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GERMANY'S TWO MODELS AND THE LONG-TERM SUSTAINABILITY OF THE EUROZONE

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ABSTRACT

The disruptive forces that only a few months ago threatened disintegration of the European Monetary Union (EMU) seem to have been defused, albeit only in part and in extremis. On the world scale, the improved relations between the United States and the European Union have not entirely dispelled the threats represented by the rapid shift from rules to power, from globalisation to protectionism, from Europe to Asia. Internally, the pandemic has mitigated the widespread disaffection with the European project (populism), but it has magnified the divergence between the core and a southern periphery which, having never fully recovered from the 2008 crisis, has been hit hardest by the pandemic. With massive public and private debt, the biggest threat to the European Union's post-pandemic recovery is premature fiscal tightening and a return to the old rules.

Germany's stance is decisive in defining the European response to these multiple challenges, since where Germany goes, the Eurozone will follow. Germany cannot go it alone in the international arena, but it can go on either together with the other member countries – giving a helping hand in the development of the whole European area – or as the leader of an economic empire. Although past experience has demonstrated the short-sightedness of the latter option, the outcome of these two conflicting positions is uncertain. Indeed, the German model is not monolithic but, rather, a complex, tense and changing process of antagonism and accommodation between different domestic 'advocacy' coalitions. It exhibits over time subtle shifts in its centre of gravity, depending on the particular situation and on which coalition is ascendant on particular issues.

In the past, the prospect of the system imploding succeeded in mobilizing counteractive forces strong enough to stall disintegration, but not to set the Union on a long-term sustainability path. The paper investigates the economic and political conditions for this to come about, arguing that it would require nothing short of a U-turn in economic theory and policies, at the macroeconomic, industrial and

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social policy level. The world economy is undergoing a structural change of proportions comparable to that experienced in the 1970s. The accelerated pace of technical change poses a serious threat to the entire EU, and in particular to its weaker members. Preventing the digital transformation from becoming an additional factor of polarization would call for a new, more cohesive industrial policy, which includes a broad investment programme and a combination of protection, administrative guidance, and encouragement of controlled competition to activate linkages and fill the gaps in the productive structures of its member states. To become a more equal partner with the US and China, the EU must grow, economically and technologically. But this calls for the concerted action of all its members, a much more difficult condition for the EU to achieve, as it will require building a consensus between very different political economies, and which will come about only within a different theoretical and political approach. Will this time be different?

Keywords: Eurozone, Core and Periphery, Keynesian Economics, Structural Change, Stability Pact.
JEL Codes: E12, E6, F15.

Introduction

The pandemic hit the EU at an extremely delicate moment, when it had to face external and internal disrupting forces. The post-Cold War dream of a rules-based international order with Europe at the centre was in tatters, the centre of global politics was shifting to Asia, and globalisation was giving way to protectionist drifts. These shocks have shaken Europe's conception of order (Leonard 2020). At the same time, widespread disaffection with the European project (populism) was challenging the Union from within, Brexit undermined confidence in a "European" response to the changing global political order (though, paradoxically, making a common political response to the crisis easier), and the asymmetric effects of the pandemic-induced crisis exacerbated the divergences within the EU, threatening its stability.

At least for the time being, the centrifugal forces threatening disintegration of the European Monetary Union (EMU) seem to have been defused, albeit only in part and in extremis. However, the paper argues that survival of the Union depends not only on responding to the severe financial problems caused by the epidemic, but also on addressing the long-term, structural problems that led to the increasing divergences among its members. This has become more urgent because Covid-19 has speeded up advance along the path of change – in technology, consumption patterns and competition – a process reminiscent of the structural changes of the 1970s. Europe is lagging far behind in the innovation race, and must compete in a global market with countries that are actively supporting their industries. As in the 1970s, the European peripheries risk seeing the gap between them and the core widening even further. Yet, convergence is essential to strengthen the Union so as to guarantee its long-term sustainability in a stormy international environment. The dilemma of the EU is simply this: its members are condemned to stay together, but, at least so far, each has pursued its own ends.

What policies and what reforms should be implemented in pursuit of long-term sustainability? Do the current answers match up to the challenge? And are they economically and politically feasible? To answer these questions, we need to understand how things have got so wrong in the Union. The paper will briefly review the distant origins of the crisis to assess EU's ability to address the causes, past and prospective, of the divergence between core and periphery [1] in a rapidly changing, and possibly less friendly, international setting. Any change in the EU's institutions and policies depends on Germany. In the past, its 'austere' model compressed all the components of domestic demand, and failed to push towards the modernization of physical and digital infrastructure and the urgently required technological innovation in key industries. So, historically low European (private and public) expenditure has been an economic drag, rather than a cause of greater European prosperity. The last section ponders whether the multiple challenges facing Europe might induce a change towards an advocacy coalition more favourable to the construction of a more cohesive Union.

1. The structural roots of divergence

The constitutive purpose of the Union was promoting communion between peoples and convergence and harmonization between economies. Instead, the integration process has resulted in an EU that has become more diverse, unequal, and divisive, with growing divergence between core and periphery and mounting acrimony among its peoples. The fragility of the European project derives from the institutional structure that the European Union and the European Monetary Union have given themselves since their constitution.

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[1] Following the distinction made in Simonazzi and Ginzburg (2015), the 'core' basically includes Germany (and the smaller Nordic member countries), while the southern 'periphery' includes Greece, Italy, Portugal and Spain. France, it is argued in Celi *et al*. (2018), shares features of both core and periphery. The broad classification in core and periphery does not exclude the possibility of different trends between the countries within each group.

The process of European integration

The principles that guided the unification process were based on two critical assumptions. Disregarding the peculiar problems of latecomer countries, the European Union's institutions were shaped on the premise that all its members were on a level playing field, except for certain 'less modern' institutions, individual values and attitudes. The implicit assumption was that an austerity regime, associated with institutions close to those assumed to be prevailing in the 'core' countries, would create the 'right' environment for growth in the periphery (Simonazzi and Ginzburg 2015). Besides this "monoeconomics" claim (Hirschman 1981b: 3), a second ingredient of mainstream economics consisted in the mutual benefit claim, i.e. the assertion that economic relations between core and peripheral countries "could be shaped in such a way as to yield gains for both" (*ibid.*), thus denying the different consequences deriving to their economic and institutional structures from the interdependent relations between the two groups of countries.

The crisis of the 1970s, which was associated with saturation of the major mass consumer goods in the advanced countries and the onset of globalization, led to profound transformations in demand, production, and competition, which came to be increasingly dominated by the quality of differentiated products rather than price. These changes affected the core and peripheral economies in very different ways. The core succeeded in restructuring its industry, leveraging on the solidity of its system of small and medium enterprises (the 'Mittelstand') and with the support of industrial policies, that, even if shunned by academia and the European Commission, continued to enjoy a very concrete and lively existence, as documented by an increasing number of studies.[2]

The restructuring of the core deeply affected the countries of the periphery,[3] which, in reorganizing their economies, struggled to adapt to the new environment, dominated by disinflation and quality competition. The fall in the relative prices of flex-price items hit their economies harder; their basic industries and 'mature' products faced the competition of the developing countries, calling for drastic cuts in production. The

[2] See Chang, Andreoni and Kuan (2013), who rate German industrial policy among the most active in Europe.

[3] Describing the difficulties faced by latecomer European countries following the oil shocks, Fuà (1980) observed that they were hurt by the austerity policies and the protectionist measures implemented by core countries in defence of their traditional industries, which compounded the increased competition from the developing countries in their products of specialisation.

new situation would have required innovation in the state's capacity to guide and facilitate the reorientation of investment so as to respond to a rapidly weakening economic structure. However, on the one hand the structural breaks of the 1970s created extreme uncertainty about the future prospects of international specialization and the prospective growth of industry, with paralyzing effects on industrial policy decisions. On the other hand, their industrial policy was more exposed to the scrutiny of the competition arm of the European Commission (EC). In fact, industrial policy means different things, and its re-definition as competition policy produces different effects, depending on the level of development. In core countries, industrial policy consists basically in coordinating the system of production (thick network of firms, research agencies, public institutions, local development banks), acting 'under the radar'. Conversely, in latecomer countries it consists of state aid, public enterprises, soft loans and subsidies to private firms – policies that represent an easy target for the EC's competition arm. Thus, precisely when the state should have been taking on new tasks to ease the process of restructuring, diversification and quality upgrading, these countries adopted across-the-board liberalization policies, implementing what might be called 'plain destruction' of their capabilities to create new products, market niches, and markets. In a context of fixed exchange rates, austerity measures in the periphery were assigned the task of implementing a 'flex-price' policy through domestic devaluation.

The regime changes of the 1980s – privatizations, financialization,[4] labour market reforms and monetary and fiscal discipline – that marked the disappearance of industrial policy, were accompanied by the macroeconomic transition from a 'politicized' management of economic policy based on discretion to a 'depoliticised' management based on the automatism of rules (Burnham 2001). In the case of EMU, the transfer of control from elected to non-elected officials (see the ECB statute); the fiscal rules; and the attribution of 'objective', and thus higher, knowledge to technocratic expertise. Two levels of de-regulation – global and European – and two role models – German disinflation and US financialisation – eventually shaped the process of European integration, leading to the 'European way' to monetary integration and global finance. The restrictive monetary policies of the core country exerted asymmetric effects on the periphery because of both its mono-specialization in commoditized products and the flight of capital to the safe-haven centre countries – a phenomenon ob-

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[4] Defined as a process in which financial activities become increasingly important in the formation of the profits of the economy (Krippner 2011).

served time and again (Ginzburg and Simonazzi 2011), most recently in the Eurozone sovereign crisis (the 'sudden stop').

To conclude, in the process of European integration, the Southern peripheral countries were exposed to macroeconomic and industrial policy measures that, although apparently neutral, generated asymmetric effects that increased regional disparities, both between core and peripheral countries and within countries. The institutional features of the euro area were not such as to sustain the capacity of the Southern European countries to achieve a sufficient level of diversification and specialization in their productive structures; indeed, they may even have contributed to depleting it.[5] While powerful counterforces were slowing down the pace of the institutional reforms required to complete the Union, the institutions and reforms already in place pre-empted any alternative policy. A point that needs to be made clear is that accounting for the increasing core-periphery divergence with the faulty institutional features of the EU construction does not amount to exempting the ruling classes of the southern periphery from their responsibilities (Simonazzi 2020).[6] Indeed, criticism of the Italian political class has been voiced by many scholars,[7] often offering support to the view favouring automatic rules.

The formation of two peripheries

Two shocks further undermined the ability of the southern countries to keep pace with change. First came the restructuring in the hierarchical organization of the supply chains across Europe following upon the fall of the Soviet Union, the eastward extension and redirection of German FDI and trade towards Eastern countries. The Eastern periphery's [8] wage and fiscal dumping brought pressure to bear on labour across the Union,

[5] In Italy, financial liberalization and privatizations of public firms resulted in the construction of 'private monopolies' in public utilities; industrial profits were diverted to finance and services, while investment and R&D expenditures, made mostly by public enterprises, fell.

[6] A relevant critique of the dependency theory, already advanced by the neo-Marxist school (the 'new dependency theory'), was that, by attributing underdevelopment only to external circumstances, it exonerated national actors from any responsibility and might even take on the form of apologetics in defence of the domestic ruling leadership (Weissenbacher 2018: 90).

[7] For a recent critical analysis see Ciocca (2020: 391), who argues that the Italian governments were not even able to draft a wide-ranging programme inspired by a clear vision of what to do. Italian firms, for their part, drugged by public aid and subsidies, became unable to stand up to international competition with innovation and entrepreneurship.

[8] The definition at first included the four Visegrad countries – Poland, Hungary, Slovakia and Check Republic – but the process gradually extended south, to Romania, Bulgaria and beyond.

impelling domestic devaluation in the South. Threats of delocalization weakened Germany's trade unions, too, forcing wage moderation in the tradable sector and outright wage reductions in the services (Hartz reforms). Then came China's admission to the WTO (on December 11, 2001), which produced asymmetric effects for EU countries: it offered a rapidly expanding market for German capital and premium consumption goods, while representing a formidable competitor for the products of the Southern periphery, caught between product competition within the EU and cost competition from emerging economies in the global markets.

Higher imports of cheap inputs from Eastern Europe helped contain the costs of German products and inflation, while the increase in inequality and working poor diverted consumption and imports away from the quality products of Southern Europe to cheap goods imported from China. The weaker suppliers in the South (as well as in Germany itself, see Dauth, Findeisen and Suedekum 2014) were displaced by their cheaper competitors in the near and far East, while only the highly specialised suppliers of components and luxury goods in the industrial regions of the South managed to maintain, and even enhance, their role in the German supply chains.

While the developments following the 2008 financial crisis further increased the divergence between the core and the southern periphery, the growing integration of Central and Eastern European economies into the German supply chains catalysed their specialization processes (Simonazzi, Ginzburg and Nocella 2013). On the eve of the Covid crisis two different industrial models co-existed: a strong industrial base in core countries, export-oriented and with a solid position on global markets, and a less diversified industrial sector in the periphery. The two peripheries – the Southern one, made up of the Mediterranean economies, and the Eastern one, with the prominent role played by the Visegrad countries – suffer from different fragilities, which descend from their common, albeit diverse, economic and financial dependence on the core. The core itself is dependent for its growth on the pattern of specialisation within the EU: the southern markets providing an outlet for its increasing manufacturing surpluses, the eastern countries supplying cheap inputs for its industries (Celi, Guarascio and Simonazzi 2019). This combination of structural divergence and economic interdependence lies behind the fragility of the Union as well as the improbability of its disintegration, given the high costs it would entail for core and peripheries alike.

2. Covid-19: A game changer?

The European lost decade

In the aftermath of the 2008 crisis it was believed that, with the evidence of the costs caused by neoliberalism and financialisation, Keynesian thinking would finally be reasserted. After a brief Keynesian spell, austerity came instead, ushered in by the bailout of the financial system. Austerity policies destroyed domestic demand across Europe: the fall in demand, production, and income in the South was offset neither by expansionary policies in core countries, the only ones with fiscal space, nor by higher demand in the eastern periphery – basically an export platform, where trickle down effects to the domestic economy are still too limited to provide support. Germany, which had built most of its huge trade surplus between 2003 and 2008 by exporting to the periphery, turned to the world market. Special international conditions – namely, China's impressive growth, which gobbled up German capital goods and high-quality durable consumer products (particularly cars, Simonazzi, Carreto Sanginés and Russo 2020), and the vigorous American recovery – supported Germany's ability to redirect its trade flows, expand its market shares outside the Eurozone, and make a speedy return to its pre-crisis production levels. By 2018 China was Germany's largest trading partner, while both peripheries became more dependent on the German (export) industry, and growth of the entire EU area was entrusted to world demand.

Changing international conditions – with China and the US moving towards a protectionist stance – exposed the vulnerability of the export-led model. Moreover, the developments following the 2008 crisis magnified the traditional weaknesses of the European model: the debtor countries' recurring crises, growing popular dissatisfaction with the European project, and the increasing technological gap vis-à-vis foreign competitors. Growing awareness of the gravity of these challenges urged a rethinking of policies and institutions. The World Economic Outlook of October 2012 opened the way for criticism of the theory of austerity with a chapter devoted to analysis of '100 years of dealing with public debt overhangs'. "The conclusion was that austerity programmes often worsen rather than solve sovereign debt problems: 'expansionary fiscal contraction' is likely a theoretical chimera" (Carabelli and Cedrini 2015). Many other institutions and academics followed, but proposals for reform met with the creditor countries' outright opposition or only partial implementation. The call for an active fiscal policy was restricted to countries with 'fiscal space', while the ECB managed to hold the monetary union together only by playing on the ambiguity of the objectives of quantitative easing (QE).[9] An unfinished banking union left out the common deposit insurance and the European social model left out a common unemployment insurance. At the same time reassessment of industrial policy, no longer conceived solely as competition policy, but as a crucial EU-wide policy essential to support R&D in the sectors on the cutting edge of innovation, remained firmly rooted in the principle of non-discrimination, without taking into account the special needs arising from the member countries' unequal development.

Then came the pandemic

Compared to the post 2008 crisis, response to the pandemic has been much faster and more enduring. The ECB's intervention has proved swift, ample and targeted to the more fragile countries. It printed money to bail out governments and businesses alike; it deviated, albeit temporarily, from compliance with the capital key, buying more Italian than German bonds, and accepted securities that had lost their investment grading. Unanimous recognition of the ineffectiveness of easy money in relaunching recovery unless accompanied by fiscal policy led to monetary financing of public deficits at a pace unthinkable only 10 months earlier.

On the fiscal front, the Stability Pact was suspended and state-aid regulations temporarily relaxed. National governments implemented huge programmes to subsidise firms, workers, and households. A temporary 'Support to mitigate Unemployment Risks in an Emergency' (SURE), providing financial support to member states to fight the consequences of the coronavirus outbreak, was approved. Finally came the Next Generation EU, ushered-in by the Franco-German agreement, and variously hailed as: historical, symbolic, the first step towards burden-sharing and fiscal unity, the basis for a shared safe asset for the Eurozone, potentially supplanting the German Bund as the region's financial market benchmark or the US Treasuries in the international market. The euro rallied, appreciating against the dollar, and even high-debt countries enjoyed extremely low interest rates: the 10-year borrowing cost of Italian government bonds fell below 1 per cent, the lowest since the pandemic, while Portugal was able to issue ten-year bonds with negative rates. And all this before a single euro was paid by the EU.

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9 Krampf (2015: 190-191) observes that "It is hard to determine to what extent German policy-makers were supportive of the ECB policy. We know that the Bundesbank was very critical of the ECB non-standard measures, but Merkel and Schäuble were silent about it. One may argue that the German government was happy that the ECB 'saved the eurozone', while Germany could maintain its initial position regarding harsh conditionality and thus satisfy domestic constituencies".

The response to Covid-19 led to a profusion of references to Roosevelt and the New Deal. The major international institutions – the IMF, first with Blanchard, then with Gopinath, and the OECD, with its chief economist, Laurence Boone – had long warned that the mistakes of 2008 should not be repeated. Even Schauble, the stern German Finance minister, acknowledged that with Greece things may have gone a bit too far.

A Keynesian moment?

Does the remarkable monetary and fiscal activism mean a rehabilitation of Keynesian theory? To answer this question, it may be useful to refer to Keynes's distinction between 'apparatus of thought' and 'apparatus of action'. Economics – Keynes argues – is a method of analysis, rather than a recipe book: the 'diagnosis' (theory) is logical and general, 'the cure' is specific and is related to times and circumstances (Carabelli and Cedrini 2015). Thus, the cures are not meant to be definitive; they are subject to all sorts of special assumptions and are necessarily related to the particular conditions of the time. In a response to the reviews of the General Theory, Keynes says of his theory that:

> It does not offer a ready-made remedy as to how […] to maintain output at a steady optimum level. […] I consider that my suggestions for a cure [for demand deficiency] […] are on a different plane from the diagnosis. They […] are subject to all sorts of special assumptions and are necessarily related to the particular conditions of the time (Keynes 1937: 221-222; quoted in Aspromourgos 2014: 10).

Thus we need to clear up the confusion between Keynes's theory, "the Keynesian analysis of the savings-investment relationship, and the 'Keynesian policies', that have been understood as a policy of generic public investments or undifferentiated incentives granted through credit or taxes" (Ginzburg 1978: 139). This (mis)interpretation of Keynes's theory, devalued to a particular case of the neoclassical theory valid only in the short term with rigid prices and wages, which came to prevail, survived the great recession caused by the financial crisis (Bertocco and Kalajzić 2019).

Has the theory (the apparatus of thought) changed with the pandemic? Well, there is the supremacy still attributed to savings as a permissive condition for investment; the claim that complementarities between monetary and fiscal policies should be fully exploited in *tail events*, but may be irrelevant or even counterproductive in *normal times*, and cannot be made to be permanent (Bartsch *et al.* 2020); [10] the frequent reference to the need to re-

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[10] The authors stress that there must be the prospect of bringing the policy mix back to the

turn, as soon as possible, to rules of sound finance; the undisputed priority given to the problem of public debt, to such an extent as to suggest allocating part of the NGEU funds to debt reduction (Clemens Fuest, president of the IFO);[11] and the influential minority in the ECB's governing council favouring an earlier end to monetary easing,[12] dismissing the danger of low inflation in a highly leveraged EU. What it all adds up to is ample evidence suggesting that we are still within the textbook 'Keynesian case' of depression. Once we are out of the 'tail event', the old rules apply.

As for the 'apparatus of action', the enthusiasm of the first hour soon faded away. The political consensus on the NGEU soon dwindled, amid concern (and mistrust) about the misuse of funds.[13] The project was downsized, the share of grants reduced, the financing conditions tightened. The long process for the approval of the loans means that the countries will have to finance the long-lasting emergency with national funds by borrowing on the market. Given the countries' differing capacity to mobilize national funds, we may with some good reason fear a further increase in divergence. The German government has been extremely generous in responding to the wreckage caused by the lock-down, arranging monetary and fiscal measures to keep the business sector viable through job retention, prompt availability of funds to avoid liquidity crunches, and guarantees with unlimited commitment (in volume and duration) ensured by the KfW.[14] Once again, Germany's handling of the crisis confirms the prag-

middle of the road, where independence still holds. Otherwise, "the cost would be a loss of instrument effectiveness as soon as this change in regime is anticipated by firms, workers, and markets".

11 This does not imply underestimation of the debt problem, but is only meant to underline the need to pay attention to the particular conditions of the time. If in the 1930s, in the midst of the great depression, Keynes opposed the idea of a sinking fund to reduce public debt, in 1943 he reacted with annoyance to the thesis of the non-existence of limits to public debt, advocated by Lerner, whose lack of judgment and intuition – as Keynes wrote to Lionel Robbins – could lead him to 'preposterous conclusions'. In our time, with an unregulated financial system and lacking political consensus on how to deal with countries' debt, uncertainty about the debtor's solvency can wreck the boat.

12 The minutes of the ECB's December Governing Council report a heated discussion on the monetary policy stance. There was a strong sense that the ECB must follow its given mandate and must not cross the line to debt monetisation. See Arnold (2021).

13 Italy and Spain – among the worst-hit countries and the top two recipients of the aid – have a historically poor record in spending EU money, leading to concerns that the funds may not be spent because of bureaucratic and administrative hurdles. Moreover, after years of acrimonious discussions between the Italian government and the EC over decimals of the public deficit, the prospect of European funding has actually created a climate of euphoria, which risks misuse and waste of money.

14 Jörg Kukies, State Secretary at the German Federal Ministry of Finance, reports that, drawing on the ECB's experience that reducing uncertainty reduces the need for funds, the German government committed much higher sums than the European average, but in the end

matic nature of its policy-making, the opposite of what it had preached to other countries over the years. The advice should then be "do as I do, not as I say". For countries with weaker finances, a major source of help is coming from the ECB, which envisages a further expansion of the bond purchase programme and financing to banks at negative rates (a programme whose legitimacy is time and again challenged before the German Constitutional Court). Still, the increase in their public and private debts is a time bomb for the stability of the Union.

Can Joe Biden do it?

Compared with the massive investments needed to tackle the emergency and post-emergency restructuring process, the NGEU funds are not a game changer. And comparison with the US is unforgiving: President Biden's big fiscal push is not just going to speed up the recovery, but will also broaden the supply capacity and strengthen the technological leadership of the US economy. However, the size of the US fiscal stimulus immediately raised the spectre of inflation. Comparison with the 1970s, when a severe shock triggered a massive policy response, is giving voice to the new-old inflation dispute. The concern is that the stimulus pact may activate demand well in excess of supply, fuelling price increases that, far from transitory, can become entrenched in inflation expectations, challenging the FED's commitment to low interest rates.

The concern voiced by a number of US economists echoes the warning of European economists to bring the policy "back to the middle of the road" and return the economy to its normal state of equilibrium of full employment, guaranteed by the operation of market forces without government interference. There is no doubt – it is admitted – that large-scale monetary and fiscal buffers were urgently needed to mitigate the immediate shock of the virus and the attendant economic lockdown. The key question is whether we can be confident that the state of exception will end and the policy will be withdrawn. If we can clearly identify that moment, we need not worry about inflation. But if one exception begets more exceptions, there will be no clear way out. By de-anchoring long-term inflation expectations, the amount of stimulus being proposed could create inflationary pressures that the FED would be unable to contain without causing a recession.[15]

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the funds actually requested were much lower: confidence that liquidity would also be available in the future effectively allayed the rush for funds. Additionally, aid (up to 75 per cent of losses), was not targeted, since it was estimated that the speed of the intervention was more important than the possible costs due to sharp practice.

[15] We refer to the debate in the March-April issues of *Project Syndicate* hosting the opinions of various economists.

The future trend of inflation will depend on a multiplicity of factors which have to do with the proportions, speed and composition of the increase in demand relative to the elasticity of supply. The traditional tools of economic policy – claims Galbraith (2021) – have been questioned both theoretically and empirically and are not a useful guide for understanding a US economy that has become fully enmeshed with the rest of the world and fundamentally reshaped by China's rise. But there is more to it. Biden's programme has a long-term goal: to modernize the economy and reassert the country's technological hegemony as well as tackling America's problems of inequality and precarity that reflect an unsustainable maldistribution of wealth and power. The American Jobs Plan is often referred to as an infrastructure package.

> The definition of infrastructure – writes Binyamin Appelbaum (2021) – depends on what a society is trying to accomplish […] Infrastructure makes other things possible […] The infrastructure of driving is roads and bridges and gasoline pipelines. The infrastructure of the digital economy is glass cables and silicon chips and millions of lines of code. The infrastructure of democracy, Mr. Reagan said on that day in 1982, includes "a free press, unions, political parties, universities" […] And as states accepted responsibility for social welfare, it is natural that the definition of infrastructure expanded to encompass the safety net, too.

Thus Biden's agenda includes higher labour standards and a fairer tax system, investments in healthcare, childcare and education, electric-car charging stations and more resilient supply chains. A higher inflation rate, higher taxes on top incomes and multinationals, and redistribution in favour of the lower-middle classes can be interpreted as the constituents of a policy aiming to redefine the power relation between finance and industry.

Maastricht reloaded

In Europe, the post-pandemic recovery issue is mainly defined in terms of: "How to pay for it". It is worth recalling that in 1930 Keynes wrote to Roosevelt to assure him that he could spend and print money to get out of the crisis. It is not a question of denying the difficulties entailed in financing the recovery, but of putting these difficulties into perspective. Within a *true* monetary union, the financial institutions have an unlimited ability to finance investment, subject to the sole restrictions represented by production capacity and, in an open economy, the external constraint. While these restrictions do not apply to the European Monetary Union, at least for now, nor does the condition of a true monetary union.

Covid-19 turned out to be an asymmetric shock. Not only did it hit countries that were in markedly different conditions, but sectoral differences in the production structures also entail that regions in Southern Europe, more specialised in services such as tourism, are likely to suffer more serious and long-lasting recessions than those in the north and east of Europe. The European Systemic Risk Board, which monitors the EU financial system, has warned of a potential 'tsunami' of corporate insolvencies once the governments' crisis-era support is withdrawn, and called for a shift to more targeted policies that help otherwise viable companies which are struggling with excessive debt. Moreover, while financial aid is badly needed to contain the worst effects of the pandemic, short-term relief should be accompanied by a wide-ranging investment programme with the aim of modernizing and innovating the production system.

We face a future of high public and private debts. With debt/GDP ratios of 160 per cent in Italy, and well above 100 per cent in other EU countries, return to the Stability Pact may well imply breakdown for the euro. There is a broad consensus among economists on the need to defuse the debt bomb. Proposals range from mutualisation to monetization – for instance, issuance of perpetuities (consols) or very long-term bonds, backed or bought by the ECB in the primary market and buried for good in its coffers. A "whatever it takes" statement by the Eurogroup on a common debt policy and provision of a safe asset (other than the Bund) could mobilise domestic savings, thus contributing to alleviating the financing problems in debtor countries.

These proposals are meeting with a chilly reception by the governments of the creditor countries. The ongoing discussions among member states seem to suggest that once the emergency phase is over, pro-austerity countries will push for reintroduction of tough fiscal rules and austerity plans. GDP growth in excess of the interest rate – it is argued – would allow for a gradual reduction of the debt/GDP ratio even without large primary surpluses. However, two conditions must be met for this to occur: a macroeconomic policy supportive of growth, and a monetary policy of low interest rates. These conditions are far from granted: the former is threatened by the debt reduction policy itself, and both are endangered by the spectre of inflation, which is being reawakened by the hawks in the ECB and some economists. Trying to get around the opposition, a French document (Martin, Pisani-Ferry and Ragot 2021) avoids questioning the Stability Pact head on, though stressing that the debt criteria are too far from the post-covid realities and lack analytical justification. It proposes, rather, the introduction of discretionality in setting the norms through definition of country specific, medium-term objectives, while keeping within a system based on rules.

It is doubtful that a change of the fiscal rules without a change of the whole model can prove decisive. As in the past, a change in policies can only come from fear of the system imploding. After all, the German Chancellor killed Barroso's Eurobond proposal in 2011 and opposed the French proposal for a collective debt no later than April 2020. Only the spectre of EU disintegration in a changed international setting can account for the rehabilitation of fiscal and monetary policy and Germany's abrupt U-turn on fiscal rules and collective bonds in the pandemic. Germany needs Europe in order to meet the challenges deriving from the changed geopolitical context, the EZ debt crisis, the rise of right-wing movements, and the widening gap in new technologies that is threatening the supremacy of its industry. These factors can also account for the new activism in support of EU (and national) plans for a common industrial policy targeting digital, green and state-of-the-art technologies.

3. It will never be the same again. Structural change and the pandemic

As in the 1970s, the EU is confronting new epochal changes in the world of production: the digital transformation, new consumption patterns, the (partial) reversal from globalisation to regional blocs. Covid-19 has speeded up these transformations, accelerating the adoption of digital technologies: remote working and cloud migration, investments in data security and artificial intelligence are changing the organization of work and the division of labour within the factory and along the value chains (VCs), making adoption of a forward-looking strategy more urgent.

The new technological transition is likely to affect both the relative positions of the member states within the EU and that of the EU vis-à-vis its competitors. The technologies popularly known as 'Industry 4.0', designed to renew and reshape manufacturing processes and value chains, are expected to substantially increase efficiency and flexibility in governing production lines and VCs. Since Industry 4.0-related opportunities are maximized when they interact with a closely connected, technologically advanced network, they are likely to thrive in the productive systems that are best equipped to develop and absorb these technologies. Conversely, for the countries lagging behind, adoption of new technologies and machines may prove inadequate to the task of adapting to systems integration that operates at both the technological and the organizational levels. Nor is the traditional industrial policy, based on granting subsidies, tax breaks or credit facilities, up to the task any longer. Even regional and national systems once thriving on incremental innovation can be put to the test.

Thanks to the digital technologies, the company at the head of the VC can control costs and production conditions, and can decide on the distribution of profits along the VC. As a consequence, many inputs and components have acquired the characteristic of a commodity in a market where the quality must be up to the standard required, but price competition determines the localisation of production. The risk of delocalisation can be all the greater for those countries that do not have lead companies and whose producers participate in value chains headed by companies headquartered outside the country, as is the case of the countries of southern and Eastern Europe, heavily dependent on German firms. European peripheries (and the Southern periphery in particular) risk lagging behind, or even falling further back in the industrial race.

Europe must compete in the global market with nations that are actively supporting their industries in the innovation race: promoting their start-up systems for the creation of new products and services through innovative technologies, and/or relying on a huge internal market to aggressively target new growth sectors at home and abroad. The EU needs to respond to these challenges by redefining its policy, offering a common, coordinated, targeted response. Yet, the European countries are still moving independently, each one for itself. This lack of coordination risks dispersing the advantages represented by the size of its common market, the complexity of its industrial structure, and the richness of its history and knowledge. This is where the German attitude is decisive, since where Germany goes, the Eurozone will follow.

4. Germany's two models

The German model is not monolithic but, rather, a complex, tense and shifting process of antagonism and accommodation between two different domestic 'advocacy' coalitions, ordo-liberalism and 'managed capitalism'. These two faces of the German model exhibit over time subtle shifts in its centre of gravity, depending on the particular situation and which coalition is ascendant on particular issues. Internal conflicting interests – capital versus labour, industry versus finance, small versus big business, political advocacies – sway German choices in European and foreign policy (Celi *et al*. 2018).

During the process of European integration, the German export-led model has undergone notable changes. Remarking on the oscillating Europeanism of the German government, De Cecco (1992: 13) pointed out that Germany tended to move closer to Europe in times of economic and political weakness, only to distance itself again in times of economic strength (adding that the plans devised when Germany felt weak came to be implemented when the German cycle was over and they were no longer needed). Since German unification, the traditional corporatist model has seen substantial changes. The integration of China and Central and Eastern Europe (CEE) in the global economy represented a double shock for Germany, with major, contrasting consequences for its industry and labour. While China provided a huge export market for its key sectors, the eastern enlargement opened the way to building regional value chains that combined cost and quality competitiveness (De Ville 2018). However, both developments caused substantial job losses in the German regions with higher concentrations of import-competing industries. Industrial relations became more adversarial and the weakening of the unions' bargaining power resulted in wages rising less than productivity, also in core sectors. Defence of industrial employment in the key sectors through strategic nearshoring came at the cost of other sections of the German society (Dauth, Findeisen and Suedekum 2014). Imports of cheap consumption goods and wage suppression in fringe sectors of industry and in the services contributed to restraining inflation in consumption goods, making wage containment in the export industry more tolerable. Hassel (2014) observes that the formation of a large area of low wages occurred with the support of the core industries and the tacit support of the work councils of the core workers. She stresses the importance of core producer coalitions in driving and shaping policy and institutional change, to the disadvantage of other producer groups. Lehndorff (2015) argues that, conversely, Germany's rapid recovery following the 2008 crisis was due to the resumption of elements of the old corporatist model.[16] As in the past, Germany's participation in the EU helped to reduce the costs of restructuring by providing a market for German industry, and to ease the pressure on wages by containing the appreciation of the currency. But the fall in the wage share and the consequent persistent depression in consumption hampered growth in the entire area.

"Export-led growth, characterized by aggregate wage suppression and high corporate profits", write Braun and Deeg (2019: 1; 4), also affected the bank-industry relation, since it "allowed non-financial corporations to increasingly finance investment out of retained earnings, thus lowering their dependence on external finance". Two qualifications are in order. First, the fall in the demand for financing must be seen in relation to the fall in domestic investments. The higher corporate profits were redirected towards

[16] The unions of core industries (IG Metall and Chemical) eventually saw the expansion of the low-wage sector – in particular, low-cost competition by atypical (agency) workers – as a direct threat and sought to close the gap in regulatory conditions and wage rates (Baccaro and Potusson 2019).

the financial markets: the resulting fall in investments accounts for the emergence of the industrial sector's net credit position. This point is rightly emphasized by Detzer and Hein (2014), who argue that the process of financialisation, with the increasing dominance of finance in the investment decisions of big companies, has been an important factor in constraining the dynamics of domestic demand in Germany.[17] Beginning in the late-1990s, the share of financial profits (interest and dividends) in the gross operating surplus of German nonfinancial corporations (an indicator for the 'preference channel' of financialisation and shareholder value orientation effects on real investment) more than doubled from around 10 per cent in the late 1990s to over 20 per cent in 2007 (and rose above 25 per cent until 2011). Many of the big banks shifted their activities from traditional commercial banking towards investment banking.[18] The second point concerns Braun and Deeg's assertion that demand-constrained lending reduced the power – and relevance – of banks vis-à-vis German industry. This claim neglects the close relations linking public (state and savings) and cooperative banks with the Mittelstand.[19] In the end, big (and not so big) banks that had turned to the international financial markets in search of easy profits, fuelling the consumption boom and the ensuing sudden stop in the European periphery, were punished by the 2008 crisis, and had to be bailed-out by the government. "Saving the banks" prevailed over the alternative "saving the states", opening the way to the bank-state doom-loop in the periphery, and the consequent austerity.

The wage suppression and the absence of "credit-led consumption", together with the fall in investments, combined with a fixation with fiscal austerity (the budgetary 'schwarze Null') in determining the stagnation of domestic demand in Germany, setting the low-growth pace of the entire Eurozone.

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[17] They add that, "with those changes, a much more active market for corporate control emerged, along with the establishment of new financial actors, such as hedge funds and private equity funds" (Detzer and Hein 2014: 5).

[18] "In the years running up to the 2008 financial crisis, the activities of commercial banks partly shifted from traditional, relationship-based banking to 'market-based banking', defined as wholesale money-market borrowing to finance bank loans, which in turn are designed to be securitised and sold. The result was that banks and securities markets became increasingly indistinguishable in a functional sense" (Braun and Deeg 2019).

[19] This section of banking is so relevant to industry that the German government expressly negotiated the exclusion of the public banks from the Single Supervisory Mechanism of the Banking Union.

Is this time different?

It was argued in section 1 that the process of European integration was accompanied by the macroeconomic transition from 'politicized' management of economic policy based on discretion to 'depoliticised' management based on the automatism of rules (Burnham 2001). As Blyth and Hopkin (2019) observe, "governing nothing is fine so long as nothing is wrong". When the system has a heart attack, policy becomes relevant once again. While, at the height of the Greek crisis, Germany's finance minister Wolfgang Schäuble could make clear that "elections change nothing. There are rules", as the effects of the debt crisis developed, the risks of a system governed by rules – or entrusted to the market – became evident even to Germany.

The decade-long compression of public and private investment has severely affected German long-term competitiveness. Speeding up the adoption of digital technologies across the economy, Covid-19 exposed Germany's weaknesses. Germany has a powerful engineering tradition, excels in technical innovation in key manufacturing sectors, but is poorer when it comes to radical innovation and lags far behind in digital services (James 2017). It lacks large-scale consumer tech companies and online platforms capable of competing with the global US and Chinese giants. In spite of its enormous manufacturing surplus, Germany runs a digital services trade deficit with the United States. And, more worryingly, given the pervasiveness of the digital technologies, this gap threatens Germany's pre-eminence in its key industries.[20] Not even finance is safe from this threat. Relying on cloud computing services operated by the Big Tech firms, Fintechs risks becoming dependent on these most formidable competitors. Big Tech firms can cross-subsidize their financial businesses, which are only a small part of their overall activity, and can thus control customers' data across the board (Eichengreen 2021).

The historically low German and European (private and public) expenditure has been a drag, rather than a cause of greater prosperity, failing to drive in the direction of the urgently required modernization of physical and digital infrastructure. Catching up with foreign incumbents and governing the technological transformation require an enormous effort in research and investment: the established oligopolies enjoy huge economies of scale, are protected by impregnable intellectual property rights and sup-

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[20] As Peter Altmaier put it: "In the future, 50-60 per cent of the value of a car will consist of digital devices and tools, and 20 per cent of batteries. So if we're not careful, we'll only be responsible for the windows, seats, and wheels". Quoted in James (2017). See also Chazan (2017).

ported by their governments. It also requires scale. Germany is too small to go it alone in the international arena, but it can forge ahead either together with the other member countries, giving a helping hand in the development of the whole European area, or as the leader of an economic empire. Past experience has demonstrated the short-sightedness of the latter option. The response will call for coordination – by governments, firms, and labour – on a European scale.

"As a European middle power that depends for exports on China, and relies on Russia for oil and the United States for its security umbrella, Germany tries to pursue its conflicting objectives by balancing allies and adversaries alike" (Stelzenmüller 2021). Depending on the particular situation, interest coalitions may sway Germany's choices in European and foreign policy (Schneider 2020). The recent agreement of the EU with China is a case in point. It was much desired by the German companies active in the highly lucrative Chinese market, but it was opposed by political parties that favoured a stronger stance on human rights (Mitchell and Manson 2020) and by the new US administration – which is pressing for a united front in dealing with China. Nor is it welcome in Europe, where memory of the early 2000s, when important sectors of industry were traded in exchange for German exports of investment goods and premium cars, is still alive, arousing concern over the aggressive penetration of the Chinese capital in European industry. German industry itself is divided. The re-orientation of the foreign direct investments of German (and European) big business towards the Chinese economy could herald a separation between the interests of the big corporations and those of the smaller and medium firms, in Germany and in its value chains across Europe. The importance of the European market in a potentially more hostile international context is not something that German industry can afford to underestimate.[21]

Well before the pandemic, the German government had begun a change of course, supporting an active European industrial policy and European and national long-term plans of investment in the fields of energy and the environment, research in artificial intelligence and digital technologies. If this proves to be the new path that Germany is willing to pursue, it opens new prospects not only for industry, but also for the banks. "We need an

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21 In 2019 the Federation of German Industry (BDI) issued a report that strongly endorsed the deepening of the economic and monetary union as the only strategy in the competition with the US and China. "Only a strong and united Europe can defend its interests and values against the emerging world power of China [...]. Key words here are the deepening of the economic and monetary union, the strengthening of research, innovation and industry, the further development of the internal market, the orientation of the EU budget towards growth, cohesion and external strength, and the expansion of the digital economy" (BDI 2019: 10-11).

industrial policy for key technologies", says Stefan Hoops, head of corporate banking at Deutsche Bank, in an interview with *Frankfurter Allgemeine Zeitung* (Kanning 2021). These transformations are deemed too risky to be financed through bank loans and the capital market alone. The state should set the right framework conditions so that private and state capital can develop their strength and potential. It should, moreover, "assume a large part of the risk also to overcome German companies' major disadvantage vis-à-vis their US and Chinese competitors, who have access to a large private and state funding pool that does not exist in this breadth and depth in Europe". Back to 'Germany Inc.'? If the size and power of the economy matters in the new world competition, massive investments in the weakest areas, aiming at strengthening infrastructure facilities, industrial capabilities and technological transfer, are urgent not only to prevent the digital transformation from becoming an additional factor of polarization, but also to ensure the dimension that Germany alone cannot achieve. But a new, more cohesive, industrial policy cannot succeed without a U-turn in macroeconomic philosophy.

Concluding remarks

The EU faces internal and external disrupting forces. Can the pressure of the current challenges finally force the development of 'countervailing forces' (Hirschman 1981a: 283), capable of transforming the 'disintegrative crisis' that leads the individual members to go it alone into an 'integrative crisis' that, on the contrary, drives them to look for some concerted action? In this paper we have argued that this development would require nothing short of a U-turn in European policies, at both the economic and the political level. As far as the economic framework is concerned, the EU should focus on the development of demand and supply strategies that place greater reliance on the domestic market, at both the national and the EU level. Export-led (or neo-mercantilist) policies clearly disrupt the long-term sustainability of a union and are meeting with increasing hostility at the international level. Moreover, it needs a coordinated industrial policy at the various levels of governance (EU, national, regional) working in the direction of reducing the inequalities between its core and peripheral member states.

The accelerated pace of technical change is jeopardising the position of Europe in the world economy and presents new risks for latecomer countries. The EU is lagging far behind established competitors in new technologies. To close the gap, it must increase its investment, replacing the doctrine of austerity with a growth-friendly model, and it must join forces to acquire minimal mass. This can only be achieved by mobilizing all forces: convergence between economies becomes the condition for achieving competitiveness against the big foreign competitors in the new sectors.

To close the core-periphery divide, public-private cooperation should contemplate a combination of protection, administrative guidance, and encouragement of controlled competition to activate linkages and fill the gaps in the productive structure. Introduction of a 'protective' element – that is 'helping losers' by temporarily shielding them from the full forces of the market – may be needed to encourage and sustain the process of structural change and productivity growth, as well as preserving existing capabilities while allowing time to develop new ones. This should not be confused with the traditional industrial policy, which often sought to preserve existing structures: on the other hand, this is what the European Union has begun to do to close the gap in innovative sectors and counter the 'unfair' penetration of foreign companies into the European market. Extensive industrial and organisational restructuring must be accompanied by policy orientation to help firms identify new opportunities, as well as supportive policies to develop the capabilities required by new technologies and products across the entire EU. To achieve these transformations at a social cost that society can bear, a macroeconomic policy supporting domestic demand and employment is essential: restructuring and creative destruction can only occur in a context of growth. Furthermore, digital technologies will impact employment with significant social effects, requiring progressive social policies to make these changes socially sustainable.

The NGEU plan can represent a first step in the direction of more cohesive management of the EU. It requires swift and non-acrimonious consensus over the funds by the creditor countries and efficient use by the receiving countries. German assent proved essential to allow any reform of the European institutions. The Southern countries' governments, for their part, have not excelled in efficiency in the past, and the planning and implementation of investment projects connected with the Recovery Fund present many hurdles and potential trade-offs. But it's worth the risk, since this could be the last chance for the rebirth of a European Union able to make the dream that gave it life come true.

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