

Competitiveness and its leverage in a currency union or how Germany gains from the euro

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Despite the claims of euro sceptics and the belief of large segments of Germany's public opinion, the dynamism of the German economy has gained considerably from the existence and membership of the euro. The fundamental reason for this gain is to be found in a rather neglected aspect of a currency union's operation, when it is not an optimal currency area. More specifically, when there are considerable differences in the competitiveness of the union's members. The union's exchange rate, which reflects the average competitiveness of the union's members, plays a crucial role in amplifying and sustaining the current account surplus of the members that have higher than average competitiveness. Concurrently, it also amplifies and sustains the current account deficit of the countries with lower than average competitiveness.

It is, of course, widely recognized that the euro's exchange rate has allowed Germany to have a stronger export performance than would have been possible if Germany had a national currency, such as the mark. At the same time, the euro's exchange rate has amplified the current account deficit of the less competitive southern countries. The resulting weakening in their competitiveness, compounded by Germany's reluctance to adopt an expansionary policy, perversely serves today¹ to magnify even further the German economy's gain. The latter benefits by the inflow of capital and labor from the less competitive southern countries, which strengthens the German economy's productive potential while correspondingly weakening further the weaker economies. Thus, the initial gap in competitiveness between the German and the southern economies tends to be increased further.

In order to examine the euro's effect on German competitiveness and, more importantly, to clarify the nature and aspects of the gain, it will be helpful to make a distinction between two different notions of competitiveness.

Two concepts of competitiveness

Before embarking on a discussion of competitiveness, it should be noted that the topic of competitiveness is a controversial one. Despite the widespread use of the notion of competitiveness in public policy discussion and the regular compilation of an international competitiveness index,² there is a marked reluctance among academic economists in

¹ Today, the Eurozone is in difficulty because the international financial crisis (originating in the US subprime housing market) made apparent its deficient architecture. In the absence of both a fiscal and a banking union, as well as a credible growth policy, the Eurozone's weakness is likely to persist.

² The first well-known index was compiled in collaboration by the Institute for Management Development (IMD) and the World Economic Forum (WEF). Since 1996, the two organizations produce independently their own separate indices; see, WEF (2015) *The Global Competitiveness Report 2015-2016*, Geneva, World Economic Forum, as well as, IMD World Competitiveness Center (2016) *IMD World Competitiveness Yearbook*, Lausanne, IMD World Competitiveness Center.

accepting the coherence and legitimacy of the concept.³

The reason is that it makes an odd fit with the economic theory of international trade. Ricardo's theory of comparative advantage shows that even if a country is more efficient in producing all goods than another country, it can still gain (indeed both countries can gain) through specialization and trade. The pursuit of competitiveness, in order to outsell the other country and avoid buying from it, does not make any sense. There is no question that the pursuit of competitiveness has a mercantilist provenance and, from Adam Smith onward, the discipline of economics has consistently rejected mercantilism as a norm of economic policy. It is widely accepted among economists that international trade (and, more generally, all voluntary trade) is beneficial to the parties concerned, even though the benefit may be unequally shared.

In fact, contrary to the mercantilist precept, a trade deficit confers a greater immediate tangible benefit than a trade surplus, since the former raises the standard of living and/or investment potential of a country while the latter lowers it. In contrast, the surplus provides claims on future production of uncertain real value. It would seem then that the deficit is clearly preferable. Leaving aside the question of whether a continued deficit is sustainable,⁴ it seems beyond dispute that if this were possible it would certainly be preferable.

Nevertheless, a deficit is not clearly preferable to a surplus in a setting of unemployment and spare capacity. In these circumstances, the surplus also increases profits⁵ and, through higher profits, encourages production and employment. On the other hand, the deficit reduces profits and tends to lead to lower production and employment. Consequently, in a world of monetary production for profit, often characterized by unemployed resources, a trade surplus makes a lot of sense. This, admittedly, may be a second-best policy but in the real world the first-best policy may, for various reasons, not be feasible.⁶ It is in such a context that competitiveness, understood as the ability to consistently achieve surpluses, becomes a useful policy aim.

Competitiveness is a notion, borrowed from microeconomics and competition among firms, that becomes rather complex and hazy when applied to a country. For this reason, a distinction is made below between "essential" and "apparent" competitiveness.

"Essential" competitiveness is, to begin with, analogous to its usage in microeconomics, where it denotes firms' relative ability to compete, and refers mainly to sales cost (including production, finance and marketing costs) but also to other elements, such as product characteristics (including quality, reputation and image), distribution networks, accessibility to

³ For example, Paul Krugman has argued that "...competitiveness is a meaningless word when applied to national economies. And the obsession with competitiveness is both wrong and dangerous"; see, Krugman, P. (1994) "Competitiveness: A Dangerous Obsession" *Foreign Affairs*, March-April. See, also, Krugman, P. (1996) "Making Sense of the Competitiveness Debate" *Oxford Review of Economic Policy*, Vol.12, No. 3.

⁴ Since the deficit is effectively financed by the credit provided by one's trading partners, it is bound sooner or later to provoke a reaction and demand for repayment from the trading partners and creditors.

⁵ See, Kalecki M. (1942) "The Determinants of Profits" *Economic Journal*, final version in Kalecki M. (1971) *Selected Essays on the Dynamics of the Capitalist Economy 1933-1970*, Cambridge University Press, Chapter 7.

⁶ See, Lipsey, R. G. (2007), "Reflections on the general theory of second best at its golden jubilee" *International Tax and Public Finance*, 14(4), 349-364.

markets and any other factor that contributes to a firm's ability to achieve sustained profitability and do consistently better than its rivals.⁷

In the case of a country, in addition to the above, it includes institutional elements, such as the quality and performance of the education system, the legal and judiciary system, labor relations and the functioning of the labor market, market structure and the degree of monopoly, as well as any other institution that contributes to the country's better economic performance relative to other countries sharing the same currency (or having a long-standing stable exchange rate). Such institutions certainly include the banking and financial system, the health and efficiency of which is crucial to the economy's financing, as well as the efficiency of the state in all its regulatory and other functions.⁸

It is evident that "essential" competitiveness may be affected by changes in any of the above elements. Consequently, it may also be affected by changes in monetary and fiscal policy (as well as other policies and conditions, such as a minimum wage or incomes policy or even prospects regarding political developments), which can have an effect on the level of prices and in the financing conditions and borrowing rates (in the latter case, either directly or through changing perceptions of country risk).

"Essential" competitiveness may be contrasted with the related but somewhat different notion, that of "apparent" competitiveness. "Apparent" competitiveness refers to the ability of a country to compete in international markets with countries that do not share its currency, which depends not only on its "essential" competitiveness but also quite crucially on the exchange rate. Thus, when countries do not share the same currency and exchange rates freely fluctuate (which is the usual condition underlying international trade theory), "apparent" competitiveness not only may be differentiated from "essential" competitiveness but becomes all important.

The comparison between the two notions of competitiveness, with respect to their direction of change, is of particular interest and underlines their difference. "Apparent" competitiveness generally changes in the opposite direction to a change in "essential" competitiveness, when countries do not share the same currency. This is because a change in "essential" competitiveness tends to be compensated by a change in the exchange rate.⁹ Thus, for example, an increase in a country's "essential" competitiveness leads to more exports and the ensuing higher demand for the country's currency by foreign importers tends to increase the exchange rate. This makes the country's exports more expensive and its imports cheaper, which is tantamount to a fall in its "apparent" competitiveness. The resulting moderation in exports' attractiveness and concurrent increase in cheaper imports, tends to restore balance in the current account.

⁷ The factors, which are relevant to competitiveness, are studied by economists in settings characterized by monopolistic or oligopolistic conditions. Nevertheless, given the strong preoccupation of economists with perfectly competitive markets and the preponderance of the "perfect competition" assumption in most of economic theory, these factors have received more attention in business and especially marketing theory.

⁸ The OECD country studies, which examine an economy's macroeconomic conditions and structural aspects, cover in effect all the main elements of "essential" competitiveness.

⁹ Given the multitude of factors influencing the exchange rate, especially through capital movements, this is a quite rough tendency and holds on strictly *ceteris paribus* terms, which are assumed in all attempted comparisons.

In trading within a currency union, the member countries' "essential" competitiveness is evidently of paramount importance in determining the intra-union trade balances. But since members also trade with countries outside the currency union, their "apparent" competitiveness is also important in determining their trade balance *vis-a-vis* their trading partners outside the currency union. In the case of a currency union, unlike the previous case of freely floating exchange rates, an increase in a country's "essential" competitiveness does not lower its "apparent" competitiveness. Within the union, a member country's increase in "essential" competitiveness clearly increases its intra-union export share. As there is no compensating change in "apparent" competitiveness to moderate the effect on exports and to restore balance in the current account, the effect of the increase in "essential" competitiveness is, in fact, leveraged.

Moreover, the increase in "essential" competitiveness is also leveraged in its trading with countries outside the union. This is because the exchange rate of the currency union is determined by the weighted average "essential" competitiveness of all its members, in trading as a bloc with the rest of the world.¹⁰ Unless the particular country's trade is large enough to weigh heavily on the determination of the currency union's exchange rate, the exchange rate is hardly affected and the country's increase in "essential" competitiveness is definitely leveraged. In other words, the compensatory change in the exchange rate, which causes the "apparent" competitiveness to move in the opposite direction of any change in "essential" competitiveness thus moderating its effect, is practically absent when a country is a member of a currency union. This is more likely to be the case for any given change in "essential" competitiveness, the smaller the country's share of the union's external trade and, hence, the smaller its importance in the determination of the union's weighted average "essential" competitiveness (WAEC).

Implications of differences between a country's "essential" competitiveness and the union's WAEC

Before assessing the nature of the gain from competitiveness in a currency union, a comparison needs to be made between a country's "essential" competitiveness and the union's WAEC (which, with the current account over time roughly in balance, tends to be reflected in the union's "apparent" competitiveness). If a country's "essential" competitiveness is higher than the union's WAEC, net exports (i.e., exports minus imports) are given a boost while if it is lower net exports tend to decrease. In other words, a country's "essential" competitiveness that is higher than the union's WAEC, favors the appearance (or enlargement) of a surplus in the country's current account while one that is lower promotes and magnifies a deficit. Thus, in achieving current account balance, the common currency's exchange rate is too low for countries with higher "essential" competitiveness than the union's WAEC and too high for those countries possessing lower "essential" competitiveness than the union's WAEC.

It may be noted that so long as the differences in "essential" competitiveness remain unchanged and the union's current account is in balance, the imbalances in the countries' current account can continue indefinitely. It is also worth noting that such current account

¹⁰ The average competitiveness of the currency union reflects the "essential" competitiveness of all the member countries, weighted by their share of the union's trade with the rest of the world. In reference to the union, it constitutes and may be termed the union's "apparent" competitiveness.

imbalances may exist for all countries. Since it is possible that the union's average competitiveness does not coincide with any one country's "essential" competitiveness, it follows that in such a case the common currency's exchange rate will not be appropriate for balancing any country's current account. The extent to which the exchange rate diverges from the one that is required to balance a country's current account, depends on the extent to which its "essential" competitiveness diverges from the union's WAEC. The wider the range of "essential" competitiveness characterizing the different countries in the union, the greater the possible divergence between the currency's exchange rate and the exchange rate needed to balance a country's current account. In other words, the potential inappropriateness (or "wrongness") of the currency's exchange rate for a country participating in the currency union to achieve balance in its current account, is aggravated, when the differences in "essential" competitiveness among the union members are greater.

It may be surmised that a currency union consisting of countries with markedly different "essential" competitiveness, necessarily results in unbalanced current accounts for at least the countries with the highest and lowest "essential" competitiveness. For these countries, the currency's exchange rate is most likely inappropriate and they will inevitably have a persistent surplus or deficit in their current account. The question is, how does the "wrong" exchange rate affect them?

Let us examine first the case of the high¹¹ "essential" competitiveness country with a persistent surplus in its current account. The surplus ensures an augmented volume of profits.¹² Thus, *ceteris paribus*, not only profits but also output and employment are all greater (when compared to a situation in which the current account is balanced). In other words, the surplus provides an expansionary impetus to the economy.

Dynamically, it tends to actuate rising wages and prices (especially, the closer capital and labor resources are to full employment). It, therefore, tends concurrently to lower "essential" competitiveness, narrow the gap between "essential" and "apparent" competitiveness and reduce the surplus. The tendency to eliminate the surplus and establish a current account balance, even if attenuated, is nevertheless present. The adjustment mechanism is more sluggish than it would be if the country were not in a currency union but it is still operative. It may even be more sluggish in the case of a country that accounts for a large share of the external trade and weighs heavily in the determination of the exchange rate. In such a case, any given reduction in "essential" competitiveness (due to rising prices) is likely to reduce also the exchange rate, thus slowing down the elimination of the gap between "essential" and "apparent" competitiveness.

Turning now to a country with "essential" competitiveness that is lower than the union's average, the exchange rate is too high for balance in its current account and it will show a deficit. A deficit implies smaller profits and, *ceteris paribus*, smaller profits imply lower output and employment. Thus, the deficit imparts a contractionary bias to the economy. The dynamic tendency is for lower wages and prices to reduce the deficit, improve the "essential" competitiveness and, by bringing the latter closer to the union's average, promote adjustment. The adjustment mechanism is blunter than it would be in the absence of the currency union but it is still in operation.¹³

¹¹ High relative to the union's average.

¹² See, Kalecki, *ibid.*, for the conditions under which profits increase by exactly as much as the surplus.

¹³ It is as if a speed bump slows down the road to adjustment.

Despite the existence of an automatic adjustment mechanism, a currency union with a balanced foreign account can shield members from correction by market forces, if they choose to override this mechanism. By following policies that lead to high or low “essential” competitiveness, it allows surpluses (by the highly competitive countries) and deficits (by the least competitive countries) to develop and be sustained without hindrance. Such imbalances may in fact continue practically indefinitely, so long as the associated intra-union capital flows are not blocked and allowed to go on.

The nature of Germany’s gain from the euro

In order to elucidate the nature of Germany’s gain from the euro, a brief historical detour needs to be made.

It is widely believed that the euro was not only an economic project but also, if not primarily, a political one that was initiated by France rather than Germany.¹⁴ The latter assented to the French demand for a decisive step in European integration, as a show of good will and a price to pay for German re-unification. The process of re-unification proved to be quite a burden to Germany and, at the time of the euro’s introduction about a decade later, its “essential” competitiveness was at a relatively low ebb, its growth rate lagged the European Union average, its current account was in deficit and it was considered “the sick man of Europe”.¹⁵

It was only after the introduction of the euro and its initial sizeable fall against the US dollar,¹⁶ that Germany’s current account was balanced (following a decade of being in deficit), while its growth performance remained weak in the first years following the introduction of the euro. The turning point seems to have taken place in 2004. From that year onward, Germany’s economic performance began to improve decisively, becoming clearly and increasingly superior to the Eurozone’s average.

It is still debated whether this turnaround is primarily due to the immediately preceding Hartz reforms, which deregulated the labor market with a series of measures between 2002 and 2005, or whether it was the result of longer-run forces, which gradually transformed the German economy. The Hartz labor market reforms reduced the duration and level of the unemployment benefits and established the institutional preconditions for the enlargement of part-time employment and the creation of a segmented, dual labor market. This probably contributed to the containment of wage rises and to a lesser extent of unit labor costs, relative to the Eurozone average, but it has been disputed whether it has been the main influence in the determination of Germany’s economic performance.¹⁷ It seems more likely that the

¹⁴ For an official recognition, see Van Rompuy, H. (2014) *Europe in the Storm: Promise and Prejudice*, chapter 2, Davidsfond, Uitgeverij.

¹⁵ See, *The Economist* (1999) “The Sick Man of the Euro”, June 3. But even then, Germany’s “essential” competitiveness was not lower than the European average.

¹⁶ From its introduction on 1/1/1999 at a value of \$1.179, the euro dropped to a minimum of \$0.825 on 25/10/2000 before gradually recovering its initial value by May 2003. (It reached the highest ever value of \$1.60 in July 2008, fell under \$1.10 in early 2015 and is hovering in the \$1.10-1.14 range since then).

¹⁷ See, Storm, S. and C.W.M. Naastepad (2015) “Germany’s Recovery from Crisis: The Real Lessons” *Structural Change and Economic Dynamics*, 32 (1): 11-24. Also, Storm, S. and C.W.M. Naastepad (2015) “Myths, Mix-ups and Mishandlings: Understanding the Eurozone Crisis” at:

<http://ineteconomics.org/ideas-papers/research-papers/myths-mix-upsandmishandlings-what-caused-the-eurozone-crisis> These economists argue convincingly that labor unit cost was of little import to the development of a surplus in the balance of payments and that superior technology and high quality of industrial products, in combination with the rapidly rising demand for such products from China and

process of transforming the economy started much earlier, in the early nineties if not before, with the gradual internationalization of the German industry. The shifting of production abroad initiated the containment of unit costs and the international outlook of the German economy.¹⁸ Moreover, the flexibility of industrial relations, which permit collective bargaining at the level of the firm, and the traditional institutional characteristics of the German labor market seem to be more important than the Hartz reforms, in explaining the performance of the German economy.¹⁹

Nevertheless, the Hartz reforms have acquired an important symbolic role, in demonstrating the German political elite's determination to safeguard and promote competitiveness in the context of the Eurozone. It must be remembered that they were instituted by a socialist government, which early in its term resisted austerity and committed the first ever transgression of the Maastricht Treaty, by running repeatedly a budget deficit exceeding 3% of GDP. This same government proved willing to confront the trade unions over the unpopular Hartz reforms, which in all likelihood contributed eventually to its electoral defeat. Thus, whether the reforms actually improved or not the economy's performance in a crucial way, a strong message was given that competitiveness is the paramount objective for the whole political class, including the socialists.

It may be noted that the strong concern with competitiveness was not a new development but a continuation of a tradition which dates at least since the first years after the Second World War.²⁰ Throughout the post-war period, Germany's economic policy was steadfastly orientated to the achievement of surpluses in the current account. Consequently, competitiveness has been traditionally a strong concern and the institutional elements of competitiveness were well developed at the time of the Eurozone's creation. Moreover, the still fresh in memory experience of re-unification and consequent collapse of the East German economy following the adoption of a common currency, demonstrated quite clearly the crucial importance of competitiveness in a currency union.²¹ Thus, the socialist government's determined implementation of the Hartz reforms confirmed beyond any doubt that competitiveness would continue to be a prime concern in the new Eurozone era. In these circumstances, given the German economy's quite high "essential" competitiveness at the Eurozone's start and favorable conjuncture of a strong demand from China and other emerging markets for Germany's technologically advanced machinery products, it is not surprising that exports reached 50% of GDP.

other growing emerging markets, were much more important factors in explaining developments in the balance of payments. They also point to the differences in productivity between Germany and the Eurozone, which have been increasing since the re-unification of Germany at least a decade before the Hartz reforms.

¹⁸ For an informative analysis of the German political economy, see Barasin, C. (2013) *Germany: A Global Miracle and a European Challenge*, Brookings Global Economy and Development, Working Paper 62, May.

¹⁹ See, Dustmann, C., Fitzenberger, B., Schönberg, U., & Spitz-Oener, A. (2014) "From sick man of Europe to economic superstar: Germany's resurgent economy" *The Journal of Economic Perspectives*, 28(1), 167-188.

²⁰ From 1950, if not earlier, Ludwig Erhard emphasized the need for the "internal discipline" that could ensure price stability, in order to achieve the prime target of export growth. See, Sauramo P. "Germany's Success: A Finnish Perspective" in Unger B. ed. (2015) *The German Model: Seen by its Neighbours*, SE Publishing.

²¹ Chancellor Kohl's insistence on the exchangeability of the Deutschemark and the East German mark at a rate of one to one was the final nail to the coffin of the East German economy. This parity "did not correspond to reality", in the view of respected central banker Karl Otto Pohl and seems to have provoked his resignation from the Bundesbank in May 1991, mid-way through his second, eight-year term.

In conclusion to this historical detour, Germany entered the Eurozone with a head start in “essential” competitiveness and begun early on a politically arduous, sustained effort (from 2002 to 2005) to implement structural reforms in order to further augment it. Thus, Germany benefited from the start and, whether as a result of this effort to reform the labor market or, more likely, the international conjuncture and its prior industrial specialization, it managed to transform itself from the “sick man of Europe” to the “model economy of Europe”. Germany’s claim to having become a model economy is based on the fact that in 2007 it achieved a current account surplus equal to 7% of GDP and managed to overcome the 2008 crisis first among all European economies, surpassing the pre-crisis GDP in just three years. This success is closely linked and, to a large extent, due to Germany’s participation in the Eurozone and, more specifically, to the leverage of Germany’s competitiveness made possible by the Eurozone.

Membership in the Eurozone tends to reinforce the “essential” competitiveness of a country (like Germany) that has higher “essential” competitiveness than the union’s average and to lessen the “essential” competitiveness of a country (such as Greece) that has lower “essential” competitiveness than the union’s average. To put it differently, and more generally, membership enables those countries which are more “essentially” competitive than the average to have an exchange rate that is lower than would have been the case if they were not members, thus leveraging their “essential” competitiveness vis a vis other countries (including, possibly most significantly, the rest of the world).²² Conversely, membership obliges countries with below the Eurozone’s average “essential” competitiveness to have a higher exchange rate than what would be the case outside the currency union, thus reducing further their “essential” competitiveness vis a vis all other countries.²³

An analogy from the world of competitive sports may be helpful here. The handicap system used in diverse sports, such as golf or horse races, is analogous to the movements in the exchange rate following a change in relative “essential” competitiveness. For example, according to horses’ relative performance in training and in previous races, they are saddled with different weights, so as to equalize the chances across all horses competing in a race. In this setting, a currency union is like grouping the horses of a stable together and assigning a single common handicap to all of them, on the basis of their average performance. Such an arrangement, would obviously grant the best performing horses of the stable an unfair advantage and, by the same token, disadvantage the worst performing ones when competing with other horses, which have been given a handicap based on their individual performance.

Given that the Eurozone’s current account has been roughly in balance (or, more recently, small surplus), the euro’s exchange rate tends to roughly reflect the Eurozone’s overall competitiveness relative to the rest of the world. The euro’s exchange rate has resulted in large surpluses for Germany and, to a lesser extent, some Northern European countries and equivalent deficits for mostly Southern European countries. In other words, the euro’s exchange rate was too low for balance in the current account of Germany and the North, while being too high for balance in the current account of the South. In this way, the union’s exchange rate has leveraged in opposite directions the “essential” competitiveness of member countries; it augmented the “essential” competitiveness of Germany and the North and weakened the “essential” competitiveness of the Southern countries.

²² It is not *all* other countries because countries that are members of the union and happen to have higher “essential” competitiveness gain an even bigger leverage, since their exchange rate would have exceeded the union’s exchange rate by a greater margin.

²³ Except those members of the union, which have an even lower “essential” competitiveness.

This effect becomes evident if we imagine Germany outside the Eurozone. Then, its exchange rate against the US dollar would tend to be higher and, as a consequence, it would be “effectively” less competitive. More importantly, unlike what has been the case whilst a member of the Eurozone, Germany would find that a surplus in its foreign account is not sustainable. Any attempt to manipulate the exchange rate and fix it at a lower level, would provoke protest and retaliation from its trading partners. Conversely, for the remaining countries within the Eurozone, the euro’s lower exchange rate would increase their “apparent” competitiveness and their current account would be improved. As a result, the increase in aggregate demand from higher net exports would enable their economies to grow.

Such a course of action for reviving the Eurozone economies has, in fact, been proposed by George Soros, who has argued repeatedly since 2012, that if Germany is not willing to bear the cost of leadership in the creation of a federal European state, it should leave the Eurozone.²⁴ This is contrary not only to the economic but also to the political interest of Germany, which has managed through the Eurozone to become the undisputed leading power in Europe.²⁵ Moreover, the Euro crisis has provided in a number of ways an additional economic benefit to Germany.

To start with, the contractionary policies and high unemployment in the Southern countries, and particularly in Greece, have caused a sizeable influx of young immigrants from these countries into Germany. This alleviated the tightness in the German labor market and, given that a high proportion of these immigrants (especially from Greece²⁶) were highly educated and well trained, this addition to the German labor force represented a considerable economic gift from the Southern countries (which had borne the cost of raising and training this labor force) to Germany.

A second major way in which Germany benefited from the Euro crisis, was from the inflow of capital from the Southern countries. In particular, the fear of Grexit and its potential domino effect have prompted a large transfer of capital from the South, in the direction of German government bonds, the Frankfurt stock exchange and real estate in various German cities. This had a stimulating effect on the German economy and resulted in an increase in the wealth of German equity and real estate owners, as well as a reduction in the cost of finance for both German firms and especially the German state.

An estimate of the benefit of lower borrowing costs for the German state, that was occasioned by the Greek crisis, indicates that it easily exceeds the cost of the Greek crisis to the German taxpayers.²⁷ More specifically, the study estimates how the German bunds’ price reacted to disquieting news concerning developments in Grexit prospects between the spring of 2010 and the summer of 2015. Such news increased the demand for and the price of bunds, thereby lowering interest rates and borrowing costs. The benefit to the German state from news worsening and increasing insecurity is estimated at well over 100 billion euros, while the total commitment through all channels (including the European Stability Mechanism) of the German state to the rescue of the Greek economy was about 90 billion euros until the middle of 2015. This benefit represents about 3% of German GDP and certainly contributed to the balancing in 2014, for the first time in many decades, of the German government budget.

²⁴ See, *Spiegel Online*, 26 June 2012, www.spiegel.de/English/Site/Europe/EuroCrisis

²⁵ See, Beck U. (2013) *German Europe*, Polity Press.

²⁶ It is estimated that about 3,500 medical doctors and 30,000 scientists have emigrated from Greece in the last 5 years; see, www.huffingtonpost.gr/loislabrianidis/2408_b_8520596.html

²⁷ Dany G., Gropp R. E. and von Schweinitz G. (2015), *Germany’s Benefit from the Greek Crisis*, Leibniz-Institut für Wirtschaftsforschung Halle, IWH Online 7/2015. Halle (Saale).

The total benefit to the German economy, including the gain for German firms from lower labor and borrowing costs and the increased wealth of equity and property owners, is not easy to estimate but is certainly considerably greater. Of course, it is not evenly shared and this probably accounts for the fact that it is not recognized by the German public opinion. Those who evidently gain are the equity owners, real estate property owners and employees of large export-oriented firms; the gain for the rest of the working class and especially the lowly-paid part-timers is disputable while interest earners, such as savers and insurance organizations, seem to lose out.²⁸

A third source of benefit emanating from both the euro and Greek crises, is the euro's weakness, which has resulted recently in a current account surplus of 3% of the Eurozone's GDP. The euro's weakness increases the "apparent" competitiveness of all Eurozone countries and leverages further Germany's "essential" competitiveness. The benefit from the weaker euro is more pronounced for those countries, such as Germany, that trade the most with the rest of the world.

Finally, an implication of the above is that Germany benefits also on a broader important issue of political economy. This is because uncertainty, following the shattering of unfounded confidence by the euro crisis, is inherent to the present state of the Eurozone and can be overcome only by a determined advance in the completion of banking and fiscal union and a decisive step towards federal Europe. A protracted state of uncertainty surrounding the Eurozone's prospects is damaging to the weaker members but not to Germany. Consequently, Germany has an invaluable bargaining advantage in determining the shape of any federal solution; in contrast to the damage incurred by other members, stalling until it gets its own way is for Germany not only costless but actually beneficial.

To briefly recapitulate and conclude, Germany gains considerably from its membership of the Eurozone, through leveraging of its "essential" competitiveness. In addition, it further gains from the euro crisis and the continued uncertainty about the Eurozone's future. These gains can be maintained, so long as the Eurozone is not totally dismantled but continues in some form with Germany being a member. All that is required for Germany to be able to gain from the leverage, is that its "essential" competitiveness remains higher than the Eurozone's weighted average. Of course, the greater the difference between its "essential" competitiveness and the Eurozone's average, the greater the leverage and the gain. Finally, though the uncertainty over Grexit served well the purpose so far, it is not essential for gaining from uncertainty. The preservation of uncertainty by some other means may also be effective, so long as Germany retains its superior "essential" competitiveness.

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²⁸ The loss of insurance organizations from lower interest needs to be set against their gain from the increase in contributions paid by the greater number of workers (due to both lower unemployment and more immigrants).