Germany goes for broke

Gabriel Kolko

The historian Gabriel Kolko's influential writings include Century of War: Politics, Conflicts and Society since 1914, Another Century of War*?, and, more recently,* World in Crisis *(Pluto Press).*

There are extremely important differences between this decade and the period after the First World War and through the early 1930s.

The most crucial is that no fascist or communist or revolutionary threats exist now, if the great economic powers do not meet the economic challenges before them. Today the political and economic contexts are fundamentally different in crucial regards but still inordinately complex and dangerous. Now, nations will only face the unpredictable political consequences that always arise when economies break down. But fascism and bolshevism were a catastrophe for the status quo and led to World War Two. For a time the Nazis aborted the threat of the Left in Germany and this won them a great deal of business support. Although there are many right-wing nativist movements today that may very well benefit from economic turmoil, there are important differences between contemporary yahoos in the US and Europe and the fascists.

But today the world economies are in a crisis, nominally involving the 'euro' nations, but even more the nature and future of world economic power. This crisis involves the United States – which was crucial in the interwar period – but also China, India, Brazil, and other nations which had no economic clout whatsoever in the world economy between the two wars. The 1920s were complex in unique ways; the draconian Versailles Peace Treaty of June 1919 guaranteed the decade would be so, both politically and economically, especially for Germany, which ultimately went Nazi, which in turn led to the Second

World War. But today's Middle East owes a great many of its problems to the settlements reached at Versailles – which broke up the Ottoman Empire and drew the borders of the new states capriciously and with almost no regard for the region's ethnic and religious character.

Stephen V. O. Clarke was a research officer at the Federal Reserve Bank of New York – which has a uniquely important responsibility for many official US foreign economic transactions – and then became a quite conventional professor of economics at Princeton. His most notable work was a 1967 monograph on the New York Fed, *Central Bank Co-operation, 1924-1931*. Its circulation must have been very small; its prose and charts do not lend themselves to easy reading.

The book caused few waves in the world – whether academic or larger – when printed, and Clarke never became known as a great economist, as did John Kenneth Galbraith. (Galbraith's thesis dealt with the bee industry in California.) Clarke was not, by Ivy League standards, productive or a 'star' academic.

His esoteric monograph is now very relevant and timely because the powerful nations of the world are today being called upon to co-operate to save the euro currency; they share a common need to solve a critical economic problem. They were also asked to resolve many similar issues in the 1920s, but each has distinctive differences, the most important being that Germany was very weak and in a defensive position by virtue of having lost the First World War; today it is economically the strongest nation in Europe. In both periods the stakes were very high.

Clarke's work is based on the papers, phone conversations, and records of the principals involved; in this regard alone it is unique because he had access to these sources, which makes him especially insightful and authoritative. The New York Fed did not publish the book thinking they had a potential best-seller in this extremely technical monograph, but because it believed it would learn something about the genesis of one of the world's great economic – and political – failures, and therefore how to avoid another like it. It makes its intent very clear in the bank president's foreword to the work. While conceding that the differences between the 1920s and the present were great, he still believed Clarke's study contained much that was of contemporary relevance, especially how each of the men involved in the 1920s negotiations had to balance his nation's objectives and interests with the needs of an international system. In my opinion, this conflict of national and internationalist goals is also the way to understand today's crisis in the euro bloc.

If the euro collapses the results will be far-reaching in terms of its failure leading to more dire economic consequences, and this may in turn make European domestic politics nastier as well. Right-wing parties are very likely to grow stronger. Clarke discusses, in great detail, how the major economic powers negotiated during the 1920s – and how and why they ultimately failed by 1931, when exchange controls were imposed on the franc, pound, mark – and the world economy broke up and stayed that way until the United States defined the post-war rules. America, too, was mired in the Great Depression. Clarke states, correctly, that domestic politics played a crucial role in the United Kingdom as well as Germany, in making co-operation even more difficult after 1929. He also concedes that New York wanted to replace London as the financial capital of the world.

Even taking into account the crucial differences between the period he covers and our own – above all the political context – it is extremely interesting to see how and why nations relate to each other when they have shared problems. They did so very badly during the inter-war period and they are very likely to do so now; and for many of the identical reasons. Domestic politics are very likely to play a crucial role in the current crisis in the nations that have the biggest deficits, and Europe's political leaders, whether from poorer or wealthier nations, are not likely to commit political suicide if they can avoid doing so, which the German plans for reform are effectively asking the leaders of Greece, Portugal, and other nations to do.

So far, the euro's fate remains unclear until some indefinite time in the future, even though I believe that the present role it plays is highly unlikely to continue, but the European Union may fail. The euro crisis is complex in unique ways, and the Germans are playing a very convoluted nationalist game, but it requires nations to lose an important measure of their economic sovereignty, and the evidence from the inter-war years – indeed, from much of recent history, for that matter – suggests they are very unlikely do so.

Since Clarke's monograph is the only account of this crucial period we have that is based on the private papers or records of many of the principals, we are compelled to consult this obscure record if we want some inkling how, and why, the men and women negotiating the fate of the euro bloc are likely to behave. If precedent gives any insights then they are likely to fail. The rulers of the world's leading economies simply did not realize the horrors that would ensue because no one could predict them; nationalism and the notion of national interests blinded them in the inter-war period, and it blinds them today in much the same manner. The major difference is that Germany, unlike after the First World War, is now the most powerful country in Europe, and we must consider the extent to which Germany is using the euro crisis to advance its own power by hiding it behind a pan-European façade that mobilizes and disciplines Europe's nations on behalf of its interests, and gives it leverage in dealing with the rest of the world.

The New York Fed was optimistic, hoping that knowledge would lead to an avoidance of the same errors occurring again. The United States never learned, politically, militarily, or economically, at least to the extent that it affected actual action, the lessons of past errors. After the Korean War, many American leaders resolved never again to fight a land war in Asia, but they did exactly that in Vietnam and Afghanistan, where they lost outright or failed to win a decisive victory. In Iraq, at best, they have stalemated, perhaps even lost a decade-old war. We shall see.

The process whereby the men who rule the United States, Great Britain, and other powerful nations make the same mistakes over again can be gleaned, to some great extent, from Clarke's now-ignored work. Forgetfulness, misjudging the risks in action or inaction, peer pressures, national hubris and interests above all; all, to varying degrees, play some role. The important point is that states have sought to co-operate on crucially important economic matters in the past and they have failed to do so; they often 'succeeded', as in the cases of the United States and NATO and the now defunct South East Asia Treaty Organisation (SEATO) and Central Treaty Organisation (CENTO) alliances, only to eventually find that such organisational schemes can also be encumbrances as well as tying up nations that might wander from US control.

For Germany the euro crisis is an opportunity to undo the economic results of defeat in two world wars and use a pan-European ideology to create a Europe that is susceptible to German domination. But most nations in Europe will likely eventually resist this effort to be led, and the European Union is likely to disappear; what will follow after is anyone's guess. In the process of going for broke, the Germans are using their formidable ability to raise demands on the various nations in the European Union, and they are also likely to see the euro disappear. A period of uncertainty, if not chaos, will then follow.

Pyrrhic victory

Germany lost two world wars and it now has the most powerful economy in Europe. Angela Merkel wants it, *de facto* and probably intentionally, to undo the onus of losing two world wars, thereby establishing Germany in a position of economic supremacy, capable of dictating to the rest of Europe how to manage its internal economic affairs. The legacies and fears of the past will have to be overcome, and the nation-state and nationalism are not likely to disappear. The events that traumatised Europe over the past decades are not forgotten by some countries, no matter how weak and small they are. It is true that most nations' leaders, nominally at least, say they want to go along with the German project, although France is also likely to see a good part of its electorate refuse to implement what the Germans demand as desirable economic policy. Indeed, even Sarkozy may not be able to follow the strict, conservative economic conditions the present German government is now demanding.

Merkel says 'if the euro fails, Europe fails'. But she assumes that the Germans will define success or failure. This is a form of blackmail because the failure of the euro, which is highly likely to have negative consequences, is not necessarily going to be the catastrophe Merkel implies. Many nations suffered economically with the euro, which is not a magic economic wand or sacrosanct. Pan-European ideologies as a façade for Germany asserting national power, in the long run, is the greatest danger now confronting Europe. Merkel is using Germany's economic clout, and if Europe adopts the measures to implement her program – they have already accepted them in principle – Germany will be able to deal with other powerful nations much more as an equal by citing its ability to define for most other European states the course they should take.

So far, Merkel has gotten nominal agreement for her plans from all the 27 nations that are members of the European Union save Great Britain, but too many crucial specifics remain unresolved for me to say she has attained victory. The British, anxious to preserve the key role of the 'City' in world finance, stayed out of the new agreement even though it nominally is in the European Union but does not use the euro as a currency. The British government also dislikes foreigners dictating their economic objectives and the means to attain them, as the Germans are doing. Prime Minister David Cameron has slight control over his Conservative Party, and the same will be true of other political leaders in democratic countries – ranging from France to Greece and Italy or Sweden – who cannot simply dictate rules to their parties or people. The problem is that there is too much democracy within Europe for technocratically-minded schemes. If a national law violates the new fiscal discipline, the Germans want the European Court of Justice, which sits in Luxembourg, to declare it illegal. Abstractly, this means that national parliaments and key legislative bodies can no longer make economic policy.

Unfortunately for the Germans, wherever a nation requires they somehow ratify something as far-reaching as this transfer of the right to define legitimacy, time will be lost and the public of that nation may not approve the new rules.

Besides, there are so many existing debts in Europe to refinance – 1.1 trillion euros in 2012 alone – and no one is sure where the money will come from or who has the authority to loan it, that Merkel won time – perhaps a year – for the continuation of the euro. (Even Germany and France are in debt; Moody's downgraded its ratings of the three largest French banks because they own too many Italian and Greek government bonds). The agreement reached the weekend of December 9th is essentially to return to the fiscal rules agreed upon at Maastricht in 1991, which were never enforced in the first place, and are unlikely to be applied now. For political reasons – too much democracy – they are likely to fail again. The euro crisis is scarcely over and Ms. Merkel has won a pyrrhic victory. That her real objective is to rebuild Germany's power through, and via Europe, will become more evident as time goes on and the members of the coalition of nations that now support her, France especially, will fall apart.

There are many sources of opposition to the new European Union treaty, ranging from most of the Conservative Party in Britain to Leftists in Greece, Italy, Spain, and elsewhere, who will oppose the austerity measures the new European accord now calls for. Cameron is concerned about the City of London maintaining its dominance over finance, and anti-foreign sentiment also motivates many Conservatives. Leftists see no reason why social welfare benefits, from hospitals to education, should be slashed just to meet Merkel's demands. And of the 17 nations that ratified measures conforming to Merkel's criteria, nine insist on their national parliaments or legislative bodies being consulted before they give the final approval to her proposals. Italy or Greece are not among these nine and large demonstrations against the new agreement have already occurred in both places.

Here Clarke's discussion is instructive. There were essentially four major players in the 1920s, but the European economic union is far larger and more complex. Nominally, it has 27 members. Nation-states may not be the ideal form to organise the world, but they are a fact we probably can do nothing about now. Attempts to impose supranational authority, ranging from central bank co-operation in the 1920s to the United Nations, have generally failed, or have been used by nations, such as the US together with NATO, to impose their hegemony on others. NATO was also established to allow West Germany to rearm, creating a framework that looked able to control the rebuilding of Germany in the immediate post-war era, when in the name of fighting communism the United States shipped Hitler's rocket scientists and torture experts to the US, and had the intelligence network under General Reinhard Gehlen, who had worked for the Nazis as chief of intelligence on the Eastern Front, go to work for it. Allegedly, he received a pension from the CIA when he retired.

Reconstructing Germany's dominant role in Europe is very much an integral part of the debate on the euro. Many nations, Great Britain excepted (and Switzerland, of course), nominally go along with Merkel's threats and visions for the moment, and many non-German businessmen find having a common currency good for their exports. What she advocates is an established aspect of all conservative economics, and is not just German: balance the budget. Hungary and Sweden, which do not use the euro, are lukewarm at best. Poland, as well, is sceptical of the German approach, which is very conservative. The US government immediately declared that the German-inspired principles were good but the problems that the euro faced had to be confronted in the next days, which was certainly not the case. President Obama himself, and the chairman of the Joint Chiefs of Staff, said the problems the euro faced had to be dealt with immediately, not next year, and there was, as the chairman of the US Joint Chiefs of Staff put it, a risk of 'civil unrest and the break-up of the union' in the abstract approach it was now taking.

Merkel is not going to attain her objectives if the US opposes her, but even if it is neutral her plans simply will not overcome the obstacles in her path.

No sooner than the European Union members met in Brussels on 8 December 2011, declaring an agreement, crucial people such as Mario Draghi, the new head of the European Central Bank, began disputing what the Bank will and can do, clarifying his earlier statements in ways that looked like a reversal. Whether existing European Union institutions are sufficient to deal with a much broader spectrum of financial needs and issues must now be resolved also. Else the EU must also create new ones. Germany and France say the existing institutions will suffice, but whether or not other nations in the EU agree is not clear. The British, led by a Conservative government, in any event, refused to go along with the new deal and it remains to be seen how many existing European political leaders are ready to lose elections just to implement the draconian economic rules the Germans and French want to impose. Britain will have no voice in drafting a new agreement among EU members and, indeed, may get out of the EU entirely.

Like most accords dealing with such complex matters, the details are crucial. Those agreed upon in Brussels the weekend of 9 December simply leave too many questions of implementing an agreement hanging. In nine of the 17 national parliaments of the governments involved, parliamentary votes are required. Ireland may have to call a referendum. This is a time-consuming process, likely to be very contentious; basic economic questions and the welfare of nations will be involved. As even Nicholas Sarkozy admits, 'Time is working against us,' but states ratifying the new agreements will take time doing so. There is still democracy to thwart the dreams of technocrats in Brussels. France and Italy, from the Left as well as the Right, have been places where strikes and protests abound when the European Union imposes its diktats.

The British, in any case, will not go along with the new European accord – they never entered the euro bloc anyway – and the International Monetary Fund has raised the question whether it, despite its experience telling poorer countries how to run their economies if they want IMF loans, has the power or the resources to help save the euro bloc. Britain may no longer have a veto power over EU decisions – it may not be a member of the Union at all. Cameron has to work this out with his divided government bloc, and it may fall, too, on this question. Politics can decide matters in the UK as well.

Nations talked to each other throughout this past century but in the final analysis, as the Clarke monograph shows, they acted with the national interest foremost in their calculations and motives. They did so in the 1920s and the Germans are doing so now. Some things never change, especially in world affairs

European Union members have often reached agreements, but these accords have generally not been honoured; in a word, they come apart and do so fairly quickly. Germany now has the leverage to get most of them to go along with a formula, which is mainly old-fashioned economics, that defines it. It assumes wealth is a sign of virtuous behaviour, if not, in its Calvinist version, God's grace, and which many of Europe's leaders are for, in theory if not practice. But will Europe's political rulers honour this agreement any more than they have honoured past ones? Ms Merkel had her way in Brussels and asserted German power.

What is more than likely is that the euro crisis will continue for a very long time. The accord reached at Brussels will soon come apart because fear of Germany is still strong in many countries of Europe; national policies and the legitimate desire of nations to define their economic needs, based on their own priorities, and the institutions of democracy, which Ms. Merkel's solution flouts as if they are no longer relevant, compared to the fiscal conservatism that underlies the German approach. Moreover, the German formulae for ending the crisis by balancing budgets and the like may not work on its own terms and the framework for it succeeding may not exist, as Draghi and others have warned. Creating a new one will take a great deal of time.

Europe's nations have agreed on an ostensibly new framework of principles – one that in fact is very much like the one agreed upon 20 years ago – and which also did not agree on concrete methods to implement it or a time frame. Even Merkel admits that formulating tangible measures to put her proposed solutions in force may take years. There is the rub.

Ms. Merkel is playing a very high stake game – and nominally won this round – but the British and American governments disagree with both the means and ends of her effort, and the people of much of Europe have yet to be heard from. History is still very important.

Ms. Merkel is more than likely to fail in her ambitious plans.