#Gexit: The Case For Germany Leaving The Eurozone

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The case for or against a British exit from the EU – #Brexit – is headline news. For the moment the earlier quarrel about a possible Greek exit from the Eurozone – #Grexit – seems to have taken the back seat – with one or two exceptions such as Christian Lindner, leader of Germany's liberal FDP. Most EU proponents are deeply concerned about these prospects and the repercussions either might have on European unity.

Yet, while highly important, neither of them should distract Europe from zooming in on the real issue: the dominant and altogether destructive role of Germany in European affairs today. There can be no doubt that the German "stability-oriented" approach to European unity has failed dismally. It is high time for Europe to contemplate the option of a German exit from the Eurozone – #Gexit – since this might be the least damaging scenario for Europe to emerge from its euro trap and start afresh.

Germany's membership of the Eurozone and its adamant refusal to play by the rules of currency union is indeed at the heart of the matter. Of course, it was never meant to be this way. And it was not inevitable for Europe to end up in today's state of never-ending crisis that impoverishes and disunites its peoples. I have always supported the idea of a common European currency as I believed that it could potentially provide a monetary order that is far superior to the status quo ante of deutschmark hegemony: the Bundesbank – in pursuit of its German price stability mandate – pulling the monetary strings across the continent. While I have also always held that the euro – the peculiar regime of Economic and Monetary Union agreed at Maastricht – was deeply flawed, I kept up my hopes that the political authorities would reform that regime along the way to make the euro viable.

In this spirit I proposed my "Euro Treasury" plan that would, among other things, fix the Maastricht regime's most serious flaw: the divorce between the monetary and fiscal authorities that is leaving all key players vulnerable and short of the powers required to steer a large economy like the Eurozone through anything but fair weather conditions, at best. Watching developments over in Europe from afar my hopes are dwindling by the day that the failed euro experiment will usher in reforms that could save it. Instead, the likelihood of some form of eventual euro breakup seems to be rising constantly. It is undeniable that the euro has turned out to be an instrument of widespread impoverishment rather than shared prosperity. It seems increasingly unclear for how much longer pro-European politics will be able to somehow cover up the blunder and hold things together – particularly as politics is turning more and more nationalistic and confrontational everywhere.

The quest for monetary stability in Europe was always about two things: price stability and the absence of "beggar-thy-neighbor" distortions in competitiveness and trade. Monetary stability was seen as a pre-condition for peace and shared prosperity. Today, the Eurozone is on the verge of deflation, domestic demand is still below the level reached eight years ago, and unemployment remains extremely high, especially in over-indebted euro crisis countries. How did we get here? And how could #Gexit help?

Germany Offside

The troubling truth is that Germany largely determined the Maastricht rules of the game but failed to abide by them. Perhaps not Germany alone. But Greece is too small to matter in any well-designed monetary union while Germany is too big not to matter hugely in any monetary union, especially a poorly designed one. Germany dictated that central bank independence, the primacy of price stability, and the prohibition of excessive fiscal deficits must be the overarching policy principles of EMU. These principles had secured both price stability and prosperity in post-war West Germany.

Pegged nominal exchange rates were key to this outcome though as German competitiveness improved whenever German inflation stayed below trends elsewhere. In this way Germany could always rely on exports as its growth engine and largely abstain from active domestic demand management. At Maastricht the German authorities overlooked the obvious fact that the German model would no longer work once Germany's trade partners behaved just like Germany – which is precisely what the euro asked of them. Germany's fatal mistake was to then interpret the consequent stagnation of the mid1990s as a call to boost its national competitiveness by wage repression instead. This move paved the way for ruin across the Eurozone.

For diverging competitiveness positions are not permissible inside a monetary union that is not also a fiscal and transfer union. (I dubbed this "Germany's euro trilemma") The effect: a buildup of imbalances, bubbles, and their inevitable bursting under the euro. Germany accumulated huge claims against its euro partners that were running up ever higher external debts. The so-called "bailouts" then allowed it (and other creditors) to pull out while taking limited losses. The ECB's liquidity support of crisis country banks was highly instrumental in this context. Essentially the migration of risks from private to public balance sheets was facilitated so as to contain and cover up the damages in creditor countries. Germany had bailed out its banks for losses suffered on their US subprime adventures. Apparently the German authorities judged that it was an easier sell to bail out its euro partners than organizing another round of bailouts for German financial institutions for losses suffered on their Eurozone adventures.

But bailouts of euro partners had to come along with punishment. Germany prescribed harsh austerity for its partners but refused to share in the rebalancing process by fiscal expansion and higher wage inflation at home. As a result, the rebalancing has been one-sided and deflationary, with unnecessary pain inflicted across the Eurozone. Germany itself got lucky once more: recovery in the US, UK, China and other emerging markets offset the repercussions of suffocating its Eurozone export market.

Wir Sind Wieder Was

And here we are today with a highly divided euro experience. Outside of Germany the euro means impoverishment and hardship. In Germany itself the vast majority of the population has not made much headway either, but compared to the mess seen in euro partner countries Germans probably feel thankful for having a job and whatever little income gains they may have experienced over the past 20 years; mainly over the past two years actually. There is systematic indoctrination to feel pride in Germany's übercompetitiveness. That makes it easier to blame any troubles existing elsewhere on others' inferiority and laziness. Yet political discontent is surging everywhere. Outside of Germany because people increasingly question any sense and fairness in their impoverishment. Inside Germany because there is a prevailing sense that the country is somehow asked to bail out everyone else – the old "EU paymaster" cliché in overdrive.

The latest incarnation of this cliché features German savers as being "expropriated" by the ECB's monetary policies. There is no appreciation of the fact that today's interest rates are a consequence of German misconduct under the euro regime, a regime "made in Germany" that has brought nothing but ruin to Europe. Instead Germans live by the myth that Germany's stronger position today proves that it has done everything right. Wage repression under the euro facilitated a massive shift in income and wealth distribution in Germany too. But the average German is unaware that the only real winner of the euro is Germany's top one percent. Fleeced by his/her own elite the average German lives in fear of being blood-sucked by his or her fellow Europeans.

One thing is clear: Germany's euro partners will not accept impoverishment as their lot forever – the euro cannot survive unless Germany changes its ways drastically. But how do you convince Germany to change given that Germans were misled to believe that they have done everything right? That is the challenge Europe must meet.

The New German Question

Europe should focus its attention and conversation on how to convince Germany to either change its ways or exit from the euro. It is no use to pretend that euro breakup is not an option. Without drastic change in policies and institutions it will happen one way or the other anyway. One option is complete breakup with all partners returning to their national currencies. In this case it would be no use pegging to the new deutschmark as that would just repeat the old problem. Another option is that only a certain (group of) member(s) leave(s). The (fear of) #Grexit experience last year (and earlier escalating euro crises) provided a foretaste of the pains that any exiting weak debtor country would go through. Creditors would suffer some unpleasant consequences of debtor country exit and default too though.

#Gexit, the departure of the strong, would be less disruptive for the Eurozone as a whole. Germany could declare next Sunday that it re-introduces the deutschmark converting all domestic euro contracts and prices at a 1:1 rate. (Perhaps the Dutch and Austrians might consider going along with it, but I leave that possibility aside here.) On Monday morning the Bundesbank would stand by and cheer the new deutschmark surge on the exchanges. It would follow the advice of Deutsche Bank and raise German interest rates to make sure savers get their well-deserved rewards.

The German government would proudly announce to its citizens that they will no longer have to bail out any lazy Europeans but will from now on enjoy the real fruits of their hard-won übercompetitiveness. And so all Germans would live happily ever after. Tranquilized by their stability-oriented ideology they would ignore any discomfort coming along with the chosen deflationary adjustment; just as they have ignored the agonies experienced elsewhere in the Eurozone since 2009. And they would be troubled even less by any surges in indebtedness (and resulting bankruptcies), private and public, coming along with such a deflationary adjustment; just as they saw no reason to concern themselves with these kind of side effects elsewhere in the Eurozone since 2009 either.

Essentially, the current Eurozone has Germany's euro partners serving as the economic wasteland that is keeping the euro low so that German exports have it easier globally. By contrast, the new Eurozone (ex Germany) would see its external competitiveness restored instantly, especially vis-à-vis Germany itself; while, internally, any remaining competitiveness imbalances would be minor compared to a status quo that includes Germany. Unshackled from German idiosyncrasies in all matters of macroeconomics, the Eurozone would follow through with my Euro Treasury plan and henceforth smartly invest in their joint future – a future of prosperity rather than impoverishment. Unhindered by German pressures and supported by constructive rather than destructive fiscal policy the ECB would continue its current course and re-establish price stability in a couple of years. If they preferred to return to their national currencies, that would be the other avenue to climb out of their euro trap. I personally think that, if the Euro Treasury were established, the members of the Eurozone (ex Germany) would be better off with the euro. But that is their choice to make.

Meanwhile, Europe is far too important to be left to the Germans.

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