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Challenges for the EU as Germany approaches recession

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Working Paper No. 948

Challenges for the EU as Germany Approaches Recession

by

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ABSTRACT

This paper analyzes recent macroeconomic developments in the eurozone, particularly in Germany. Several economic indicators are sending signals of a looming German recession. Geopolitical tensions caused by trade disputes between the United States and China, plus the risk of a disorderly Brexit, began disrupting the global supply chain in manufacturing. German output contraction has been centered on manufacturing, particularly the automobile sector. Despite circumstances that call for fiscal intervention to rescue the economy, Chancellor Angela Merkel's government was overdue with corrective measures. This paper explains Germany's hesitancy to protect its economy, which has been based on a political and historical ideology that rejects issuing new public debt to increase public spending, thus leaving the economy exposed to the doldrums. The paper also considers serious shortcomings in the European Union's (EU) foreign and defense policies that recently surfaced during the Syrian refugee crisis. The eurocrisis revealed near-fatal weaknesses of the European Monetary Union (EMU), which is still incomplete without a common fiscal policy, a common budget, and a banking union. Unless corrected, such deficiencies will cause both the EU and the EMU to dissolve if another asymmetric shock occurs. This paper also analyzes recent geopolitical developments that are crucial to the EU/eurozone's existential crisis.

KEYWORDS: Balanced Budget; Fiscal Stimulus; Debt Brake; Recession; Austerity; Geopolitical Tensions; Syria; Libya

JEL CLASSIFICATIONS: B22; E50; E60; F02; F15; F45; H30; H60

INTRODUCTION

After a prolonged expansion of about ten years, Germany experienced a small decline of 0.1 percent in real GDP during the second quarter of 2019. In the third quarter, Germany grew at the anemic rate of 0.1 percent. Many current economic indicators reported for both quarters signal an imminent downturn. The most important causes of the possible global recession are the US-China trade war and the risk of a disorderly Brexit. Other geopolitical tensions are also expected to negatively affect the world economy and the economies of the European Union (EU).¹ Fears of reescalation of the Libyan crisis have weakened after the Berlin Conference on January 19, 2020, where it was decided that the disputing parties must seek a peaceful solution based on political negotiations.

The possibility of a German recession was signaled by declines of various indicators, such as the retail sales index and the German business sentiment, which hit a seven-year low. Additionally, the purchasing manager's index declined to a record six-year low. On Tuesday, October 8, 2019, a decline of the industrial sector at an annualized 2 percent rate was reported for the third quarter. Over the 12 months ending September 2019, German industrial production declined by 4.3 percent. Similar statistics predicting recession were reported for the eurozone and the global economy. However, recent data show there were differences between the two major sectors for both the eurozone and the German economy. The domestic sector consisting of construction and services is booming, whereas the industrial sector of manufacturing of automobiles and capital goods is stagnating. German economic experts warned that the longer the industrial decline lasts the higher the probability that the recession will spread to the entire economy.² Annual GDP growth for 2019 was the lowest since 2013, at a rate of 0.6 percent, indicating that the threat of a recession is still alive.

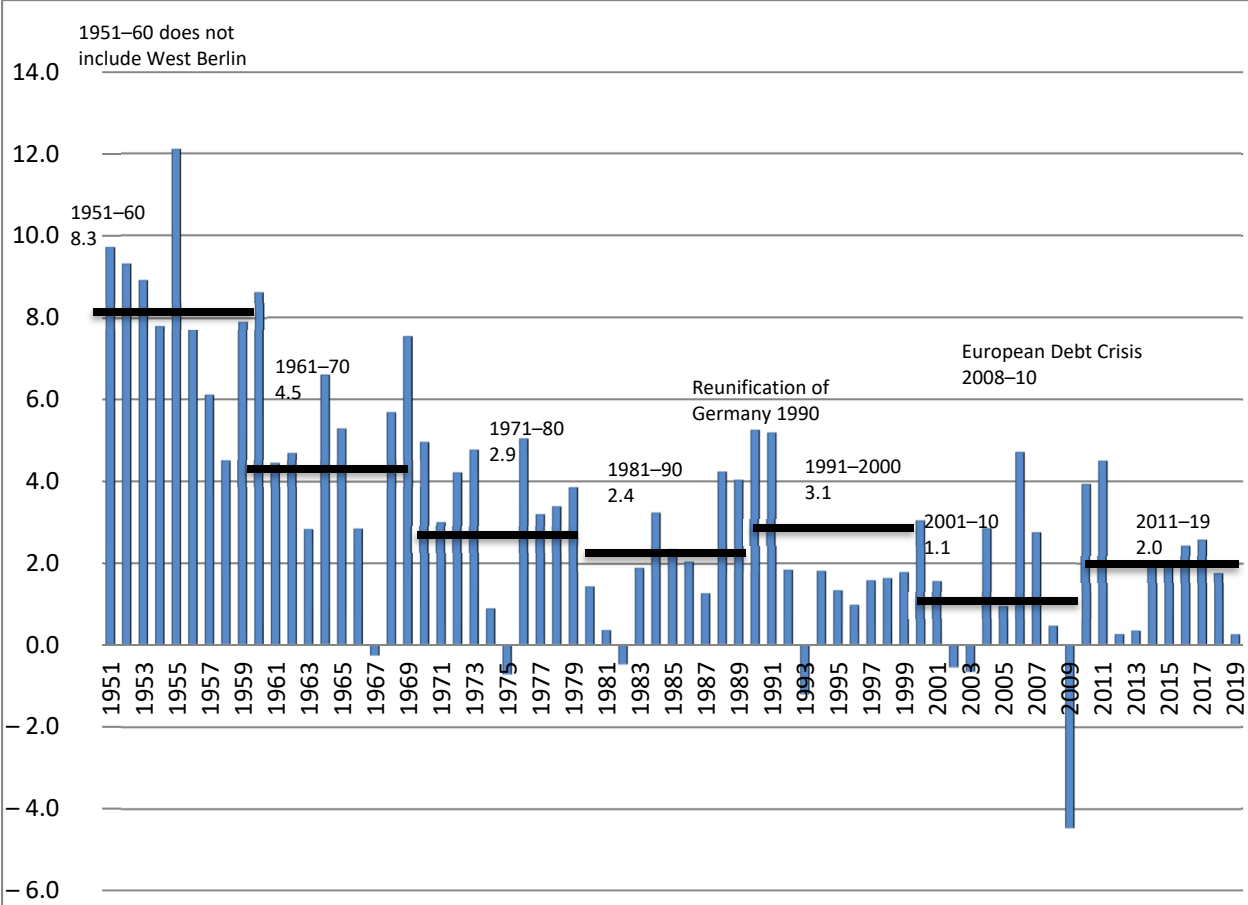
¹ The most direct effects may come from renewed trade disputes between the European Union and the United States. This was triggered when France introduced the digital service tax, leading the United States to propose retaliation tariffs of 100 percent. Such disputes may lead to transatlantic trade wars.

² Source: several articles in the *Economist*, the *Wall Street Journal*, the *Financial Times*, and other newspapers.

HISTORICAL OVERVIEW

In the first three decades following WWII, Germany experienced phenomenal economic growth, mainly fueled by its booming export sector. During the same period, almost all other European economies also grew, but not as rapidly. European economic growth, nonetheless, started declining in the early 1970s for several reasons such as: overregulation, rigidity in labor markets, and the two oil crises in 1973–74 and 1979–80. As a result, many EU countries experienced a prolonged recession and rising unemployment due to loss of international competitiveness. The successful reunification of Germany, spearheaded by Chancellor Helmut Kohl in the early 1990s, created additional economic problems for the German economy, since large fiscal transfers from West to East Germany increased both public deficits and public debt.

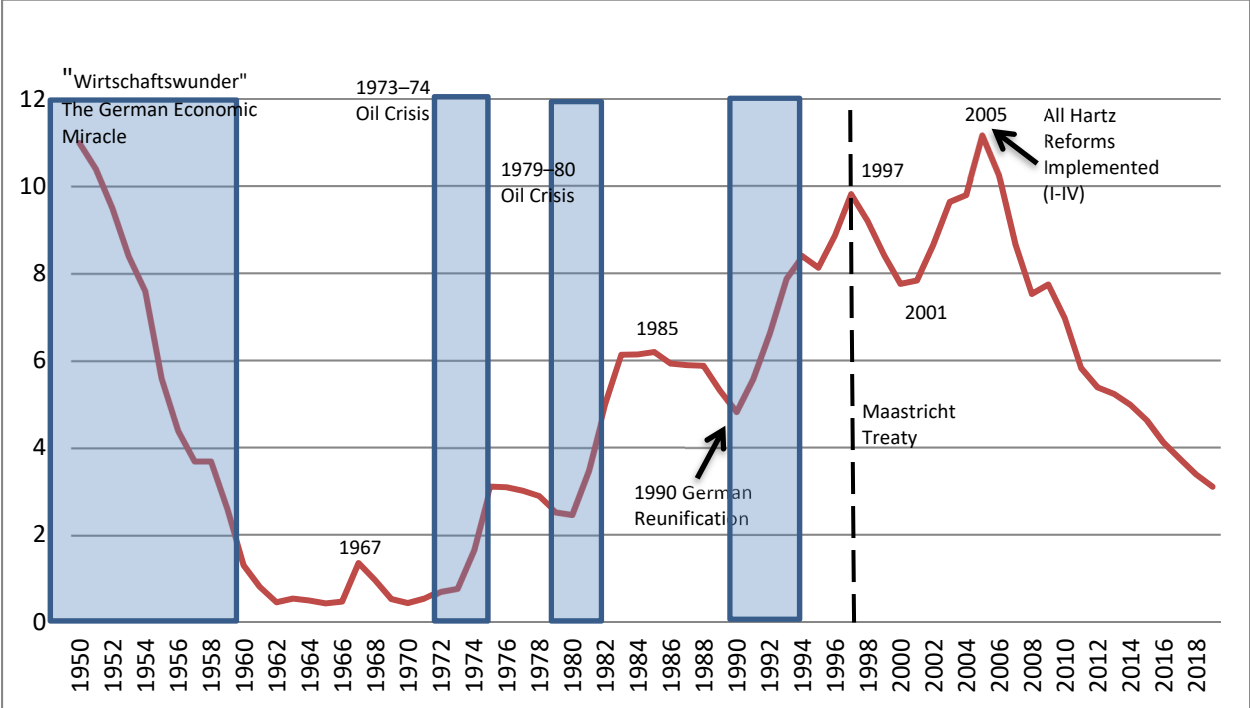
Figure 1: German GDP Growth, 1951–2019



Source: AMECO and World Bank. Figure 1 is an updated version of a graph reported in Zestos (2016).

Figure 1 portrays real GDP growth in Germany. During the first decade (1951–60), West Germany grew at a phenomenal rate of 8.3 percent; economists refer to this period as the miracle growth period (*Wirtschaftswunder*). After 1960, West Germany grew, but at a lower rate. Many analysts attribute the exceptionally successful expansion of the German economy to the development of a unique socioeconomic system known as a “social market economy.” This system relies on free markets, strong cooperation between employees and employers, and government participation in promoting social inclusion and reduction of income inequality. It was a very successful socioeconomic system that the Germans developed, but were forced to abandon due to international competition.

Figure 2: German Unemployment Rate, 1950–2018



Source: Germany Federal Statistical Office. Figure 2 is an updated version of a graph reported in Zestos (2016).

The German unemployment rate is shown above for the period 1950–2019. During the first decade (1950–60)—the German economic miracle period—the unemployment rate dropped drastically from about 11 percent to 1 percent. In the next decade (1960–70), unemployment remained low, below 2 percent. Starting in 1971, the unemployment rate began a prolonged rollercoaster ride for the next 25 years, increasing until 2005 when it reached a maximum rate of

11.16 percent. Since then the German unemployment rate began declining and in 2020 reached an exceptionally low rate of 3.1 percent.

To cope with economic stagnation, the EU launched the Lisbon Agenda, also called the Lisbon Strategy, in 2000, that consists of many neoliberal, probusiness policies, such as a reduction of worker wages/pensions and liberal tax breaks for EU firms to help them become internationally competitive. The objective of the Lisbon Strategy was to transform the EU into the most competitive economy in the world by 2010. Germany, under the chancellorship of Gerhard Schröder, launched its own version of the Lisbon Agenda during 2003–05. Known as the Hartz I-IV Reforms,³ it reduced workers' benefits more than in any other EU country. As a result, steady economic growth and low unemployment were attained at the expense of higher income inequality

The consequences of the Hartz I-IV Reforms became evident when Angela Merkel was the Chancellor of Germany. In 2005, Merkel succeeded Kohl as the leader of the Christian Democratic Union (CDU) party and kept this position for a long time; she is now serving her fourth term in office. During her political career, Merkel evolved to be the strongest EU leader as she gained the trust and support of most German voters. Chancellor Merkel promised the German taxpayers that the EU and the eurozone would never become a transfer union that shifts funds from the northern EU countries to southern EU members; thus, she promised to protect the taxes of the German voters.

THE EUROPEAN SOVEREIGN DEBT CRISIS (EUROCRISIS)

Angela Merkel was the first chancellor to place national interests above the common EU interests since the establishment of the German state at the end of WWII. Her noncommitment to the EU and the eurozone became evident when the first asymmetric shock, the US subprime mortgage crisis in 2008, challenged the EU and the eurozone. Instead of announcing solidarity

³ Named after Peter Hartz, a personnel manager at Volkswagen. He was appointed by Chancellor Schröder's centre-left government to head a committee on labor reforms that became part of the German Government's Agenda 2010.

with the financially distressed eurozone countries to calm the markets, Merkel convinced the EU leaders to invite the International Monetary Fund (IMF) to jointly offer bailouts to financially distressed eurozone countries (Paterson 2011). The bailouts, however, were only approved after the countries accepted the IMF's notorious conditionality: the "bitter pill" of austerity. Applying austerity in the midst of a recession deepened the crisis because investors quickly dumped their government bond holdings of financially distressed countries. As a result, the prices of such government bonds (sovereigns) dropped substantially, inducing the credit rating agencies to downgrade them to junk status. This is how the European sovereign debt crisis began (Zestos 2016).

Borrowing from the IMF was criticized because such funding is intended for the less developed countries and not for the EU, which is mainly comprised of wealthier countries. Furthermore, applying fiscal austerity during the recession turned out to be the wrong economic policy, one that was detrimental to the economies it aimed to assist, thus prolonging the recession. Persistent endeavors by the German government to protect taxpayers (voters) affected other eurozone countries by inadvertently reigniting the eurocrisis. An example of this is Chancellor Merkel's insistence in 2012 (when Greece received its second bailout) that bond holders of Greece and any other future bailout countries accept a haircut (a loss) in their investment. This EU program, officially known as private sector involvement (PSI), turned out to be devastating for Greece and other eurozone countries as investors rushed to sell their bond holdings. Such a decision inflamed the eurocrisis, which spread and deepened via contagion.

The Greek PSI, upon the insistence of Chancellor Merkel, was followed by a haircut on the bank depositors and bond holders in the Republic of Cyprus.⁴ The Chancellor's eagerness to protect German taxpayers (voters) has had a negative impact and repercussions far beyond the European borders, creating financial instability and uncertainty in the global economy (Zestos and Williamson 2012).⁵

⁴ The program created uncertainty, not only in Europe, but in the entire world. Since then, bank depositors and bondholders feel less safe about their investments.

⁵ As a result, by pursuing its narrowly defined national interest, the German government persistently caused unnecessary pain by prolonging the recession in the southern eurozone countries and Ireland.

HISTORY REPEATS ITSELF: THE 1992–93 ERM-EMS CRISIS

To cope with a major asymmetric shock after the collapse of the Berlin Wall in 1989, the West German government launched expansionary fiscal policy.⁶ To keep prices from rising, the German central bank (the Bundesbank) applied contractionary monetary policy. The two policies triggered the 1992–93 exchange rate mechanism–European Monetary System (ERM-EMS) crisis. During this crisis of the EMS, the Bundesbank refused to extend loans to EMS members. Such loans would have prevented the crisis, as EMS member countries would have been able to buy back their own currencies and stabilize the foreign exchange markets. The Bundesbank was obligated to extend such loans since West Germany was the anchor (reserve) currency country of the EMS.⁷

Lack of Bundesbank cooperation caused the collapse of the ERM and the loss of billions of dollars by EMS member countries to currency speculators. One such currency speculator was George Soros, who made billions of pounds at the expense of the Bank of England. Speculators profited at the expense of EMS central banks, as the latter were trying to defend their national currencies. These memories may still be fresh in the minds of many British people, as the Bank of England lost billions in its effort to support the pound, which turned out to be an impossible task (De Grauwe 2016). Consequently, the United Kingdom withdrew its currency from the EMS and decided not to join any new monetary agreements with the EU countries.

THE ASYMMETRIC EFFECTS OF THE EUROCRISIS ON THE EUROZONE COUNTRIES

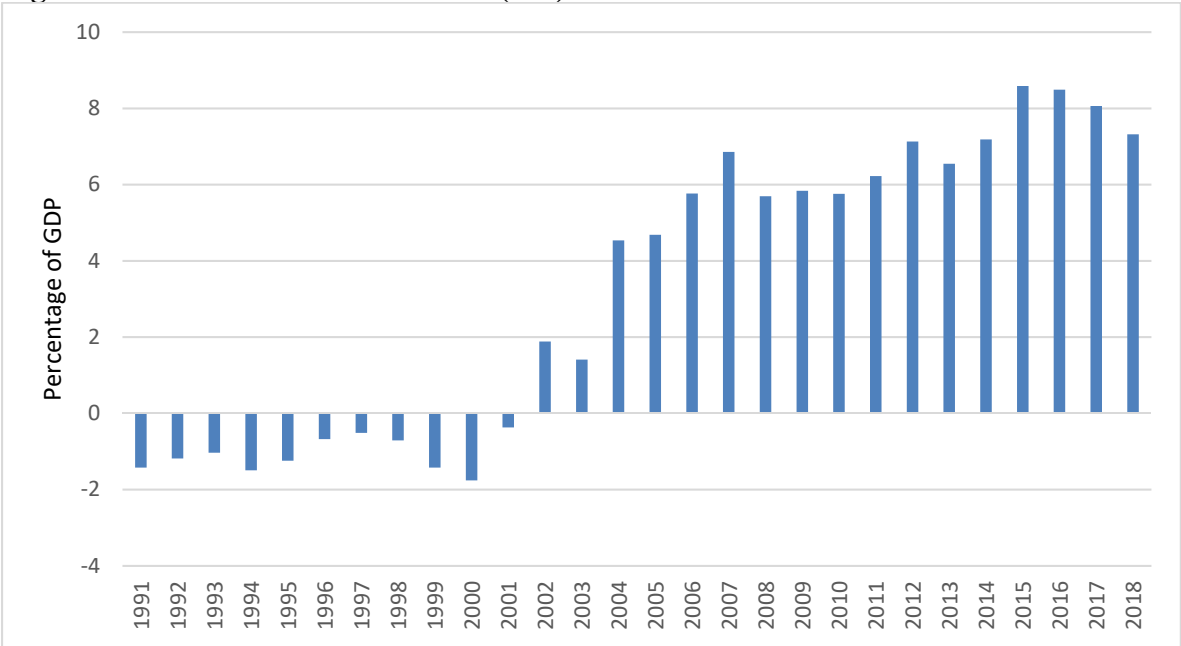
During the recent European sovereign debt crisis, Germany was able to weather the crisis better than most eurozone members. Unlike some other eurozone members, Germany received huge benefits from its EU/eurozone membership for two main reasons. First, Germany received immense capital flows from the southern eurozone members because it is considered a safe

⁶ This led to an increase in aggregate demand.

⁷ Such an arrangement was ratified by the Basle-Nyoborg Agreement on September 1987.

haven country. Second, Germany generated large and chronic current account (CA) surpluses with the rest of the world and especially with the southern eurozone countries. German membership in the Economic and Monetary Union (EMU) allowed Germany to generate excessive CA surpluses. However, such surpluses are considered destabilizing by many world leaders, economists, the IMF, and the EU Commission, which communicated its sincere concerns to the German government. Figure 3 shows that excessively large and chronic German CA surpluses prevailed only during the post-euro period. If Germany had not adopted the euro, its currency, the Deutschemmark, would have appreciated and would have corrected their excessive CA surpluses.

Figure 3: German Current Account (CA) Balance



Source: OECD

All these criticisms nonetheless were repeatedly ignored by the German government. As a result, German fears that the EU would end up a transfer union turned out to be correct. But the transfers were misdirected, from the financially distressed countries to Germany and to its northern allies, especially the Netherlands.⁸ In other words, financial capital transfers were flowing in the wrong direction, from the countries that needed them the most to the countries that

⁸ During the same period, after launching the euro the Netherlands generated the largest trade balances as a percentage of GDP in the eurozone.

needed them the least. These asymmetric benefits were not communicated to the German people by their leaders. Nonetheless, the German news media began a relentless campaign attributing the cause of the eurocrisis solely to profligate Greek government spending. This campaign, which was later found to be biased, became popularly known as “Greek bashing” (Bickes, Otten, and Weymann 2014; Kutter 2014). Nevertheless, Germany, a country of savers, lost as well since the European Central Bank’s (ECB) prolonged expansionary monetary policy (adopted to cope with the eurocrisis) drove interest rates down to the zero bound and even to negative levels. Germany does not prefer low interest rates, as indicated by the Bundesbank’s long and unsuccessful campaigns to block the ECB. However, it is widely recognized that without the ECB’s ultra-expansionary monetary policies of zero bound interest rates, quantitative easing (QE), the outright monetary transactions (OMT), and a few other programs, the euro would have been defuncted long ago.

CHANCELLOR MERKEL REDIRECTS THE EUROPEAN COURSE OF GERMANY

Since the end of WWII, all German leaders prior to Angela Merkel supported the European course of Germany. Helmut Kohl, German chancellor (1982–90) and Chancellor Merkel’s predecessor in the CDU, “visualized the future of Germany only within the EU” (Zestos 2016). Chancellor Merkel deviated from this course, as she chose to remain popular with the German taxpayers and voters who elected her four consecutive times. Teaming up with her former finance minister, Wolfgang Schäuble (the fiercest proponent of austerity), and with the support of her own CDU party and the coalition partners, she promoted policies detrimental to Europe’s recovery from the deep recession. During the eurocrisis, the well-rooted German economic theory of ordoliberalism—which promotes responsibility, reliability, fiscal discipline, and low inflation—played a major role in the adoption of policies that were detrimental to a few eurozone economies.⁹ As a result, the German government erred by defying orthodox Keynesian economics.¹⁰ For many Germans, ordoliberalism was the dogma that led them to inscribe in their constitution a maximum limit on public spending, known as the “debt brake.”

⁹ This is how ordoliberalism was understood by the German government according to Dold and Krieger (2019)

¹⁰ See Bibow (2018) and Wolf (2013)

A RECESSION THREAT AND CRITICISM FOR POLICY INACTION

Warnings of an upcoming recession triggered strong criticism of the German government's adherence to its strict fiscal policy. The two major parties, CDU and the Social Democratic Party (SPD) in the present grand coalition government, have been running public surpluses since 2014. Recently, calls for fiscal stimulus have come from everywhere, even from where they were least expected. The president of the Federation of German Industries (BDI), Dieter Kempf, predicted a long recession unless the government abandons its balanced budget policy (Chazan 2019b). The root of the present problem in Germany is that economic policy is based on dogma and political ideology, not on facts and sound economic analysis. This approach deters policymakers from clearly discerning the economic changes that have been occurring over time, which call for the adoption of new policies. Since the beginning of the European sovereign debt crisis, austerity policies became an obsession in many EU/eurozone countries and this is a reason why recovery became so difficult.

Many economists, politicians, and other analysts expressed strong criticism of the government and offered advice to help avoid the predicted economic recession that could spread to the rest of Europe. The expected upcoming recession is not a surprise, because Germany has not revitalized its economy for many years. Investments in deteriorating infrastructure were absent for many years; for example, several bridges cannot be used when traffic is heavy. Similarly, outdated broadband slows down the flow of electronic information and the internet. Germany, for a long time the power engine of Europe, presently lags in innovation; this is noticeable when comparing the number of German patents awarded in high-tech sectors of the economy to a few other countries. Similar statistics regarding the number of patents and expenditures on research in advanced technological sectors are reported for the entire EU in comparison to the United States, China, and Japan.¹¹ Prolonged insufficient spending on education, infrastructure, and research are some causes of the looming recession. Christian Odendahl, a chief economist at the Centre for Economic Reform in London, pointed out that the problems of Germany are the consequence of policies dictated by dogma (Odendahl 2019). Odendahl suggested that Germany must

¹¹ Several articles in the *Economist*, the *Wall Street Journal*, and the *Financial Times* have reported on this phenomenon.

abandon fiscal austerity because balanced budgets are “economically incorrect” and detrimental to the very people that they aim to safeguard.

PUBLIC DEBT AVERSION

Germany’s strong aversion to high public debt in the post–WWII period has its roots in the recession following the collapse of the Berlin Wall and the reunification of Germany. Helmut Kohl, one of the most pro-European chancellors, was successful in reunifying the country thanks to the trust he created among Western European and American leaders. Due to unequal levels of economic development and disparity in the standards of living, the West German government, under Chancellor Kohl, committed substantial resources in the form of fiscal transfers to expedite the integration of the country. This was a political decision and was not necessarily implemented in the most efficient way. Reunification was costly; thus, Germany experienced a steep rise in both unemployment and public debt following the collapse of the Berlin Wall.

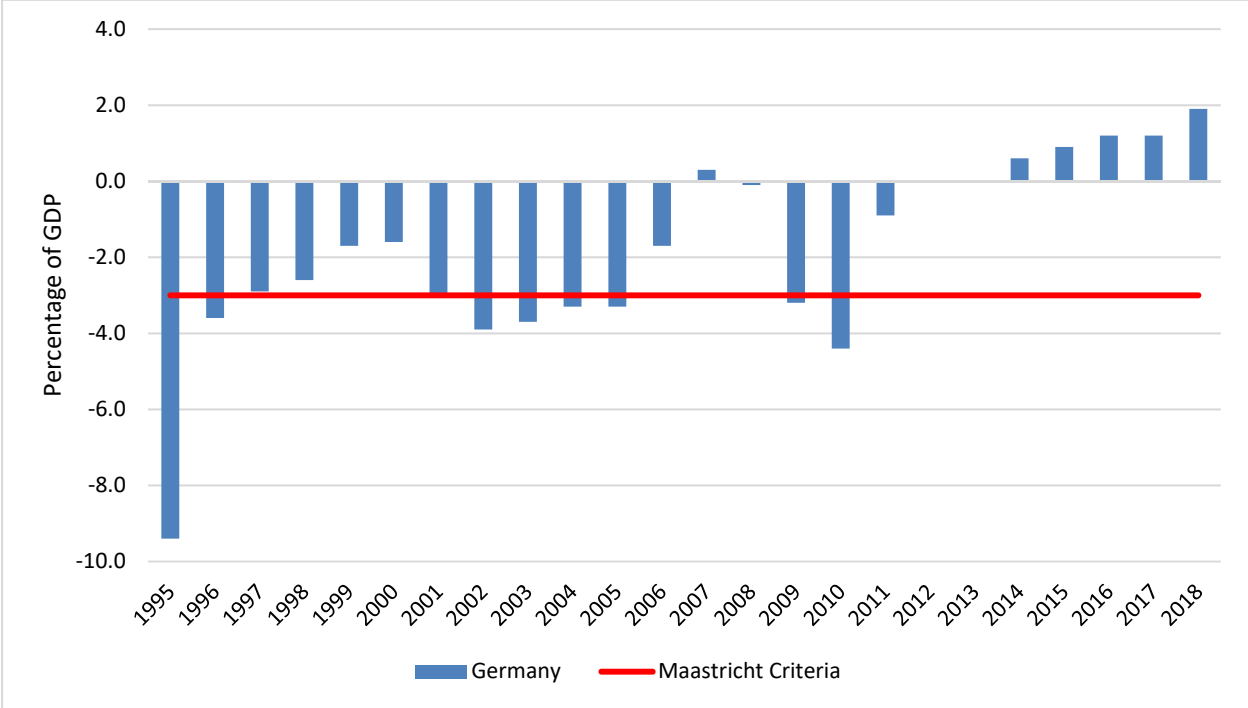
To reverse what some economists considered “profligate public spending,” the West German government supported a strict fiscal rule to restrain the rising public debt; it achieved this by legislating what became known as the debt brake, which in 2009 was inscribed in the German constitution. The debt brake prohibits the federal government from running structural deficits above 0.35 percent of GDP.¹² The debt brake also prohibits the 16 regions of Germany from generating annual deficits.¹³ Since the inception of the debt brake, black zero (*Schwarz Null* in German), a very closely related concept, has been the policy, requiring the budget to be above zero (in the black and not in the red). This austerity policy became a symbol of national pride for many Germans and especially for Merkel and the top members of her CDU party.

¹² A structural deficit is the federal deficit that would have been generated if a country operated under full employment.

¹³ This provision is similar to that of the fiscal legal arrangement among US states prohibiting them from running annual deficits.

Figure 4 shows the German public budget deficit/surplus for the period 1995–2018. According to figure 4, Germany generated a sequence of deficits from 1995 to 2006 and a small surplus in 2007. Starting in 2008, to cope with the eurocrisis, Germany adopted an expansionary fiscal policy and in two consecutive years (2009 and 2010) violated the Maastricht public deficit criterion, which is the rule that mainly Germany insistently imposed on the EMU candidate countries. Obviously fiscal rules during this period were not as important to Germany as employment and a healthy economy.¹⁴ In 2012 and 2013 the public budget was balanced, but for the next five years (2014–18) the public balance turned to a surplus that gradually increased, approaching 2 percent of the GDP. Looking at this trend, one can understand how difficult it may be for the German government to reverse the budget commitment from black to red.

Figure 4: German Budget Deficit/Surplus



Source: Eurostat

¹⁴ This was indeed the correct policy to follow under the circumstances.

THE DILEMMA OF REVOKING THE DEBT BRAKE

After numerous external and internal requests for fiscal intervention to halt further economic deterioration, the coalition government has been hesitant. Chancellor Merkel postponed a decision for spending beyond 0.35 percent of GDP. Increasing government spending by a substantial amount requires lifting the constitutionally protected debt limit. This is what torments Merkel and many of her colleagues in the CDU who would not accept her decision if she ever rendered the debt brake moribund. The debt brake, however, has to be removed from the constitution. This would be the optimal solution since this decision would protect both Germans and non-Germans from the unnecessary, painful punishment imposed by Procrustean fiscal rules.

The best way to end German fiscal rigidity and the neoliberal antilabor policies is for the German people to actively participate in the formation of new policies. Such drastic changes usually only occur after major economic disasters that motivate workers (voters) to seek major alternative solutions. Since the most recent German unemployment rate for October 2019 is exceptionally low at 3.1 percent, the government does not perceive an urgent need to give up the debt brake, which it values highly. But existing policies have acutely increased income and wealth inequality domestically and contributed to the divergence in the standards of living between the northern and southern eurozone countries. Such divergence goes against Article Two of the Treaty of Rome that explicitly states the purpose of the Union: "...to promote throughout the community harmonious development of economic activities."¹⁵ Furthermore, neoliberal antilabor programs promote unfair international competition in favor of German firms.

Neoliberal policies, such as the Hartz I-IV Reforms, help German businesses become internationally competitive, but promote precarious employment in Germany. Part-time work, agency work, and fixed-term contract work are innovations in the labor market; these policies increased labor force participation, unfair international competition, and caused a sharp rise in income inequality (Evans and Gibb 2009). In addition, these types of employment reduced both wages and benefits to workers in favor of business profits. Although such policies were accepted

¹⁵ No country, including Germany, can afford to ignore the principles upon which the Community was established. Violating the principles of the founding treaties goes against the rights of German and EU citizens.

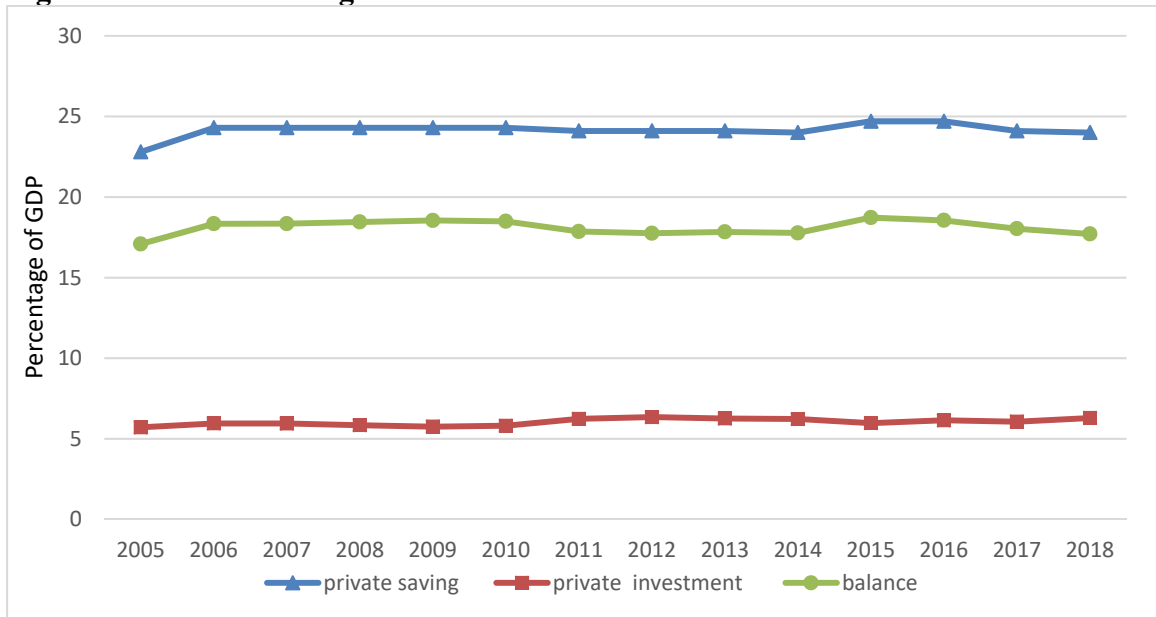
as temporary means to help the country recover from the eurocrisis, they cannot remain permanent, as they constitute beggar-thy-neighbor trade policies and promote domestic income and wealth inequality.

High profits in Germany are earned by the owners of small- and medium-size enterprises (SMEs), or *Mittelstand* in German (Zestos 2006: ch. 6). The SMEs are exceptionally successful; these exporting firms are almost always family owned and are a pride of Germany. SMEs are mainly responsible for Germany's massive CA surpluses, the largest in the world at 7.3 percent of its GDP (almost €300 billion) in 2018. Nevertheless, SMEs are also responsible for the acute income inequality, which is one of the highest among the 35 OECD member countries (*The Economist* 2019). High profitability of the SMEs comes at the cost of large income inequality. Government labor and tax policies play a major role in boosting high profits for the SMEs, which contribute to the formation of asymmetrically large private saving in relation to private investment. Excess saving in relation to investment is necessary to support the extraordinarily large German CA surpluses.

THE EFFECTS OF TRADE IMBALANCE AND AUSTERITY IN THE EUROZONE

Since the trade balance is by far the largest component of the CA, it is customary for the two accounts to be employed interchangeably. Thus, economists often discuss the issue of global trade imbalances, which is widely publicized by the news media. For the last few years, Germany has generated one of the largest export sectors in the world. To support such a large export sector, Germany needs substantial savings. Such savings are generated by the profits of the SMEs and by households; consequently, the savings are lent abroad through the banking system to finance German exports. An excessively large German export sector is a major factor contributing to world trade imbalances and has been criticized by world leaders, economists, the IMF, and the EU Commission. Figure 5 depicts the asymmetry between German private saving and investment.

Figure 5: German Saving versus Investment



Source: OECD and European Economy Statistical Annex (2019)

The July 7–14, 2017 issue of the *Economist* published a front cover article explaining the detrimental effects of the German CA surpluses on the world economy. Germany’s large export sector and the austerity imposed on the southern eurozone countries and Ireland are considered two major causes for the prolonged recession in the bailout of eurozone countries. Accumulation of excessive CA deficits by southern eurozone countries and Ireland brought these countries to the brink of bankruptcy during the eurocrisis. A recent econometric study found empirical evidence of Granger causal econometric relations between German CA surpluses and public indebtedness in southern eurozone countries. The study found statistical evidence that German CA surpluses caused an increase in the public-debt-to-GDP ratio of southern eurozone countries and Ireland.¹⁶

Almost all periphery countries in the eurozone experienced unnecessary pain from the eurocrisis that could have easily been avoided. Millions of people became unemployed, homeless, and ill during the eurocrisis because medical services deteriorated as hospital budgets were slashed due to austerity that was externally imposed by the EU and the IMF, and promoted by Germany. This was definitely the case for Greece, which experienced the worst recession. Even large countries

¹⁶ Replacing German CA surpluses with the northern eurozone countries’ CA surpluses in the model yields identical results (Zestos, Taylor, and Patnode 2016).

like Italy and France did not escape the pain of austerity. Italy is currently divided and almost paralyzed politically, and it is threatened by extreme anti-EU and antirefugee political parties. Additionally, the Italian government has been involved in a long dispute with the EU Commission regarding its public deficit, even though it does not violate the Maastricht criterion of negative 3 percent.¹⁷

In France, President Emmanuel Macron's success in national elections was challenged. A political movement known as Yellow Vests (*gilets jaunes*) has emerged; for weeks it fiercely protested against a fuel tax and against probusiness policies adopted by the new government and criticized Macron for favoring the rich. A €25 billion increase in spending above the 3 percent Maastricht maximum limit seems to have quieted the protesters. However, strikes and new protests starting in early December 2019 challenged pension reform programs proposed by President Macron's government. This is a large labor protest, the longest in French history, organized by many trade unions. The protests turned violent, threatening President Macron's life.

Portugal weathered the last few years of the eurocrisis relatively easily by successfully going against the rigid eurozone rules, welcoming Chinese investment, and welcoming an increasing number of tourists in the country. Greece has not recovered despite the bailouts it received. Greece's unemployment rate as of January 2020 stands at 16.8 percent, and its GDP is still below the precrisis level. Greece, more than any other country, was devastated by the imposed austerity that continues even after it officially exited the bailouts.¹⁸ Greece is still required by its creditors—mainly the EU members' central banks—to generate annual budget surpluses for several more years. This may turn out to be very difficult to continue if recession returns.

¹⁷ However, Italy has the second largest public-debt-to-GDP ratio, next only to Greece.

¹⁸ Bibow (2018) stated that the treatment of Greece during the crisis was barbaric. Forcing a country to generate government surpluses is a punishment to its people. However, all of the politicians and bureaucrats who pass and enforce such policies have little idea how they affect the life of the everyday person.

HESITANCY TO SPEND

The German government presently has the fiscal space to take the measures necessary for preventing further deterioration of its economy. Since Germany has the largest economy in the EU, a fiscal expansion in Germany will spill over to the eurozone, the EU, and to the global economy. Because interest rates are recently very low (negative), depositors and investors are charged interest on their deposits and bond holdings. All German government bond yields, including the long-term 30-year bond, are negative. This is an ideal time for borrowers, both in the public and private sectors, to obtain loans. Because almost all suggested funding for the public sector is intended for public investment and not for public consumption, Chancellor Merkel's concerns about lifting the debt brake in order to protect future generations of Germans are totally unfounded.

Hesitancy in lifting the debt brake is shared by Germans outside the CDU, for example by the SPD Finance Minister and Vice Chancellor Olaf Scholz. Since the SPD entered the grand coalition government with the CDU, it lost much of its popularity and support from the voters as it stopped promoting its own distinct SPD positions. Members of the SPD forced Martin Schultz, the party leader during 2017–18, to resign as the party leader and as the German foreign minister.¹⁹ This decision of the SPD members was not only a decision against Martin Schultz, the former president of the European Parliament, but also a decision against European integration. Schultz's views were strongly pro-European, similar to those of President Macron of France. Their views are too pro-European for many Germans who, after many years, have discovered a strong preference for ethnocentric nationalism. However, it can never be certain why Mr. Schultz was removed from his key positions in the SPD and in the German government.

¹⁹ Martin Schultz, according to many SPD members, made the mistake of letting his party join the grand coalition with Merkel's CDU although he had promised the SPD members that they would never do so. Such a decision turned out to be very costly because SPD supporters massively abandoned the party in all state and EU elections.

ACTION ON CLIMATE CHANGE CANNOT BOOST THE GERMAN ECONOMY

After high expectations that the German government would intervene and take measures in order to protect the environment, the government announced a program on September 20, 2019. The environmental program was written while demonstrators across the world, inspired by Greta Thunberg, were marching for climate change (Sengupta 2019).²⁰ The German environmental program introduced a carbon price (cost) on polluters, giving them incentives to reduce the greenhouse gases they emit.

The environmental package also includes €54 billion (\$60 billion) that will be raised between 2019 and 2030 through taxes on pollution activities to subsidize the production of green energy. The program was immediately criticized by environmentalists and economists as being minimalist. Since the package is self-financed and does not require government spending, it is not expected to provide much fiscal stimulus. Because it was previously publicized that a massive environmental program was expected to be a substantial fiscal stimulus (hundreds of billions of euros) to boost the green economy, the newly introduced program was a disappointment.²¹ On January 16, 2020, the German government announced that they will end the use of coal power by 2038. Combining this with the shutdown of nuclear powerplants by 2022 makes Germany the first country to commit to ending both nuclear and coal power use.

MONETARY POLICY NO LONGER PROVIDES HOPE FOR RECOVERY

Since fiscal policy was not forthcoming, despite the numerous requests for such action by many experts and world leaders, the ECB intervened on September 12, 2019, despite warnings of a possible “backlash.” This happened after the former ECB president, Mario Draghi, and the new president, Christine Lagarde, both appealed to Germany for fiscal intervention by explaining that

²⁰ Greta Thunberg, a sixteen-year-old Swedish high school student, began a protest movement for climate change when one day in 2018 she went on a strike in front of the Swedish parliament instead of attending classes.

²¹ This was particularly true for the Green Party members.

the ECB cannot do much more to boost the eurozone economy. After this request, the ECB revived its previously launched QE policy of €2.6 trillion.

Consequently, the ECB began buying €20 billion in bonds every month, starting November 1, 2019, and will do so until the inflation rate approaches its target rate, which is close to, but not above, 2 percent (Telford, 2019). Critics are concerned that such purchases will destabilize asset markets and increase the number of zombie companies, which are already on the rise.²² In addition, the ECB reduced its deposit rate, which was already negative, from -0.4 to -0.5 percent, to encourage financial institutions to issue loans instead of parking funds with the ECB. Nevertheless, this time the ECB has faced stiff opposition both from outside and inside its own governing council.

The effectiveness of this round of QE is not certain. Since interest rates are already negative, it is doubtful that monetary policy can rescue Germany from the possible upcoming recession. It is obvious that if the German government does not launch an expansionary fiscal policy now, the damage will be immense. It can only be expected that the German government will do for their own people what they failed to do for the peripheral eurozone countries, which unknowingly became victims of a dogmatically formed and imposed German fiscal policy.

COMPLETION OF EUROPEAN INTEGRATION

Germany's ethnocentric and minimalist approach to European integration is at least partially responsible for the current EU economic and geopolitical problems. Since the early years of the EU's formation in the 1950s, Germany has played a key role in the integration path followed by the EU because Germany evolved to be its largest and strongest economy. However, a case could be made that Germany promoted economic integration in areas its politicians perceived would maximize short-term benefits. As a result, Germany eagerly embraced the EU Common Market. This happened since many German firms enjoy a strong competitive advantage vis-à-vis firms

²² A zombie company is an overindebted company that is kept operating due to additional loans. Such companies are presently attractive due to negative interest rates.

from other EU countries, especially in the manufacturing sector. German politicians did not however have an incentive to visualize the significance of the long-term benefits resulting from deeper European integration. Such foregone benefits would have been appreciated now that both the EU and the eurozone are threatened by domestic economic and political upheaval, plus external threats. It is evident that if the EMU was complete and the EU more integrated, it would have been easier to better cope with the eurocrisis, the refugee crisis, and other external threats.

As the strongest economy in the EU, Germany has always been a net contributor to the EU budget. This has not set well with most German taxpayers. Consequently, the German government fought, along with other EU countries in a similar position, many battles within EU institutions to keep the EU budgets slim. Germany achieved this throughout the years and kept the EU budget slim, very close to 1 percent of the EU GDP.²³

Many Germans feel that since their country is a net contributor to the EU budget, this implies that they disproportionately bear the burden of European integration. However, the reality is that Germany, along with its northern allies, derive the most benefits from EU and eurozone membership. Such benefits though are not as visible to them as the country's payments to the EU budget. German benefits come from market integration, but these benefits are indirect and arise from dominance in manufacturing and also by free capital mobility, the latter introduced with the launching of the Single European Market (SEM) in 1987.²⁴ These benefits were received by firms and indirectly by the average citizens who found many employment opportunities within the SEM. European integration in other areas was purposely slowed down to keep the cost of integration to a minimum. Germany and its allies throughout the years became masters in the art of postponing economic and political integration in the EU and eurozone.

The perceived "success" in postponing further integration by Germany and its allies left the structure of the EMU unfinished, short of a fiscal and banking union and a common budget to protect the eurozone from future financial and economic crises. Individual EU and eurozone

²³ National budget expenditures of the eurozone member countries are a very large percentage, around 50 percent, of their GDP.

²⁴ Single European Act, February 17, 1986, 1987 O.J. (L 169) 1, 25 I.L.M. 506; available at: <http://data.europa.eu/eli/treaty/sea/sign>

countries cannot alone confront major asymmetric shocks, as they lack the necessary resources and tools. Since joining the EMU, member countries lost both their monetary and foreign exchange rate policies. If the EMU was accompanied by a fiscal union and a banking union, then the eurozone would have been in a position to effectively exercise fiscal policy and protect every member country. Although the EU and eurozone introduced several measures to fight future crises, such measures are still insufficient.

GEOPOLITICAL PROBLEMS

From a geopolitical point of view, as of January 2020 the EU is in a dire situation, as it is on the brink of becoming irrelevant; this was vividly demonstrated during the recent Turkish invasion of Syria on October 9, 2019. Lacking the vision and courage to continue with political integration, the EU has been reduced to no more than a simple spectator who idly watches other countries dictate outcomes in the Middle East. Relying on US President Donald Trump to maintain peace in Syria turned out to be a gigantic mistake. This, however, should become a lesson for the group of 27 European democratic countries to never again become free riders in such important areas of foreign and defense policies.

The EU can draw strength and power from its unity since even the larger EU countries are not big enough to stand alone and exert geopolitical influence.²⁵ A reinvigorated EU would have a positive influence on its neighboring countries. An EU political and military union (a possible subset of countries within NATO) comprised exclusively of European countries would help the EU gain self-confidence and respect from other countries, including those that destabilize the Middle East and the eastern EU border. At a minimum, the EU can safeguard its citizens within the outer European borders. Most EU countries, including Germany, maintain small defense budgets, much below the NATO target of 2 percent of their GDP. European military integration and coordination of national defense policies must become a priority. To achieve this goal, the

²⁵ EU influence is expected to be always welcome and constructive when dealing with other countries because it is based on 27 democratic countries that respect human rights and protect all religions and minorities.

EU has to increase its defense expenditures if the Union is to be geopolitically relevant and respected.

GERMAN-TURKISH RELATIONS

Massive foreign private investment in Turkey by the United States, Germany, and a few other countries contributed to rapid Turkish economic growth for many years. Several countries liberally invested in Turkey, taking advantage of a skilled, young labor force and a large market of over 80 million people. Contrary to expectations, economic growth did not help the country transform into a modern democracy, where freedom and human rights for all of its citizens, religions, and minorities are protected. Such a path would have paved the way to EU membership, which Turkey sought for a long time. The leaders of the present government set ambitious ultranationalistic objectives to transform the country into an economic and military power that has demonstrated very aggressive long-term expansionary aims against its neighbors. Furthermore, Turkey appears to take pride in its new self-appointed role as the hegemon of the Islamic states. To achieve their objective, Turkish leaders do not hesitate to take strategic positions between the United States and Russia, that so far have been accepted.²⁶

Germany's historic ties with Turkey date back prior to WWI, when Germany was an ally of the Ottoman Empire, the predecessor of modern Turkey. Since then the two countries developed strong trade relations, as German companies launched an ongoing large direct investment to Turkey. Trade and investment relations were complemented by an inflow of many Turkish workers to Germany. Turkish workers began arriving in Germany in the beginning of the Miracle Growth decade in the early 1950s, when labor was scarce in Germany. Presently (2020) more than seven million Turks live in Germany. In a recent interview with the Turkish Anadolu Agency, the chief executive of the association of the German Chambers of Commerce (DIHK),

²⁶ This may change, as indicated by the recent developments in Libya. The UN and many countries in Europe, the Middle East, and Africa strongly oppose Turkish interference in Libya. Some fear that Erdogan aims to restore a modern Ottoman Empire.

Mr. Martin Wansleben, tried to demonstrate the excellent relations between the two countries by stating that more than 6,000 German firms presently operate in Turkey.

DANGEROUS TURKISH STRATEGIC PLANS

NATO proved incapable of restraining Turkey, one of its own members, from violating international law by crossing the borders of a neighboring sovereign country, Syria, on October 9, 2019. The purpose of the invasion was to defeat and push out Kurdish fighters (YPG) from the northern part of Syria. These fighters fought on the side of the Americans and their allies and defeated ISIS. The United States turned its back to the YPG when it decided to pull out of the area, allowing Turkey to attack the US ally. Turkey threatens others countries as well, namely Greece and Cyprus, while it tries to exploit the weakness of another Mediterranean-African country, Libya, which is struck by a civil war. Turkey was invited to provide support by the government of Libya, which is officially UN recognized.

Turkey, or more correctly the ruling Justice and Development (AK) party, and its autocratic leader, President Tayyip Erdogan, agreed to send troops to Libya. Erdogan's motive, however, is not only to help the Libyan government that is threatened by opposing forces in the civil war, but also to gain access to mineral rights in the eastern Mediterranean, an area covering the distance from Turkey to Libya. Turkey signed two memoranda of understanding with the Libyan government for this arrangement. However, this action ignored the legal marine rights of the countries that are in between Turkey and Libya, who vehemently oppose these two illegal agreements. Thus, Turkey's plan has already found strong opposition from potentially threatened countries and the EU.

Turkey has a very important ally and partner in many projects, Russia, and its autocratic president, Vladimir Putin, who is using Turkey to weaken NATO and increase the Russian sphere of influence in the entire region. Turkey purchased and installed the antimissile defense system S-400 from Russia, which is against NATO's rules; this was a NATO violation that could have been punished with expulsion. Erdogan has adopted a gun boat diplomacy, not missing an

opportunity to flex muscles and intimidate countries that get in his way. For example, Turkish military aircraft violate Greek airspace on an almost daily basis by flying above the Greek islands. After a few international oil companies came to an agreement with the government of Cyprus to drill for gas, Turkey also began drilling for gas within Cyprus's exclusive economic zone (EEZ). Erdogan ignored warnings by the EU not to drill within Cyprus's EEZ. These warnings will soon be translated into sanctions if Turkey does not comply.

Erdogan argued that there are plans by other countries to exclude Turkey and its occupied part of the Republic of Northern Cyprus²⁷ from participating in the sharing of the eastern Mediterranean Sea's natural resources. Indeed, on January 2, 2020, Greece, Cyprus, and Israel signed an agreement for the construction of a long natural gas pipeline (1,900 km). The pipeline will originate from Israel's Leviathan reservoir, which was discovered 75 miles off the Israeli coastline in 2010, and would carry natural gas from the three countries to Italy (Tzimas 2020). The trilateral agreement aims to also make the EU more independent in energy supply. The United States supports this project, as it helps the EU not rely on Russia.

Turkey, however, signed its own agreement with Russia to bring natural gas to Turkey, gas which will also be destined to the EU. This gas pipeline begins at Novorossiysk and goes through the Black Sea to Kiyikoy, a northern Turkish village, to avoid the Ukraine route (given the armed conflicts between Russia and Ukraine over the last few years). Erdogan and Putin signed the TurkStream agreement on January 8, 2019 when Putin visited Istanbul. The TurkStreamline goes through Bulgaria and Serbia and is destined for central Europe. Greece also began receiving natural gas from this gas line. During the same visit the two leaders announced the proposal of a ceasefire for the two Libyan fighting parties by January 12, 2019. Libyan General Khalifa Haftar, who was marching with his forces closer to Tripoli, refused to accept the ceasefire until the terrorists (sponsored by Turkey) were arrested, unarmed, and prosecuted. He was referring to the Syrian soldiers brought by Turkey from Syria to fight for the Libyan government.

²⁷ No other country except Turkey recognizes the so-called Turkish Northern Republic of Cyprus as an independent country. Greece and Cyprus claim there cannot be negotiations for settlements and solutions to the Cyprus problem under threats from Turkey.

Russia will also supply natural gas to Germany in 2020 via the Nord Stream 2 pipeline that will come from Russia straight to Germany through the bed of the Baltic Sea. The United States is critical of both the TurkStream and the Nord Stream 2 projects, as they will make the EU dependent on Russia. The US Senate approved sanctions signed into law against all those companies participating in the construction of the two pipelines. Both Russia and Turkey do not agree with the United States. Germany does not agree with the US sanctions and considers them as interference in its domestic affairs. The EU supports Germany.

VOLKSWAGEN EMISSIONS VIOLATIONS AND COVER-UP (DIESELGATE)

The world's second-largest automobile company, Volkswagen (VW), was involved in a major fuel emissions scandal in 2014–15 regarding two of its models: the 2012 VW Jetta and the 2013 VW Passat. The scandal unfolded when the West Virginia University Center for Alternative Fuels and Engines tested these two cars and found they substantially exceeded the EPA's standards in terms of a common pollutant, nitrogen oxide (NO_x) (Jaffe 2015). The West Virginia Center for Alternative Fuels undertook the study for the International Council of Clean Transportation (a nonprofit organization) to investigate emissions for the two VW cars and one BMW model. Gregory Thompson, Daniel Carder, Marc Besch, Arvind Thiruvengadam, and Hemanth Kappanna were the five members of the research team that received a small \$50,000 grant to carry out the study.²⁸

If it was only that the road emission test results were a relatively small percentage above what is allowed by the EPA, then VW would have been able to easily escape this violation with a relatively small fine, and this would have been the end of the story. It was, however, the huge difference in the emissions test results in terms of NO_x performed under two different conditions. The first test was performed in the testing lab when the steering wheel was stationary (not turning), whereas the second was the road test, performed while the steering wheel was turning. The same tests were performed in the state of California, the US state with the strictest

²⁸ It is surprising, however, that although the 117-page study was presented about a year and a half ago it was publicized much later (September 2015).

environmental protection standards. This took place at El Monte by the California Air Resources Board's certification facility. The California tests reconfirmed that the two VW cars failed the NO_x emission test and the BMW model passed the test.

University of Michigan Professor of Engineering Anna Stephanopoulou explains that during lab testing the steering wheel is not moving but the wheels of the car are moving. This has to be the signal for the "defeat device" to turn on the catalytic scrubber and to reduce NO_x pollution, thus the car passes the test. During the on-the-road test, the steering wheel is moving and the "defeat device" turns off the catalytic scrubber, causing increases in NO_x. One can inquire how such a reputable corporation can take the easy and unethical option of cheating. And how high up in the corporate hierarchy did awareness of this bad decision go? The impact of the negative press affected and still affects VW and its consumers. The engineer who designed the "defeat device," James Liang, is serving a 40-month prison sentence and was fined \$200,000. The chairman of the corporation, Martin Winterkorn, revealed he was shocked and resigned. Millions of cars were recalled, amounting to billions of lost dollars. VW faced several class-action lawsuits that may result in billions of dollars lost and tarnished the reputation of VW, as well as other German automobile companies.

RENEWED CALLS FOR FISCAL STIMULUS

On November 18, 2019, a 10-year, €450 billion public investment package for education and infrastructure was proposed. This time the call was different, as it jointly came from the German BDI Business Lobby and the German Trade Union Confederation (DGB). The fiscal program was jointly prepared by the German Economic and the Macroeconomic Institutes, two research institutes that are associated with businesses and labor, respectively. It is interesting to note that the new request does not call for a lifting of the debt brake, since the €450 billion would not come from the federal budget but through the creation of a special purpose vehicle (SPV). Such a decision vividly demonstrates how deeply the idea of the balanced budget is rooted within Germany's governing political system; it is so ingrained that it is difficult to imagine challenging it. Chancellor Merkel was quick to reject the new request for investment in education,

digitalization, the environment, and infrastructure (Chazan 2019c). The urgency and need for fiscal stimulus is so imperative and obvious that even some of the most fervent and outspoken supporters of fiscal discipline have recently spoken against the balanced budget in order to allow new spending for public investment. For example, Bundesbank President Jens Weidmann, who was one of the most fervent proponents of austerity and strict fiscal rules, now supports abandoning a balanced budget.

On Tuesday, January 14, 2020, the German government decided to launch a major investment of €86 billion over the next 10 years to modernize the railway systems. This is a move in the right direction to remove the debt brake from the German constitution. However, the amount is insufficient to require this removal. First, only €62 billion will be government expenditures, the remaining €24 billion will come from the railroad company Deutsche Bahn. Therefore, the investment amounts to €6.2 billion in annual expenditures. This is much less than the 0.35 percent that is inscribed in the constitution, which amounts to €11.8 billion (based on 2018 GDP). Furthermore, the German government announced it generated a €13.5 billion budget surplus for 2019, which means that the surplus money is more than sufficient to cover the railroad expenditures for the year. In addition, the program received severe criticism by Alexander Kirchner (the head of the railroad union, EVG) who said that the railroad network was neglected for so long it requires “backlog investment of €60 billion a year” (Chazen 2020). That amount is almost equal to the total government investment for a 10-year period.

SYRIAN INVASION COULD TRIGGER A NEW EU GEOPOLITICAL APPROACH AND MORE

On December 1, 2019, as a result of the new EU parliamentary elections and new administrative appointments of key top EU positions, it is possible for the EU to embark on a new geopolitical course and a more dynamic path toward European integration. Five key appointments should make a difference for the future course of the EU. The first is that of Mr. Charles Michel, the former prime minister of Belgium, who became the president of the European Council. In this role, he chairs all EU summits of the European Council where foreign and defense policies are

formed. President Michel wants the EU to take a stronger stand in foreign relations. He stated in a recent interview with the *Financial Times* that the EU must act “boldly in the global stage” (Brunsdon and Fleming 2019). Such a statement indicates a disapproval of the present, passive EU policy.

The second key appointment is to the office of the president of the EU Commission, which was filled by Ms. Ursula von der Leyen, the former German defense minister. Her appointment brings much optimism for the future of the EU, as she strongly supports deeper European integration, unlike most other recent German representatives in the EU.²⁹ Ms. von der Leyen’s new EU Commission has already launched a green program with very ambitious goals, aimed at making Europe the world’s first carbon neutral continent by 2050. The new president of the EU Commission announced that her administration will be the most environmentally “aware” among the EU administrations. Furthermore, Ms. von der Leyen strongly supports a more important geopolitical role for the EU.

The third appointment that also raises hope for the future of the EU and European integration was of Christine Lagarde, the French former managing director of the IMF, as president of the ECB, a very important position in the eurozone. In her very first speech as ECB president, she requested eurozone governments increase spending to aid slow growing economies in the eurozone. Additionally, Ms. Lagarde urged eurozone leaders to focus on domestic consumption instead of exports. She has already demonstrated her determination to effectively lead Europe in the right direction. Although Ms. Lagarde has not directly named Germany, she has made it obvious that Germany’s government is to be liberated from its self-imposed fiscal constraints. Other eurozone members with the ability to increase public spending, she suggested, must increase government spending as well.

The fourth EU appointment was the commissioner of the EU economy, Paolo Gentiloni, the former prime minister of Italy. Gentiloni, upon his appointment, was quick to express his views that the present eurozone fiscal rules are not well-suited for the present eurozone economy,

²⁹ The exception to this being Martin Schultz, the former president of the European Parliament

which hardly grows and is on the verge of a recession. He also pointed out the asymmetry regarding the EU fiscal rules. While EMU members are criticized and, according to fiscal rules, must be penalized when they violate the Maastricht deficit limit, they are not criticized or punished when they do not spend enough, even though they have the ability to do so.

Lastly, the fifth appointment is the former Spanish foreign minister, Josep Borrell. As the EU's foreign policy chief (High Representative of the Union for Foreign Affairs and Security Policy), Mr. Borrell brings experience to the already-tenured group. He formerly served as European Parliament president and is an advocate for economic cooperation in the EU and supports the EU advancing into a more prominent role by shaping world order. He also strongly supports EU action on climate change. Violating international law, Turkey recently signed a memorandum of understanding with Libya that "delineates marine borders" between Libya and Turkey and ignores the rights of Greece and Cyprus (Ekathimerini 2019). As the High Representative, Mr. Borrell expressed concern over this memorandum. After an EU foreign ministers meeting, he expressed solidarity with Greece and Cyprus (Euronews 2020). Mr. Borrell seeks a diplomatic solution, as he sees no military solution can exist.

In response to rising tensions in the Mediterranean over illegal drilling in Cyprus' economic zone by Turkey, EU leaders have stepped onto the global stage and are taking action against Turkey. They announced sanctions that penalize "person and entities" involved in this illegal drilling (ILKHA 2020). A list of sanctions includes asset freezes (of people and organizations) and bans on travel. EU citizens who aid in the illegal drilling will also be punished. Additionally, President Macron sent the Charles De Gaulle French aircraft carrier, with helicopters and planes, to the East Mediterranean. The airplanes flew over Cyprus, challenging Turkey's presence in the area (Ekathimerini 2020).

THE LAST WORD BELONGS TO THE EU COUNTRY LEADERS

Very little progress toward deeper European integration or toward improved international status for the EU can take place if the EU country leaders resist necessary changes. The EU country that has been blocking or diluting most proposed changes is Germany. Recently, plenty of evidence from most strata of German society (businesses, labor, and the central bank) exists for abandoning “the small fetish”: the CDU’s debt brake and the balanced budget. It is now only a matter of time before it will happen. Regrettably, since economic policy works with lags, the change may occur when it is too late. Removal of the debt break from the German constitution will only be the beginning of many changes that must take place in the eurozone’s governance for the EU and the EMU to succeed. Many changes have to be adopted for the EU to become influential in the geopolitical arena, particularly in the proximity of the EU borders and beyond.

Several reforms have to be introduced to improve recession resistance in the eurozone. Such reforms can be classified in two major areas: 1) the establishment of a fiscal union with a shared eurozone budget and a common debt instrument (eurobond) and 2) the completion of a banking union, which will also include a European deposit insurance fund to protect bank deposits in the entire eurozone. In addition to the previous two requirements, the European Stability Mechanism (ESM) must be strengthened with increased funding and more freedom to intervene when necessary to save countries. If the above reforms are introduced, then the eurozone would be able to stave off any future crises that may threaten it.

French President Emmanuel Macron, one of the most open critics of the German government and its trade surpluses, stated that they occur “always at the expense of others” (Chazen 2019a). It is logical and expected that all EU/eurozone countries adopt policies that do not go against other EU/eurozone members. Germany imposed fiscal rules on the eurozone that have been detrimental to several eurozone countries. Because of its size, Germany created negative externalities that affected a vast number of people who may or may not have been captured in the official statistics, as it is difficult to quantify pain and human suffering. For the EU/eurozone transformation to take place, a change of attitude and minds must occur in Germany and in other northern EU countries that for so long were blind followers of the rigid fiscal rules.

If European leaders fail to meet expectations and do not succeed in promoting deeper European integration, an alternative will be to launch a program known as “two-speed” Europe. Such a solution was discussed and proposed in the Rome Summit of 2017, when the EU was celebrating the 60-year anniversary of the establishment of the European Economic Community (EEC). One suggestion was that the eurozone can be divided into two regions with two distinct currencies, for example euro-north and euro-south. A two-speed Europe would reduce friction among northern and southern eurozone countries. Northern eurozone countries are highly likely to maintain low inflation and would try to generate both trade and budget surpluses. Trade surpluses, however, would not last long, as their currencies would appreciate. Southern eurozone countries, on the other hand, would not accept high unemployment, but would accept relatively high inflation and budget deficits during times of recession (see Zestos and Simmons 2018).

CONCLUSION

This study examined the possibility of an upcoming recession in Germany. Several economic indicators send warnings for a likely downturn of the German economy. The crisis, if triggered, will be due to trade wars between the United States and China, as well as Brexit, which already interrupted the international manufacturing supply chain. For Germany, this has already had a negative impact, especially on the machinery and automobile sectors. The automobile industry is presently undergoing a major structural transformation from diesel to electric engines. Because the success of such a massive project is not certain, the future of the German auto industry is uncertain. In addition, Volkswagen, by far the largest German automobile company, has been confronted with serious, long-lasting litigations in both the United States and Germany over its US emissions scandal.

Because of the many warnings and threats of the looming recession, numerous requests have been made by economists, leaders of major business associations, labor union representatives, think tanks, and officials of international organizations for the German government to intervene with fiscal stimuli. Such calls so far have been ignored, as Germany’s fiscal policy is formed according to dogma and political ideology. In terms of fiscal policy, the Maastricht criteria and

the Fiscal Compact Treaty have taken their toll on several eurozone countries. More recently, the debt brake and the balanced budget present a threat to the German economy. If not removed from the constitution, these policies would cause a recession in Germany and have negative spillover effects on the rest of the world. Considering the troubling reports on German infrastructure, an expansionary fiscal policy is necessary even without the warnings of a recession.

On the geopolitical front, Germany's present position is not to be envied. Although admitting one million refugees in 2015 was a generous and humanitarian act, other EU countries cannot be expected to follow this German policy. The best solution for the refugees is for them to remain in their ancestral homes. This can be achieved by forming a strong military alliance within NATO with the other 27 EU countries to defend Europe's borders, safeguard peace, and promote economic development in the surrounding countries that are torn by wars and violence. The EU can promote peace and prosperity in these countries.

On January 19, 2020, an international conference aiming to establish permanent peace in Libya was held in Berlin, Germany. Chancellor Merkel invited world leaders with vested interest in Libya to discuss solutions to end the nine years of civil war that have plagued the country. Following the end of the conference, Secretary General of the United Nations Antonio Guterres announced that all parties had agreed to respect an UN-backed arms embargo, permanent ceasefire, and withdrawal of all armies. Chancellor Merkel agreed to continue with the peace processes until a final settlement is reached and respected by all parties concerned. Chancellor Merkel and her foreign minister, Heiko Maas, orchestrated the conference and delivered an unexpectedly optimistic and successful outcome, but time will only tell if the success of the Berlin Conference will last.

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