

Tullett Prebon Research, a blog by Dr Tim Morgan

The gift that keeps on taking – Germany and the euro

by Tim Morgan on December 10, 2012

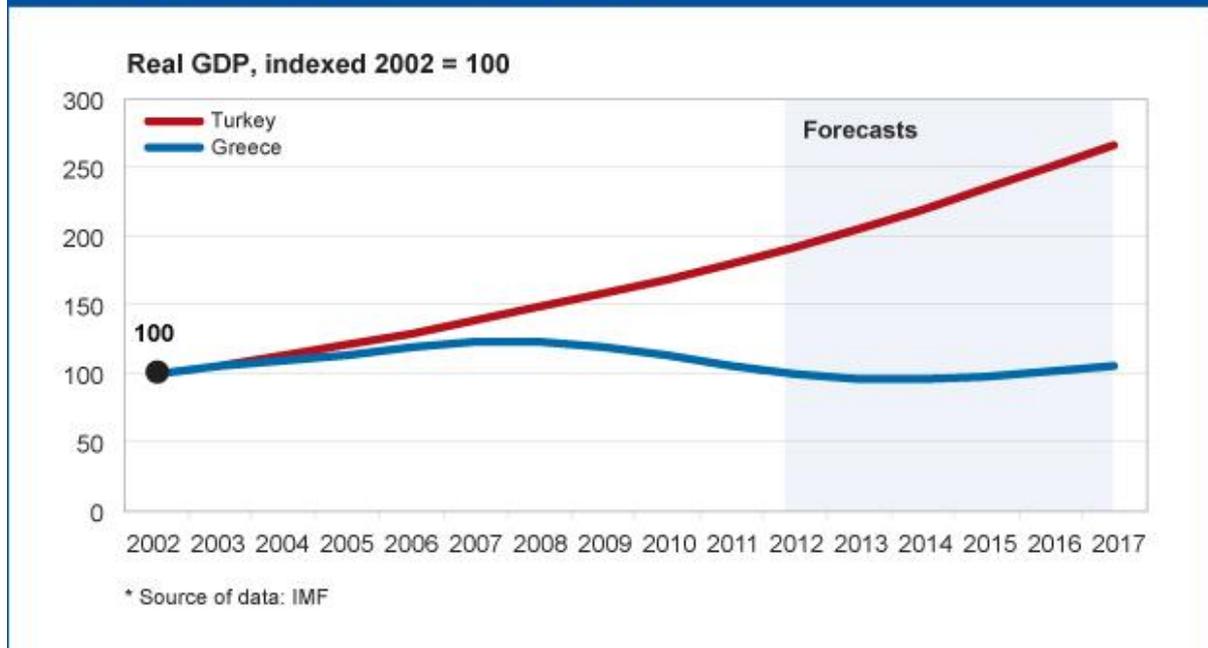
Germany has been, for many years, a huge net beneficiary of eurozone membership, but there has been a decisive turn in the cost-benefit equation. Do Germans realise that, because the single currency is structurally unworkable, bail-outs to the competitively-disadvantaged southern euro countries are not a temporary phenomenon, but are going to turn into a perpetual life-support system funded, ultimately, by Germany alone?

It is a sign of the times that, just as Alex Salmond's SNP is wondering whether an independent Scotland could get in to the European Union, many politicians in Westminster are asking themselves if Britain should get out. The Scottish position is a strange one, with EU membership now close to the hearts of nationalists who, not so long ago, craved membership of an "arc of prosperity" which included more non-members (Norway, Iceland) than members (Ireland). Whilst the Irish "Celtic tiger" is now a rug, Norway continues to prosper outside the EU.

In the inner circle of the eurozone, meanwhile, people in countries such as Portugal and Spain are waking up to the reality that the single currency, once a political dream, has become an economic nightmare. Because the euro system provides neither automatic stabilisers nor economic harmonisation in return for exchange rate rigidity, these competitively-disadvantaged nations are being forced into processes of internal devaluation which are as painful as, ultimately, they are futile.

In particular, Greece – which, despite its own profligacy, is also a victim of the system – must wonder quite what kind of blessing euro membership has been, particularly where economic comparisons with Turkey are concerned (see chart).

Turkey v Greece, Real GDP, indexed, 2002 - 2017*



The country which should really be asking itself tough questions about the euro, however, is not Portugal, Spain or even Greece, but Germany. Germans are unlikely to relish the irony that their country – hitherto a big net beneficiary of the single currency – now faces an interminable process of bailing out the weaker members.

What most Germans may not realise is that the eurozone crisis isn't (as they are so often told) a temporary problem, imposing one-off costs on German taxpayers. Rather, it is a structural breakdown for which costs can only continue to mount. As we explained in a [recent report](#), the single currency simply doesn't work. As any economist could have explained before the project even began, monetary and fiscal policy need to work together, so combining a single currency with a multiplicity of budgets was always going to be a recipe for disaster.

So it has proved, most obviously for the southern member countries. Portugal, Spain and others have been victims of a system which has crippled their competitiveness whilst stripping them of the usual – devaluation – solution to such problems.

The country facing the toughest decisions, though, is surely Germany. Hitherto, euro membership has been advantageous for Germans. Competitiveness has improved – which would have been far less likely to have happened under a strong deutschemark – and this has been reflected in enormous trade surpluses.

German voters may or may not lose sleep over the widening imbalances in the Target2 system, but they should be getting very worried indeed about the price-tag attached to eurozone membership. They would worry even more if they realised that there can be no end to the bail-out process, because the central contradiction of the “one currency, multiple budgets” system means that Greece (et al) can never cut their way back to competitiveness. They will be living on a drip-feed, life-support system of bail-outs for as long as the euro system continues in its present form.

This problem is set to become even worse for Germany, because France, which hitherto has shared the German burden, is lurching ever nearer to disaster under the bizarre policies of M. Hollande.

For Germany, membership of the euro is going to be “the gift that keeps on taking”. When that pfennig drops, the Germans are likely to want out.