

Angela Merkel's comeuppance is Europe's misfortune

No one should be surprised by the position in which Angela Merkel and Europe find themselves today. But only a dangerous fool would celebrate



German Chancellor Angela Merkel. Photo: AP

One of the most common mistakes European leaders make in interpreting US President Donald Trump's hostility toward America's traditional allies is to assume that all of this is unprecedented. Nothing could be further from the truth.

"My philosophy is that all foreigners are out to screw us, and it's our job to screw them first." Thus argued John Connally, then-US secretary of the treasury, in 1971, in his successful bid to convince president Richard Nixon that the time had come to punish Europe by pulling the plug from the Bretton Woods system.

What distinguishes today's situation from the one Europe faced in the 1970s is the Weimar-like implosion of Europe's political centre. In the 1970s, America's financial assault on Germany, France, and Britain was met by a united European establishment. By contrast, today's defenders of the European status quo must

fight on two fronts: against Trump's encroachments and, within Europe, against the likes of Matteo Salvini and Luigi di Maio, the rising stars of Italian politics who, despite their parliamentary majority, were denied the right to form a government by the country's besieged pro-establishment president.

The US announcement of tariffs on steel and aluminum imports, while ostensibly aimed at China, was also the latest signal to Europe that the Trump administration's "America First" rhetoric must be taken seriously. Next came the US withdrawal from the Iran nuclear deal, which offered Trump yet another splendid opportunity to luxuriate in Europe's powerlessness, and especially that of German Chancellor Angela Merkel.

Forced to insist that Germany would uphold the Iran deal, Merkel found herself immediately humiliated as one German company after another pulled out of Iran. All were unwilling to challenge US financial might or to forfeit the tax cuts Trump had delivered to almost 5,000 German companies with a combined balance sheet of \$600 billion. And, before the Iran shock had been absorbed, the US threatened a 25% import tariff on cars, which would shave at least \$5 billion annually from German exporters' revenues.

The scale of Germany's difficulties can be comprehended only once their causal link with developments in Italy is grasped.

Just as it is Trump's aim to overturn the global system from which Germany has benefited for decades, Salvini and di Maio see the disintegration of the euro as a welcome development and a boon to their anti-immigration campaign. Just over three years ago, when I was negotiating on behalf of Greece with the German government to end the combination of unsustainable loans and hyper-austerity that are still crushing my country, I warned my interlocutors at a Eurogroup meeting of eurozone finance ministers:

"If you insist on policies that condemn whole populations to a combination of permanent stagnation and humiliation, you will soon have to deal with anti-Europeanist xenophobes who see it as their vocation to disintegrate the EU"

That is precisely what is happening now. Having vetoed much-needed EU reforms, Merkel's successive governments guaranteed Europe's fragmentation. Germany's establishment media are now referring to the Italian economist, whose appointment as finance minister was vetoed by the president, as "Italy's

Varoufakis". That moniker obscures a fundamental difference: I wanted to keep Greece in the eurozone sustainably and was clashing with Germany's leaders in favour of the debt restructuring that would make this possible. By crushing our Europeanist government in 2015, Germany sowed the seeds of today's bitter harvest: a majority in Italy's parliament that dreams of exiting the euro.

The causal link between Germany's two political headaches has an economic basis. Trump understands one thing well: Germany and the eurozone are at his mercy, owing to their dependence on large net exports to the US and the rest of the world. And this dependence has grown inexorably as a result of the austerity policies that were first tried out in Greece and then implemented in Italy and elsewhere.

To see the link, recall the "fiscal compact" to eliminate structural budget deficits that Germany insisted upon as a condition of agreeing to bailout loans for distressed governments and banks. Then note that this pan-European austerity drive took place against the backdrop of excess savings over investment. Finally, note that large excess savings and balanced government budgets mean large trade surpluses—and thus the increasing reliance of Germany, and Europe, on massive net exports to the US and Asia. In other words, the same incompetent policies that gave rise to the xenophobic, anti-Europeanist Italian government also bolstered Trump's power over Merkel.

Europe's inability to get its own house in order has engendered a new Italian majority that is planning to expel a half-million migrants, blowing fresh winds into the sails of militant racists in Hungary, Poland, France, Britain, the Netherlands, and, of course, Germany itself. Meanwhile, with Europe too enfeebled to tame Trump, the US will aim to force China to deregulate its financial and tech sectors. If it succeeds, at least 15% of China's national income will gush out of the country, adding to the deflationary forces that are breeding political monsters in Europe and in the US.

All of this was predictable—and in fact was predicted. So no one should be surprised by the position in which Merkel and Europe find themselves today. But only a dangerous fool would celebrate. **©2018/Project Syndicate**

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