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Germany after the Greek summit – the helpless hegemon

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The deal struck with Greece overnight on 12 and 13 July has proven that Germany has an ever stronger position in the eurozone and is backed by an increasing number of other countries. Chancellor Angela Merkel, who wanted the support of German public opinion for loans to be granted to Greece, pushed through strict conditions on aid being granted. The deal has been positively received in Germany, and this will make it possible to maintain the consensus inside Germany regarding the strategy on the eurozone crisis, which is based on the slogan: loans for reforms. However, some doubt remains as to whether this deal will bring the eurozone closer to resolving the problem of Greece, which is in fact an insolvent and unreformed country, and which in addition to all this has an ace up its sleeve in the form of there being no legal option to remove it from the monetary union. There is still no deeper reflection in Germany as to how the eurozone can be further reformed beyond pushing through reforms and austerity measures.

The conditional agreement between the eurozone and Greece

Overnight on 12 and 13 July, eurozone member states, following months of negotiations, reached an agreement with Greece concerning the conditions on which it will be granted financial aid. Under this agreement, eurozone countries will lend Greece between 82 and 86 billion euros (the creditors hope that the International Monetary Fund will grant more than ten billion euros of this sum). The eurozone member states will begin preparing an aid package only when Athens has passed the required reforms in parliament. The establishment of a special fund to which Greek assets worth 50 billion euros will be transferred in order to be privatised is a completely new proposal. Even though the headquarters of the fund will be located in Greece, it will be directed by a Greek managerial staff "under the supervision of the relevant European institutions." The incomes generated by the fund will be allocated to repay the loans, and the accumulated assets will be used as security should the government in Athens fail to fulfil its obligations with regard to its creditors. Around 25% of these funds will be re-invested in the Greek economy. In addition to this, Greece has undertaken to restrict pension privileges, to raise taxes and to liberalise many areas of the economy.

Germany as the main advocate of stricter conditions being imposed for Greece aid

Before the referendum on 5 July, when Greeks spoke out against the continuation of negotiations with its creditors on the previous conditions, Germany adopted a clearly

tougher stance on Athens. However, it is worth emphasising that this stance was in line with those adopted by most of the eurozone member states. Only France and Italy were ready to take a more conciliatory approach towards Greece. The outcome of the referendum gave a clear victory to the opponents of a consensus with the creditors and this strengthened Berlin's conviction that the stance taken by Greece could serve as a model to be copied by other countries which have been forced to carry out tough economic and social reforms under pressure from the eurozone.

It turned out during the summit that Germany had prepared the toughest conditions, insisting that Greece maintains all previous aid conditions, such as Athens consenting to the continued participation of the International Monetary Fund as the institution which will monitor the government's moves as part of the aid programme, and also pushing through new strict requirements which Greece should meet in order to be granted further loans. The Greek government will still need to consult its key decisions concerning public finances with 'the Troika' (representatives of the International Monetary Fund, the European Central Bank and the European Commission). The German minister of finance, Wolfgang Schäuble, insisted for a long time that the agreement should include a provision stating that Greece's failure to implement reforms may lead to temporary removal from the eurozone. Berlin has also refused to back any promise to cancel part of Athens' debt, even though the IMF stated that it was necessary to reduce the country's debt. Nor does the deal mention the investment package worth several billion euros which was reportedly promised to Greeks by Angela Merkel before the referendum.

The internal German context

Chancellor Angela Merkel proved once again during the summit that internal political issues have a strong impact on her stance on the eurozone crisis. The tough stance presented by Germany during the summit sent such a strong message to German public opinion that it is very likely that internal political consensus will once again be maintained regarding the manner in which the Greek issue needs to be addressed.

The opinion that from the economic point of view Greece should be expelled from the eurozone – even if this would result in part of the money lent to this country being lost – has become increasingly popular in Germany. This would be a tough lesson to other countries, showing that austerity measures and improving competitiveness are still the top priority issues, and there will be no shift from this policy. Already in March this year, numerous Christian Democrat politicians announced that they would not back further loans for Greece. There was also speculation that Chancellor Merkel might have to apply for a vote of confidence to the Bundestag when presenting the motion for further financial aid to Greece. Chancellor Merkel was also aware of the fact that it is still difficult to assess all the political and economic costs of Greece leaving the eurozone. On top of that, she did not want the first serious failure of European integration (which Greece leaving the eurozone would be) to become part of her political legacy. For this reason, she would not disclose the stance she would present at the summit in Brussels until the last moment. Even German public opinion was surprised by the tough stance adopted by the federal government and by the fact that it had been possible to push through so many proposals concerning Greece.

The deal with the Greek government has been positively evaluated by almost all the political parties in Germany, including representatives of the CSU, who had previously been sceptical about further aid to Athens, and the Social Democrats, who are traditionally viewed as 'pro-European' and more ready to make concessions to Greece. At present, SPD is positioning itself to demand that Greece be set strict conditions before aid is granted. The split inside the Alternative for Germany (AfD) is also helping Merkel. AfD is the only party which has strongly criticised Germany's granting loans to eurozone member states, and its support levels are in freefall. So if Athens complies with its part of the deal, there is no doubt that the Bundestag will agree to offer further aid to Greece.

The deal will not solve the problem

The deal which was reached as a result of the negotiations during the summit in Brussels can only be viewed as a temporary success in the negotiations, but this will not resolve the Greek issue in the eurozone, nor will this provide a long-term strategy for dealing with the crisis.

Since the Greek political scene is less and less stable, only an optimistic scenario can envisage that the reforms will be implemented and will later bring economic growth. There is no doubt that Athens is unable to repay its debt, and the hidden redemption of Greece's debt through extending its repayment deadline and lowering the interest rate will bring only limited results. If further reform measures fail, the Greek problem may re-emerge at a later date. Germany may be then forced to make tough decisions. The scenario that Greece will leave the eurozone is ruled out in theory, since pursuant to the treaties the monetary union is irrevocable, and therefore no exit procedure was envisaged. A change in these regulations would require consent from the government in Athens, to which neither the Greek public not the government elite will agree. Although it may be imagined that Greece will leave the eurozone by mutual consent (if it agrees for the treaties to be amended and to voluntarily leave the monetary union in exchange for a certain form of financial aid), the implementation of this scenario would completely change the character of the eurozone project and might mark the beginning of the end for it.

The uneven distribution of the benefits of participation in the monetary union is another unresolved problem of the eurozone. Many economists point out that eurozone membership has offered Germany perfect opportunities to develop its exports, and this has made it possible for Germany to maintain the highest trade surplus worldwide over the past few years. As in the case of Switzerland, if Germany had its own currency, it would have had to take into account the negative consequences of of its appreciation, which was often the case in the 1990s. Furthermore, Berlin would not be able to count on the benefits offered by low interest rates imposed on debts. Countries such as France, Italy and Spain have lost the possibility of devaluing their national currencies since joining the eurozone and have had to deal with a trade deficit ever since. Additionally, their debt service costs have significantly increased during the eurozone crisis, thus raising their public debt. For this reason, these countries have called for the introduction of compensational transfers for countries which need to deal with an economic crisis. However, Germany has so far rejected any proposals for a debate on this issue and has instead preferred solutions which feign the introduction of structural reforms of the eurozone, such as the European Semester (the European

Commission prepares non-binding recommendations for improving the economic competitiveness of the member states) or the Fiscal Pact (the obligation to reduce budget deficit written in the constitutions of all eurozone member states). These have brought hardly any changes to the way the eurozone functions. The only tangible difference so far has been the engagement of the European Central Bank, which is able to support countries with debt problems by buying their bonds with in fact printed money. It became engaged in economic policy contrary to Germany's stance, since this collided with the goal of having an independent monetary policy. Changes in the construction of the eurozone would, however, require a much higher degree of integration (including amendment of the EU treaties) and a reduction of sovereignty in the area of economic policy, and this is something even Germany is still not ready for.