# **Why German Economic Thought Made the Greek Crisis Inevitable**

July 10, 2015 by [Kevin Baker](https://tropicsofmeta.wordpress.com/author/kbaker42/)

Yesterday, after months of negotiations, Greece’s Syriza government relented to the demands of its creditors and offered a set of “reforms” in exchange for continued loans. [This reform package](http://www.naftemporiki.gr/finance/story/976680/the-greek-reform-proposals), which essentially matches the content of the draft plan Greek voters voted down on Sunday’s referendum, will force the country to slash pensions, make further budget cuts, and adopt a series of regulatory changes designed to make the Greek economy more “competitive.”

In the lead up to Sunday’s referendum, many observers hoped that a decisive vote against the proposed measures would force the Troika—Greece’s creditor institutions, the European Commission, European Central Bank, and International Monetary Fund—to compromise their hardline stance in favor of continued austerity. The IMF’s [announcement last week](http://www.theguardian.com/business/2015/jul/02/imf-greece-needs-extra-50bn-euros) that Greece would need an additional €60 billion in debt relief and 20-year grace period on debt repayments seemed to add credence to this optimistic assessment. The US Treasury Secretary Jack Lew, fearing the fallout of a potential Grexit, urged the Eurogroup to come to a “pragmatic compromise” on Greece.

But after Sunday’s decisive no vote, Greece’s creditors, led by Germany Chancellor Angela Merkel, were unflinching. Even Sigmar Gabriel, the chairman of the center-left Social Democratic Party of Germany (SPD), who had previously pushed Merkel to adopt a less hardline approach to Greece, has accused Tsipras of pulling down “[the last bridges over which Europe and Greece could have moved to a compromise.](http://www.ft.com/intl/cms/s/0/0a805a22-2556-11e5-9c4e-a775d2b173ca.html#axzz3fJMAxTGf)“

**Burning bridges in Europe, building them in the US (well, sort of, for a while)**

Despite being a party of the far left, Syriza’s official position—that in a time of recession, governments should engage in countercyclical deficit spending—is a fairly conventional Keynesian view. Indeed, **in the wake of the 2008 financial crisis, Keynesian stimulus programs were launched in the United States, under George W. Bush and Barack Obama, the UK under the center-left government of Gordon Brown, in France under the center-right administration of Nicolas Sarkozy, and many other countries. So complete was the return to a Keynesian orthodoxy that the (neoclassical) Nobel Memorial Prize winning-economist Robert Lucas famously uttered in 2009, “I guess everyone’s a Keynesian in the foxhole.”**

Not the Germans. In late 2008, Peer Steinbrück, an SPD member, and Germany’s then-finance minister, denounced Gordon Brown’s stimulus package, saying “[the switch from decades of supply-side politics all the way to a crass Keynesianism is breathtaking](http://www.ft.com/intl/cms/s/0/22e7ed04-c6f9-11dd-97a5-000077b07658.html).” Early the next year, under the watch of Steinbrück, Germany launched its own €50 billion stimulus package, amidst much “wailing and gnashing of teeth” in the Bundestag.[[1]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn1) But this brief encounter with Keynesian fiscal policy was an aberration. **Throughout the financial crisis and subsequent Euro crisis—and in fact throughout much of it postwar history—Germany has been obsessively focused on fiscal restraint, lest it lead to inflation.**

On the surface, it seems puzzling that Germany should be so united behind calls for continued austerity in Greece and against the more moderate Keynesian proposals recommended by France, the United States, and even the IMF. Germany, after all, is a social democracy with a comparatively robust social welfare system, and these are characteristics normally associated with Keynesian macroeconomic policies. But this isn’t the case in Germany. In fact, aside from a brief period in the late 1960s and early 1970s, Keynesian ideas have never had much traction in Germany, even on the political left. **The reasons for this are deeply rooted in Germany’s economic history. This history and the ideology it helped to spawn have shaped the European Union’s economic institutions, and continue to guide Germany’s response to the Greek crisis.**

### **The Peculiarities of German Economic History**

In June 1990, Hans Tietmeyer, who was the President of the Deutsche Bundesbank during Germany’s adoption of the Euro, spoke to an audience at the IMF about the reasons for the success of German monetary policy and the strength and independence of Germany’s central bank. The reasons, he argued, were partly historical. “The experience gained twice with hyperinflation in the first half of this century,” he claimed, “has helped to develop a special sensitivity to inflation and has caused the wider public to believe in the critical importance of monetary stability in Germany.”[[2]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn2) This peculiar historical experience, Tietmeyer believed, explained the unusually low inflation rates of the Deutschmark in the postwar period. “In light of the success of the Bundesbank,” he argued, “it is only natural that the German public will expect any successor, which could take its place at the European level, should be at least as well equipped as the Bundesbank to defend price stability.”[[3]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn3)

**A funny thing happened on the way to strangling a continent**

The Maastricht Treaty, which established the European Union and created the common currency, fulfilled these German expectations. The Maastricht convergence criteria, which determined whether or not EU member states would be allowed to join the Euro, focused heavily on controlling inflation and maintaining a low government budget deficit and debt-to-GDP ratio. Further, the European Central Bank (ECB), which was established in 1998 and manages the monetary policy of the Eurozone, has a single mandate: to maintain price stability. **The monetary and fiscal assumptions of Germans have served as the guiding norms of the monetary union since the very beginning: acceptance into the Eurozone would depend on fiscal discipline and the ECB, unlike, for example, the US Federal Reserve which (ostensibly) has a dual mandate to fight unemployment and inflation, the ECB would only be concerned with fighting inflation.**

But the experience of hyperinflation doesn’t seem sufficient to explain the single-mindedness with which Germany has approached the Euro crisis. After all, as many have noted, Hungary and Austria also had their own domestic experience with hyperinflation in the interwar period, and Greece’s hyperinflation of 1943-1944 was much more recent than Germany’s, but did not leave the same imprint in national policy. And this historical experience definitely doesn’t explain the severe and often punitive conditions and interest rates on loans to Greece that Germany has insisted on. To understand this, we have to look at the immediate postwar period.

### **Crowding Out Keynes**

After the Second World War and the Great Depression, laissez-faire economics and the notion of an efficient, self-regulating market were on the ropes. In the United States and much of Europe public intellectuals and scholars declared unregulated capitalism obsolete. Some argued that market principles had been useful in the nineteenth century, but that large, complicated twentieth century societies required economic management and planning.[[4]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn4) Fearful libertarian commentators like Friedrich Hayek, who had spent much of the twenties and thirties suggesting that economic planning was impossible, argued that attempts to manage the economy represented a slippery slope to tyranny and “serfdom.” But, until the 1970s, these perspectives had only limited influence in the English-speaking world. Demand-side, managerial policies seemed triumphant. In the United States, the UK, and much of Western Europe, Keynesian macroeconomic policy held sway, and, through the [Bretton Woods](https://en.wikipedia.org/wiki/Bretton_Woods_system) institutions, set the guiding norms and assumptions for the international economic order.

**It’s a miracle!**

In Germany, though, Keynesianism never really took hold. During the years of the so-called Wirtschaftswunder, or “economic miracle” of the postwar years, West Germany only occasionally employed Keynesian policies. Indeed, the only real period of Keynesian influence in the economy was during the Grand Coalition government (1966-1969) and during the early years of Willy Brandt’s government (1969-1974). According to the political scientist Christopher S. Allen, “Keynesianism in Germany was effectively preempted by another set of policies, oriented toward the supply side and the social market economy, that was progressively reinforced—both institutionally and ideologically—over succeeding stages in the postwar period.”[[5]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn5)

This other policy framework—the so-called “ordoliberal” or Freiburg school of economics—took a different lesson from the history of twentieth-century capitalism. The theory was developed by postwar West German economists like Walter Eucken, Franz Böhm, Leonhard Miksch, and Hans Großmann-Doerth as a response to the unregulated markets of the early twentieth century and to the interventionism of the Nazi regime.[[6]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn6) Like their cousins in the libertarian Austrian school of economics, early ordoliberals feared economic planning and most kinds of government intervention in the economy, which they linked to the tyranny of Nazi economic planning as well as the centralized planning of the allied occupational authorities. But they also took from the interwar Weimar-era an abiding fear of hyperinflation, a concern about the dislocative effects of proletarianization, and a fear of haphazard economic experimentation. **Combined, all of this created a climate in Germany, which was receptive to a strong state and a comparatively extensive system of social provision, paired with extreme skepticism toward any macroeconomic policy, which could potentially be seen as inflationary.**

### **The German Ideology**

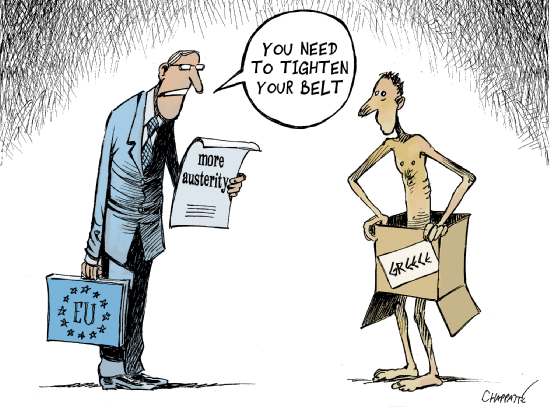
So what is ordoliberalism? In his book Austerity, the History of a Dangerous Idea, Mark Blyth refers to ordoliberalism as the German twin of neoliberalism.[[7]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn7) This is true, but the two are fraternal, not identical twins, as they differ in fundamental ways. Unlike for classical liberals in the Anglo-Saxon tradition, for ordoliberals the state is not an impediment to the efficient functioning of markets; for them strong government regulation is a necessary prerequisite for competitive market activity. And unlike in the Austrian or Chicago variants of neoliberal thinking, a strong state is seen as necessary to produce the moral, legal, and social frameworks (the Ordnung) essential for the functioning of markets.

These state-initiated rules were intended to approximate as closely as possible the functioning of a perfectly competitive market. Consequently, ordoliberals place an outsized emphasis on preventing the establishment of cartels and monopolies. By preventing the formation of powerful economic agents which can influence the prices of goods and services, the state can create a situation approximating a state of perfect competition, which will drive economic development without government stimulus or non-regulatory intervention. By controlling the size and power of economic agents, and by encouraging the formation of a strong state, ordoliberals hoped to prevent a situation of regulatory capture, thus protecting the market from subversion by powerful economic actors.

Perhaps unsurprisingly for a philosophical tradition from Germany, a famously rule-obsessed country, the need for a robust system of rules runs throughout the ordoliberal project. For them, economic rules are seen as constitutional, as an inviolable part of the fabric of society. For people in the ordoliberal tradition, as the legal scholar David Gerber put it, any action “which does not conform to constitutional economic principles should be overturned by the courts…just as if it had violated the political constitution.”[[8]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn8) In effect, ordoliberalism “constitutionalizes” the economy and embeds it in a broader normative framework.  Consequently, when the former Italian Prime Minister Mario Monti famously said that for Germans “[economics is a branch of moral philosophy](http://www.economist.com/node/21563741),” he was on to something. Liberal economic thought in the British tradition often frames the economy as something autonomous from moral and social life. Ordoliberals see economics, law, and social norms as fundamentally linked. In a sense, they reflect a [Polanyian urge](https://en.wikipedia.org/wiki/Embeddedness) to embed the market into society, to adapt it to suit the moral beliefs of a people. This desire for morally embedded market explains their acceptance of the “social” component of Germany’s social market. But on the other hand, ordoliberals seek to adapt social norms and institutions to suit the needs of a competitive market. For ordoliberals, this is a product of human design, as the early ordoliberal Walter Eucken notes:

This problem will not solve itself simply by our letting economic systems grow up spontaneously. The history of the last century has shown this plainly enough. The economic system has to be consciously shaped. The detailed problems of economic policy, trade policy, credit, monopoly, or tax policy, or of company or bankruptcy law, are part of the great problem of how the whole economy, national and international, and its rules, are to be shaped.[[9]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn9)

But beyond the mere construction of rules and institutions, ordoliberalism also calls for a reengineering of the social framework in which markets are embedded.  This requires, as Gerber puts it in his sympathetic account, “a broadening and deepening of economic knowledge throughout society.”[[10]](https://tropicsofmeta.wordpress.com/2015/07/10/why-german-economic-thought-made-the-greek-crisis-inevitable/" \l "_ftn10)  For thinkers in this tradition, the social logic of ordoliberalism needs to be broadly defused and continuously maintained by an uncompromising enforcement of economic rules. This means that the state needs to protect against the subversion of the economic constitution by powerful firms, but also against democratic demands.

[](https://tropicsofmeta.files.wordpress.com/2015/07/austerity-cartoon-eu-greece.png)

### **Discipline and Punish**

This mentality goes some way towards explaining the German reaction to the Euro crisis and the demands it has forced upon Greece. Ordoliberal ideas undergird the competitive “reforms” that Greece will have to undergo as well as the continued budget cuts. It also explains the punitive terms Germans have attached to Greek loans and the uncompromising stance with which they’ve approached negotiations. By violating the rules of the “economic constitution,” the Greeks risk not only generating “[moral hazard](https://en.wikipedia.org/wiki/Moral_hazard),” but they, in German eyes, also challenge the logic on which the common currency rests. If, as an ordoliberal sees it, rules are the foundation on which an economy rests, any failure to enforce the rules puts the whole system into a state of jeopardy. In a market based on ordoliberal principles, Greece has been forced to choose one of two unappealing options: an ordoliberal diet of austerity, budget cuts, and continued economic hardship or Grexit.

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