Angela Merkel did not save the euro, she just bandaged it up

By Eric Reguly
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On the day before the opening of the London Olympics in July, 2012, Mario Draghi, the newish president of the European Central Bank, popped into London to say a few words at the Global Investment Conference at Lancaster House. I was there, expecting him to say nothing important on the eve of the greatest sporting event the city had ever hosted.

Mr. Draghi surprised us all. At the time, Europe was in the fourth year of the financial and debt crises and there were still open questions about whether Greece would bolt from the euro zone of if Italy would require a bailout. In his usual unflappable style, he said the crisis had gone on too long and promised the ECB "would do whatever it takes to preserve the euro."

True to his word, a week later, the ECB unveiled a novel firefighting program called outright monetary transactions (OMT), which would buy the sovereign bonds of any country that was on the verge of getting shut out of the debt markets. Even though OMT was never put into action, its mere presence was enough to put the crisis in reverse. Sovereign bond yields plunged across the euro zone and Italy, whose collapse would have wrecked Europe, no longer had to worry about defaulting.

Had Mr. Draghi saved Europe? While the ECB flaunts its independence, I (and other voyeurs of the crisis) have always believed it could never go massively off script – as it did with OMT – without at least the tacit approval of Germany, which meant getting the nod from Chancellor Angela Merkel. Germany was, and still is, Europe's biggest and most successful economy and Ms. Merkel its most powerful leader. The ECB was largely designed to Germany's liking and was stuffed with former German central bank officers. It was Ms. Merkel who kept the euro intact. Mr. Draghi was her messenger boy.

Ms. Merkel is now on her way out. This week, a year into her fourth term as chancellor, she announced she would step down as leader of her centre-right Christian Democratic Union (CDU) party and not seek re-election as chancellor in 2021, when the next federal election is due.

In recent days, her political obituary has been written everywhere, and many – perhaps most – of the reports have been rather flattering. Ms. Merkel, with Mr. Draghi's ECB doing the heavy lifting, spared the euro zone from certain destruction in 2011 and 2012. She approved the bailouts of Greece, which kept it inside the euro zone, albeit at terrible cost to the Greek people. She may have played a key role in the effective ouster of Silvio Berlusconi as Italy's prime minister in late 2011 when he appeared to be paying scant attention to Italy's soaring bond yields. (Mr. Berlusconi later accused Ms. Merkel and other leaders of orchestrating a coup against him because he refused to take a bailout loan from the International Monetary Fund.) Later, she supported the €2.7-trillion ($4.03-trillion) quantitative-easing program and pushed euro zone countries to clean up their fiscal acts.

While I agree that Ms. Merkel was instrumental in saving the euro during the crisis, I also think she's guilty of having taken a bandage approach. The euro is still an ill-fitting currency for the 19 countries that use it and could yet rip the euro zone apart. The two populist parties that came together last spring to form the Italian government had both wanted to hold a referendum on the euro (a stance they have now dropped), and are enjoying tormenting Brussels by proposing a

budget that defies the European Union's debt rules.

Ms. Merkel's Germany was, and remains, a surplus machine exporting economic hardship throughout Europe. It runs a huge trade surplus and the world's biggest current-account surplus, worth about 8 per cent of gross domestic product. A positive current-account surplus, in effect the glut of savings over investment, indicates net lending to the rest of the word. Germany is a huge net lender, which generates high profit and low unemployment at home. Incidentally, it was able to fuel the export machine partly by suppressing German wages.

But here's the catch for the rest of Europe and other countries that do not have German-style export-driven economies. To offset German surpluses, countries such as Italy must spend like mad, running fat deficits to keep buying highly competitive German products such as Volkswagens and Miele dishwashers. In some cases, these persistent deficits lead to crises, as it has in Southern Europe.

Market commentator Marshall Auerback of Bard College's Levy Economics Institute says there is a paradox in Germany's economic model. The weak Southern European countries have to live beyond their means to soak up the German surpluses. But doing so lands them in economic trouble, hence the need for austerity – lower spending and lower wages – which dampens growth. Mr. Auerback calls this cycle an "economic death loop" for the deficit countries. In Southern Europe, the deficit countries cannot use currency devaluations to make themselves more competitive; the euro is not theirs.

Throughout her reign as chancellor, Ms. Merkel never recognized that German surpluses were part of the problem, not part of the solution. She viewed the surpluses as virtuous, a sign of the mighty German economic engine revving ever higher. The German savings glut persisted and German investment went lacking, suppressing the domestic demand that, had it been high enough, could have levelled the current account playing field. The deficit countries are still suffering a decade after the crisis. No wonder their love for the euro is waning. Ms. Merkel did not save the euro, far from it. She bought time by kicking the can down the road.