany is that German political economy since 1945 – the German model – has been an embodiment of ordoliberalism. This is understood as a quintessentially German ideology, which supports the *social market economy*, a 'third way' or middle ground between liberalism and socialism, combining fiscal and monetary conservatism with social solidarity (see, for example, Berghahn and Young, 2013; Bofinger, 2016). In German politics, like *Modell Deutschland*, ordoliberalism appears ubiquitously across the political spectrum. The Christian-Democrats, on their official website (CDU.de, 2017), describe the party stance as being guided by the principles of the social market economy laid out by Ludwig Erhard, former CDU Economics Minister (later Chancellor) of Germany, in the late 1940s. Meanwhile, Sahra Wagenknecht of the Left Party (*die Linke*) also refers to Erhard's intellectual influence; in her book, titled *Freiheit statt Kapitalismus* (Freedom instead of Capitalism), she praises ordoliberalism as a leftist alternative to market capitalism (sahra-wagenknecht.de, 2017).

This current indiscriminate use of the term obscures the origins of ordoliberalism, as a doctrine founded at the University of Freiburg in the late 1920s-early 1930s by economics professor Walter Eucken and lawyer Franz Böhm, and further developed by Rüstow, Röpke, and Müller-Armack, intellectuals allegedly influenced by the economic instabilities of the Weimar Republic to rethink the role of the state in stabilising the economy. As the CDU and die Linke references above suggest, however, ordoliberalism has not entered popular culture via the writings of these aforementioned thinkers, but through the public persona of Ludwig Erhard, whose reforms, branded 'ordoliberal', are remembered (erroneously, as we shall see in section 4.4d) for having produced the economic boom of the 1950s. Erhard himself did much to promote his own image as architect of the German social market economy: 'I developed the principles of the new German economic policy and put it into practice', he stated publicly in the 1950s (Erhard, 1958, p 611).

The original ordoliberal doctrine started from the idea that the weaknesses of the Weimar Republic in the 1920s have shown that true economic freedom is incompatible with a weak state. This discredited the 'old' liberal tradition in the eyes of German ordoliberals, who perceived it as laissez-faire (Bonefeld, 2012). Freiburg theorists emphasised the concept of freedom, and argued that freedom can only be obtained if a strong – yet limited – state intervenes to sustain an operational competitive free market. They believed in the allocative efficiency of the price mechanism, but on the other hand, thought that particularistic demands, which could come both from cartels and strong trade unions, could distort this efficiency. The role of the state in this view, therefore, is to create an 'ordo', a legal framework that prevents discretionary distortions of the price mechanism, by establishing strict fiscal, monetary, and competition rules (Berghahn and Young, 2013). State intervention beyond these spheres, however, would only pave the way for an increase in particularistic demands, which would then lead to tyranny.

This link drawn between state intervention and tyranny made ordoliberalism suddenly popular immediately after the collapse of the Nazi regime, when mistrust of state intervention and planning, be it National Socialist, Marxist, or Keynesian, had reached its peak within Germany. In this context, ordoliberalism could be 'sold as a lesson learned the hard way from the statist-dictatorial Nazi regime and its war economy: from the failure, political, moral and economic, of the Behemoth' (Streeck, 2015b, p 363). In practice, ordoliberalism was thus perceived as the only possible clean break from Nazism. Some of the earlier writings of prominent ordoliberal thinkers seriously challenge this perception, however (Bonefeld, 2012). Back in 1929, Rüstow was contemplating the possibility of a 'dictatorship within the bounds of democracy' ('Diktatur innerhalb der Grenzen der Demokratie' [Rüstow, 1929]), whereas Müller-Armack described the Nazi regime in 1933 as an 'accentuated democracy' which stifles class struggle, allowing for free initiative to develop (Müller-Armack, 1933). The freedom ordoliberals refer to is thus freedom of the entrepreneur (Gamble, 1979), whom the state needs to shield from mass demands. That is something both the Nazi regime and the earlier Weimar Republic had done to a certain extent, both having been deferential to the demands of capital and having intervened against trade unions (Gamble, 1979; Menendez, 2015; Streeck, 2015b).

Even without the authoritarian dimension of Nazi or Weimar politics, the utility of the strong state as a limited state to uphold markets is actually far from an original ordoliberal idea. As Gamble (1979, p 4) underlines, no capitalist state has ever been laissez-faire in the sense of a 'quiescent or inattentive state'. The classical liberals, whom ordoliberals claim to depart from, had recognised the need for the state to intervene for market-making purposes, prioritising the sphere of exchange (rather than production or distribution). As such, ordoliberalism represents 'continuity (…) with the tradition of liberal political economy, not a departure from it' (ibid., p 5). The continuation of the liberal tradition means that German ordoliberalism shares common roots with the Chicago School, strengthened by a 'series of persons, theories and books [that] pass between these two forms of neo-liberalism' (Foucault, 2010 [1976], p 79). Especially significant in this sense is the intermediation of Austrian economists von Hayek and von Mises as 'agents of transmission' (Foucault, 2010 [1978], p 161), in particular through the Mont Pèlerin Society founded by Hayek, of which German ordoliberals and Chicago economists alike had been members. The term 'neoliberal' itself had been coined by a German ordoliberal, Alexander Rüstow. Labelled 'ordoliberal' in Germany, competition rules and conservative targets for fiscal and monetary policy are not actually idiosyncratic German policies, but fairly typical of right-wing parties elsewhere in Europe as well (Gamble, 1979).

The originality of the social market economy is nonetheless assumed to lie in the fact that it combines market-making policies with extensive social policies and gains for labour. Some observers believe that, in coining the term 'social market economy', ordoliberal theorist Alfred Müller-Armack had likely drawn inspiration from the notion of 'social capitalism', developed by Werner Sombart of the German Historical School in 1913 (Goldschmidt and Wohlgemuth, 2008). In Sombart's formulation, 'social capitalism' was used to denote a form of capitalism characterised by the presence of strong trade unions, workers' participation, job safety and security, etc. Some of Müller-Armack's statements seem indeed to suggest a more progressive conception of society, in line with Sombart's earlier ideas, yet this perception is swiftly demolished by Müller-Armack himself:

> ‘The market is incapable of integrating society as a whole (…) It nibbles away the substance of historical forces of cohesion and places the individual into a painful isolation (…) It, therefore, must be complemented by a social policy which views man not only in his function as a producer and consumer, but also in his experience as a person’ (Müller-Armack, 1978, p 327).

Versus

> [Referring to democratic socialism] ‘Mixed systems of economic policy, intent on reaching economic ends by an unsystematic mingling of methods in some type of interventionism, cannot be continued’ (…) the idea of a Social Market Economy, applied to economic policy (…) require[s] a transformation of economic policy in the direction of conformity to the market’ (ibid., pp. 328-29).

In reality, therefore, leading figures of the ordoliberal school preferred a trickle-down approach to growth and prosperity as opposed to active gain-sharing between employers and employees, which, they believed, would only reduce responsibility and lead to moral hazard. By depicting workers as ‘entrepreneurs vis-à-vis their own labour power’ (Bonefeld, 2012), the ordoliberals absolve the government of any attributions to tackle poverty (Gamble, 1979), suggesting that the poor are only poor because of a ‘poverty of aspiration’ (Bonefeld, 2012).

Nonetheless, German policy in practice did include a strong active social policy component, at least between 1945 and reunification (Berghahn and Young, 2013). The Adenauer governments in the 1950s wherein Erhard had served as a Minister implemented welfare-improving policies; according to Schwartz (1995), between 1950-53 social security benefits increased by roughly 50%, whereas the pension reform got Chancellor Adenauer re-elected in 1957. Active social policies were also implemented by Chancellor Schmidt, coinciding with the time when Schmidt was popularising the phrase *Modell Deutschland* in the early 1970s. Such examples (even with the possibility that these welfare-improving policies had been implemented for populist reasons) show a discrepancy between ordoliberal theory and German policymaking in practice.

Many German observers see the German model as continuous, because they assume a continued impact of a coalescing, uniquely German ideology, on German policy since 1945. By contrast, the analysis above emphasised that, rather than a unique ideology, ordoliberalism is a continuation of the liberal tradition, and, secondly, that there have been significant differences between ordoliberal theory and German policy-making in practice, especially as pertains to employer-employee relations and social policy in general. This gulf between theory and practice means that the interchangeable usage of the terms 'ordoliberalism', 'social market economy', and 'the German model' in public discourse only exacerbates ambiguity. Talking about the 'continuing importance of the ideas of ordoliberalism to understand Germany's (contested) role in resolving the Eurozone crisis' (Berghahn and Young, 2013, p 768) has become a trend in recent scholarly debates. But perhaps Germany's economic model does not have its origins in a coherent ideology 'made in Germany', but is an amalgamation of more disparate ideas. We contemplate this possibility below; instead of chasing the ordoliberal ideology any further, we search for the origins of the German model by tracing its main features back to ideas associated with defining moments in German modern history.

4.4. Defining episodes in German modern history and the origins of the German model

a. Late industrialisation

Apart from literature on the German model *per se*, the idea of a close relationship between firms and financiers in Germany also features prominently in literature that characterises the country as a late industrialiser. An oft-cited monograph in this respect is Gerschenkron's *Economic Backwardness in Historical Perspective,* where the author argues that Germany's relative economic backwardness determined the emergence of 'institutional instruments for which there was little or no counterpart in an established industrial country' (Gerschenkron, 1962, p 7).

According to Gerschenkron, the industrialisation process in England – due to a lack of serious contenders – had been gradual and unpressured, financed by earnings from trade and agriculture and then progressively from industry itself; as such, the country's reliance on banks for long-term investment was minimal. By contrast, Germany as a late developer is described as having suffered from capital scarcity, high costs, catch-up pressures, and a shortage of entrepreneurial skills, factors which forced a much tighter symbiosis between financiers and industry than is common for more advanced economies. Comparing German banks, as an archetype of the universal bank, to British banks, Gerschenkron (ibid., p 13) claims that 'between the English bank essentially designed to serve as a source of short-term capital and a bank designed to finance the long-run investment needs of the economy there was a complete gulf'. German banks are depicted as accompanying enterprises 'from the cradle to the grave', providing them with long-term credit while acquiring considerable power over managerial decisions, above and beyond financial matters. It is emphasised that banks initially favoured heavy over light industries almost exclusively, and that these lines of production especially became highly cartelised, with banks encouraging an amalgamation of the industrial enterprises they presided over. Although this 'master-servant' relationship began to be contested, and sometimes reversed, by firms in the early 20th century, through firms creating their own banks, or working with several banks instead of one, Gerschenkron (ibid., p 21) concludes that 'the specific features engendered by a process of industrialization in conditions of backwardness were to remain, and so was the close relation between banks and industry'.

The validity of Gerschenkron's analysis has, however, been called into question. As pertains to the close relationship between banks and industry, Lee (1991, p 13) argues that, although at the beginning of the 20th century 17 of the 25 largest concerns in Germany had indeed been banks, their sheer number is not enough to establish a causal link between an idiosyncratic approach to banking and Germany's industrial development. At the same time, there is documented evidence of self-financing firms even in the early stages of the industrialisation process, meaning that the acute capital scarcity thesis may be an overstatement (Lee, 1991). Furthermore, the Gerschenkronian hypothesis has been criticised for promoting an overwhelmingly positive assessment of the consequences of the links between industry and financiers (this positive view is also reflected in the 'model' narrative, as we have seen above). It omits the abusive activities of German banks, which often supported German rentiers in exploiting low-income groups: in order to obtain bank loans, people who did not have sufficient private property to act as collateral were required to present a signature from a local rentier, to be renewed at regular intervals; in practice, the signature was renewed only in exchange for free labour from low-income groups, reinforcing feudal-like, rather than progressive, production relations (Seabrooke, 2006).

Gerschenkron's argument that German economy is based on close cooperative relationships between financiers and industry as a result of late industrialisation could conceivably have inspired theorists working on the German model, yet it is rarely, if ever, referred to in this literature. Critiques of Gerschenkron's assessment thus indirectly also undermine the notion of a continuous model, but these are seldom recognised.

b. The Weimar Republic (1919-1933)

Germany's macroeconomic policy focus on price stability through tight monetary policy is sometimes explained by reference to collective memory, defined as 'group experiences and recollections whose subsequent interpretation fundamentally drives a nation's identity and interests' (Warburg, 2010, p 53). Specifically, reference is made to the fact that the Germany of the Weimar Republic remains in collective memory irrevocably conjoined with the hyperinflation of 1922-3:

> 'At its height, prices were rising so fast that waiters had to climb on tables to call out new menu prices in restaurants every half hour. Banknotes became sufficiently useless that workers had to bring wheelbarrows with them to work to collect their daily pay, and bundles were given to children to play with, being cheaper than actual toys.' (The Economist, 2013b [no pagination]).

This conspicuous lack of stability is thought to had left behind deep psychological scars, which can explain German present-day obsession with monetary stability, as evidenced also by recent surveys which show that inflation remains a primary concern of German people (O'Callaghan, 2012). The standard historical narrative is that the extreme price fluctuations that had wiped out Germans' wealth through their destructive impact on savings, capital, and output, had been caused by misguided and arbitrary Keynesian expansionary policies in an attempt to prevent recession following World War I, which only succeeded instead to unleash an uncontrollable phenomenon (Blyth, 2015). Per the same standard narrative, Weimar hyperinflation is thought to have been instrumental in bringing the Nazi party into power, as a result of violent price changes having deprived people of both material resources and moral standards (O'Callaghan, 2012).

However, both points are 'factually questionable' (O'Callaghan, 2012). Blyth (2015) denies the arbitrariness of government policies in the 1920s, as well as demand-pull explanations for hyperinflation. He argues instead that Weimar hyperinflation was a premeditated and conscious response to Franco-German rivalry and the humiliating conditions imposed on Germany in the 1919 Versailles Peace Treaty:

> '[Hyperinflation] was the German government's deliberate policy, designed to make the payment of reparations, especially after the French occupation of the Ruhr, all but impossible. In that regard, it was quite successful. Knowing that the reward for putting their fiscal house in order would be giving the French even more money meant that Germany decided to pull the fiscal house down' (Blyth, 2015, p 193).

Blyth's contention is thus that Weimar inflation was by no means an uncontrollable phenomenon, as commonly believed, but an intentional endeavour to reduce Germany's debt burden. It, of course, had deleterious effects on living standards and purchasing power within Germany, but these had been calculated risks, and were actually reduced quite quickly, with the 1923 currency reform, which linked the domestic currency to real estate assets. Nevertheless, this newly-found stability was to be itself short-lived, with the crash of the US stock market plunging the whole world into depression in 1929.

It was the management of this latter instability through *deflationary* policies introduced by Chancellor Brüning in 1930 that 'helped to bring Hitler to power far more than any memory of inflation a decade earlier' (ibid., p 196). The Great Inflation of 1922-3 can be said to have led to Nazi ascendance only in an indirect sense: fear of future inflationary episodes motivated punitive deflationary policies in the 1930s as a precaution, on a background of already weakened democratic processes in Weimar Germany (Brunnermeier et al, 2016). Deflation in the early 1930s played, on the other hand, a direct role in thrusting the Nazi Party from the political fringes, where it lay throughout the 1920s, into power (The Economist, 2013b). While hyperinflation had actually benefitted some groups of debtors in German society, the severe Brüning deflation hurt creditors and debtors alike, the former losing their savings, the latter their homes, following the collapse of the German banking system in 1931 (The Economist, 2013b). Unemployment skyrocketed as businesses went bankrupt. Meanwhile, mainstream political parties looked upon this with idleness, under an injudicious belief that inaction would eventually lead to systemic transformation, once the crisis runs its course (Blyth, 2015). It was this conjuncture that bred support for the Nazis, as the only political party in Germany at the time to present an anti-austerity, anti-depression and anti-fatalistic political programme. The Nazis made use of the experience of deflation to attract the support of the masses, attempting to ameliorate internal tensions through a boost in domestic spending, while in fact exploiting racial differences as an antidote to class conflict (Aly, 2006).

If the standard historical narrative of the causes and consequences of Weimar hyperinflation is factually erroneous, why is inflation still perceived in Germany as a great threat, especially given that 'almost no Germans alive today have experienced the Great Inflation' first-hand (Brunnermeier et al., 2016, p. 54), whereas the dangers of deflation hardly receive a mention? O'Callaghan (2012) provides an answer to this by invoking Henri Bergson's distinction between 'pure memory' and 'habit memory'. The former records every detail but requires great conscious effort to access, while the latter is more selective and *ad-hoc,* an unthinking reflex enabling people to react to external stimuli based on past action. According to O'Callaghan, the memory of deflation remained untapped in the unconscious of pure memory, whereas that of inflation forms part of habit memory. This is because of subsequent events that reinforced inflation aversion, namely the perception (itself also factually erroneous, as we will see in section 4.4d below) that the German 'economic miracle' of the 1950s and ensuing prosperity was made possible only through inflation control:

> '[…] the memory of the traumatic period of hyperinflation is not *a priori* more distinct or intense until contrasted with the prosperity (and low inflation) of the *Wirtschaftswunder* (and vice-versa). So, as a consequence of a dialectical relationship between the devastation of the Great Inflation and the prosperity of the *Wirtschaftswunder*, German collective memory accentuates price stability' (O'Callaghan, 2012, pp 656-7).

Not only did inflation control play a prominent part in postwar reform discourse (Brunnermeier, 2016), but this discourse also conflated inflation and hyperinflation (O'Callaghan, 2012), converging to construct a selective memory of the past (The Economist, 2013b). It is this selective memory, rather than historically-faithful memory, that feeds into the German model. This, too, is something rarely acknowledged in practice.

c. The Nazi era (1933-1945)

An exhaustive exploration of the legacies of National Socialism, one of the darkest episodes in modern European history, is both very difficult and beyond the scope of this thesis. For the purposes of this chapter, we searched specifically for links between the perceived features of the

German model and the German political economy between 1933 and 1945, finding one argument that is of particular relevance. The argument is that German industrialists had benefitted the most from the Nazi regime, so that when the regime collapsed they had to devise a ploy to erase from collective memory any recollection of their complicity; in this context, they came up with an idealised image of the German industrialist, generous with their employees, pursuing prosperity for all (Wiesen, 2001). This reinvented image of the German industrialist resonates with the idea of a close relationship between employers and employees in the German model.

The low level of opposition to the Nazi regime within Germany suggests Germans in general derived benefits from it, which made them 'amenable to Nazi propaganda' and gave them 'a vested interest in the Third Reich' (Aly, 2006, p 4). Between 1933-35, the benefits derived by the average German had perhaps been more easily noticeable, in the form of Nazi job creation and housing programmes and infrastructure development (Adorno, 2010), which however were afterwards halted in favour of war production, starting in 1935. Yet Germans continued to benefit after 1935 too, through the exploitation of occupied and allied territories, where German soldiers could buy very cheaply a variety of goods and send them to families back in Germany, thus shielding them from scarcity problems typical of war economies elsewhere (Aly, 2006).

While most of the German population benefitted in one way or another, German industry can nonetheless be seen as the prime beneficiary (Wiesen, 2001). Despite having been formally founded partially 'on an anti-big capital, pro-shopkeeper platform' (ibid., p 13), the Nazi party in practice implemented policies that favoured big business. The cartelisation of German industry intensified in the 1920s, with the foundation of the IG Farben chemical cartel and United Steel Works, in 1925 and 1926, respectively. The Nazi regime in the 1930s did nothing to break this trend or nationalise industry altogether (although it had been quick to crush the German unions), especially because high business concentration in the steel, electrical, chemical, automotive and aircraft industries facilitated rearmament and war production. Besides actively supporting war production and directly profiting from it, German corporations also 'actively participated at all levels of the compulsory labour program, with apparently little mind to the moral implications' (ibid., p 16). After 1945, leaders of industry insisted that they had had no choice during the Nazi years but to introduce slave labour; all the while though, this constituted free labour supply to compensate for the loss of German workers sent to war, and undeniably increased corporate profits. Most firms had had no qualms in eliminating Jewish employees and treating foreign populations as wholly expendable. They exploited war prisoners from occupied territories as well as civilians, and seized public and private property abroad, which ranged from raw materials to assets of foreign firms (ibid.).

The culpability of German industry is thus incontrovertible. This meant, after 1945, that industrialists were confronted with the 'challenge of infusing a new morality into capitalism (…) at a time when [they] were being linked to the most heinous of crimes' (ibid., p 4). Wiesen (2001) explores how industrialists responded to this challenge, in a dual process of sanitisation of collective memory and simultaneous reinvention of the industrialist. He does so by analysing corporate publicity in the immediate postwar period as 'the obvious locus of memory' in a free market system. German corporate publications in the 1950s refashioned the industrialist, about whom people had had negative or neutral opinions at the time (ibid.), by casting the businessman as the protagonist of the German 'economic miracle', inextricably linking the fortunes of the economy with those of the industrialist (the German word 'die Wirtschaft' denoting both 'the economy' and 'industry'):

> 'By identifying the economy with industry (to the obvious exclusion of trade unions), business leaders were able to portray the material successes of postwar Germany as their creation. The term die Wirtschaft facilitated industrialists' attempts to depict themselves as the nation's providers and protectors – as the economy incarnate. Who was responsible for Germany's material and spiritual recovery after 1945? Die Wirtschaft' (ibid., p 7).

A conjoined public relations technique was to lump together in corporate discourse all types of industrialist (under the term 'Unternehmer' – 'entrepreneur'): at a time when big business had its reputation in tatters, 'it behoved leaders of large companies to identify with a less compromised and still romanticized symbol of the business world: the small-time entrepreneurs who were at one with their capital, their employees, and the workings of their firms' (ibid., p 8).

The German industrialist was thus recast as an enabler of economic recovery and success, who rebuilt the country from ruins, created jobs, and put the needs of workers above profits. The resulting association in collective memory between this romanticised image of the industrialist and the prosperity of the 1950s-60s can help explain why a close, cooperative relationship between employers and employees forms part of the narrative about the German model. At the same time, this goes beyond simply 'selective memory', as is the case with Weimar hyperinflation, constituting in fact a deliberate manipulation of memory.

d. Germany's postwar 'economic miracle'

The German economic boom of the 1950s and 1960s, commonly referred to as the *Wirtschaftswunder* (economic miracle), enabled not only the creation of the symbol of the responsible, magnanimous industrialist, as mentioned above, but also, in parallel, of the symbol of the hard-working German, it too a way to sanitise collective memory:

> 'On the subjective side, in the psyche of the people, National Socialism increased beyond measure the collective narcissism, simply put: national vanity. (…) The damaged collective narcissism lies in wait of being repaired and seizes upon anything that brings the past into agreement with the narcissistic desires, first in consciousness, but that it also, whenever possible, construes reality itself as though the damage never occurred. To a certain degree this has been achieved by the economic boom, the feeling of ''how industrious we are''' (Adorno, 2010, p 220).

It was at this time that exports became Germany's primary focus, with Ludwig Erhard (quoted in Bonatti and Fracasso, 2013, p. 1029) stating that foreign trade is 'the very core and even precondition of our economic and social economic order'.

The standard narrative about Germany's postwar revitalisation and economic success is that recovery, driven by improved export performance, was due to a combination of the aforementioned alleged German culture of hard work with the 'ordoliberal' reforms introduced by Ludwig Erhard. In particular, the currency reform of 1948 which replaced the Reichsmark with the Deutschmark and established a Central Bank whose key role was to prevent demand-pull inflation, is often highlighted. Sometimes reference is also made to the Marshall Plan, albeit in a much-subordinated role. Typical versions of the same standard narrative can be found in Giersch et al. (1993), Wolf (1993) or Kerber and Harting (1999).

Giersch et al. (1993) write that Erhard established an 'appropriate economic order': monetary policy aimed at price stability, in conjunction with fiscal conservatism (especially cuts in corporate taxation, but also Erhard's resistance to Allied calls for fiscal expansion). These came in stark contrast to demand-side policies adopted elsewhere in Europe after World War II (Wolf, 1993). Giersch et al. (ibid., p 20) also mention an increase in productivity due to German industriousness: ‘in terms of skills, experience, and motivation, West Germany’s labour force was probably second to none’ (Giersch et al., p 20). This idea was first popularised by Wallich (1955), who, in turn, must have been influenced by declarations made by Erhard himself, such as that on 22 February 1951, in a press conference in Germany, that ‘hard work’ represents ‘the basis of continued recovery’ (Manchester Guardian, 1951). More moderate versions of the main narrative also acknowledge the role of demand-side factors in powering Germany’s export boom - e.g. Wolf’s conclusion that ‘while the ordo-liberal policies succeeded in fine-tuning the German growth machine, the fuel transforming a potential into an actual miracle was to a significant degree provided by largely fortuitous demand disturbances’ at the international level (Wolf, 1993, p 30), generated by the Korean War. Others, however, maintain that even ‘in the course of normal business cycle movements, some sort of export surge would have occurred and thus carried the economy over to grow into its supply-side potential’ (Giersch et al., 1993, p 9).

A documentary commissioned by German broadcaster ARD (2013) sets out to challenge this dominant narrative behind Germany’s economic miracle. Using comparative data on working times across Europe, the documentary invalidates the notion that Germans have been more hard-working than other Europeans. The documentary also argues that Erhard’s role is overrated in collective memory, given Allied influence in organising postwar Germany. This point had been stressed earlier by Michel Foucault (2010 [1978]) who underlined that Erhard had only delivered the speech that communicated to the German public the reforms proposed for West Germany’s revitalisation, developed by a scientific committee established by the Allied powers, and was thus more of a messenger than a reformer.

As to the reform programme *per se*, the ARD (2013) documentary challenges the extent of its contribution to economic growth via exports. A series of interviews with German academics, foreign policy experts, and former car industry leaders reveal that brain drain from the Eastern bloc (the exploitation of foreign labour as cheap input), management continuity, and the Korean War (high demand for outputs) played a much greater role in stimulating German growth than domestic reforms. Kershaw (2015) also identifies cheap labour, along with high demand from abroad, and management continuity as key causes of postwar recovery. The existence of a limited educated elite is offered as a justification for leadership continuity in industry and politics, throughout two World Wars and the Weimar years in between, as well as the postwar period (Blyth, 2015; Kershaw, 2015). Other sources claim that the seeds for economic recovery had been planted unwittingly in the form of Nazi countercyclical policies under the heading of 'the four-year plan' (Abelshauser, 1998; Adorno, 2010). Contrary to the popular perception that Germany had faced capital depletion immediately following World War II and the country had to be rebuilt from ruins, Abelshauser (ibid., p 146) estimates that 'in 1945, surviving capital stock in western Germany still exceeded the prewar level by one-fifth'.

Finally, it is argued (ARD, 2013) that German collective memory omits a very important episode in postwar history: the London Debt Agreement of 1953, which assisted the reconstruction and subsequent growth of Germany's economy. This argument is based on Ritschl's (2012) work, according to whom Germany, as the most indebted European country in 1945, could never have experienced such a speedy recovery and export surge, had it not been relieved of all its war debts by its European partners in the London agreement. This suggests that German recovery and growth needs to be understood in a broader context of 'geopolitics recast' following World War II (Kershaw, 2015). War victors had then pledged to accept a renewed Germany (even one focused on exports) as long as it renounced political dominance claims by subordinating itself to supranational institutions as part of the European Community project. Germany's export model was thus encouraged, for the sake of discouraging German imperialism (Ritschl, 2012).

The common academic view is that collective memory constrained German national politics and identity, leading to caution in foreign policy and political rhetoric based on regret, which eventually morphed into pride in being remorseful:

> 'German identity has no coalescing ideology. With no positive pre-Weimar Republic state or even Weimar milestone to hold up, and no imperial success to cherish, German national identity and pride traditionally have hinged on self-awareness' (Warburg, 2010, p 66).

This redesigning of the country to fit within the postwar order is described as a process of 'normalisation'. The theme of normalisation in the absence of democratic experience or a coalescing ideology is also taken up by Hagen (2012), but in a much less positive way. While he does identify a shift in German collective memory from 1950, when public opinion surveys revealed that a majority of respondents thought that National Socialism had been, 'in principle', 'a good idea' (Hagen, 2012), to a more subdued mentality in later years, he does not associate this with self-awareness, but rather with a lack thereof:

> 'Many retreated into silent conformism, single-minded pursuit of economic recovery, and the sentimentalism and narcissism that formed one side (not the best) of postwar 'Americanized' popular culture' (ibid., p 358).

Perhaps the most important repercussion of the *Wirtschaftswunder*, then, is that postwar economic growth itself superseded other notions in German collective memory (Foucault, 2010 [1978]). Growth via exports became the 'overriding economic imperative of the post-war West German state' (Graf, 1992, p 14), as the surest and quickest strategy for re-legitimising the German capitalist state following the collapse of the Nazi regime, both in the eyes of Germans themselves by securing domestic prosperity, as well as of foreign observers by setting new standards of economic performance. This (in fact temporary) congruence between export competitiveness and domestic prosperity had, however, long-term effects in the sense of facilitating a domestic consensus between the German state, capitalists, and unions in favour of a continued pursuit of export surpluses (Graf, 1992). This class compromise turned 'miracle' into 'model', establishing a 'new dimension of temporality' in Germany that was no longer 'a temporality of economic history, but one of economic growth' (Foucault, 2010 [1978], p 86). The absorption of East Germany into West Germany following German reunification in 1990 further inflated the miracle-model narrative (Schissler, 2001).

On the other hand, the appropriateness of the 'miracle' epithet itself as applied to 1950s-60s Germany has been disputed, for instance at the beginning of an edited volume on German cultural history:

> What was so miraculous about 1950s West Germany? The weekly Spiegel first spoke of the economic miracle in 1950. How people actually felt was an entirely different story: in 1951, 80 percent of the population considered 1945-48 to be the worst years of their lives, followed

> by the period 1949-1951. People had a much better opinion even of the war years […] There are surprises and unexpected developments in history, but there are few miracles in our day and age. The ''economic miracle'' is a label attached to the 1950s in retrospect, in all likelihood at first by foreign observers of the rapid economic growth in West Germany. It is the thankless task of historians to deconstruct what once seemed miraculous (Schissler, 2001, p 3).

A case has been made that even if we focus exclusively on growth rates, Germany's postwar boom does not warrant the 'miracle' label, given that 'most of Western Europe had by 1948 long surpassed their initial capacity levels and approached prewar production, some three years before Germany' (Wolf, 1993, p 50). Adopting a wider purview, the various contributions to the aforementioned book (Schissler, 2001) highlight the insensitivity of the 'miracle' label to issues of race, class, gender, minority, and intergenerational differences. Taken collectively, the personal recollections of individual contributors who had lived in West Germany throughout the 1950s and 60s speak of rigid, paternalistic and hierarchical social relations, with religion and race serving as early-life instruments of demarcation and social exclusion, and the image of a levelled class society constituting little more than a myth. The editor remembers West Germany as pervaded by a 'threatening authoritarianism': 'authority in Germany asserted itself everywhere in the 1950s in an exaggerated manner, particularly because male authority had been thoroughly undermined by the end of Nazism and the circumstances of the lost war' (Schissler, 2001, p 8).

As we have seen in this section, there is a substantial counternarrative to the standard view on the causes and nature of Germany's postwar boom. Nevertheless, because Germany's economic success in the 1950s, based on exports, happened on a background (albeit arguably *in spite*) of monetary and fiscal restraint, these aspects are conjoined in collective memory and treated in a causal relationship, as per the standard narrative. This could then explain why the 'model' discourse associates success with tight fiscal and monetary policy. In effect, the German model discourse includes some of the same factors that are believed to have been instrumental in generating postwar growth; these are sometimes branded 'ordoliberal', as we have seen in section 4.3 above. 'Miracle' has morphed into 'model'. Once again, we have stumbled upon a case of selective, distorted memory, that feeds into the present-day 'model' discourse.

4.5. Conclusions

This chapter has built on the notion that the German model represents an important facet of German hegemony in the EMU, introduced in chapter three. Here, the main focus was on the (perceived) features of the German model and their potential origins.

We began this chapter by analysing the German model through the RS and VoC literatures. It was shown that these explain the features of the model functionally, as a result of state-level compromises (RS) or rational choices made by strategic actors (VoC). Both approaches see the German model as a particular form of institutional complementarity, wherein macro and micro/meso features reinforce each other. They often praise Germany as a superior model of political economy; this resonates with the treatment of the US as an ‘ideal type’ by hegemonic stability theorists. As such, the RS and VoC literatures share some of the shortcomings of problem-solving theories of hegemony, in particular a fixity bias. Fixity assumptions will be challenged in chapter six, through an empirical analysis of changes in the German model as a result of monetary integration.

Whereas the RS and VoC approaches therefore remain largely unconcerned with the origins and evolution of model features, prioritising their functions instead, the *Modell Deutschland* discourse from within Germany does answer the question of how the model arose, insofar as presenting the model as an incarnation of quintessentially German ordoliberal ideology. Yet, as we argued in section 4.3. above, ordoliberalism is neither uniquely German, nor consistent with all of the model features. Consequently, rather than treating the model as a by-product of a continuous German ideology, we then made use of historical sources to provide an alternative explanation.

We searched for the origins of the model in ideas associated with key episodes in German modern history. We discussed close, cooperative relationships between industry and financiers with reference to the standard narrative on Germany’s late industrialisation. Inflation aversion stemming from the Weimar experience, superimposed on memories of the *Wirtschaftswunder*, explains Germany’s conservative stance on monetary policy. We argued that the notion of a strong cooperation between employers and employees emerged from the reinvention of German industrialists in an effort to sanitise collective memory of their involvement in the Nazi regime. Finally, export focus on a background of fiscal and monetary conservatism comes as a result of the mainstream reading of the causes of Germany’s *Wirtschaftswunder*. The features of the German model were found to have their origins, for the most part, either in selective memory, or in a deliberate retelling of history. The fact that the German model is thus conceivably based on historical distortions makes its supranational hegemony at the EMU level all the more problematic, as well as contestable. The supremacy of the German model at the EMU level in the context of the euro crisis is discussed in more detail in the next chapter.

Chapter five: German influence on the evolution of the EMU

5.1. Introduction

In a recent special issue of the *European Law Journal*, Wilkinson (2015, p 315) points to a renewed concern – reflected, especially post-2008, in academia, policymaking, the media, and public opinion more widely – about the role of Germany in Europe, and in particular in the EMU: 'the spectre of a 'German Europe' continues to haunt'; 'German hegemony is firmly back on the agenda'. This concern extends beyond the literature on German hegemony *per se*. On the one hand, the German model is often praised as a success story at the European level, a worthy example to other countries. On the other hand, Germany is also condemned for its intransigence in managing the euro crisis, attitude which is too often written off as a 'Pavlovian German reflex' embodying 'rigid ethics of punishment' (Bonatti and Fracasso, 2013, p 1024; 1036). Treating nations as 'homogeneous moral individuals with joint liability' (Streeck, 2014, p 92), like HST-inspired literature does, risks to amplify conflict and mistrust between the peoples of Europe. It leads to deep and dangerous polarisations of the type: hard-working Germans versus lazy Greeks, the Greek culture of cheating versus the German culture of punishment, etc. (Guiso et al., 2013), further exploited by sensationalist parts of the media across the continent.

This chapter aims to assess empirically the extent to which Germany has shaped monetary integration, in view of drawing our own conclusions about German hegemony in the EMU. Recall that in chapter three we underlined that conclusions about German hegemony fundamentally hinge on the definition of hegemony used in the analysis. In chapter two, we concluded that various hegemonic theories, despite their differences, agree, on a basic level, that a hegemon is the occupier of a dominant position within any system. In this chapter, we use this as baseline, and develop our analysis in the spirit of critical theory. Our focus is then on the *nature* of German hegemony in the EMU in evolutionary perspective. In chapter three, we described the evolution of the EMU from the Maastricht Treaty to the present-day 'structural lock-in' (Dymski, 2013); in chapter four, we noted that the German model has become dominant at the supranational level. Here, we are concerned with Germany's role in this evolution from Maastricht negotiations towards structural lock-in, as well as with the conditions that propelled the German model into a position of supremacy at the Eurozone level.

As such, we significantly depart from problem-solving, HST-inspired literature, which defines hegemony through stability, and measures German hegemony by treating the US during Bretton Woods as a sort of index. The problem with this is that it creates analyses that look for similarities and differences between Germany and this 'ideal type' to assess how well Germany performs given stabilising functions, instead of focusing on Germany's concrete role in the EMU. Another hallmark of HST we take issue with is the notion of a unitary, unchanging hegemon, which, as noted in chapters two and three, has permeated more critical approaches as well. In this chapter, we challenge the idea that Germany as a hegemon is unitary (homogeneous), by directly raising the question of who gains the most from the present configuration of the Eurozone under German leadership. The next chapter will then challenge the other fixity assumption, continuity, by highlighting change in the German model at the micro-meso levels as a result of monetary integration.

Our methodology also constitutes an element of novelty. We build our narrative by combining insights from academic literature, policy documents, public discourse and media sources, and interviews with German elites, paying heed to Bonatti and Fracasso's (2013) comment that the debate would benefit from a conscious effort to examine the German stance *from Germany's point of view* as well.

As mentioned in chapter three, section 3.2a, the Werner report and the EMS represented important first steps towards monetary integration in Europe. Here, we begin our critical account of German hegemony in the EMU by analysing Germany's role in the EMS as 'prestructuring' (Dyson and Featherstone, 1999) of the role the country has subsequently come to play in the EMU, thus tracing the origins of German regional hegemony in the EU back to the 1970s. We characterise the influence exerted by German officials on both the features of the EMS as well as those of the EMU as 'hegemony by design'. We argue further, however, that Germany as a hegemon is not homogeneous, but rather, reflects the interests of German industrial capitalists and European financial capitalists, which explains why it had been successful in setting the agenda at Maastricht in the first place. It also explains why Germany has been portraying the Eurozone crisis as a crisis of competitiveness – because this conceals the true culprits, financial capitalists, while at the same time praising German industrial capitalists. In turn, the portrayal of the crisis as one of competitiveness made the German model a yardstick for success, granting Germany even more power over EMU policy design. Consequently, while substantial, German hegemony in the EMU is also diffuse, enmeshed with the dominance of free market ideologies, and of European capital. Power is thus not wielded by any particular German politician. Rather, they are constrained by the powerful interests they represent, and incapable of resolving the structural lock-in of the EMU. Therefore, while German hegemony appears fortified at present, it is also unsustainable.

This argument is developed over four main sections. Following this introduction, section 5.2 below analyses Germany's role in the EMS in connection with the transitions taking place in *Modell Deutschland* at the time. Section 5.3 then assesses the role played by Germany during Maastricht negotiations, wherein the EMU was designed. Section 5.4 asks whose interests Germany has been serving at Maastricht and beyond. Section 5.5 studies the implications this has had for crisis management. In terms of crisis management, we analyse first short-term stabilisation policies following the Greek crisis, then look at long-term policies aiming for changes in the architecture of the EMU, before considering the future of the EMU by returning to the notion of structural lock-in introduced in chapter three. Section 5.6 concludes.

5.2. Hegemony by design: Germany in the EMS

In this section, we draw upon existing literature to analyse Germany's role in the EMS, in connection with transitions taking place in *Modell Deutschland* at the time, as 'prestructuring' (Dyson and Featherstone, 1999) of Germany's subsequent role in the EMU. Scholars affiliated with the German Konstanz School in particular have analysed the German model throughout the 1970s and 1980s by taking a relational approach, situating the model in its wider international context (Graf, 1992). As mentioned in chapter three, the EMS was established in the aftermath of the collapse of the Bretton Woods system of fixed exchange rates and the oil shocks of 1973-4. According to Konstanz School scholars, the ensuing instabilities created a 'Darwinian landscape' where 'the advance of one nation (…) is 'usually at the expense of others' (Graf, 1992, p 6). In this context, hegemony is understood as 'the strategic use of power with the goal of imposing extrapolations or projections of one's own internal structures on the surrounding or outside world'

(Schlupp, 1992, p 313). Based on this view, the West German government's strategy to internationalise the German model in the 1970s through the establishment of the EMS, an arrangement which effectively subordinated other countries' policies to those of Germany, represented 'an inextricable component of hegemony' (Graf, 1992, p 6).

Germany's internationalisation project as a response to the collapse of the Bretton Woods system and the oil crises of the early 1970s was launched during Helmut Schmidt's chancellorship (1974-1982). These shocks undermined the premises of Germany's postwar boom, which had depended on the world economy expanding faster than domestic consumption and investment (Graf, 1992). Slowdown in the external demand for German goods created difficulties for German producers in terms of their ability to hold market shares in key industries, and hence meant that a new strategy needed to be found in order to preserve Germany's export model (Lankowski, 1982), which dated back to the *Wirtschaftswunder*, as discussed in section 4.4d.

Schmidt's strategy consisted of two main interconnected elements (Ryner, 2003). The first was a revaluation of the DM vis-à-vis the dollar, which lowered the costs of raw materials for German producers, as these costs were denominated in dollars. The shift from an undervalued DM during the *Wirtschaftswunder* years to a high DM in the 1970s was made possible, *inter alia*, by the reputation for quality that German products had acquired in the meantime (Riemer, 1982). Nevertheless, in order to guarantee that this revaluation does not cause German products to become price uncompetitive, a second, conjoined aim of Schmidt's strategy was to induce stable exchange rates between Germany and the EC states, which constituted Germany's largest export market. This presupposed nothing less than a 'reorganization of international monetary relations and refocusing these relations on Europe' (Lankowski, 1982, p 93) through the creation of the EMS, to limit exchange rate fluctuations. For their part, other EC countries had an interest in the EMS as well, since linking their currencies to the DM could help them also derive advantages in terms of the costs of raw materials denominated in dollars, while at the same time facilitating their imports of investment goods from Germany (Lankowski, 1982).

As 'the least deferential of German Chancellors towards the Bundesbank' (Dyson and Featherstone, 1999, p 287), Schmidt's approach was to work together with his French counterpart

Valéry Giscard d'Estaing to present the Bundesbank with a *fait accompli* vis-à-vis monetary integration, which the bank opposed because it challenged its independence. According to Dyson and Featherstone (1999, p 299), Bundesbank officials were indeed taken by surprise in 1978 when Schmidt proposed 'a major step towards monetary union beyond the Snake', but then quickly reacted, mobilising 'a formidable domestic coalition' behind them (Dyson and Featherstone, 1999, p 302). This coalition comprised savings banks as 'a natural ally for monetary stability', big banks as clients of the Bundesbank's lender-of-last-resort facilities, as well as industrialists in exporting sectors with stakes in price stability, all convinced that the only way to safeguard their own interests was to enable the Bundesbank to participate fully in the design of the EMS (Riemer, 1982, p 64). Schmidt then found himself pressured to give in to the demands of the Bundesbank, which consequently exerted great influence over the design of the EMS. Bank officials ensured that the EMS intervention system would be based on the 'parity grid' between existing currencies and not the newly-created ECU as weighted average (the latter situation would have singled out the strength of the DM as a problem, forcing the central bank to intervene). They were also able to place strict limitations on credit facilities, arguing successfully that the creation of a European Monetary Fund would require treaty change, and would, therefore, be best postponed, which minimised the Bundesbank's financing responsibilities vis-à-vis other countries in the system. Finally, they also obtained signed agreement from the government that, if faced with a trade-off between internal and external stability, the Bundesbank would be free to focus on the former (Dyson and Featherstone, 1999).

The EMS was thus created as a European 'zone of monetary stability' with the DM as an anchor, and hence with a highly asymmetric character, which forced other countries to regularly adjust their economies to German conditions, effectively functioning as an external disciplining mechanism on their fiscal and monetary policies (Dyson and Featherstone, 1999). Germany's hegemony by design in the EMS signified a shift away from German pre-Werner scepticism vis-à-vis monetary union on account that it would cause imported inflation, to a system where Germany as a surplus country, 'the only country which can pay for whatever it wants' (Hueglin, 1992, p 290), was able to act as standard-setter, predicating monetary cooperation on Germanstyle policy adjustment in other member states (Lankowski, 1982; Ryner, 2003). Ironically, Schmidt's vision of internationalising *Modell Deutschland* turned into reality as a supranational extension of the Bundesbank's monetarism, the very institution he had sought to exclude from his strategy (Dyson and Featherstone, 1999). Whereas Dyson and Featherstone (1999) speak of an apparently voluntary process of policy emulation on the part of other countries, Deubner et al. (1992) as well as Hueglin (1992) describe the EMS as acting as a straightjacket, *inter alia* by forbidding devaluations against the DM, forcing other participating nations into 'a permanent state of 'grow less than your neighbour' subordination' (Hueglin, 1992, p 291). If this were to continue, the end result would be 'a pauperization' of Southern Europe, Hueglin (1992, p 292) predicted.

A process towards pauperisation during the EMS years was underway not only within the EMS, however, but also domestically within Germany. In the 1960s, the West German economy had been operating at near-full employment, conferring greater bargaining power upon workers. Labour militancy was further encouraged by the brief Keynesian policy turn that was Brandt's chancellorship (1969-1974); unions in this period were calling upon the state to pursue an expansionary and proactive employment policy, including active support for declining industries (Markovits and Allen, 1984; Ryner, 2003). The 1969 and 1973 strike waves (the latter of which were especially significant for mobilising women and foreign employees) resulted in substantial gains for labour, both in terms of pay rises and 'quality of work-life' improvements: better job security, better training, increased safety at work (Markovits and Allen, 1984). All of this changed, however, during Schmidt's chancellorship.

In *Gewerkschaften in der Krise* (*Unions in crisis*) Esser (1982) raises the question of whether German unions accommodated themselves to Schmidt's internationalisation project, or whether, alternatively, they stood in the way of restructuring; the title of his book is intentionally ambiguous, referring both to the way in which German unions reacted to the new world market conditions in the 1970s, as well as to a crisis of union strategy itself. Based on a series of case studies, Esser (1982) concludes that union praxis in the late 1970s and early 1980s was characterised by a manifest interest in maintaining Germany's competitive position in the world economy as a means of securing the fiscal base for financing social spending in the future (Esser, 1982). This was based on the earlier experience of the *Wirtschaftswunder* which had linked together export competitiveness and domestic prosperity, generating a class compromise, as described in section 4.4d above. Adopting an accommodationist stance, unions agreed to wage restraint for the sake of competitiveness in the hope of extracting extensive welfare provisions from the government in exchange (Swenson, 1989) – a 'distributive bargain' (Ryner, 2003, p 203). Since the mid-1970s, German unions have been operating under this competitiveness constraint, at first as 'hostages to a friendly government' (Markovits and Allen, 1984, p 143) while the SPD was still in power, and then placed in a more difficult position still, following the 1982-3 *Wende* (turnabout) which marked the conservatives' return to power (Hueglin, 1992).

Increased competition from Asian producers in the 1980s, in a context where German capital was already succeeding in placing the blame for the instabilities of the 1970s on labour (Graf, 1992), gave rise to union concerns vis-à-vis job exports and the introduction of labour-shedding technologies which would affect first the old, women, and migrant workers as vulnerable categories (Esser, 1982). Against this backdrop, the unions' response was to campaign for work time reductions and early retirement in an attempt to avert increases in unemployment (Swenson, 1989); this strategy met with considerable success (Ryner, 2003) but was of course unable to grapple with structural long-term unemployment which arose as a consequence of the Bundesbank's monetarism (Schlupp, 1992). The shift away from union militancy to defensiveness in union policy and its subordination to competitiveness goals, from a strategy focusing on real wage increases to one that accepts a narrowing of active labour market participation (Markovits and Allen, 1984; Ryner, 2003) meant that labour relations within Germany became redefined (Hueglin, 1992). Negative consequences for labour began to be accepted as a matter of fact (Esser, 1982), with unemployment rates between 7 and 10 per cent presented as 'the healthy corollary of a boom economy' (Hueglin, 1992, p 288). On the other hand, the unions did manage to minimise wage dispersion within the unionised core, and high rates of social insurance coverage were maintained via domestic redistribution of export gains (Ryner, 2003). The result was, then, a bifurcated system – hence the term *Spaltungspolitik* (divisive politics/dualism), which captures the reality that Germany's internationalisation strategy led to relative job security and the maintenance of living standards for a large segment of the German population, but also to increased job strain and real wage stagnation, or, for a 'not inconsiderable' part of the population, even to long-term structural unemployment (Esser, 1982, p 9). The 1970s and 1980s thus marked the beginning of a process of 'sweeping change' in German labour relations (Deubner et al, 1992). We will discuss the evolution of this process of change in the context of the EMU in chapter six.

For now, an important point to retain is that Germany's role in the EMU was prestructured by its hegemonic position in the EMS (primarily via the policies of the Bundesbank). As mentioned in the introduction to chapter three, German reunification acted as a catalyst for Maastricht negotiations. Having experienced the inbuilt asymmetry of the EMS which had favoured the Germans, French officials began to see the EMU as an opportunity to rebalance power in the EC to their own advantage (Dyson and Featherstone, 1999). Nevertheless, representatives from other countries were in broad agreement that, in designing the EMU, it would be easier to 'diffuse existing best practice' (or what they perceived as such) than to come up with a completely new idea (Dyson and Featherstone, 1999, p 756). This provided ample scope for Germany's then Chancellor Helmut Kohl to seek to gain agreement on the German model as a basis for the EMU. Having learned from Schmidt's mistake of trying to marginalise the Bundesbank when it was, in fact, supported by a considerable coalition of German banks and industrialists, Kohl's strategy was to include the central bank in Maastricht negotiations from the start. The Bundesbank's prominent role in Maastricht negotiations was facilitated also by the new ideological consensus in favour of 'sound money' at the European level: following the instabilities of the 1970s, central banks 'acquired a new legitimacy' on account of their perceived ability to 'handle' instability with the use of tight monetary policies (Dyson and Featherstone, 1999, p 27).

Germany's role in Maastricht negotiations and the ensuing repercussions are discussed in section 5.3 below. Before moving on to that, however, it is important to note also that, during the late 1990s, the success of the German model appeared to have reached its limits, with the country dubbed 'the sick man of Europe'; this aspect is discussed in the following chapter, section 6.4.

Germany has since re-emerged as a policy model in Europe during the euro crisis; the context behind this is analysed in section 5.5b below.

5.3. Hegemony by design: Germany at Maastricht

In this section, we argue that Germany has been hegemonic by design in the EMU via the Maastricht Treaty. As mentioned in chapter three, the Maastricht Treaty, itself a successor of the 1989 Delors Plan, set the basis for the EMU. It was signed by EC heads of state in December 1991. While at the time the popular view had been that monetary union is simply a natural spillover from the common market, scholars have since revived the notion of 'the Franco-German axis as a ''motor'' of integration' (Ryner, 2003, p 202). From this latter perspective, Maastricht had been a 'political bargain' between German and French national interests, in the context of German reunification reopening the 'German question' (see Baun, 1995; Varoufakis, 2013;2014; Brunnermeier et al., 2016). German fragmentation in the past had served to contain the country's power, so its reunification raised new concerns for France. French resentment of German Bundesbank monetary dominance in the EMS, with its deflationary and antigrowth bias, led to the Delors plan aiming to force Germany to a renouncement of its currency, in exchange for France recognising German reunification (Baun, 1995). According to Varoufakis (2014 [no pagination]) though, the Delors Plan indicated *intention* of French leadership, but did not manage to bring it about, because 'the French elites' campaign to subjugate the Bundesbank, to usurp German industrial and financial power, was something that the Bundesbank had sensed and fought powerfully against'. By letting the ERM collapse and plunge France into recession, the Bundesbank had turned French ambitions of dominance to ashes. Only afterwards did Germany agree to monetary union, 'making sure that it would work beautifully in its own national interest' (ibid). This narrative then suggests that Germany had been the most powerful party at Maastricht, with significant influence on the design of the EMU. While the aforementioned sources do not use the term 'hegemon' explicitly, in chapter two we have seen that scholars such as Barry Eichengreen (1987) take a country's influence on the design of the system it is part of as a prime indicator of hegemony.

To assess the veracity of this idea that Germany had been dominant in Maastricht negotiations, we examined documents pertaining to the intergovernmental conferences wherein these negotiations had taken place. Access to these documents is granted by the General Secretariat of the Council of the EU upon request, as part of a transparency initiative. Of these, two documents proved to be relevant for our purposes: a proposal by the German delegation to amend the Maastricht Treaty draft, dated 26 February 1991, and a summary of debates taking place in an interinstitutional conference on the topic of the EMU on 12 November 1991. The German position, as reflected in the former document (Council of the EU General Secretariat Archive, 1991a), favoured price stability as main objective, financial liberalisation, fiscal conservatism and a lack of joint liability. The relevant proposed articles representing these preferences are reproduced in Table 5.1 below.

Table 5.1.: The German policy stance at Maastricht

Composite Proposal by the German Delegation, Brussels, 26 February 1991 (Council of the EU General Secretariat Archive, 1991a)

Article 2a (Economic and Monetary Union): ‘Economic union shall be characterized by convergent economic policies of the Member States, in particular budget policies geared to stability’ (…) The activities of the Community shall include: the irrevocable fixing of exchange rates between the currencies of the Member States and the introduction of a single currency, the definition and conduct of a uniform currency and monetary policy the overriding objective of which shall be to maintain price stability’ (Council of the EU General Secretariat Archive, 1991a, p 2; p 4).

Articles 8d and 8e (Rules for the transition to stage II of economic and monetary union): ‘The second stage of economic and monetary union shall begin on 1 January 1994 provided the following conditions are met (…) d) Central bank policy may not be used to finance budget deficits and the Community or its Member States are in no way liable for another Member State's debts. (e) Member States have made adequate and lasting progress towards convergence, in particular with respect to price stability and the consolidation of public finances’ (ibid., pp. 6- 7).

Articles 67-73 (Capital): ‘As far as the German Government is concerned, it is essential that the movement of capital be freed from all restrictions and discrimination, including vis-à-vis third countries’ (ibid., p 10).

Article 102e (Exclusion of liability): ‘Neither the Community nor individual Member States shall be obliged to support overall economic mismanagement in any Member State’ (ibid., p 12).

Article 105b (Budget policy): ‘The Member States shall conduct a budget policy which contributes to price stability through strict discipline with regard to expenditure and deficit limitation. The general government deficit may not exceed, either in planning or execution, expenditure on investment’ (ibid., p 14).

An article which appeared in the Guardian the following day, on 27 February 1991, stated that the French delegation had been particularly unhappy about Article 105b, dissatisfied ‘with German insistence of a ‘golden rule’ under which national governments will not be allowed to run public sector budget deficits greater than investment expenditure in any year’ (The Guardian, 1991, p 15). Regardless of French opposition, the rule found its way into the final version of the Maastricht Treaty, which stipulates limits of 3% of GDP for government deficits and 60% of GDP for public debt (Europa website, 2015a). According to Baldwin and Wyplosz (2012), the 3% threshold for deficits coincides with the average yearly level of public investment in Germany. These fiscal limits were transplanted into the Stability and Growth Pact in 1997, which included provisions to enforce the limits, at the initial request of Germany’s Finance Minister at the time, Theo Waigel (Europa website, 2015a).

Fiscal restraint and price stability were further emphasised by Horst Köhler, Secretary of State in the German Finance Ministry between 1990-1993, and Germany’s chief negotiator on EMU issues (who later went on to serve as IMF managing director). In an interinstitutional conference on 12 November 1991, a Dutch Socialist MEP had raised concerns that the draft Treaty focuses exclusively on price stability and the ECB being ‘even more independent than the Bundesbank’. He added that this leaves little room for other considerations, such as growth and investment, and questioned the legitimacy of the treaty, given the limited role of the European Parliament and the near absence of democratic consultation (Council of the EU General Secretariat Archive, 1991b, pp.8-9 [own translation from the original French]). In response, Köhler simply insisted that ‘there is no contradiction between growth and stability’, but rather, ‘a durable stability is an indispensable precondition for durable growth’. Stability, in turn, would require ‘strict budgetary discipline’ (ibid.), in his view.

Therefore, in the face of opposition from other countries’ representatives – French and Dutch representatives, in the examples above – the German delegation remained adamant vis-à-vis its policy preferences. Ultimately, these became enshrined in EMU legislation, generating the policy setting discussed in chapter three. The fact that German national interest exerted great influence over the EMU setting implies that the country has occupied a dominant position in the EMU system from the start: in our view, it has been 'hegemonic by design'.

When we asked our interview partners whether they think Germany's national interest has (or has had) an impact on Eurozone developments, they mostly focused on crisis management policies; nevertheless, some of them did refer back to German influence on the design of the Eurozone. One industry representative said that 'in the construction of the EMU, Germany played a major role'; a policymaker agreed that 'Germany was, and is, the most important country when it comes to setting the agenda'. In terms of particular policy decisions, one policy advisor enumerated 'the Stability and Growth Pact, the Maastricht criteria, no money printing for sovereign debt' as bearing German imprint. Another policy advisor traced fiscal restraint at the European level back to the German 'Swabian housewife view that the macroeconomy is like a household', part of 'a mindset typical of a small, open economy'. This mindset 'was never challenged' within the country, the respondent went on to argue, because of the *Wirtschaftswunder*, which, as mentioned in chapter four, is commonly understood to have happened on a background of monetary and fiscal restraint.

These comments by German elites in interviews reinforce the notion that German national interest had been at the core of Maastricht negotiations. But whereas the Maastricht Treaty can thus be seen as an instance where German politicians successfully pushed their own agenda, there is little reason to believe that this reflected the preferences of the average German. After the ratification of the Treaty in November 1993, journalists were reporting a great degree of popular opposition to the euro within Germany: 'closer European integration, which Germans overwhelmingly support, requires Germany to give up the D-mark, a move Germans overwhelmingly oppose' (The Economist, 1995, p 58). Referring to the Maastricht Treaty, Baun (1995, p 605) was writing in the mid-1990s that there are 'many who believe it will never be fully implemented'. Meanwhile, though, Wolfgang Schäuble (then chairman of the CDU/CSU group in the German Parliament, after having held ministerial positions in Chancellor Kohl's government) wrote for *Financial Times* (1997, p 12) that 'Germany has a direct interest in, and a special responsibility for, the completion of monetary union', as the largest economy with the strongest currency. Whose interests had German politicians then served at Maastricht, and beyond? This question is the topic of section 5.4. below.

5.4. German hegemony in the EMU: *cui bono*?

In chapters two and three, we have critiqued existing literature on hegemony as misleading in assuming that states (including hegemonic ones) are unitary, and that the national interest represents an aggregate of domestic preferences. In this section, we use interview responses to show that Germany as a hegemon is not homogeneous, and to identify whose interests are actually being served by German hegemony in the EMU (here we focus on the beneficiaries, whereas chapter six then concentrates on those who lose out the most from the present configuration). A first indication that German national interest is not simply an aggregate of domestic preferences is a comment made by a labour representative in one of our interviews. The person was speaking about the design of the EMU, and specified that 'the Eurozone is a project of open markets, one of the most important things pushed forward by Germany'. This highlights that Germany was in the stronger position at Maastricht because it used the 'power of speaking in the name of the dominant economic thinking' (labour representative) – in other words because the policy proposals made by the German delegation were more in tune with the dominant free-market climate at the European level.

To test our claim that Germany as a hegemon is not homogeneous, we asked all interview participants to define Germany's national interest – a concept often invoked in public communication nowadays across the globe, yet the majority of people interviewed were uncomfortable with it at first, classifying the concept as 'too vague' or 'general'. After initial hesitation and caution, two main types of answers emerged: industry representatives generally said that Germany is first and foremost a strong manufacturing nation and hence an export-driven economy; other people put forward a variation of 'Germany's interests lie with Europe'.

While at first glance these two types of answers appear to be different, it soon became clear that they actually mean the same thing, namely that the EMU framework underwrites Germany's export strategy. For example, one policymaker stated explicitly that 'Germany cannot split between national and European interest, because Germany, as a country in the middle of Europe, with a lot of neighbours, a country which is an export nation, has to be very interested that the EU goes well.' Similarly, an industry representative replied that 'Germany's economic success is based on an export-driven highly competitive decentralized business model. In fact, the share of exports in German GDP sums up to nearly 40 percent of GDP. (…) Everything that triggers sustainable world-wide growth is in Germany's national interest as well as a functioning and reliable Euro system that reduces transaction costs.'

Very few respondents denied the pursuit of national interest altogether; those interviewees appealed to the idea of 'normalisation', of Germany still feeling remorseful vis-à-vis its 20th century history. It can be argued that the denial of national interest is indeed also compatible with the 'Germany's interests lie with Europe' variant (e.g. 'Germany, in its own best interest, is tied into a broader European alliance'). A few respondents chose to point out explicitly that the national interest reflects the preferences of the dominant class rather than aggregate preferences, while agreeing that a main feature of German political economy is its export focus:

> 'In any society which is determined by conflicting interests, you could argue the national interests are the dominant interests in the country, which then translate into government policies. If you say the dominant interest, then I think that the dominant feature of German policy has been to support an economic strategy which you could call mercantilist, where you always try to have a trade surplus. That can be traced back to the postwar situation, when Germany had to rebuild the country, and so export orientation was seen as a way to rebuild the capital stock quickly.' (Labour representative)

The answer above resonates with Foucault's (2010 [1978], p 86) observation that Germany's economic revival in the 1950s coloured its political economy stance thereafter, establishing in Germany 'a new dimension of temporality (…) that will no longer be a temporality of economic history', but one measuring export growth.

Later on in the interviews, we asked participants to list what they perceive as the main gains and losses for Germany from the EMU project, and to specify whether they think the gains exceed the losses. Interview responses reflected unanimous agreement that 'the country that profited most from the euro and the way it developed, is Germany' (labour representative). In Germany's case, gains were thought to overwhelmingly exceed losses, mainly due to improved terms of trade: 'the euro preserved German competitiveness by preventing currency appreciation' (policymaker).

Here, as was the case with responses discussing German national interest, 'Germany' actually denotes 'German industry': 'exporters profit extraordinarily from reduced transaction costs in general, and a weak single currency in particular' (industry representative); the EMU generated 'huge gains for businesses' (labour representative). These gains had been identified by Germany's biggest corporations even before the euro was officially introduced, in 1999. Industrialists at BMW and Siemens, cited in *Financial Times* (1996) were expressing a desire to move on with monetary integration as quickly as possible, to put an end to currency fluctuations and appreciations which affect export sales; 'what they most fear', the FT concluded, 'is too strong a D-Mark if EMU is postponed' (Financial Times, 1996, p 17). Successive rounds of Eastern enlargement in this context were cited by interviewees as having further bolstered the power of German industry: 'With increasing globalisation, especially in the manufacturing sector, the value chains are organised in a European context. Germany as the centre of this value chain is becoming more and more important' (labour representative). These interview findings resonate with Martin Wolf's conclusion in one of his columns written for the FT: 'Germany needs both captive markets and a competitive exchange rate. The eurozone has delivered both, to an inordinate degree' (Financial Times, 2010b [no pagination]).

When it came to discussing losses, however, opinions expressed by interviewees were more divided. Replies here ranged from 'I don't see what we could have lost' (policymaker) to 'Germany benefits, but the problem is that it is part of a monetary union that cannot be sustainable' (labour representative). It was mainly labour representatives who talked about losses: some said that there are no real gains to workers, and that, on the contrary, EMU membership has weakened codetermination; others pointed out that the EU blocks room for manoeuvre in industrial and social policy; one respondent went as far as to say that the euro means 'the death of trade unions'.

So far, then, interview responses point to the fact that German industrial capitalists have gained the most from the present configuration of the Eurozone. But there is another aspect worthy of consideration here: finance. In chapter three, we noted that monetary integration in Europe proceeded on a background of financial liberalisation, the Delors Plan having endorsed 'a large degree of freedom for market behaviour' (European Council, 1989, pp. 16-17). In section 5.3

above, we listed capital liberalisation as one of the top preferences of the German delegation at Maastricht (see Table 5.1). Yet in interviews, people rarely spoke about finance; this constitutes an important finding in itself, which suggests that German elites continue to uphold an image of Germany as a strong manufacturing nation, immune from financial developments elsewhere in the world – a trope encountered in the VoC literature. On the other hand, respondents did highlight current account surpluses as gains for Germany resulting from EMU membership, which increased the country's power and wealth, cementing its position as a main creditor in Europe. What most responses omit is the corollary that German surpluses vis-à-vis European countries meant a corresponding flow of money into Germany, which German banks had used to extend loans to banks in Southern Europe in search for quick profits (Palley, 2013). Only one respondent (policy advisor) emphasised this aspect.

The person explained that 'these capital flows from Germany, that have been fed into Spain, Italy, Greece, have caused an overheating, a housing boom, and then wages reacted. You then got some effects on competitiveness, but not to the extent that they explain 100% of the current account imbalances in Europe.' From this perspective, therefore, the euro crisis has been primarily financial, and not fiscal or one of competitiveness in Southern Europe; we return to this point in section 5.5 below, where we discuss the role of Germany in the crisis. The interviewee added that, while German financial institutions clearly benefitted from this configuration, they were not the only ones; French financial capitalists had used their association with Germany to derive credibility and pursue interests of their own:

> 'What France has done was to use the close Franco-German relationship to borrow credibility in the eyes of financial markets, so that French banks can borrow money from the rest of the world under relatively cheaper conditions, and then lend it further to countries like Spain, Italy, and so on. The French financial sector has big stakes in that. A rupture with Germany would imply a loss in credibility for the French finance industry. I don't think anyone will risk that. Any President of France, whether it's Sarkozy or Hollande or Le Pen, will have to keep this alliance with Germany going. The relationship between France and Germany is very special. France is in a subordinated role because they don't have the strong current account balances that Germany has.' (policy advisor).

Overall, this section has shown that, if we treat Germany as a single, isolated entity, it is indeed the main beneficiary of the monetary union. However, these benefits are inequitably distributed within German society, with hegemonic gains accruing primarily to German industrial and financial capitalists; French financial capitalists have also derived gains, by association. The problem of distribution within Germany will be further discussed in the following chapter. Now, having established that Germany as a hegemon has been representing the interests of financial and industrial capitalists as hegemonic groups, we proceed to examine the implications of this in the context of the euro crisis.

5.5. Crisis management à la Germany: fortified hegemony?

The first decade of the euro (1999-2009), characterised by moderate growth and enlargement of the EMU, was followed by a much more tumultuous period: since 2009, most Eurozone policies have been crisis policies, and the sustainability of the euro itself was called into question. In this section, we assess the role Germany has been playing in managing the crisis, both in the short- and long-term. It will be shown that in the short-term, German elites have been engaged in portraying the Eurozone crisis as one of competitiveness, and, on this basis, promoting structural reforms in crisis countries. It has been possible for Germany to portray the crisis as one of competitiveness precisely because Germany had already been hegemonic at the EMU level by design, as argued in section 5.3 above. The reason it has been doing this has been to shield the true culprits – financial capitalists – while praising German industrial capitalists, the two societal groups that have benefited the most from European monetary integration to begin with, as argued in section 5.4 above. The depiction of the crisis as one of competitiveness, in turn, made the German model, with its focus on exports (and thereby competitiveness), a yardstick for success at the European level. Finally, this has been giving Germany further power over EMU policy design in the long-run. At the same time though, German politicians are constrained by those very interests that they are representing, such that, while German hegemony appears fortified at present, the structural lock-in of the Eurozone casts doubt over the sustainability of Germany's hegemonic position.

a. Short-term crisis management policies: stabilisation policies following the Greek crisis

Following the global financial crisis and recession (2007-2008), EU leaders had agreed, in December 2008, to a stimulus plan to promote recovery and growth, worth 200 billion euros (BBC, 2012). The need for this plan, outside the regular institutional framework of the EU, indicated the weakness of existing institutions, whose limited competencies had enabled them to deal with incremental integration, but not existential crises (Brunnermeier et al, 2016). Further weaknesses of the EMU system came to the surface a year later, in December 2009. Just as the worst of the crisis seemed to have passed, Greece announced that its debts had reached 300 billion euros, triggering an existential crisis of the euro, which soon engulfed Portugal, Ireland, Italy and Spain as well.

The obvious challenge then became how to stabilise the economies of those countries. European leaders were looking at Germany, as the strongest economy in the monetary union, to propose solutions. These were, however, not forthcoming. Instead, in February 2010, *the Guardian* (2010 [no pagination]) reported that 'hopes on the markets of a German-led rescue plan to shore up Greece's critical public finances were dashed by Merkel, who repeatedly emphasised that Athens would need to put its own house in order and brushed aside all questions of financial support'. This reflected the view that the crisis had been one of competitiveness and sovereign debt. Indeed, German elites had been principal promoters of this narrative. In an article for *Financial Times* (2011 [no pagination]), Germany's Finance Minister, Wolfgang Schäuble, wrote that:

> 'Whatever role the markets may have played in catalysing the sovereign debt crisis in the eurozone, it is an undisputable fact that excessive state spending has led to unsustainable levels of debt and deficits that now threaten our economic welfare. (…) the eurozone crisis unfolded after a decade during which economies with markedly different and, indeed, diverging fiscal profiles and competitiveness were all able to borrow at close to benchmark rates.'

Based on this diagnosis, the policy prescriptions highlighted later on in the article – which was titled 'Why austerity is only cure for the eurozone' (Financial Times, 2011 [no pagination]) – were the following:

> ‘Governments in and beyond the eurozone need not just to commit to fiscal consolidation and improved competitiveness – they need to start delivering on these now. The recipe is as simple as it is hard to implement in practice: (…) fiscal consolidation, a smaller public sector and more flexible labour markets.’

Such policies were supported also by The German Council of Economic Experts (2012), who were recommending, along the same lines, structural reforms, especially wage cuts and labour market deregulation, to Greece and other crisis countries.

Merkel eventually did change course over the following months as pertains to the provision of financial assistance to Greece, but all the while continued to promote the conventional narrative summarised above. Consequently, the German parliament ultimately approved a rescue plan for Greece in May 2010, but only on condition of harsh austerity measures in Greece, to be monitored by the troika (the European Commission, the ECB, and the IMF). The Greek bailout raised legal issues, because of the ‘exclusion of liability’/’no-bailout’ clause, which prohibited individual and Eurozone intervention to help any single member state in trouble (The Guardian, 2010). Recall that this had been included in the Maastricht Treaty at the insistence of the German delegation. To get around the ‘no bailout’ clause, the Germans declared the Greek crisis an exceptional circumstance threatening the future of European integration (Young and Semmler, 2011). Further bailouts were approved in 2010 and 2011 for Portugal and Ireland, as well as a second one for Greece (BBC, 2012), on the rhetoric that the euro itself was at stake. Within Germany, the stabilisation of peripheral economies has been presented as an act of magnanimity in the name of saving the euro.

Pace Schäuble, this German vision of the crisis is actually far from ‘undisputable’. Non-mainstream economists have repeatedly pointed out that most crisis countries saw an increase in public deficits only *after* their governments had intervened to save failing financial institutions (see, for example, Young and Semmler, 2011). Critics of the conventional view emphasise also that competitiveness deteriorations came as a result of capital inflows from core Europe (primarily Germany and France) into Southern Europe. These inflows had made extra credit available for consumption in the latter countries, thereby pushing up wages and inflation, which subsequently made foreign goods cheaper (Gabrisch and Staehr, 2015). This is fully compatible with the empirical observation that current account deficits in Southern Europe primarily reflect an increase in imports, rather than a fall in exports, as a result of an increase in labour costs (Kang and Shambaugh, 2013). In this sense, the competitiveness problem in Southern Europe is the 'dog that barked after the crisis' (Palley, 2013), which had been the result of increased competitiveness in core countries like Germany on a background of financial liberalisation (therefore caused by real and financial factors combined). In the context of a large German trade surplus vis-à-vis the US, payments for German exports to the US were channelled through the major German banks, which used the money to invest on the US subprime market in search for easy returns, thus tying the German (and hence the European) financial system to the American one. Similarly, Germany's export surpluses vis-à-vis European countries meant a corresponding flow of money into Germany, which German banks had used to extend loans to banks in Southern Europe; this constituted cheap finance for the latter, given the real interest rate differentials, but dried up once German banks had started to feel the effects of the US subprime crisis (Palley, 2013).

Schäuble's Greek counterpart, former Finance Minister Varoufakis (2017) argued that the flaws of the EMU under conditions of financial liberalisation were the factors that had allowed Greece's economic and political weaknesses (underdevelopment, mismanagement, corruption) to turn into full-blown insolvency. With the drachma, deficits were manageable through devaluations, but once Greece had adopted the single currency, its deficits were financed and sustained through excessive cheap credit loaned by French and German banks under conditions of unrestrained capital flows, unperturbed by worries over lending to a country with a weak currency. For Varoufakis (2017), Chancellor Merkel's U-turn on the Greek bailout, disguised as an act of magnanimity in the name of saving the euro, had actually been a strategy to save German and French banks. Given that, as mentioned above, German banks had become investors on the US subprime market in search for quick profits, they had been amongst the first in Europe to suffer losses as a result of the collapse of the US subprime market (Dymski, 2013), and had to be bailed out once the US housing bubble collapsed. In 2009, the German government alone had spent €406 billion to keep German banks afloat; yet that proved to be insufficient, as soon enough French and German banks needed more money to cover the losses they had made lending to peripheral countries (Varoufakis, 2017).

According to Varoufakis (ibid.) French and German elites had then agreed to 'portray the second bailout of their banks as an act of solidarity with the profligate and lazy Greeks', turning the peoples of Europe against one another:

> 'Unaware of the fact that they were actually paying for the mistakes of French and German bankers, the Slovaks and the Finns, like the Germans and the French, believed they were having to shoulder another country's debts. Thus, in the name of solidarity with the insufferable Greeks, the Franco-German axis planted the seeds of loathing between proud peoples' (Varoufakis, 2017, Chapter 2, location 489/10668).

A poll conducted around the time of the first Greek bailout revealed that 86 % of Germans were opposed to it (Financial Times, 2010a). This opposition to Eurozone-wide redistributive policies, we argue in the following chapter, is due to a worsening of living conditions for the average German following monetary integration. Years of fiscal restraint accompanied by repeated public statements that the existing budget is insufficient to support various social projects (in education, healthcare, infrastructure) and pay or pension increases had made German workers sceptical of solidarity at the European level.

Meanwhile, German intellectuals continued to fuel 'loathing between proud peoples'. This culminated in July 2012 with an open letter published by *Frankfurter Allgemeine Zeitung* (FAZ, 2012), signed by 172 economists, stating that it is 'unfair' to ask the taxpayers of yet 'solid' economies to support 'irresponsible' peripheral countries through debt mutualisation, and complaining about the fact that debtor countries have structural majority in the Eurozone. A riposte was published by *Handelsblatt* (2012) the following day. It was authored by 7 economists who argued that the letter in FAZ only serves to fuel fear and uncertainty, containing not facts, but clichés and questionable arguments which constitute a disgrace to the economics profession. One economist part of the latter group said, in private conversation, that the idea had been to come up with a quick response, not to match the number of signatories; yet one is left to wonder whether that would have been at all possible.

This analysis so far has thus left us with two competing narratives vis-à-vis the Eurozone crisis: Schäuble's and Varoufakis's. To evaluate these narratives further, we now bring in some relevant interview findings. Considering the causes of the crisis, industrialists and policymakers generally agreed with Schäuble's diagnosis introduced above, that the Eurozone crisis is due to labour market rigidities in Southern Europe which rendered these countries uncompetitive, coupled with fiscal profligacy: ‘sovereign debt levels reached unsustainable heights’ (industry representative); ‘if you have large and persistent current account deficits, that means your products are not wanted, not competitive on a global scale’ (industry representative). The policy recommendations they made were therefore also in tune with this line of discourse: ‘only the diligent implementation of competitiveness-enhancing reforms can bring these EMU member countries back to a convergence path’ (industry representative); ‘countries such as France, Spain, Portugal, Italy, Greece should undergo country-specific labour market liberalisation reforms’ (policymaker); ‘it is not up to Germany to provide money to keep alive inefficient business models’ (industry representative). One industry representative warned that, if structural reforms are not implemented in crisis countries, ‘the failure of the unwilling will also impact the willing’.

The wage cut policy prescription was justified by interviewees as a quick policy fix: ‘if you say you are not competitive because you haven’t organised your work processes, or the quality of your products is outdated, to address that takes time. But wage cuts are things which immediately change your competitiveness’ (labour representative); ‘to build up a basis for high quality production and also to establish a reputation, so that people who go into a shop automatically think ‘’it’s a German product, or a Swedish product, it’s good!’’ is not something you can change very quickly. So I suppose that gives some sort of credence to this argument - ‘’you’re in a mess right now; in twenty years you can build up a reputation for high quality products, but what you need to do at the moment is make sure you are price competitive’’’ (policy advisor).

While this type of answers predominated, more sensitive arguments also considered the fact that competitiveness is relative – one country’s competitiveness automatically implies the uncompetitiveness of another – and raised the question of whether competitiveness is a legitimate goal in itself, or should be replaced with other values:

> ‘The wage restraint – competitiveness policy advice assumes that all countries can get out of their situation by achieving export surplus, which is obviously not possible, but still, it is an advice you can give to everybody, hoping that not everybody succeeds’ (labour representative).

> 'To talk about competitiveness is not a stupid idea necessarily; whether you put that above other concerns is the first thing, and what conclusions you draw from the fact that one has to be competitive, is another. But we tend to see that always the same kind of conclusions are drawn.' (policy advisor).
>
> 'Not every country can be like Germany; this is neither possible, nor desirable.' (industrialist)

Overall, these responses show that German elites (with some exceptions, which highlight heterogeneity) are indeed trying – and succeeding – to sell the Eurozone crisis as a crisis of competitiveness; as one labour representative concluded, 'this very strong focus on increasing competitiveness through structural reforms is a race to the bottom, and far from over yet, which is a huge problem'.

While the emphasis on competitiveness has been overwhelming, very few respondents referred to the financial dimension of the crisis. One notable exception was a labour representative who said the following:

> 'The Greek crisis has clearly shown that Germany was, or felt itself, in the pole-position, together with France. The original Greek deal in 2010 was to prevent the French and the German banking system from collapsing, because of the huge exposure of banks in both countries to Greek public debt, but also Greek private debt. It was probably one of the best-kept secrets that what was called a rescue plan for Greece was indeed a plan to rescue foreign banking systems, at the expense of the Greek population (working population, mainly, but also, retirees). It mainly served the interests of the wealthy, who have their assets parked in the accounts of those banks, or managed by those banks, and of course, of the banks themselves.'

This is extremely important as empirical confirmation of Varoufakis's (2017) narrative, as well as of non-mainstream economic literature on the euro crisis introduced above (e.g. Palley, 2013) more generally, coming from a German source. It is also in line with the comments made by a policy advisor about the close association between German and French banks, which we introduced in section 5.4 above. There, we argued that Germany as a hegemon has been acting in the interests of European financial capitalists and the dominant economic thinking that supports them. It is, therefore, unsurprising that, in crisis, it had acted to save German and French banks, as the quote above underlines. The portrayal of the crisis as one of competitiveness is thus a mere smokescreen, one which shields the true culprits, while at the same time praising the other main beneficiaries of German hegemony: 'competitive' German industrial capitalists.

b. Long-term crisis management policies: changes in EMU architecture

A wider approach to crisis management needs to go beyond immediate stabilisation policies and consider reform of the EMU architecture. Long-term policies adopted at the Eurozone level have so far all been based on the prevailing narrative introduced above, according to which the Eurozone crisis is a crisis of competitiveness. Competitiveness itself had occupied a prominent role in EU policymaking at least since the Lisbon Strategy, launched by EU leaders in March 2000, with the aim of turning the EU into 'the most competitive economy in the world' (Europa website, 2017b), but became even more dominant during the euro crisis. Schäuble (Wall Street Journal, 2012 [no pagination]) credits Germany for 'putting the restoration of competitiveness at the centre of the efforts underway in the member states to rejuvenate our economies'; this is a further indicator of German hegemony at the EMU level. As a result of the supremacy of this competitiveness narrative, the long-term solutions sought by European leaders have been limited to competitiveness provisions and strengthening fiscal rules.

A crucial moment towards such reforms was the Deauville meeting between Chancellor Merkel and President Sarkozy in October 2010. In this meeting, they had discussed the development of a permanent crisis-management fund, as well as the conditions that should be attached to financial aid, afterwards issuing a joint statement summarising their decisions. The fact that this meeting took place at the same time as national Finance Ministers were convened in Luxembourg with the purpose of designing new budget rules led to uproar over a Franco-German dominance: 'We're more or less used to Germany and France cooking things up, but this was really flagrant.', one official had told Financial Times (2010c). In this meeting, Merkel and Sarkozy agreed on private sector involvement (PSI) – on top of IMF involvement, at the insistence of the Germans – in crisis management. PSI amplified the uncertainty attached to sovereign debt, with interest rates in Southern Europe increasing to reflect greater risk. In this context, spreads with Germany – the main creditor and the country with the best economic 'fundamentals' – became the primary concern:

> 'Divergences and deviations from German orthodoxy would be swiftly sanctioned by deterioration in financial parameters and conditions (…) Although other governments often resented the new corset imposed on them, they could not resist the facts: the German economy

> was doing well, unemployment was low, and exports were booming. That made it difficult to challenge the German vision now that it had been adopted as the norm by investors and markets' (Brunnermeier et al., 2016, p 31; 33).

Therefore, the portrayal of the crisis as one of competitiveness has led to a situation where the German model, with its focus on competitiveness, is revered as a benchmark. In a column for *Financial Times* (2013a [no pagination]), Martin Wolf wrote that 'Germany is reshaping the European economy in its own image', 'using its position as the largest economy and dominant creditor country to turn members of the eurozone into small replicas of itself'. But it is a fallacy of composition to assume that all countries can achieve export surplus at the same time, which is why 'the German model is not for export', as the title of the column stated (ibid.). Seemingly unaware of this, Sarkozy's presidential campaign in France in 2012 was revolving around ways to emulate the German model to achieve comparable 'success' in international markets (the Economist, 2012)!

Chancellor Merkel herself had also stated publicly that the German model is a yardstick for success at the EMU level; in 2011, she told a group of journalists that 'we need to increase competitiveness and the yardstick should be the member state that is leading the way' (EU Observer, 2011 [no pagination]), i.e. Germany. At that time, Germany and France had come up with a so-called 'Competitiveness Pact' to promote structural reforms across Europe, on the model of Germany's labour market reforms adopted in the early 2000s (which we shall discuss in chapter six).

Being revered as a benchmark further cemented Germany's hegemonic position and increased its power over policy design. The Competitiveness Pact turned into what is now known as The Euro Plus Pact, 'a Berlin-inspired project' signed in 2011 (Europa website, 2015b) by all Eurozone member states (for which it had been originally conceived), plus six non-euro area EU countries. All of these countries are to be granted access to the EU's now permanent bailout fund upon request on condition that they implement structural reforms. The primary objective of the Pact is to 'encourage cost competitiveness' in order to reduce both 'the likelihood of financial and economic imbalances', as well as divergence between member states (Europa website, 2015b). The Pact is based on the mainstream underlying assumption that 'deteriorating cost competitiveness' was the primary cause of the Eurozone crisis (ibid.). It also made reference to the need for better fiscal governance, but fiscal rules ultimately became the topic of a second agreement. The Fiscal Compact, signed in 2012 by all EU member states apart from the UK and the Czech Republic, was an update on the Stability and Growth Pact, containing even more stringent fiscal rules. Signatory countries are required to transpose into national legislation a rule according to which the general government budget needs to be in balance or surplus ever year (ECB, 2012). This effectively enshrines austerity into law and constrains growth.

Interview responses also capture the manifest tendency to treat Germany as a benchmark, as a result of the competitiveness narrative: 'German representatives should rather use their influence to trigger a consistent implementation of structural reforms in the crisis countries' (industry representative); 'we could help other governments, give them some advice what to do and what not to do' (policymaker); 'political leaders are somehow of the conviction that the way they do it should serve as an example for the rest of the world (…) ''we are that successful, so how we do it must be the right way'''(industry representative).

Interviewees also highlighted that this, in turn, increased German power over policy design. An important finding from the interviews overall is that, when asked to describe Germany's current role in the Eurozone, interviewees (industrialists less than the other two categories of respondents, though) talked about power more openly than expected, as illustrated by the quotes below:

> 'People in the early 2000s would never have said, like they do now, that the Chancellor of Germany runs Europe. The political power of the German government, or the Chancellor, the Finance Minister, relative to their peers, has shot up' (policy advisor).
>
> 'Over the last eight years or so, all Eurozone policies have been crisis policies. Germany has been a major player in these policy areas, as well as in the concrete situation of crisis countries, influencing the Troika politics. It's the German Finance Minister who says 'it should go this way, it should go that way'; it always looks like a European thing, but there is a huge influence, a dominance by the Germans, the German Finance Ministry' (labour representative).
>
> 'Germany has manoeuvred itself in a position where it has the best so-called fundamentals, the lowest interest rates. The crisis has put Germany, as a main creditor, in the driving chair. Germany is the leader of the EU, everyone owes Germany money. To the extent that countries like the Netherlands, Belgium, Austria do not owe debt to Germany, they are also part and parcel of the German industry-dominated supply chain, and creditor nations themselves; they are small countries also, so they huddle up with the German leadership, so you get this alliance of creditors under the heading of Germany that is dictating the rest of the euro area what to do' (policy advisor).

These responses represent a significant overt admission of German hegemony from within the country, as well as a suggestion that this hegemony had been made even stronger by the crisis. They also reinforce the notion that Germany's management of the Eurozone crisis benefitted the wealthy, in the name of the dominant economic thinking. However, interestingly, only one participant (labour representative) used the word *hegemon* as such. The person gave it positive connotations, along the lines of HST: 'rather than accepting the role of the hegemon, which always implies responsibility for your partners, the Germans were sort of bulldozering over the rest of Europe, without much resistance…'. This suggests that the reductionist HST-version of hegemony has become dominant outside academic circles as well.

c. The structural lock-in of the EMU: German politicians as simultaneously powerful and powerless?

The analysis so far suggests that German hegemony in the EMU has been fortified by the crisis. This position cannot and should not, however, be reduced to pure domination by individual politicians within Germany, to 'rigid ethics of punishment' (Bonatti and Fracasso, 2013). Recounting his experiences as Finance Minister negotiating a deal for Greece, Varoufakis (2017, Preface, location 81/10668) wrote that the euro crisis is 'the story of what happens when human beings find themselves at the mercy of cruel circumstances that have been generated by an inhuman, mostly unseen network of power relations', such that his battle was with 'the establishment' rather than any particular politician. This is most tellingly illustrated through Varoufakis's account of his interactions with Germany's Finance Minister, a man described as having full control over Eurogroup meetings (informal meetings of the finance ministers of the Eurozone) and renowned for his intransigence. Yet Schäuble is also someone who had told Varoufakis in private conversation that he had always known the construction of the euro was flawed from the start in the absence of political union, and admitted that austerity would not help.

Presumably, what Schäuble had in mind when he told Varoufakis that 'the Eurozone is constructed wrongly. We should have a political union, there is no doubt about it. So, you see, (…) the only way I can keep this thing together (…) is by greater discipline' (Varoufakis, 2017, Chapter 15, location 7311/10668) is the structural lock-in of the Eurozone, which we introduced in chapter three. To reiterate, this lock-in, as we have argued in chapter three, denotes the present situation where wage and labour market policy are the only available adjustment mechanisms at the Eurozone level. This is the result of monetary integration ('one-size-fits-all' monetary policy) on a background on financial liberalisation, which also constrains fiscal policy, given that member states borrow in a currency they do not issue. From Varoufakis's point of view, Schäuble is all too aware of this impasse.

Equally aware had been other German politicians before him. In fact, immediately following Maastricht, German politicians were insisting on the need for a political union to complement monetary integration, with Chancellor Kohl declaring in 1992 that 'it would be a betrayal of history if political union were not brought about by the end of this decade' (The Guardian, 1992, p 1). Kohl was preparing at the time a proposal to strengthen supranational institutions, especially the European Parliament, and reduce the EU's democratic deficit, but defensiveness over national sovereignty ultimately put an end to this ambition. This shows that German elites are, and have been, aware of this lock-in, but at the same time, they are not solely responsible for it.

Presently, German politicians are also constrained by this lock-in. They are simultaneously powerful and powerless, as the conclusion of Varoufakis's narrative of his interactions with his German counterpart suggests:

> 'By that stage Wolfgang looked like a broken man. As I departed that day, I was not leaving behind me a Machiavellian dictator; I was leaving behind a sunken heart, a man ostensibly more powerful than almost anyone in Europe who nevertheless felt utterly powerless to do what he knew was right. As the great tragedians have taught us, nothing causes greater wretchedness than the combination of supreme authority and wholesale powerlessness' (Varoufakis, 2017, Chapter 15, location 7434/10668).

Interview responses also demonstrate that German – as well as European more generally – elites had been aware of the design flaws of the euro, and of the fact that they would eventually cause an impasse:

> 'When we had discussions with the Economic Committee of the ETUC [European Trade Union Confederation] in the '90s, we had one member of the Delors cabinet – after the meeting, in the corridor, he told a group of us, 'we're going to create the euro, that's going to cause so many problems, that European politicians and governments will have no other choice than to proceed with European integration.' […] The words of this cabinet member of Delors were rather enlightened, but also underestimated the consequences of it' (policy advisor).

> [In the 1990s] It was discussed, not so much in the public, but within the trade unions, that the problem of a big external shock would be that – it was clear from the beginning – the only thing they would focus on would be wages, because that's the only thing they immediately have. But then I think everyone just hoped that it would not happen… (labour representative).

On the other hand, there were some respondents who perceived this impasse as simply a desire to maintain the status quo, rather than the lock-in it truly is: 'the Chancellor and the Finance Minister are happy with quite a lot of things. Germany does not really see a need to change things. It's more focused on enforcing the existent institutions and rules' (industry representative); 'Germany is interested in the status quo. I think the main interest is that everything stays the same' (labour representative). But this perceived idleness of German politicians in itself can also be understood as an indicator of powerlessness. Of Chancellor Merkel, one interviewee said that 'domestically, she stays in the background and says nothing in Parliament; it's only in the EU where she appears to be determined and focused, but at home she's not'. This matches Varoufakis's (2017) impression of Schäuble as simultaneously powerful and powerless.

What future is there, then, for the EMU? Overall, the German industrialists we interviewed shared a more positive view of the euro system than policymakers or labour representatives. Some issues of design and governance were raised, such as the need for a banking and capital markets union, but industry representatives insisted that fiscal integration, a European social policy, and political union are 'dispensable', the current EU budget is 'probably not necessary', structural reforms are the way forward, and the Fiscal Compact is a step in the right direction. By contrast, labour representatives emphasised the need for fiscal transfers, joint liability and debt mutualisation mechanisms, a reform of the ECB, a comprehensive and active industrial policy to correct imbalances, as well as financial reform, especially in the sense of a re-separation between commercial and investment banking. They also said, however, that such reforms are as unlikely to be implemented as they are necessary. Such policies are incompatible with the interests of powerful industrial and financial capitalists that German hegemony has been representing at least since Maastricht.

If the structural lock-in of the EMU is openly acknowledged, this would, in our view, lead to two options: European leaders would either have to agree to the dismantling of the Eurozone, a colossal political and economic risk, or alternatively, to the implementation of redistributive policies to create a level-playing field, which would, however, go against the interests of powerful European capitalists. To change the construction of the EMU would mean to challenge both current economic thinking and the societal factions supported by this thinking. It would require a systemic and ideational transformation, a complete change of course: in the words of an interview respondent, 'the whole culture and way of looking at monetary and economic things would need to change radically' (labour representative). It is then perhaps no wonder that instead of conceding that the EMU is facing a deadlock, European elites describe this publicly as a crisis of competitiveness. As one policy advisor concluded, 'the most likely scenario is that we keep on muddling through, until there is another crisis that cannot be muddled through'. The EMU – and, by extension, German hegemony within it, albeit appearing fortified at present – is on a slippery slope.

5.6. Conclusions

This chapter aimed to contribute to the literature on German hegemony in the EMU by analysing the ways in which Germany has shaped monetary integration. We left behind the dominant, reductionist HST approach that emphasises axiomatic functions of hegemony based on the US during the early Bretton Woods years as an 'ideal type'. This approach, as shown in chapter three, leads to the argument that Germany had been hegemonic in the EMU before the crisis, when the Eurozone was characterised by relative stability, and is not hegemonic in the more recent context of instability. Instead, the empirical assessment in this chapter has built on more critical parts of the extant literature on German hegemony, which pay attention to the nature of German hegemony in the EMU, and the conditions behind Germany's leadership position. Nevertheless, our approach differs from this literature too, as we discard the assumption of homogeneity by questioning whose interests are being served by German hegemony, as well as by including the voices of the researched into the analysis via interview responses.

We argued that German elites held considerable influence over the design of the monetary union in Maastricht negotiations, and characterised this as hegemony by design. We then showed that Germany as a hegemon is not homogeneous, but instead has been serving the interests of German industrial capitalists and European financial capitalists, at Maastricht and beyond. This constitutes the primary condition behind Germany's leadership position: Germany has been successful in imposing its policy preferences at Maastricht because these were in tune with the dominant free-market economic thinking and the societal factions supported by this thinking. In terms of the Eurozone crisis, German elites had constructed, in the short-run, a narrative according to which the problem with the EMU are competitiveness deficiencies in Southern Europe. This narrative, which as a result of German hegemony became dominant, masks the culpability of European financial capitalists while simultaneously praising German industrial capitalists for their competitiveness. This depiction of the German model as a success story fortified German hegemony at the EMU level in terms of long-term policy design. But simply disguising the design flaws of the euro, which, on a background of financial liberalisation, degenerated into a structural lock-in, as a crisis of competitiveness, does not solve the problems of the EMU. The fact that the flawed design of the monetary union favours the interests of capitalists blocks much needed EMU-level reform; European political elites are well aware of this, but also constrained by those powerful interests. As such, the main problem with the EMU are not merely institutional design flaws, but the power relations behind them.

For now, we conclude that Germany is clearly hegemonic in the EMU, promoting the wider interests of German and European capitalists, and the free market ideologies supporting them, which makes its power more entrenched, and simultaneously more diffuse. But the future of the EMU looks bleak; Germany's dominant position within it is not sustainable indefinitely either.

Chapter six: Change in the German model as a result of monetary integration

6.1. Introduction

The purpose of this thesis has been to analyse the role of Germany in the EMU, in the wider context of debates about German hegemony. We aimed to undertake this analysis in a way that is more sensitive to change and heterogeneity than conventional IPE, entertaining the possibility that Germany simultaneously shapes, and is shaped by, monetary integration, in complex interactions.

In chapter four, we started from the observation that, in European debates, Germany is often equated with the German model. The perceived features of the model can be summarised as a strong export focus, tight monetary policy and fiscal conservatism at the macroeconomic level, and close, cooperative relationships between employers and employees on the one hand, and employers and financiers on the other, at the meso- and microeconomic levels. These micro- and meso-level relationships are said to result in high job security and pay, as well as high-quality production. We noted that continuity emerges as a property of the German model in those schools of thought (VoC, RS) that assume and emphasise institutional complementarity, with stability implicit in complementarity. The RS approach studies the German model primarily in contradistinction to the French one, whereas in the VoC literature the key comparison is between Germany and the US; these two approaches therefore focus on dualisms (diversified quality production versus mass production, coordinated versus liberal market economies), often omitting interactions between countries. The centrality of the notion of institutional complementarity, coupled with limited attention paid to interactions between countries, perpetuate the fixity bias typical of problem-solving theories of hegemony.

In chapter five, we looked at the ways in which Germany has been shaping monetary integration, highlighting that the portrayal of the Eurozone crisis as a crisis of competitiveness made the German model a yardstick for success. Interview responses on the role of Germany in the EMU underlined that German exporting industries are primary beneficiaries of European monetary integration, revealing an important continuity as pertains to the German model: namely, that export focus at the macroeconomic level remains a dominant interest in German policymaking.

This chapter, by contrast, focuses on change in the German model, considering the reverse perspective: the ways in which monetary integration has shaped Germany. It thereby challenges the static models introduced in chapter four, and fixity biases in hegemonic theory. We argue that, while the German macroeconomic focus on exports and competitiveness has endured in the context of the EMU as a new institutional framework, the way competitiveness is achieved has, however, changed, producing an upheaval in meso- and microeconomic relationships within Germany. We combine academic literature, official policy documents, media sources, interview responses, and quantitative data, to demonstrate that, using monetary integration as a cover, Germany's export model has adapted at the expense of German workers, increasingly shifting away from quality competitiveness to price competitiveness. Back in the early years of the euro, Ryner (2003, p 202) highlighted the paradox that, while German elites appeared to be the principal 'enforcers and guarantors' of the hegemony of free market ideology at the European level, through the role they had played in EMU design, domestically the country was still characterised by an extensive redistributive welfare system, linked to a dynamic export sector. It will be shown in this chapter that the idea that the German model relies on close relationships between employers and employees to their mutual advantage is not supported by present economic realities. Reality does not consist of institutional complementarities, but rather of transient arrangements – in Germany's case, arrangements that support its export drive. While a benchmark for other European countries, *Modell Deutschland* is therefore not time-invariant, but shifting terrain, which makes German hegemony all the more elusive.

Chapter six is structured as follows. Section 6.2 below summarises the relevant scholarly literature on change in Germany's economic model, arguing that these sources implicitly raise the question of how Germany competes, as well as whether this has changed throughout the past decades. This leads us then, in section 6.3, to search for answers to these questions, in German policy documents and interview material, triangulated with quantitative data. Albeit characterised by a high degree of ambiguity, these sources taken together nonetheless suggest there has been a shift from quality to price competitiveness following the Hartz labour market reforms of the early 2000s. These reforms constitute the topic of section 6.4. There, we start by presenting the official narrative within Germany, which posits that this policy measure had been necessary to overcome the challenge of monetary integration, and to put the German model back on track. We then use interview responses, supported by quantitative data, to construct an alternative narrative, which argues that monetary integration provided powerholders in Germany with a pretext for labour market liberalisation as part of a wider process aimed at disciplining German labour force. We show that the Hartz reforms have undercut the micro- and meso- aspects of the German model through a precarisation of employment and a weakening of labour representation. Section 6.5 concludes.

6.2. Literature on change in the German model: from quality to price competitiveness?

Whereas chapter four discussed literature that views the German model as continuous, the purpose of this section is to introduce literature that, by contrast, emphasises change. We shall see below that those scholars who argue the German model has changed or was ephemeral likely base this on an implicit understanding that Germany may have competed on quality in the past, but now does so increasingly on price (costs), although they do not openly state this. Therefore, the question of whether or not there exists a continuous German model, as debated in the literature, enshrouds another question: that of how Germany competes. This is not to say that the relevant literature is devoid of ambiguity or contradictions. On the contrary, there are also scholars (e.g.: Boyer, 2015, discussed in chapter four) who, despite noting changes in Germany's competitive strategy (from an alleged complementarity between diversified quality production and cooperative labour relations to competitiveness at the expense of pay, welfare and domestic consumption) ultimately still believe in a continuous model. This is due to their basic assumptions about how the economy works – a devotion to the static VoC/RS models we introduced in chapter four.

Perhaps the most well-known narrative emphasising change in the German model, written by a German author, is that developed by Streeck (2009, 2015a). He argues that the 'model' discourse was 'a purposefully created political myth' (Streeck, 2009, p 113), born out of a desire to demonstrate that capitalism and social justice are not mutually exclusive. The narrative goes that traditionally, German industry was characterised by specialisation in diversified quality production (Streeck, 2015a), with German exports having a very low price elasticity. This is why, Streeck argues, successive revaluations of the Deutschmark, starting in 1969, actually increased Germany's trade surplus instead of reducing it. This, in turn, made Germany slow to follow other countries in their transition to services, as it was still reaping considerable gains from manufacturing; even where there was an expansion of services, these were usually related to manufacturing (e.g. maintenance and repair services, sale). This phase of quality competitiveness is described by Streeck as akin to a public good, benefitting German society at all levels, resulting in 'a stable pattern of labour inclusion, with strong trade unions' (ibid., p 82), in the context of a strong welfare state preventing a race to the bottom in labour standards, incentivising firms to innovate instead so they can retain competitiveness.

However, this all came to an end, Streeck argues, in the 1990s, as a consequence of intensified globalisation and monetary integration pressures, which opened new debates centred around ways to maintain or increase competitiveness. In this period, external outsourcing threats mounted, given the relative ease of relocating manufacturing processes. Internal outsourcing was made possible through the deregulation of temporary employment, leading to an increasing number of workers being loaned from temporary work agencies, with opposition from unions, but tacit consent from works councils (Streeck, 2015a). Labour market deregulation, along with privatisations, had an intimidating effect on workers, exerting downward pressure on wages, and leading to a rise in inequality, Streeck adds. In his view, cooperative relations between employers and employees broke down not because of poor economic performance, but due to the maturation of the capitalist contradiction between the social organisation of production and the private appropriation of surplus (Streeck, 2009). He concludes that there is no time-invariant German model; rather, Germany has responded differently to capitalist developments at various points in time:

> 'National models exist, or may be socially constructed to exist, as long as their elements happen to be so configured that their internal tensions and mutual dysfunctions are kept sufficiently in check for the system to ''work'' and project an appearance of organic coherence. No guarantee can be offered, however, that this will always remain so' (ibid., p 108).

However, this conclusion is, to some extent, inconsistent with Streeck's mention of diversified quality production, a notion he had coined to describe Germany's economy in the 1980s in direct opposition to French mass production/ Fordism, and which thereby betrays his own implicit thinking in terms of national models. Another contradiction is Streeck's description of the rise in German trade surpluses following successive currency revaluations as embodying an inverted J-curve pattern (Streeck, 2015a): if this were so, however, surpluses should have gradually turned into deficits, as a result of a shift from low to high export price elasticities – which is in itself inconsistent with the idea of German exports traditionally having one of the lowest price elasticities in the world. These inconsistencies aside, the main point – although not explicitly stated – appears to be that globalisation and integration altered the German model by changing the way in which Germany competes, at the expense of German workers.

Similar accounts can be found in Lehndorff et al. (2009), Allen (2010), or Eichhorst (2015), with minor differences. Like Streeck, Lehndorff et al. (2009) argue that the 'model' narrative aimed to prove that economic growth is compatible with social equality, and that during the 'economic miracle' years Germany relied on high-quality manufacturing, with export gains being fairly distributed through high pay and high job security. However, their narrative differs from Streeck's in that the turning point they identify is German reunification at a 1:1 currency rate, which turned the economy of East Germany uncompetitive overnight, triggering campaigns for labour market liberalisation which weakened the position of German labour, ultimately leading to 'upheaval' in the German model, which became 'contested terrain' thereafter (Lehndorff et al., 2009, p 127). For Allen (2010), the model 'eroded with a whimper', the breakdown of cooperative employer-employee relationships arising as a result of the exogenous factors enumerated by Streeck (2015a) and Lehndorff et al. (2009), combined: reunification, globalisation, and monetary integration pressures. Allen (2010) also mentions the possibility of endogenous factors at play, i.e. the model fading naturally after Germany finalised its catch-up process as a late industrialiser. Eichhorst's (2015) narrative is centred around the concept of German labour market dualisation into core (high pay, high job security) and marginal (low pay, low job security) employment, with the key point of divergence from the aforementioned sources being his belief that low pay and precarious work in the service sector had been introduced to increase competitiveness of the service sector itself, not just to cut the costs of services annexed to manufacturing.

These sources summarised above therefore implicitly suggest that change in the German model actually reflects change in the way in which Germany competes – a shift from quality to price competition which undermined the cooperative relationship between employers and employees (the micro-meso dimension of the German model); opinions diverge as to the factor(s) that caused this shift, but monetary integration is generally mentioned as a challenge. In the remainder of this chapter, we develop our own narrative that contributes to existing literature on change in the German model in three main ways. First, we explore further the question that is implicit in this literature – that of how Germany competes – drawing upon German policy documents and interviews with German elites. Secondly, while extant literature treats monetary integration as a challenge to German policymaking, we argue that, instead of having been a real challenge, monetary integration had provided powerholders in Germany with a further *pretext* to push for labour market liberalisation, part of a longer-term process to discipline German labour force, which started soon after German reunification. A third contribution is methodological: our chronicle of change in the German model triangulates information across a variety of sources: interviews, policy documents, quantitative data and media sources.

6.3. How does Germany compete? Evidence from policy documents and interviews

At the time of writing, Germany is running a current account surplus of 9.2% of GDP (OECD, 2017a), with exports constituting 46% of GDP (OECD, 2017f). Its world export market share is 7.84%, third after China and the US (having peaked in the mid-2000s and been second only to the US until 2010, when it was overtaken by China) [OECD, 2017a]. It continues to have the greatest share of intra-EU exports (as was the case throughout the 2000s), currently at 22.8% (Eurostat, 2017a). These data reflect that export focus is an unchanging macroeconomic pillar of the German model. This explains why, in turn, competitiveness remains the dominant theme within German political discourse: given that exports constitute such a large proportion of GDP, being competitive 'becomes a question of survival', industry representatives said in interviews.

However, 'being competitive' can mean a variety of different things. Based on policy documents analysis and interview findings (amongst which we place also some data where relevant, to illustrate or verify points made), this section shows that, while the emphasis on competitiveness represents continuity in German policymaking, the way in which competitiveness is achieved has changed in practice. While at first glance none of these sources seem to have any particular interest in setting the record straight as pertains to the ways in which Germany competes, being riddled with contradictions and inconsistencies, they – like the literature summarised in section 6.2 above – nevertheless hint at a shift away from quality to price competitiveness, following the Hartz labour market reforms.

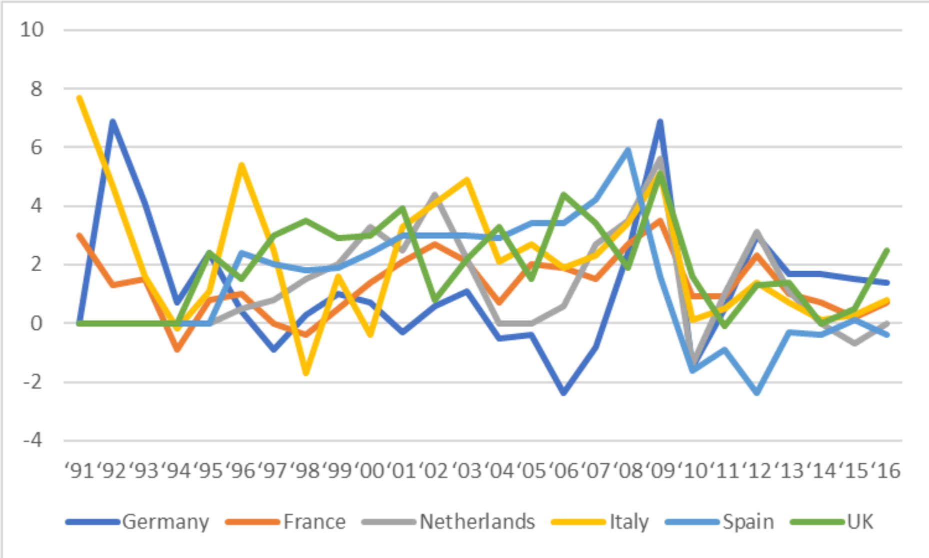
a. The notion of competitiveness in German policy documents

During the euro crisis, Chancellor Merkel specified that Germany's policy focus is 'greater competitiveness to make sure Germany is fit for the future' (German Federal Government Archive, 2013b [no pagination]). This reconfirmed earlier statements that formed part of Germany's 2011 National Reform Programme (Europa website, 2017c [no pagination]); there, the policy of the German government was described as 'geared towards competition and open markets'. Even in the face of criticism from abroad, German elites continued to emphasise competitiveness. Most notably, the US Treasury (2013, p 3) expressed concerns that 'Germany's anaemic pace of domestic demand growth and dependence on exports have hampered rebalancing' globally following the financial crisis, forcing a deflationary bias upon the world economy. A spokesperson for the German government responded to this criticism by saying that 'there are no imbalances in Germany that need correction', and there is altogether 'no cause for concern', describing demand as 'stable' and wage growth as 'robust' (Financial Times, 2013b [no pagination]). Chancellor Merkel later also stated that artificially reducing German exports is in no one's interest (German Federal Government Archive, 2013a).

The notion of competitiveness is central to most policy reports issued by German institutions; the concept is, however, never clearly defined, and often within the same document we can observe frequent oscillations between arguments that Germany competes mainly on quality and that it competes primarily on price. A case in point is a policy brief issued by the German Ministry of

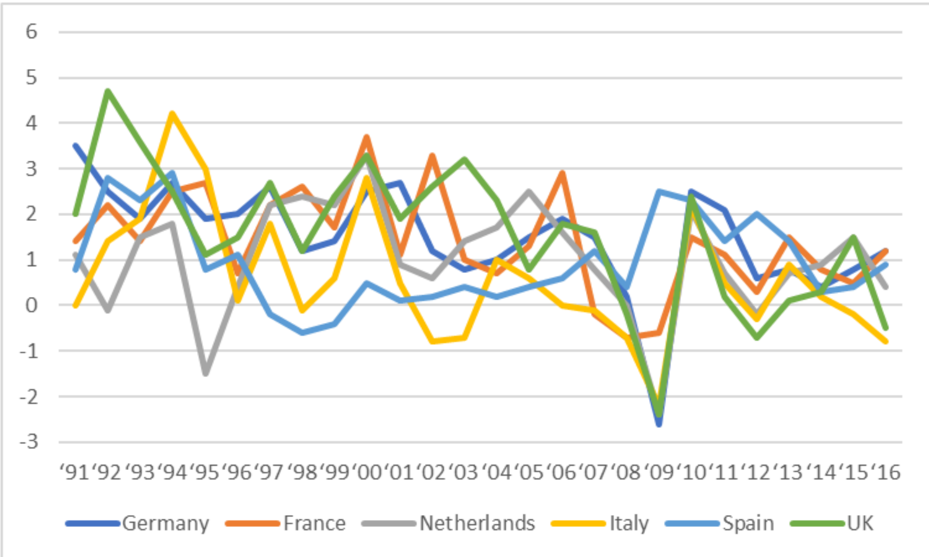
Economics (BMWi, 2010), titled ‘Germany as a competitive industrial nation’. This starts by claiming that Germany improved its competitiveness throughout the 2000s due to a combination of successful labour market liberalisation reforms (the Hartz reforms) which reduced unit labour costs, and a high level of specialisation in manufacturing coupled with high labour productivity.

Figure 6.1.: Unit labour cost growth (%), 1991-2016, selected EU countries



Source: OECD, 2017c. Unit labour costs calculated as total labour compensation per hour worked/output per hour worked (labour productivity).

Figure 6.2.: Labour productivity growth (%), 1991-2016, selected EU countries



Source: OECD, 2017c. Labour productivity measured as GDP/hour worked, in US $, at constant prices, 2010 PPPs.

Indeed, in Figure 6.1 above, German unit labour cost growth is easily distinguishable as much lower compared to that in other European countries between 2000-2008. On the other hand, comparative data on labour productivity growth, plotted in Figure 6.2 above, demonstrate that the trajectory of this variable in Germany's case is not dissimilar to that of other EU countries, calling into question claims about high labour productivity made in the aforementioned document.

'A large domestic market and modern infrastructure', as well as 'a motivated and skilled workforce' are also mentioned in the document as important factors that explain high German competitiveness (BMWi, 2010, p 8). Incongruently, a few pages later (ibid., p 16) we are told that a skills shortage constitutes 'an urgent problem' for German industry! In the end, recommendations for further cost-cutting to reduce labour costs that remain 'high' in international comparison, despite the decline over the last decade, betray a drive towards price competitiveness rather than quality.

A similar picture emerges if we analyse reports issued by the German Council of Economic Experts throughout the 2000s and 2010s. Representatives of this institution (German Council of Economic Experts, 2014), matching Merkel's stance mentioned in the opening paragraph of this section, wrote that no action is required on Germany's part as a result of US criticism vis-à-vis its trade surpluses. This is ironic, for an institution that was, nominally at least, established to advise the German government how to maintain, among other things, '**equilibrium** in foreign trade' (German Council of Economic Experts, 2005b, p 44, emphasis added). In the same document responding to US Treasury criticism, they added both that Germany's advantage is simply a low price elasticity of exports, because it produces goods that are highly differentiated and specialised, and that, on the other hand, cuts in corporate tax and wage moderation by collective agreement between 2000-2007 contributed to an improvement in competitiveness. Their claim that demand for German exports is not sensitive to price directly contradicts a previous report, which had stated that 'the numerous appreciations of the D-Mark in the past caused severe economic problems for exporters and destroyed many jobs on balance' (German Council of Economic Experts, 2011, pp. 1-2). Moreover, an analysis of the policies implemented by the newly-elected coalition government in 2009 concluded that 'the coalition agreement does not go far enough towards making the labour market more flexible': the rejection of a national minimum wage and the facilitation of temporary employment contracts are cited as positive developments, but all in all the government is being criticised for not making collective bargaining rules 'more flexible' and for failing to reject 'the equally harmful idea of industry-specific minimum wages' (ibid., 2009, p 4). The 2007 report (ibid., 2007, p 1) previously spoke of 'a marked improvement in German firms' price competitiveness' due to the Hartz labour market reforms, whereas in 2005 they wrote that 'many German firms are proving to be competitive on the world markets both in terms of prices and technology' (ibid., 2005a, p 2). Like the Economics Ministry policy brief mentioned above, these reports thus oscillate between arguments that Germany competes primarily on quality versus primarily on price, but the repeated focus on labour market flexibilization starting with the Hartz reforms betrays the importance they place on price competitiveness as opposed to quality.

b. The notion of competitiveness in interview responses

'In Germany, there has been a narrative for a long time that all that counts is competitiveness', a policymaker emphasised in one of our interviews. That much is agreed upon; however, as was the case with the policy documents mentioned above, things become more muddled when trying to identify how Germany competes exactly.

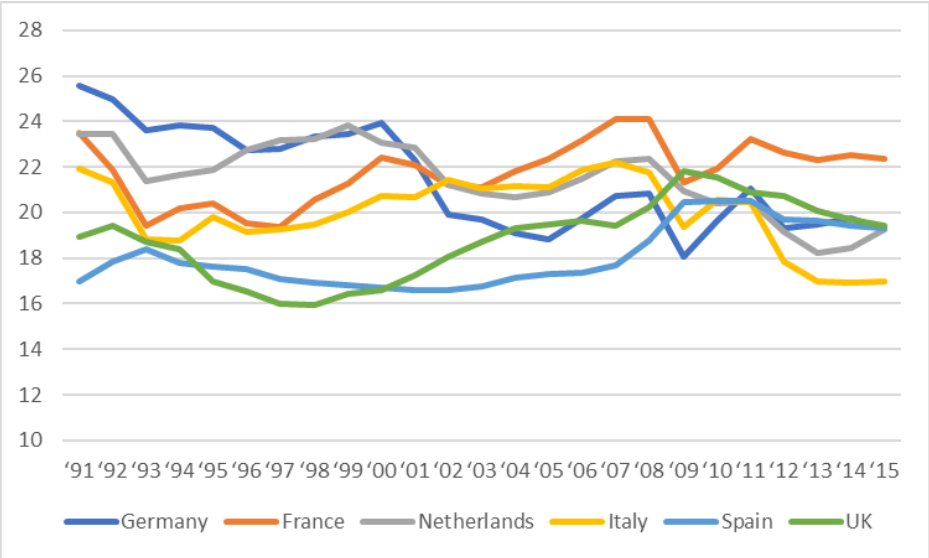
In the first instance, most interview participants suggested that Germany competes on quality, with a strong manufacturing sector specialising in products for which demand is not very sensitive to price, and having built an international reputation during the past decades. Structures, institutions, and social dialogue were also thought to be essential to German success. 'The strength of the German exports is based on comparably high productivity in Germany', one industry representative insisted. Industrialists talked about a continued importance of the German *Mittelstand* (medium-sized companies), a high degree of innovation, and the promotion of renewables (*Energiewende*). One industry representative said that, compared to other countries, what makes Germany stand out is 'a completely different openness to manufacturing', which is 'unique'. The car industry was described by another respondent as 'the inner engine that drives the German economic model', an epitome of quality competitiveness.

On the other hand, some industrialists have said that the German government is not doing enough to promote competitiveness, that corporate tax reductions would be needed, and that it is a wonder that Germany has remained competitive in spite of labour costs that are deemed by them to be 'too high' (betraying a notion of price competitiveness rather than quality). Obfuscating the issue even more, one industry representative said that labour costs cannot be an issue for German entrepreneurs, because these are 'totally taken out of your control' as part of the collective bargaining setting, insisting that the only viable option to reduce labour costs is 'transferring everything to Eastern Europe'. Industrialists sometimes mentioned a shortage of skilled labourers, but other respondents vehemently disagreed: 'that's simply not true, they are only after cheap employees!'.

The notion of quality competitiveness as applied to the German car industry has also been challenged by some interviewees. A labour representative said that the German car industry 'has no concept for the future', and is riddled with problems in terms of quality. This person added that innovation in German industry is nothing more than a myth. This resonates with arguments in the literature that German industrialists had grown complacent after the 'miracle' years, failing to innovate and update the quality of their products, generating a problem of managerial failure as early as the 1990s, when already only 16% of German products could be classified as high-quality (Bloch and Groth, 1998). The interview respondent referred to the Volkswagen scandal which erupted in September 2015, when the public was informed that Volkswagen had equipped their cars with software to circumvent emissions regulations. According to German newspaper FAZ (2015), the illegal software had been designed and installed as early as 2005. Amidst the scandal, Germany's Minister of Economics, Sigmar Gabriel, expressed worries that the quality reputation of Volkswagen, as well as of Germany's car industry as a whole, would suffer (The Guardian, 2015); some scholarly outputs maintain that this has indeed been the case: 'Volkswagen (VW) has traditionally been known as a quality brand of automotive organization; but now they will also continue to be recognized as a global company that wilfully and consciously manipulated their cars' software to falsify data' (Cavico and Mujtaba, 2016, p 303).

Other respondents argued that Germany's lack of investment hampers productivity and quality competitiveness. A labour representative said that fiscal conservatism has led to a chronic lack of public investment and decaying infrastructure, directly contradicting assertions about high-quality infrastructure made in official policy documents (e.g. BMWi, 2010). Indeed, total investment as a proportion of GDP has been considerably lower in Germany than in other EU countries for the last 15 years, as shown in Figure 6.3. below.

Figure 6.3.: Investment as a share of GDP (%), 1991-2015, selected EU countries



Source: World Bank, 2017. Investment as gross fixed capital formation: outlays on additions to the fixed assets of the economy plus net changes in the level of inventories.

One policymaker's conclusion stands out amidst this diversity of opinion. The respondent explicitly stated that Germany may have competed on quality in the past, but 'over the last ten years or so, it became more focused on price-competition'. The switch to price competition happened, according to this interviewee, via the Hartz labour market reforms of the early 2000s. It is this specific policy measure and its effects, we now turn to, in section 6.4 below. While the policy documents mentioned in section 6.3a above refer to the Hartz reforms from the perspective of the decline in unit labour costs, in the following section we show that the effects of these reforms are more far-reaching than just wage restraint. Domestic changes in Germany encompass the wider spectrum of *labour relations*, including pay, but also job security, type of employment, and strength of labour representation, reflecting an upheaval in the micro and meso fabric of the German model.

6.4. Domestic policy change in the context of monetary integration: the Hartz reforms

The previous sections argued that, while competitiveness has remained a dominant theme in German policymaking as a result of a continued export focus at the macroeconomic level, there has been a change in the way in which competitiveness is achieved in practice. Literature on change in the German model, policy documents, and interview responses, all point to labour market deregulation via the Hartz reforms as the turning point that marked a switch from quality to price competitiveness in the context of monetary integration. In this section, we explore the links between monetary integration, the Hartz reforms, and changing labour relations within Germany.

a. The Hartz reforms – cause and effect: the conventional narrative

The Hartz reforms, named after Peter Hartz, the former Volkswagen personnel director who had chaired the reform committee (Gerhard-schroeder.de, 2017a), consisted of four successive reform packages (Hartz I-IV), adopted over 2003-2005. These included legislations to deregulate temporary employment, to bundle together unemployment and social welfare benefits as well as reduce benefit payments overall and tighten the criteria for obtaining assistance, and to allow and promote marginal and informal employment through the creation of the so-called ‘one-euro jobs’ or ‘mini-jobs’: low-paid short-term or part-time work, exempt from social security contributions (Rinne and Zimmermann, 2012). They had been presented to the German public as a necessity, as a means by which to save the German model when faced with the challenge of monetary integration.

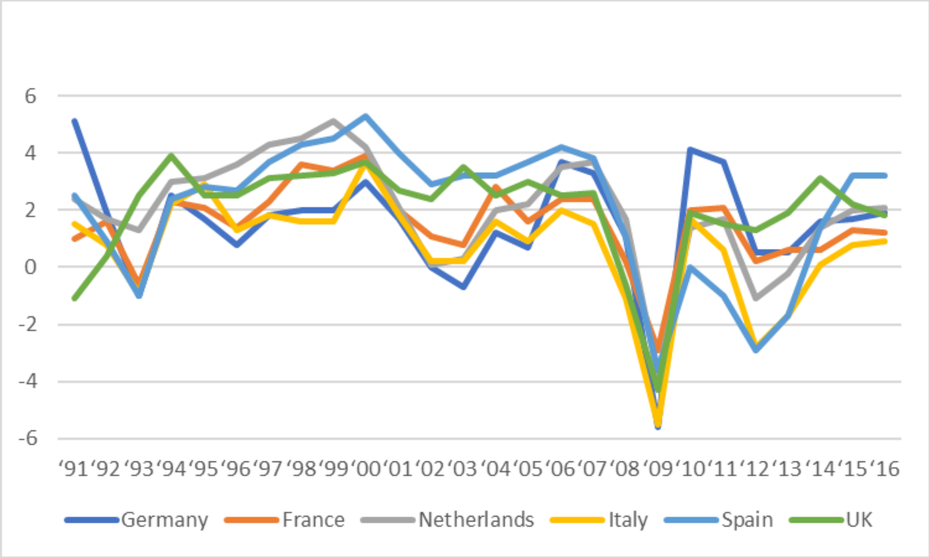
At the time when the EMU was launched, the most publicised aspect about the German economy was its ill-fated status as ‘the sick man of Europe’ (The Economist, 1999 [no pagination]), plagued by slow growth and high unemployment. Germany’s ‘ills are a main cause of the euro’s own weakness’, *The Economist* wrote back then; according to them, tight monetary and fiscal policy in accordance with EU rules, along with the challenge of integrating the two Germanies, and the crisis in emerging markets which led to a decline in those countries’ demand for German products, made matters worse, but were not the root cause of Germany’s woes. Rather, ‘a byzantine and inefficient tax system, a bloated welfare system and excessive labour costs' were to blame, in their view (ibid.).

Within Germany too, leading economists such as Hans-Werner Sinn had been staunch promoters of this conventional view that Germany had become too expensive, and was for that reason lagging behind its competitors in the monetary union. The solutions proposed to save the German model, therefore, were tax cuts, a cutback in the welfare state, and labour flexibilization to give firms 'the right to agree wages below the negotiated level' (Sinn, 2003). Those very policies were implemented in the early 2000s by Chancellor Schröder's (social-democratic) government, under the 'Agenda 2010' heading: cuts in corporate tax (which went down from 40% to 25% during Schröder's time, and sank even further thereafter, currently at 18%), along with the Hartz labour market and welfare system reforms (Gerhard-schroeder.de, 2017a).

The official reason given by Schröder for the Hartz reforms in his speech presenting 'Agenda 2010' to the German Bundestag in 2003 was that 'Germany is suffering from slow growth, the causes of which are among other things structural'. He added that his government 'have made great efforts to increase labour market flexibility' and 'will take steps beyond the Hartz reforms to open the labour market' (Gerhard-schroeder.de, 2017b). As for the consequences of this policy change, Schröder's personal website now states that 'thanks to the reforms, Germany's economic competitiveness grew stronger and the number of unemployed dropped by around two million' (Gerhard-schroeder.de, 2017a). Titles of academic works such as *From Sick Man of Europe to Economic Superstar* (Dustmann et al., 2014) also hint at a spectacular recovery which readjusted the German model, helping it adapt to the new EMU environment.

Data showing the trajectory of GDP growth plotted in Figure 6.4 below, however, call into question Germany's 'economic superstar' label. Indeed, German GDP growth was lagging behind other EU countries throughout the 1990s, before eventually increasing in the mid-2000s, but it only surpassed GDP growth in other EU member states for a brief period after the financial crisis, before declining again.

Figure 6.4.: GDP growth (%), 1991-2016, selected EU countries



Source: OECD, 2017b. GDP measured in US $ at constant prices, 2010 PPPs.

This, in conjunction with high export performance, suggests that while Germany may have improved its competitiveness through labour flexibility, this does not necessarily translate into growth gains, and may, therefore, have actually undercut the German model, instead of saving it. Both the effects of, and the reasons behind, the Hartz reforms as presented in official discourse are questionable; below, we provide an alternative narrative of the Hartz reforms, building mainly upon interview findings.

b. An alternative narrative: insights from interviews

Reasons behind the Hartz reforms

In section 6.4a above, we mentioned that the justification given for the Hartz reforms was that Germany had become uncompetitive in the late 1990s due to excessive labour costs. An important counterargument provided by one of our interviewees (policy advisor) is that the real reason behind the Hartz reforms was that German firms had been pushing for labour market deregulation as a result of losses made on financial markets. This respondent suggested that it is important to shatter the illusion (still maintained by VoC theorists) that Germany is a country isolated from Anglo-Saxon financial developments. In the 1990s, after years of financial deregulation, many German corporations realised that they can make more money from speculation than production, and hence speculated heavily on the US ‘new economy’ boom, which eventually collapsed, generating enormous losses, which prompted firms to demand flexibility on the labour market to cut costs and recoup those losses.

It was possible in practice for firms' demands for labour flexibility to be met, with little opposition, because a longer-term process to discipline Germany's labour force had already been underway at least since German reunification. Labour representatives maintained that in the early 90s, 'the structural deficiencies in East Germany were not tackled with an active industrial policy, but became an easy prey for the West German businesses'. According to them, reunification was exploited by West German firms, which disciplined their workers with outsourcing threats, based on the argument that, if their demands rise, they can always be replaced with workers from the former East Germany, 'who have no prior identification with trade unions, who speak the language, who are highly mobile, who are willing to work under lower conditions than others' (labour representative). These threats, in turn, were couched under the rhetoric of protecting Germany as an industrial location (*Standort*). This enabled an initial shift away from a system of 'high-wage, high-productivity growth, and high collective bargaining coverage' to a system with a large low-paid sector, according to interview participants.

Part of this wider process, monetary integration provided a further pretext for liberalisation. We have seen in chapter five that all respondents agreed that monetary integration was a benefit rather than a challenge to German industrial capitalists (improving price competitiveness through a weak single currency and preventing competitive devaluations). Indeed, throughout the 1990s, before the adoption of the euro, Germany's current account had been in deficit, and exports constituted a much smaller proportion of GDP, between 20-30% (OECD, 2017a; 2017f), compared to 40-50% today. One industry representative openly declared that 'for Germany, it [joining the EMU] was absolutely great, it got rid of most of the Western-European competition'. So what was clearly a benefit to German exporters, further increasing their relative power vis-à-vis workers, got presented as a challenge in practice; at the same time though, the very 'weakness' of the euro might have supplied a strong impetus to price competitiveness rather than quality. Comments made by industrialists about 'millions of German jobs transferred to Eastern Europe', suggest that the outsourcing threat changed slightly between the 1990s and now, to 'as a result of European integration, we need to liberalise our labour markets to remain competitive; if you oppose this, jobs can easily be relocated'. The longer history of outsourcing threats can help explain why unions in Germany appear to be more concerned about retaining jobs in Germany rather than their quality, and why they consequently ultimately agreed to the Hartz reforms.

The challenge of monetary integration was thus only the pretence behind the Hartz reforms, but the consequences of this policy change in terms of Germany's domestic economy are nevertheless very real and poignant, as will be shown in the remainder of this chapter.

Consequences of the Hartz reforms: the change in labour relations

Regarding the consequences of the Hartz reforms, industry representatives and some policymakers, mirroring the official narrative within Germany, said that 'the Hartz reforms really shaped the economy', helping Germany overcome its 'sick man of Europe' status. In contrast, other respondents shared the view that recovery was due to 'a short period in German policy-making when we didn't follow the rules, we followed a Keynesian expansionary policy' (labour representative). This matches the conclusion reached by researchers at the Böckler Foundation who found that unemployment in Germany fell throughout the 2000s not as a result of the Hartz reforms, but of expansionary fiscal policy pursued at the same time as the Hartz reforms (boeckler.de, 2013).

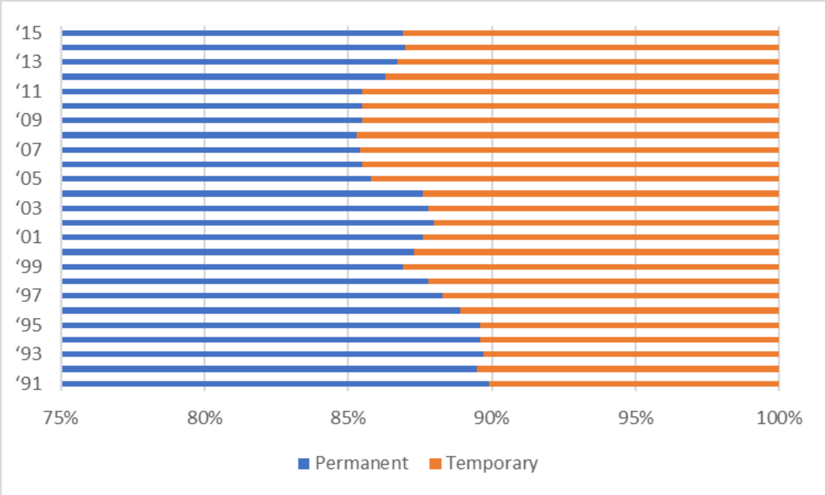
A different interpretation still is that unemployment may have gone down simply because previously unemployed people were forced into low-paid precarious employment (the Guardian, 2013). A policy advisor pointed out that 'on the surface, a lot of jobs were created' but 'if you look closely, you see that mini-jobs became widespread, while the number of normal, social-security jobs went down'. Consequently, 'it's not a net increase in the number of jobs that happened', but 'simply substitution': 'bad jobs have been driving out what would have been good jobs'.

A policymaker who had been in office at the time of the Hartz reforms said during the interview that they opened the possibility for temporary work in the hope of reducing unemployment, assuming that firms would more readily employ people on temporary contracts, and would switch them onto permanent contracts if the company does well and expectations for the future are positive. However, what actually happened, the respondent added, was that firms increased the number of limited contracts and reduced the number of permanent ones, which also gave employers greater bargaining power over the wages of their permanent staff. Workers hired through employment agencies are now used as a standard form of outsourcing; while the threat of external outsourcing made by employers in the early 2000s did not materialise to a great extent, there has been a considerable shift towards internal outsourcing. Besides temporary work, internal outsourcing also happened through the expansion of part-time work. ‘We have understood now, that what we wanted, to help people find employment in such companies, had another impact: a precarious employment situation and lower wages. That’s one of the reasons why the income situation in the overall economy split up more and more’, the person concluded.

Based on the testimony above, the consequences of the Hartz reforms can be summarised as: an expansion of precarious employment (temporary and part-time work), which resulted, as per the relevant literature also, into a dualisation of the labour market into core employment characterised by relatively high pay, plus a growing low-wage sector reflective of non-standard employment; an increase in poverty and inequality as a result of the expansion of precarious low-paid employment; and a weakening of labour representation, given that non-standard forms of employment are not covered by collective bargaining or union representation. Quantitative data in Figures 6.5.-6.10. and Table 6.1. below support this conclusion.

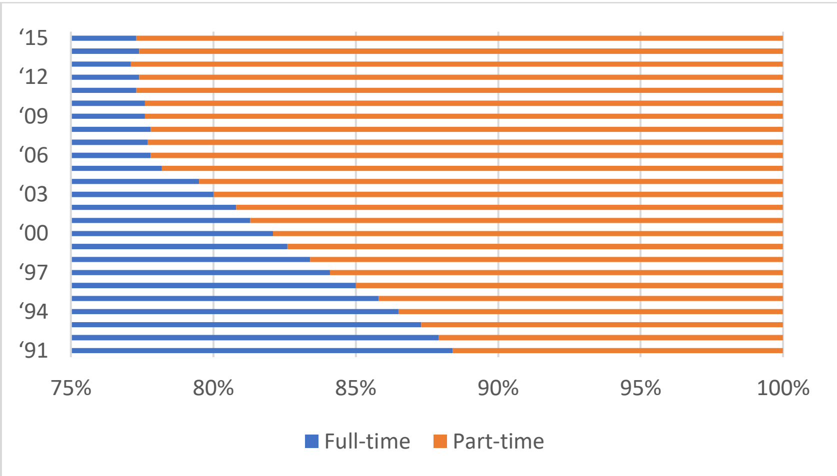
Figures 6.5. and 6.6. depict the expansion of precarious employment in Germany between 1991 and 2015. Figure 6.5. shows that the share of temporary work in total employment had been between 10-12% throughout the 90s, and increased to 13-14% throughout the 2000s. It peaked between 2006 and 2008, which indeed also captures crisis effects; however, the greatest *growth* in this share was between 2004-5, amidst the Hartz reforms. As per Figure 6.6. below, the proportion of part-time employment in total employment increased steeply between the early 1990s and mid-2000s, remaining high thereafter. The share of part-time work in total employment almost doubled since reunification: it was 11.6 % in 1991, and 22.7% in 2015; it has been over 20% every year since 2003, which coincides with the first phase of the Hartz reforms.

Figure 6.5.: Incidence of permanent and temporary employment in total employment, Germany, 1991-2015



Source: OECD, 2017e. Permanent contracts have no termination date, whereas temporary employment has a predetermined termination date; the latter includes seasonal jobs, persons on a training contract, and people hired out to third parties through temporary employment agencies.

Figure 6.6.: Incidence of full-time and part-time employment in total employment, Germany, 1991-2015



Source: OECD, 2017e. Part-time employment is defined as less than 30 hours worked per week in the main job.

At the time of writing, 1 in 7 German part-time workers is an involuntary part-timer (Statistisches Bundesamt, 2017). According to the OECD (2017e), more women than men were working part-time involuntarily in Germany every year over the last two decades. This appears to be in line with the notion of a gender bias behind the Hartz reforms mentioned by the few women interviewed as part of this research. For example, one labour representative stated that ‘the narrative was that it [part-time work] gives women especially better opportunities to combine work and family life. In the trade unions, there was a big conflict about the mini-jobs; trade union women were totally against it, but were not successful in convincing the trade unions as a whole to go against this.'

Table 6.1.: Low-wage earners as a proportion of all employees (%), selected EU countries

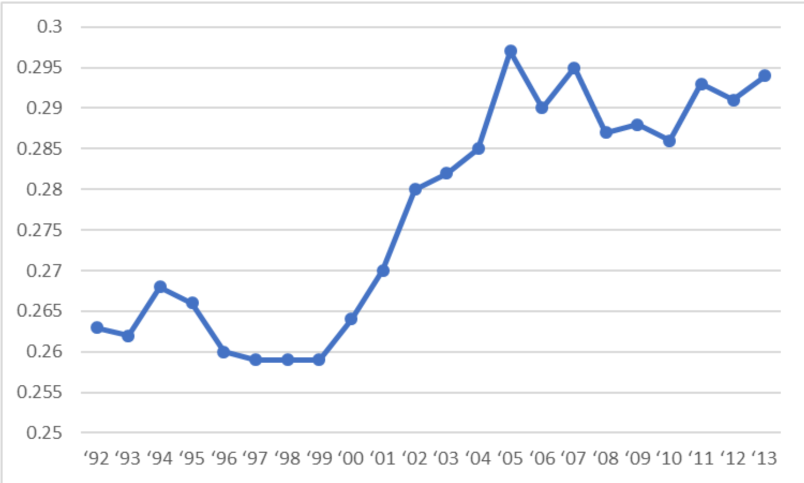
	2006	2010	2014
European Union	16.69	16.93	17.15
Euro area	14.27	14.78	15.7
Belgium	6.82	6.37	3.79
Germany	20.3	22.24	22.48
Greece	15.73	12.82	:
Spain	13.37	14.66	14.59
France	7.13	6.08	8.81
Italy	10.27	12.36	9.44
Netherlands	17.74	17.46	18.52
Poland	24.72	24.16	23.56
Romania	26.85	25.82	24.4
Finland	4.75	5.85	5.28
United Kingdom	21.77	22.06	21.26

Source: Eurostat, 2017b. Low-wage earners are defined as those employees (excluding apprentices) earning two-thirds or less of the national median gross hourly earnings in that particular country.

The switch to atypical employment enabled the expansion of Germany's low-wage sector. According to Eurostat (2017c), Germany has one of the biggest low-wage sectors in Europe, currently surpassed only by former Eastern bloc countries (Latvia, Romania, Lithuania, Poland and Estonia), and much larger than both the Eurozone average and the EU average. This conclusion is based on data collected every four years, starting in 2006, reproduced in Table 6.1. above.

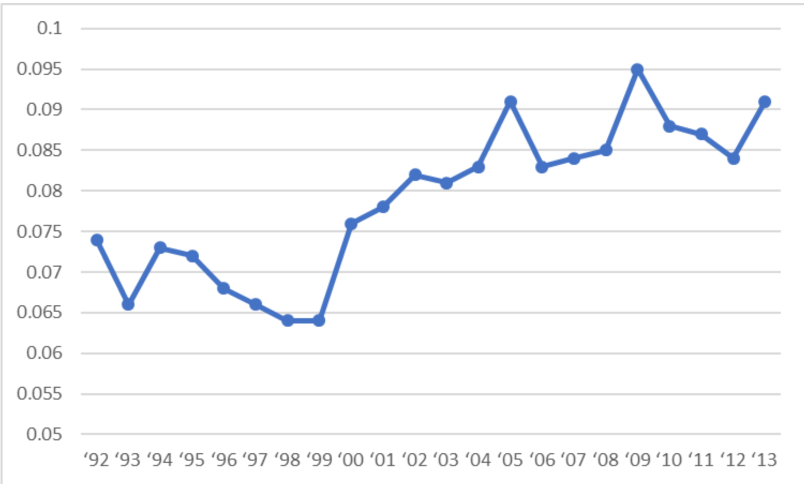
Figures 6.7. and 6.8. below show the increase in poverty and inequality as a consequence of the expansion of precarious work and Germany's growing low-wage sector.

Figure 6.7.: Inequality in Germany, 1992-2013 (Gini coefficient, disposable income, post taxes and transfers)



Source: OECD, 2017d. The Gini coefficient is based on the comparison of cumulative proportions of the population against cumulative proportions of income they receive, and it ranges between 0 in the case of perfect equality and 1 in the case of perfect inequality.

Figure 6.8.: German poverty rate, 1992-2013



Source: OECD, 2017d. The poverty rate is the ratio of the number of people whose income falls below the poverty line (defined as 50% of the median equivalised income) to total population.

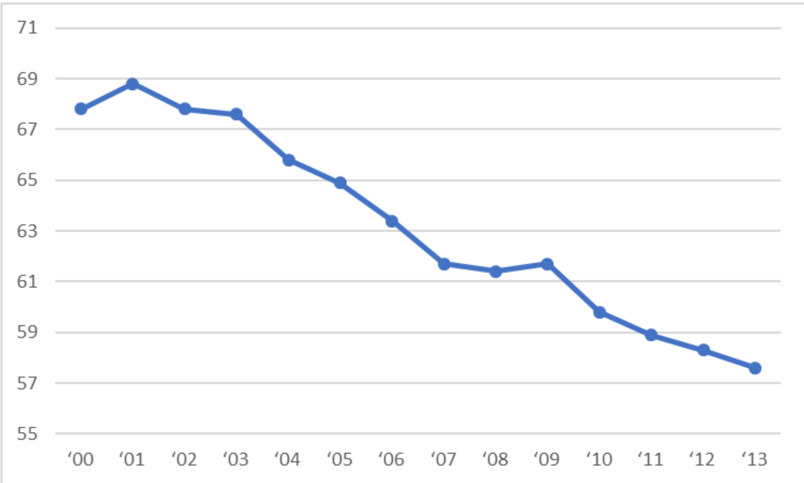
Figure 6.7. above depicts inequality as measured by the Gini coefficient (where a value of zero means perfect equality and 1 absolute inequality). Immediately after German reunification the coefficient was 0.263, it then went down to 0.259 by 1999, and increased sharply thereafter, peaking at 0.297 in 2005, and not diverging much from that by 2013, when the figure was 0.294. A similar trend emerges based on poverty data: in Figure 6.8. above, it can be seen that poverty

fell between the early and late 1990s, but increased significantly after 1999, peaking in 2005 and returning to the same value in 2013. On average, the poverty rate in Germany was between 6 and 7% throughout the 1990s, but between 8 and 9% after 1999.

Based on these data, grouped into five-year data clusters, an OECD report written in 2008 stated that, since 2000, income inequality and poverty have grown faster in Germany than in any other OECD country. They increased by more in five years (2000-2005) than in the previous 15 (1985-2000) combined (OECD, 2008). In light of this, the claim made by some interviewees that competitiveness improves living standards through a trickle-down process – 'with the basic promise that if a company does well, it will trickle down' (policymaker), 'the bigger the cake, the more everybody gets, of course' (industry representative) – seems particularly unsubstantiated.

Finally, figures 6.9. and 6.10. below reveal the weakening of labour representation, and hence a shift in industrial relations, as a result of the transition to non-standard employment.

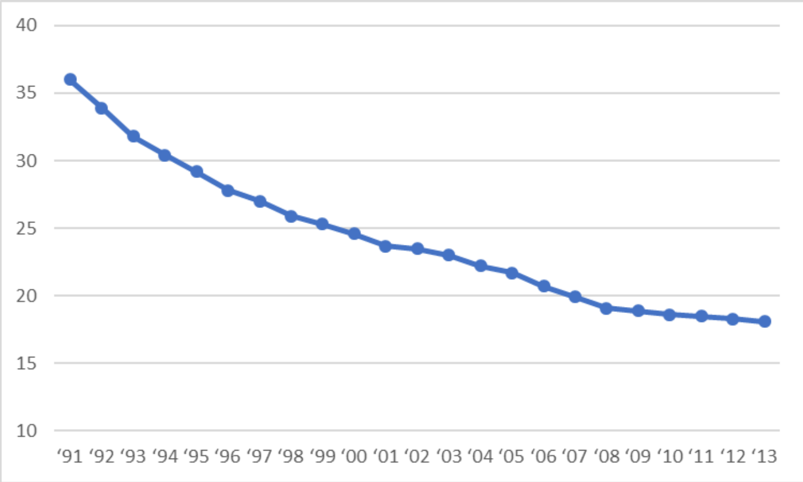
Figure 6.9.: Collective bargaining coverage rate in Germany (%), 2000-2013



Source: ILO, 2017. Collective bargaining coverage refers to the number of employees whose pay and/or conditions of employment are determined by one or more collective agreement(s) as a percentage of the total number of employees.

ILO (2017) data (available for the period 2000-2013) plotted in Figure 6.9. above show that in 2000, 67.8% of German workers had been covered by collective bargaining agreements; this figure fell to 57.6% by 2013. Figure 6.10. below shows a marked decline in trade union density over the last decades, starting with a value of 36% in 1991, falling to 25.3% by 1999, and further declining to 18.1% by 2013, the most recent data point available.

Figure 6.10.: Trade union density in Germany (%), 1991-2013



Source: OECD, 2017g. Trade union density corresponds to the ratio of wage and salary earners that are trade union members, divided by the total number of wage and salary earners.

Some policymakers and labour representatives said that the negative effects of the Hartz reforms are now being corrected, referring to a piece of legislation passed in May 2016, according to which, after nine months, firms will have to pay their temporary workers the same wage as someone on a permanent contract performing similar work. The same piece of legislation also prohibits firms from using temporary workers as strike-breakers if their permanent workers go on strike. Then again, a couple of respondents pointed out that there is nothing stopping firms from simply firing these workers after nine months, instead of increasing the rate of pay – which seems to be the case. Following the emissions scandal, in December 2015 Volkswagen announced plans to lay off over 600 temporary workers at the Zwickau plant in Saxony to cut costs (Reuters, 2015), plans which took effect at the end of June 2016 (Handelsblatt, 2016), after the adoption of the aforementioned piece of legislation; similar cost-cutting arguments may be used against temporary workers regardless of the new legal provisions vis-à-vis equal pay. Additionally, it appears as if such decisions are being made with the consent of labour representatives: 'nowhere is the relationship between executive board, trade union, works council, and the world of politics as close as it is at VW', wrote Blackwelder et al. (2016, p 11), in the context of the emissions scandal.

Indeed, a worrisome finding from these interviews is that it is becoming increasingly unclear who, if anyone, is representing the interests of German workers. The social-democratic party pushed for labour market liberalisation as much as any conservative party could; through this, the SPD lost its traditional working-class voters, and 'trust was never re-established' (labour representative). One might assume workers are better represented by works councils – 'labour representation from the grassroots', as opposed to unions described as 'labour aristocracy' – yet a works council is more susceptible to become narrowly interested in the performance of a specific company, and not care about workers in other companies or sectors. As one interviewee explained:

> 'If you were a works councillor at Volkswagen, you as a trade union representative of the company, obviously have an interest that this company is profitable, because that means employment, good wages, and so on. If this can be achieved through an aggressive export strategy, from a company point of view, that is something you can support, even if as a trade unionist for the overall economy you'd say wages have to rise in the economy, you have to increase internal demand'.

The respondent talked about 'a corporatist alliance' between labour representatives and capitalists, in support of export orientation, which sets the tone of German policy. Since the 1990s, works councils have been engaged in practices that contravene German labour law (Ryner, 2003); based on evidence from labour force surveys, even before the Hartz reforms, around 60% of workers in some East German regions were being paid below the rate established by collective bargaining, with the tacit agreement of works councils (Thelen, 2000). The Hartz reforms *per se* would not have been possible without the consent of works councils (Fuchs, 2012); the fact that Hartz was charged in the late 2000s for having bribed Volkswagen works council members (BBC, 2007) suggests that the reforms had been enabled by buying the acquiescence of labour representatives.

This includes unions. Hartz himself had been not only a member of the SPD, but also of IG Metall, Germany's biggest sectoral trade union; he likely used his influence within the union to garner support. Fuchs (2012 [no pagination]) writes that 'union officials had no objection', 'as long as their own positions and privileges (…) remained untouched'. In our interviews, we noted important differences between the stance of the DGB (whose representatives play only a consultative role) and sectoral unions (which are the ones actually involved in negotiations with employers). The diverging positions of the DGB on the one hand, and sectoral unions in manufacturing on the other hand, are reflected, for instance, in debates over the introduction of a national minimum wage in Germany, which was eventually adopted in 2015.

While a labour representative at DGB stated that ‘in some areas, especially Eastern Germany, and in some segments – restaurants, hotels – the introduction of the minimum wage led to double-digit wage increases, sometimes up to 11% or so; of course this has an impact’, unions in the exporting sectors had initially been against the introduction of the national minimum wage. Representatives in these sectors were saying that wages there are anyway higher than the proposed minimum wage, and also expressing concern that such a policy would give the state a mandate to intervene in, and distort, collective bargaining. This latter point is actually in line with views expressed by industry representatives on labour market policy: ‘the decentralized actors on the labour market know better about their needs and demands than the state ever could’, ‘the minimum wage does not really make a difference in the exporting sectors’. Labour representatives in these sectors say that they eventually supported the adoption of a national minimum wage in solidarity with their colleagues in the service sector, but that it does not affect them. A labour representative for the overall economy had a very strong reaction upon hearing the above:

> ‘This is nonsense! This is nonsense! If you have a company where every cleaner, every person in the canteen, every employee in the past was getting the wage rate of the collective bargaining agreement, and they have all been outsourced, no longer covered by the collective bargaining agreement, then they are now dependent on the minimum wage. For the remaining core in the manufacturing sector the minimum wage might not matter, but a substantial part of the workforce that used to be seen as an integrated part of the export industry, because they are part of these enterprises, has been outsourced, and wages have been driven down. In that sense, also part of the workforce in manufacturing is benefitting, it’s just that they are legally no longer part of that enterprise, but *de facto,* and economically, and from their integration process, they are.’

It was a sectoral trade unionist who said that ‘in a German context, I think the main problem is not that people are worse off, but they fear to potentially be worse off’, downplaying the issue of inequality. On the other hand, one labour representative with a consultative role mentioned that inequality is precisely the reason why the average German opposes redistributive crisis management policies at the European level:

> 'The whole benefit of the export surplus is pocketed by capital, it doesn't translate into indirect wage rises. Because German workers benefit less from the export strategy, they rightly feel that society has become more unfair and less inclusive. People experience greater inequality within the country. Those who are losing out from the current model can hardly be expected to support cross border solidarity when it cannot even be achieved within the country. And I think that is the underlying reality why the idea of having more transfers within the Eurozone is very difficult to sell to the German public.'

This problem of distribution is exacerbated by the current refugee crisis. Instead of searching for solutions, German economists like Hans-Werner Sinn are making morally abhorrent arguments that pit one vulnerable part of German society against another – German working poor against refugees, for example by claiming that, because of the influx of migrants, the minimum wage would need to be scrapped (*die Zeit*, 2015).

All the changes in labour relationships within Germany mentioned in this section suggest that the German export model has adapted at the expense of labour. This implies a breakdown of the traditional model of close, inclusive relationships between employers and employees, although not a breakdown of cooperative relationships between employers and employees' *representatives*; if anything, we have seen that labour representatives at the sectoral level express views that are more similar to those of employers in the same sectors than to those of labour representatives for the whole economy. This embodies, in itself, further evidence of a weakening of German labour vis-à-vis capital. The findings of this chapter, coupled with the analysis of German domestic *Spaltungspolitik* at the time of the EMS in chapter five, section 5.2, point to a long process of change in German labour relations since the 1970s. While the subordination of labour policy to export competitiveness can thus be seen as an element of continuity, the degree of subordination has increased following German reunification and the country's integration in the EMU. Change is therefore evident in the fact that exploitation has been extended over more and more segments of the German labour force, increasingly affecting also the unionised core that used to be relatively well-protected throughout the 1970s and 1980s.

6.5. Conclusions

This chapter analysed change in Germany's domestic economy following the country's integration in the EMU. We began by examining literature on change in the German model, concluding that these sources are bound together by an implicit assumption that Germany has altered the way in which it competes on international markets, having switched from quality to price competitiveness. Given this, we then paused to reflect on the competitiveness discourse itself, drawing upon policy documents and interview material, which reveal Germany's continued export focus at the macroeconomic level while hinting, like the relevant literature, at a shift towards price competitiveness, which implies a change in labour relations – the micro-meso part of the model. Afterwards, we analysed the Hartz reforms as a particular policy measure undertaken in the name of competitiveness during the early years of the EMU. We argued, using interview responses, that the real reason behind the Hartz reforms were losses on financial markets rather than a fall in competitiveness once Germany joined the EMU. Deregulation to compensate for financial losses was met with little resistance because a longer-term process to discipline Germany's labour force had already been underway since reunification. Monetary integration – a benefit to German exporting industries – got presented as a challenge in practice, as part of this wider labour-disciplining process. A pretext rather than a challenge, it still produced real changes at the domestic level: a weakening of labour representation, an expansion of precarious employment, internal outsourcing, an increase in inequality and poverty.

These changes invalidate the idea of a cooperative relationship between employers and employees to their mutual advantage. For this reason, we conclude that, while export focus remains the principal characteristic of the German model at the macroeconomic level, micro-and meso-level relationships have changed, to the detriment of labour. The upheaval in labour relations in the context of continued German export surpluses despite weak productivity growth, low investment, and growing concerns regarding the quality of German products, suggests that Germany's export model has adapted, switching from quality competitiveness to mere cost-cutting, relying increasingly on labour exploitation rather than manufacturing strength. It is particularly ironic that such changes should be missed by the VoC literature, given their alleged commitment to subnational analyses that reinstate the firm (as opposed to the state) as the key unit of analysis, although, as we noted in chapter four, it is not so much that this literature is ignorant of change, but rather is ill-equipped to incorporate it.

These changes in Germany's domestic economy are the reason why the benefits Germany derives from being the leading country in the Eurozone are filtered increasingly unequally throughout German society, which explains the growing dissatisfaction of average Germans with the monetary union and their opposition to EU-wide redistributive policies as crisis-management instruments. To treat Germany as a single, homogeneous entity means therefore to ignore the costs faced by German workers. Discussions around Germany's hegemonic role in the Eurozone would benefit from an open acknowledgement of the importance of within-country heterogeneity.

Chapters five and six together revealed another aspect of heterogeneity, namely heterogeneity of perceptions within Germany, as reflected in interview responses. We highlighted important similarities and differences between groups of respondents as appropriate throughout, so we do not repeat this here; however, it is worth adding that opinions differ even as to whether the German model has changed or not:

> 'For decades, Germany has been a social market economy, focused on export-driven growth in the manufacturing sector. A second pillar then would be social security, a lot of transfers, redistribution within the tax system and also through other instruments' (industry representative).
>
> 'Probably at the end of the 1990s, you had a strong break concerning this kind of model, if you want to call it 'model'. Up to the end of the 1990s, domestic demand still had a huge impact on growth rates, while since the year 2000 or so, domestic demand stagnated, and growth since then depended almost exclusively on export surpluses' (labour representative).

Heterogeneity and change imply an aspect of elusiveness behind Germany's position of dominance. This elusiveness reinforces German hegemony in the sense that it obscures the source of power while taunting would-be imitators.

Chapter seven: Conclusion: The shapeshifting hegemon

7.1. Summary of findings and contributions

This thesis has been a case study of a topical, yet underdeveloped, subject: German hegemony in the EMU. It was inspired by the apparent inconsistency in the relevant literature between those who argue Germany is insufficiently hegemonic versus those who claim it is overly so. We set out to find the source of this contradiction; in order to do this, we needed to transcend simple 'yes' or 'no' answers to the question of *whether* Germany is hegemonic in the Eurozone, and ask instead '*in what way?*'.

Answering this question presupposed first of all an analysis of the different meanings of hegemony, and subsequently, of how these have been applied to the case of Germany. We synthesised the applied literature on German hegemony, linked it back to the general literature on hegemony, and explained its contradictions. The main theoretical contribution of this thesis, emerging from chapters two and three together, is that we explain the dichotomy in the debate on German hegemony through the distinction between problem-solving and critical theories of hegemony, applied to the German case. We showed that the HST (problem-solving) version of hegemony dominates both the general literature, and the applied literature on Germany. It defines a hegemon either on the basis of four pillars of structural power that in fact describe the US at a fixed point in time during the Bretton Woods years, following Keohane (1984), and links this with notions of stability axiomatically, or in a yet more reductionist way, simply equating it to 'stabiliser' to begin with, ignoring that the concept of hegemony long predates HST. This understanding of a hegemon as a stabiliser has led to arguments that Germany had been a hegemon in the EMU prior to the crisis, but is not hegemonic in the present context of instability. By contrast, more critical sources, which focus on the nature of, and conditions behind, hegemony, rather than its functions as tactical actions to defend the existing order, argue that Germany is a coercive hegemon in the EMU, whose power increased with the euro and turned its model of political economy into a yardstick for success. This notion that a hegemonic nation is one whose model of political economy becomes a pattern for emulation abroad reflects Cox's critical (neo-Gramscian) understanding of hegemony.

Beyond helping us provide an explanation for the conflict of views in the applied literature, chapters two and three have also highlighted the limitations of existing literature on German hegemony. In particular, we emphasised its fixity bias: the tendency to treat states as unitary (homogeneous) and unchanging (continuous models). We argued that this bias comes from neorealism, and has influenced not only HST (as a hybrid neorealist-neoliberal institutionalist theory), but has later permeated critical theories as well, undermining them to some extent. For instance, sources that discuss the German model as a facet of hegemony generally assume it represents a continuous arrangement, which may elicit change at the supranational level, but remains fixed itself.

Our empirical contribution, in chapters four-six, has been to analyse Germany-EMU relations in a way that is sensitive to change and heterogeneity, in order to overcome the fixity bias in extant literature. By highlighting these aspects, the empirical analysis in this thesis, while focusing on Germany, also makes a more general contribution, making the case for critical theory as a guide to understanding and researching hegemony and also wider issues in political economy. We emphasised change by treating Germany-EMU interactions as a two-way relationship, whereby Germany shapes, and is also shaped by, monetary integration. This has allowed us to analyse the German model in evolutionary perspective instead of merely assuming continuity: from its origins (chapter four), to how it became dominant at the EMU level (chapter five), and finally, to how its micro-meso dimension has changed as a result of monetary integration (chapter six). We challenged heterogeneity assumptions by asking who stands to gain or lose the most from the present configuration of the Eurozone; chapter five focused on German industrial and financial capitalists as prime beneficiaries, whereas chapter six discussed the costs faced by German workers.

We conclude from our empirical analysis that Germany is indeed hegemonic in the EMU. This is based on an understanding of hegemony as 'the occupation of a dominant position within any system' (*Routledge Encyclopedia of International Political Economy*, 2002b, p 669), which is a common denominator in all theories of hegemony, coupled with a commitment to critical theory which emphasises the need to study the *nature* of hegemony and of the system it applies to, in historical perspective, highlighting the inequalities of the system. In chapter five, we showed that German national interest had a significant impact upon the design of the EMU in the Maastricht Treaty, and characterised this as hegemony by design. We then proceeded to highlight the inequalities of this setting, revealing that this interest reflected not aggregate preferences, but the preferences of German industrial capitalists, and of European financial capitalists. In this sense, Germany can actually be understood to have acted as an ‘agent of hegemony’ (Agnew and Corbridge, 1994), victorious in imposing its preferences precisely because it had been representing interests that were in tune with the already dominant trend towards market liberalisation. The fact that Germany succeeded to portray the Eurozone crisis as a crisis of competitiveness, to shield financial capitalists as the true culprits, demonstrates continued hegemony. This, in turn, made the ‘competitive’ German model a yardstick for success at the European level, fortifying German hegemony at present by granting it even more power over EMU policy design, with the German Finance Ministry widely perceived as the locus of power in Europe currently. This is problematic not least because, as we have seen in chapter four, the model itself is based on distorted interpretations of history. Furthermore, German elites have a harrowing dilemma to manage, since their policy choices are constrained by the interests they are serving, whereas policy inaction will eventually cause the demise of the euro system itself. Domestically, instead of manufacturing strength, Germany has cultivated a societally disastrous cost-cutting approach, allowing precarious employment, inequality and poverty to expand while quality competitiveness, investment levels, and labour productivity all decline. This raises important questions about whether there is actually still a German model to speak of, and whether it can still be deemed ‘successful’.

Our main empirical findings, revolving around change and heterogeneity, can be summarised using the phrase ‘shapeshifting hegemon’. Germany is an evolving entity with no defined or final shape, which also produces change at the supranational level. Like mythological shapeshifting creatures, the German model continues to exert a certain fascination. Change contributes to its appeal by making it more difficult to understand and replicate Germany’s position, thereby cementing German hegemony for the time being. Those enthralled with German 'success' all too often overlook the dark side of it – the exploitation of ordinary people at home and abroad.

Besides the theoretical and empirical contributions mentioned above, this thesis makes a methodological contribution as well. Our understanding of reality, and, by extension, hegemony, as multifaceted, stratified, and shifting, is compatible at the broadest level with pragmatist philosophy, leading us to adopt a case study approach as research design, calling for pluralism in terms of both theory and method. We have built our analysis as a narrative which triangulates findings across a variety of sources: eclectic academic literature, elite interviews, policy documents and public discourse, as well as official statistics and media sources. This particular research strategy (as well as interviews as an individual method within this strategy), has not been used before in the relevant literature on German hegemony, so it represents a contribution to methodology in the field, generating new insights into the topic.

7.2. Policy implications

An important element that sets critical theory apart from problem-solving theories of hegemony is that, while the latter defend the existing order and the interests of those served by it, critical theory, by contrast, asks not only how a particular order came about, but also what alternatives there are. The Ancient Greek version of hegemony considers alternatives in the sense that Greek historians focused on changes in the type of leadership Athens had been exercising during the Peloponnesian War; Gramscian analyses of hegemony emphasise the need for counterhegemonic forces to challenge the very fabric of capitalist society. In this section, we complete our critical analysis by considering alternative policies for the Eurozone.

The policy recommendations in extant literature on German hegemony largely reflect a polarisation between views that Germany is not hegemonic, but should be (by providing the five public goods enumerated by Kindleberger [1973;1986]), and perceptions that Germany is hegemonic, but should not be. Because both of these statements concentrate on Germany and how it (allegedly) functions, they are implicitly defending the current EMU order by leaving it out of the discussion. This thesis has shown that reality is more complex: German hegemony is diffuse, interwoven with that of industrial and financial capitalists, and shifting. For this reason, we believe radical change needs to start from the design of the EMU itself, which was influenced by Germany, but, in turn, also affected Germany's position. Our critical overview of the evolution of European monetary integration towards a structural lock-in, located in chapter three, can be used as a basis upon which to make alternative policy recommendations.

In that chapter, we argued that, in the context of a shift towards market solution worldwide, monetary integration in Europe – a structurally diverse geographic area that did not meet OCA criteria – proceeded on the basis of the endogeneity hypothesis. According to this hypothesis, financial liberalisation increases allocative efficiency, thereby reducing divergence and helping the EMU meet OCA criteria *ex post*. In practice, however, financial liberalisation diverted funds away from the real economy and into speculative activities, exacerbating rather than reducing deep-seated differences, and created a culture of financial permissiveness that ultimately triggered the Eurozone crisis.

The adoption of a common currency – hence the simultaneous surrender of nominal exchange rate policy and independent monetary policy – on a background of free financial flows is what dictated strict fiscal rules. Eurozone governments borrow in a currency they do not issue, so financial markets can force default upon those countries whose deficit and debts are deemed unsustainable (even when, as was the case with the Euro crisis, government finances become precarious as a result of saving failing financial institutions in view of maintaining systemic stability!). Pushing for stringent fiscal rules disguises the fact that the real problem is excessive power in finance.

Reform has to start, therefore, with the financial sector. Drastic changes in European fiscal policy are also necessary, but if they are implemented without prior policies to control finance, they will likely only serve to further increase the power of finance over national governments in the monetary union. Adhering to the goal of an integrated capital markets union, supported also by some of our interviewees, will only redistribute wealth to the already wealthy, as argued in chapter three. In our view, Fleming (1963) had been right in his insistence to rein in financial capital in order for monetary integration in Europe to stand a chance. Reinstating capital controls, adopting policies that help curtail unsustainable credit expansion in favour of allocating credit towards the accomplishment of social goals, and reforming the banking sector towards a re-separation between commercial and investment banking is crucial. Regulation of domestic banks will only be credibly implemented if control over foreign banks is also reinstated, which, for reasons of international financial competition, needs to come as a global initiative.

Only when unwarranted faith in financial markets has been abandoned can the structural differences within the monetary union be adequately tackled. Current account imbalances, competitiveness differentials, and unemployment are all consequences of those differences in a context where the monetary, fiscal, social and industrial policies that could mitigate them had been immobilised. We have seen that the pressure of adjustment is now exclusively on wage policy. The words of our interview respondent who said that the Eurozone means ‘the death of trade unions’ foreshadow what will happen if this is not reverted soon.

In chapter three we mentioned the 1977 MacDougall Report (Commission of the EC, 1977) which had concluded that the EU budget would have to be increased by 5-7 times to tackle structural differences and support the EMU. At that time, there had been less divergence between member states than there is now, after successive rounds of enlargement. The report also assumed ample room for manoeuvre in domestic fiscal policy, which is by no means the case today. The lessons that can be drawn from that and applied to the present-day context are that the EU budget should be increased significantly in order to support social and industrial policies that bridge the structural gaps between member states. Arbitrary rules on domestic fiscal policy should be discarded in favour of policies that fulfil aims such as prosperity and a high level of standard employment. Similarly, to reduce unemployment, ‘one-size-fits-all’ European monetary policy needs to abandon its deflationary bias, as well as restructure its objectives over the long-term beyond inflation targeting.

Regarding this last suggestion, note that inflation control is perceived by many policymakers and analysts as one of the key features of the German model. As one interview respondent said, policy change in this area would require ‘the whole culture and way of looking at monetary and economic things’ in Germany ‘to change radically’. On the other hand, in chapter four we argued that the ideas that feed into the perception of model continuity are in fact distortions of history; what has been distorted may be used as an indicator of what can, and should, be changed. Chapter four underlined that it was not inflation, but the Brüning *deflation*, that had brought the Nazi party into power in Germany. Also, the German 'economic miracle' had not been due to inflation control and fiscal conservatism, but fortuitous demand disturbances elsewhere in the world, a brain drain from other countries, as well as debt forgiveness. A more mindful recognition of this could contribute to a shift away from deflationary policies.

Decades of market liberalisation have led to a prioritisation of an 'unseen network of power relations' (Varoufakis, 2017) over people. The poor do not suffer because of a 'poverty of aspiration' as the original ordoliberal thinkers maintained; they are at the mercy of policy decisions beyond their control. This is no less true in Germany, the nation deemed most successful in Europe at present. Chapter six has argued that the lack of financial regulation encouraged German corporations into speculative financial activities, the losses from which then prompted a switch to cost-cutting policies, and, in conjunction with a weak euro, a change in Germany's export model away from high-quality production to price competition. Germany's export strategy needs to change, not only for the sake of the global economy, but primarily for the sake of German workers. So far all we have seen is patchwork regulation which only pretends to tackle non-standard employment and inequality, without a genuine refocus on human dignity.

Equally specious have been the policy changes introduced post-2008 at the supranational level, nominally to stabilise peripheral economies. Germany's Finance Minister, regarded as the most powerful player in EMU policymaking, wrote in an article for *Financial Times* (2011) that the solution to the Eurozone's problems is simple (involving fiscal conservatism and labour market flexibility); in private conversation with Varoufakis (2017), he admitted it is anything but. Accusations of uncompetitiveness against individual countries conceal the real reforms that are needed, which are not applied because they go against the interests of the wealthy. Alternatives to the current policy mix do exist, but their implementation would require a conscious and strong mobilisation against the dominant economic thinking and the 'unseen network of power relations' supported by it.

7.3. Directions for future research

There are four main directions in which we would like to take this research in the future. The first would involve a deeper study of those societal factions that gain or lose the most from German hegemony. In chapter five, we identified German industrial and financial capitalists as the main beneficiaries from the present configuration; however, future research is needed to ascertain how 'German' these truly are – in other words, to examine in more detail the interface between the German state and subnational, as well as transnational, actors. In chapter six, we showed how German workers had been losing out in this context; had financial and time constraints not been so pressing, a step further would have been to also interview German workers and corroborate findings with those from elite interviewing, comparing and contrasting the interpretations of groups regarded as relatively powerless with those of groups regarded as relatively powerful, respectively. To be sure, this would raise a whole new set of issues, ranging from the fact that non-elites are usually intimidated by the interview process, fearing their answers might reach management, to the possibility that interview questions would need to be designed differently (since German non-elites would undoubtedly have important opinions on Germany's contemporary policy stance, but may not be so familiar with the EMU setting or particular policy decisions). Furthermore, in chapter six we also raised questions about labour representation within Germany, highlighting the differences between sectoral unions and the national trade union confederation – this aspect is also worthy of deeper inquiry.

Secondly, while the capital-labour divide is a significant element that demonstrates states are not 'homogeneous moral individuals with joint liability' (Streeck, 2014, p 92), further research is needed to go beyond class and also pay closer attention to other two variables of social demarcation: gender and race. Literature which otherwise focuses on change in the German model does, however, also make subtle references to a particular continuity: a gendered logic behind the model. Even at its zenith, the model's redistributive features meant in practice that the German welfare state was supporting the single (male) breadwinner (Lehndorff et al., 2009), relying on women to play the part of the proverbial Swabian housewife. In chapter four, we referred to the paternalistic social relations that characterised the *Wirtschaftswunder* years. Since then, women have gradually been entering the labour market, but, as briefly mentioned in chapter six, they are more likely to be found in low-paid, involuntary part-time, precarious employment, especially following the Hartz labour market reforms which had been introduced against opposition from female trade unionists. Taking an aggregate view on expanding female labour supply, it would be easy to say, like some German labour economists do, that the income situation for a traditional German household may actually not have changed much, because declining rates of pay in the full-time (male) job are offset by the added income received by their female partners in marginal employment (Eichhorst, 2015). Yet this would mean to ignore the discriminatory practices at the heart of German export 'success'. Gender bias is one issue. Similarly, we referred to race also in chapter four, in the context of Germany's 'economic miracle' in the 1950s, which relied, *inter alia*, on the exploitation of cheap foreign labour (ARD, 2013). In chapter six, we mentioned race in the context of Germany's management of the current migrant crisis, arguing that issues of distribution within Germany are further exploited at present by commentators pitting Germany's working poor against refugees. Both gender and racial discrimination within Germany deserve greater scrutiny as self-standing topics which further highlight the stratified character of hegemony. These issues imply that there may have always been a dark side to German export success, predating the 1990s, when exploitation was extended also over Germany's own core working class.

A third topic for future research would be to study German perceptions of ordoliberalism. An interesting finding from the interviews, which we have not mentioned yet, is that, while the interview itself contained no questions on ordoliberalism, many respondents chose to talk about it unprompted. Our exclusion of the topic from the original design of the interview had been based on the assumption that people outside academia would not want to discuss ideology, but this was proven wrong in practice. At the same time, while ordoliberalism was often referred to, respondents usually meant different things by it, mirroring wider trends in German society, where ordoliberalism appears ubiquitously across the political spectrum. By some, it was equated to the notion of a social market economy, and as such perceived to be a middle way between socialism and liberalism, whereas others identified it more closely with laissez-faire liberalism. Indeed, it was particularly interesting to watch interviewees attempt to explain what the differences between ordoliberalism and neoliberalism are. Those who understand neoliberalism as a complete roll-back of the state said that ordoliberalism entails ‘a much stronger state than neoliberals would be happy to accept, but it does only a few things’, such as ‘setting a competitive framework and regulating competition and property laws’ (policy advisor). Others saw an overlap between the two: ‘Ordoliberalism is about special monetary policy, trying to avoid inflation, and fiscal policy by fiscal restraint. Fiscal restraint is also a neoliberal thing, though…Actually, I am confused about this myself… Laissez-faire, ordoliberal, neoliberal…it’s just words that are being thrown about; in principle, it’s all in the same direction’ (labour representative). The diversity of responses, along with an explicit comment by a labour representative, that ‘the popular perception of a social market economy is totally different from the theoretical concept of a social market economy in the ordoliberal model’ appears to support our conclusion in chapter four that the German model is not an incarnation of a coherent German ideology, as commonly viewed, but the result of an intersection of more disparate ideas. It would be interesting to return to the field and explicitly gather views on this issue to shed light on the origins of the German model from an empirical point of view as well.

Finally, an important aspect of this thesis, dealing with a contemporary phenomenon, has been to emphasise change. Contemporaneity and change imply that we have been writing ‘about processes, not about outcomes’, ‘about struggles not about victories or defeats’, ‘about indeterminacy rather than determinacy’ (Cawthorne, 2001, p 74). We are acutely aware that our findings are therefore not ‘results’; the complexity and fluidity of Germany-EMU relations mean that we should, in time, return to update and revise these findings. In chapter five, we noted that Germany’s current position of hegemony within the monetary union is not sustainable indefinitely. Challenges can come from various sources, ranging from the faulty EMU architecture, to domestic pressures (e.g. demographics), to what may seem initially only tangential problems (e.g. changes in international demand patterns). Events that are yet to unfold will, therefore, demand a fresh perspective on the topic.

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