

# “GERMANY” AND THE CONTAGIOUSNESS OF MONETARY STABILITY

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**Abstract** In this paper, I examine an aspect of stability-oriented fiscal politics shaping the social ramifications of austerity. The term *contagion* is frequently used to describe the spread of liquidity shortages (for example because of solvency doubts) from asset to asset within a specific asset category, such as sovereign bonds. Thus, for example, contagious doubts about fiscal solvency spread from Greece to Portugal in 2010. Consequently, austerity policies are uniformly applied to the entire asset class, particularly when a supposedly successful example of austerity policies is contained in it – Germany in the Eurozone case. However, I argue that this implies a continuity between Germany, Greece and Portugal the term contagion does injustice to (or purposefully obfuscates). It implies that Germany is a stable core of fiscal solvency and monetary stability threatened by a circulative dynamic outside of its control. The susceptibility of this core to the circulative dynamic of contagion, however, implies that *stability* is a circulative – a *contagious* – item just as much as contagion is. This has two implications. The idea of *virtuous* fiscal policies must be recognized as what it is – a stratagem circulating by the same contagious dynamics as *contagion*. By the same token, market assessment need not be the measuring rod of policies as which it is currently regarded.

**Keywords** Eurozone crisis, contagion, austerity, virtuous fiscal policies, stability

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## 1. Introduction

The self-referentiality of so-called market signals has long been an object of discussion in the political economy of financial markets. This holds in particular in the context of the Great Recession following the 2007/2008 crisis. For example, economic literature has discussed self-fulfilling prophecies where asset price movements follow predictions of asset price movements (Runde 1990; Lux 1995). In the same vein, sociological and anthropological literature has argued that financial statements are performative speech acts – ostensible assessments of reality create the reality they supposedly assess (MacKenzie and Millo 2003; Ho 2009). In this paper, I examine a specific aspect of this self-referentiality in the context of the Eurozone crisis.

I focus my discussion on the notion of 'contagion.' In the conventional narratives of the Eurozone crisis, 'contagion' arose from the policies of European peripheral governments (Shambaugh 2012).

When the Greek annual deficit projection had to be corrected from 15 % in October 2009, its overall

debt-to-GDP ratio (126.8%) became a source of concern for lenders who – in the conventional narrative – subsequently directed this concern to the structural weaknesses of Ireland (with its overinflated banking sector), Portugal (with a debt-to-GDP ratio of 83.6% in 2009), Spain (with a real estate bubble) and Italy (with chronic macroeconomic instabilities) (Berend 2013; Eurostat 2015). These countries were then grouped together as a common source of concern for international lenders: the GIIPS countries, subject to multiple European bailouts (Bastasin 2012).<sup>1</sup>

The concern, it is argued, resulted from the exposure of European banks to the debt issued by these countries: if a bank holds government bonds and the country is unable to service its debts, these bonds will be worthless. Bank exposure to GIIPS government bonds was high across Europe in 2009 (Lucarelli 2011: 211). 'Contagion' thus marks, in the conventional narrative, the spread of fears about governments being unable to service their debts – inferred from already existing debt-to-GDP ratios – as well as fears about bank exposure to such governmental inability (Coeuré 2013). In this narrative about the mechanisms at work in the Eurozone crisis, Germany occupies the 'safe haven' position: it is assumed to be the European benchmark of prudent and virtuous economic policies which make it an epicenter of stability (Belke 2012). Only by virtue of peripheral contagion and its effects on the European banking system did Germany come to be implicated, eventually contributing to bailouts and lending guarantees to such an extent that peripheral 'contagion' affects Germany as well.

Proceeding from an examination of lending patterns during the crisis, however, I argue that Germany is not the virtuous pole of stability and tranquil fiscal prudence it is assumed to be in this argument. Nor, as I argue, are peripheral governments the recklessly profligate actors endangering Eurozone banking operations the way the commonly given narrative has it. Rather, my analysis shows that, first, the Eurozone crisis is a series of occurrences on bank balance sheets which are then transposed to governmental policies. Secondly, I argue that the contagious dynamics to which

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1 The order of countries in this acronym is irrelevant: often, one will find less neutral versions, like PIIGS and GIPSI.

European peripheral countries are subject are exactly mirrored by procyclical lending improvements in the European core – particularly for Germany. This means that, thirdly, German fiscal purity is much less of an autonomous result of German policies and much more of a result of self-referential market lending practices. Fourth and finally, I argue in this paper that this self-referentiality is as 'contagious' as that denoted by the term 'contagion': 'stability' radiates through the Eurozone as much as 'contagion.'

My argument proceeds in three steps. In the second section of this paper, I discuss the term 'contagion.' I show that the assumptions upon which the notion is based within the conventional narrative do not, in fact, support this narrative: particularly, the argument that markets merely react to governmental policies – reckless peripheral ones in this case. To this end, I examine the technical role sovereign bonds play on bank balance sheets, as well as the political role sovereign bonds play when they are used for debt roll-overs creating the means to bail out national banking systems. I thus agree with Mark Blyth that, in the Eurozone crisis, “[w]hat were essentially private-sector debt problems were rechristened as 'the Debt' generated by 'out-of-control' public spending.” (2015: 73) Consequently, 'contagion' ceases to be a descriptive term analyzing government behavior, and becomes a prescriptive term structuring their behavior.

In the third section, I draw a conclusion from the previously established observation that the Eurozone crisis is an occurrence primarily situated on bank balance sheets. If this is the case, I argue, the pre-2009 credit exuberance in peripheral countries must be interpreted as the exact reversal of the post-2009 crisis. Awash in Northern European and American liquidity, European sovereign bond markets acted on inferences vis-à-vis the stability of the GIIPS countries, just like they did during the crisis. Here, the result was an abundance of lending rather than an abundance of caution. Yet, the structure of lending operations remains the same: during the crisis, observations on Greece gave rise to inferences about Ireland and Portugal, while prior to the crisis, observations about Germany gave rise to inferences about the remainder of the Eurozone.

In the fourth section, I elaborate on the structure of these observations about Germany. An analysis of the lending conditionalities and funding structure of the European bailout facilities EFSF (European Financial Stability Facility, operating since 2011) and ESM (European Stability Mechanism, since 2013) shows that, like the inferences about the GIIPS countries discussed previously, markets did not react to actual observations about Germany, but rather to themselves. I show that Germany's status as a fiscally sound economy, a status which gives it the necessary credibility to stabilize the credit ratings of EFSF and ESM, is in turn derived from market lending behavior. The very flights-to-safety which give rise to 'contagion' in the periphery, allow Germany to occupy a position of 'stability.' Thus, 'stability' is as much an inference – socially constructed within market lending operations – as 'contagion.' The Eurozone crisis is therefore much less a sovereign debt crisis as is commonly assumed.

## 2. Contagion

The primary site of the so-called Eurozone crisis are European banks' balance sheets (Acharya and Steffen 2013). Prior to the 2007/2008 crisis, European interbank markets were embedded into global streams of wholesale funding from money-market funds, insurance companies, pension funds, and other global financial actors (Giannone et al. 2011: F469-F470; Guillén 2012: 50). In accordance with theoretical predictions (Wolf 2002: 45), procyclical credit movements exacerbated the situation for Eurozone banks after the collapse of Lehman Bros.: in July 2007, German IKB was affected by global counterparty contagion; in August 2007 French BNP Paribas, and so forth (Claessens et al. 2010: 274; Giannone et al. 2011: F470; ECB 2013: 17).<sup>2</sup>

Sovereign bonds issued by European governments are relevant for the crisis because of the role they play on banks' balance sheets. European banks hold sovereign bonds as tier 1 capital since the

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2 It is noteworthy that the close connections between the 2008 subprime crisis and the European crisis are not just negative. Through global interconnections, 35 non-American banks were able to receive money out of the U.S. Troubled Asset Relief Program (TARP), showing – quite predictably – that the country-fundamental transposition is not a European phenomenon either.

European Credit Requirements Directive (CRD III until 2013, now CRD IV) designates sovereign bonds as assets eligible for this status without reserve (BIS 2013). Because of this endorsement, sovereign asset deterioration leads to deleveraging and a contraction of both interbank lending and lending to businesses in the real economy (Guerreri et al. 2012: 203). Prior to 2007, however, sovereign bonds played their role well: European sovereign bonds enjoyed stable prices in secondary sovereign bond markets since their issuing governments could be trusted to be able to easily roll over old debt at low interest rates (Ehrmann et al. 2011). Much of the liquidity making this possible, however, froze up after the U.S. subprime crisis and had reached Europe in 2009 (Claessens et al. 2010: 285). In addition to this funding restriction driving up interest rates, sovereigns were subsequently forced to bail out their own oversized banking systems, which raised the debt-to-GDP ratio in many European countries (ibid.). Combined with generally negative market sentiments after the 2007/2008 shocks, this resulted in the rapid spread of what came to be known as 'contagion.'

By separating primary and secondary bond markets in Europe, bank holdings of nationally issued sovereign bonds are allowed to cross borders – indeed, this is the purpose of the sovereign bond market integration in Europe. This means that sovereign bonds can be grouped together to an asset class and can become subject to flights to safety (as well as yield panics). Portfolio restructurings across European sovereigns – capital movements on the European secondary sovereign bond market – are free. A bank situated in any European country is free to shift its portfolio allocation from its own sovereign's bonds to a different sovereign's bonds: a flight-to-safety from, say, Greece to Germany. This drives the interest rate for Greek bonds up and German bonds down, making it harder for Greece to issue new debt and repay old debt.

By selling its sovereigns' bonds, therefore, the bank in question contributes to the asset price deterioration it aimed to escape from, thus exacerbating both the country's fiscal distress and other banks' incentives to join the flight to safety. Such flights-to-safety spread across the entire asset class

of GIIPS countries because Greece's weakness engendered fears of Portugal's weakness, in turn making Spain questionable, and so on (Shambaugh 2012). On the secondary sovereign bond market, this lowers prices for the bonds of the entire asset class subject flights-to-safety. Since this is an integrated European market, it has ramifications beyond country banking sector. Banks in the European core are threatened by deteriorating peripheral sovereign assets. At the end of 2010, when the crisis had reached its first peak, slightly less than half of all sovereign debt of Greece, Portugal, Spain and Italy was held by non-domestic banks – 41.7% by European and 8% by non-European banks. For both Portugal and Greece, the percentage of sovereign bonds held by European core banks was above half: 51.6% for Greece, 55.7% for Portugal (Guerreri et al. 2012: 194). In both cases, therefore, sovereign bond contagion to the European interbank system is immediate. Since the resulting flight-to-safety further exacerbates asset price reduction, and hence further threatens banks' portfolio stability, a procyclical spiral can set in, from country to country and from bank to bank.

It could be argued that the European banking system is not substantially threatened by this, since it can always be rescued by an intervention by a government to relieve its banking sector of its own assets. Yet, this would constitute another threat since a bailout would have to be financed by issuing more debt and would thus further increase the country's debt-to-GDP ratio and hence its sovereign bond interest rates at the next auction (Acharya and Steffen 2013). Moreover, since its ability to issue debt is thus threatened, any banking bailout results in lower prices for sovereign bonds on the secondary bond market and hence engenders a threat for other banks. Nevertheless, there is a power differential here: while banks can shift their portfolios across Europe, countries are obligated to bail them out if necessary. Furthermore, since such bailouts are immediately converted into sovereign bond interest rate mark-ups by the very banking system thus rescued, market liquidity shortages get converted seamlessly into governmental solvency problems.

Thus, the general mechanism responsible for the Eurozone crisis is this liquidity-solvency

conversion. The oscillation of global liquidity from pre-2008 boom times to post-2008 bust times manifested on the European interbank markets as presence or absence of wholesale funding from non-European (mostly American) sources (Giannone et al. 2012: F469; Lane 2012: 55). However, from the perspective of the banking system, the disbursement and subsequent retraction of liquidity from these markets constituted merely a readjustment of international portfolios (McKeown 1999: 14 Fn. 3; Lane 2012: 60). This is not to argue that the 2007-2009 shocks did not affect the Eurozone's banking system. On the contrary: its involvement in pre-2007 leveraging and lending practices are well documented (Hau and Thum 2009: 703; Heintz and Balakrishnan 2012: 397-398). I do argue that the European banking sector was always able to hedge based on the certainty of a government bailout (Acharya and Steffen 2013).

'Contagion' is a banking category and has very little to do with government practices. It is an inference: despite their tangible differences, Spain and Ireland, Italy and Portugal and Greece are lumped together into a common asset category. This category originates in the realm of banking liquidity, not governmental solvency, yet is applied to governments by a conversion of liquidity to solvency shortages (Blyth 2015: 73). If countries serve as extra-market hedges (in the form of bailouts), this necessitates further debt roll-overs as well as the issuance of new sovereign bonds, worsening the conditions under which debt roll-over occurs, in turn threatening the portfolio function of sovereign bonds as tier 1 capital – and the fiscal maneuverability of governments. The liquidity-solvency conversion engenders a solvency shortage. This is important because it explains how Portugal, Spain, Italy and Ireland came to be lumped together with Greece when, as Blyth argues, “only Greece was in any meaningful sense profligate” (2015: 73). Italy in particular never suffered from an unsustainable debt-to-GDP ratio when compared to the European 'core' (Belke 2012: 685). Yet, 'contagion' is applied to all countries which are part of the GIIPS category.

The market's tool to operate in such a way are so-called 'risk premia.' These are interest rate mark-

ups of sovereign bonds which are judged more risky than those issued by the risk-free proxy asset: in the European case, Germany's sovereign bonds. Such risk premia, as shown here, do not reflect the country's policies as such, but rather the mismatch between the country's fiscal abilities and the combined demands of sovereign bonds as tier 1 capital and as funding capacities for bailouts which increase steadily as secondary sovereign bond market contagion prolongs and reinforces fiscal troubles. This has disastrous effects on the country subject to such liquidity-solvency conversions – and thus, ultimately, on the stability of bank portfolios. It is crucial to note here again that 'contagion' does not originate in governmental fiscal practices as such, but is an effect transferred upon countries – trapped between their triple function as tier 1 asset producers, potential bailouts, and democratic responsibilities to their people (Streeck 2013). It allows banks to demand risk premia *and* to utilize sovereign bonds as tier 1 assets. Thus, the country's fiscal capacities are harnessed by the conversion of a country's fiscal abilities to prioritize its role as portfolio stabilizer: 'contagion' thus means that whichever interbank market demands (cuts in wholesale funding; deleveraging; restructuring) are transmitted to the country must be met – demands to serve as fiscally stable portfolio stabilizer and ultimately as bailout capacity. This, in turn, makes the country's fiscal priorities subject to the constraints of a liquidity-solvency conversion, where the freeze of interbank market liquidity is transposed by banks to demands on governments' fiscal abilities: to austerity to preserve the “confidence channel” (Mario Draghi as quoted in Blankenburg et al. 2013: 464), i.e., maintaining the government's abilities to maintain debt roll-over credibility (Eaton 1993: 166-169), and ultimately capacities for a bailout.

Moreover, this conversion is subject, as discussed above, to shifts in market sentiment: from pre-2007 exuberance to post-2007 credit dearth. Thus, 'crisis,' as a discursive element as well as a political wager circulates alongside 'contagion.' Firstly, 'crisis' is a market status allowing the conversion of liquidity dearth into a solvency condition. Prior to 2008, as discussed above, investors considered Greek and Portuguese sovereign bonds (and private investments in the Irish banking and Spanish



construction sectors) to contain only reasonable risk – because of global excess liquidity (Claessens et al. 2011: 270; Schiaffino 2013: 458). After 2008, however, and *a fortiori* after the beginning of the European period of the Great Recession in October 2009, international market risk assessment reversed and capital flights away from the European periphery occurred (Shambaugh 2012: 216). Within markets themselves – exclusively with regards to liquidity – there is no difference between the pre-2008 and post-2008 periods; just a portfolio reallocation secured by bailouts (Acharya and Steffen 2013; Blyth 2015).

Yet, the discursive element 'crisis,' in this case, is structured by its combination with the element 'contagion' which shifts the blame for post-2009 liquidity freezes away from the banking system and to European governments (Blyth 2015: 73).

1. 'Crisis' reinforces debt repayment prioritization. The argument here is that 'crisis' signifies the unraveling of a general tendency of Western societies to live beyond their household's (and the public's) means by permanently extending credit purchases (Berend 2013: 91-114; Schäfer and Streeck 2013), rather than a banking internum. In the particular European context, as argued above, this posits European peripheral governments as reckless spenders of borrowed money ultimately responsible for the 'crisis' (Blankenburg et al. 2013: 464). This justifies the enforcement of austerity measures as conditions for liquidity assistance (ECB 2010; ECB 2012), shifts blame away from the European 'core,' and makes debt repayment a self-evident, even moral necessity (Lazzarato 2012; Blyth 2015).

2. Therefore, 'crisis' also reinforces debt roll-over as the primary means to gather funds to repay debt, as opposed to taxation (Mundell 1996). By positing that governments' reckless borrowing and spending is the underlying factor of 'crisis' – rather than the provision of credit according to the oscillation of global market sentiments (Manganelli and Wolswijk 2009: 194; Lo Conte 2009: 344) – 'crisis' becomes a diagnostic tool. The 'crisis' is a crisis of sovereign debt, not of markets, nor of domestic property owners (Ansell 2012). Rather, markets remain the in itself unquestioned disciplining

tool punishing excessive public borrowing and spending (Lo Conte 2009: 343; Belke 2012: 679). That governments finance their debt repayment through debt roll-over under conditions of rising interest rates is therefore not only a value-neutral market tool, but also a disciplinary tool: it forces governments to prioritize measures to reduce interest rates, which is to say, it makes these interest rates the yardstick of anti-inflationary commitment (Wolf 2002: 44; Botta 2013: 427-428).

3. By this last token, 'crisis' and 'contagion' reinforce each other. As governments' funding situation deteriorates because liquidity dries up, their scramble for new funds becomes more and more urgent since their debt roll-over requires higher and higher interest rates. Through the trope of 'contagion,' moreover, governmental fiscal distress spreads: from Greece's sovereign bonds to those of the GIIPS asset class as a whole, and then to countries like France and Great Britain (Treanor 2010; Kraemer and Gill 2012). This, in turn, heightens the urgency of 'crisis' and makes it even harder for governments to get new funds to refinance old debts. The banking system's stability gets jeopardized in turn, as primary and secondary bond markets cease functioning (Coeuré 2013). The European banking system may have successfully orchestrated a 'bait-and-switch' outsourcing blame to governments, yet that does not mean it controls the dynamic it created (Blyth 2015).

One must therefore be wary of two related one-sided arguments. On the one hand, it would be too easy to ignore the gaps in output and efficiency between Northern and Southern European countries prior to 2009. Reforms were and are certainly prudent – as acknowledged by none other than the newly elected Greek SYRIZA government in February 2015. More importantly, however, the austerity narrative must be countered: the Eurozone crisis is not a crisis of sovereign debt. It is an effect of 'contagion' – a phenomenon entirely situated on banks' balance sheets. What engenders 'contagion' is the fact that sovereign bonds are held by banks as tier 1 capital, securing their more leveraged (risky) assets. Given this, and the sudden global post-2007 liquidity withdrawal, 'contagion' emerges as the linchpin of a market climate of universal distrust – particularly into the GIIPS category, but also into

the French government or even that of Great Britain. This climate, however, radiates as 'contagion' and circulates throughout Europe in the same 'confidence channels' as the linchpin of the pre-2008 lending exuberance – as well as the restored 'confidence' after the creation of the European rescue facilities for governments. 'Contagion' is thus the exact reversal of a prior – and subsequent – “market sentiment” (Lo Conte 2009: 344) which one may call 'stability' and whose corresponding exemplary asset producer, so radically opposed to the GIIPS countries, is Germany.

### 3. Stability: before 2009

Like 'contagion,' 'stability' circulates; like 'contagion,' 'stability' has its genesis and site on banking portfolios; and its supposed anchoring in governmental fiscal practices is really an effect of its circulation, not its origin. European market unification is therefore a unification of contagion channels: sovereign bond risks spreading from country to country on secondary bond markets; portfolios deteriorating and engendering interbank counterparty risk. Considering European market unification only this way, however, is too one-sided. Contractions and negative contagion are only one side of the circulation by which European financial markets are unified. The mechanisms by which 'contagion' circulates are also the channels through which stability circulates: confidence channels. That the amount of peripheral debt held by core banks increased between 2005 and 2009 (Guerreri et al. 2012: 181) is not an accident. Contagion is a form of market integration just as much as credit expansion and the radiation of stability. The 'crisis,' which is to say the difference between the two – the switch from expansionary 'stability' to contractionary 'contagion' – occurs entirely within the financial system. 'Contagion' is a mode of European unification; a contraction exactly mirroring the previous expansion. The very same mechanisms engendering contagion and crisis after 2009 circulated soundness and stability prior to 2009. Just as unsound fundamentals have contagious effects, so do sound fundamentals.

Boom and crunch occurred without changes in the underlying market practices – indeed, they

occurred because these practices did not change. This holds particularly in the European periphery. The conditions under which European monetary convergence occurred between 1999 and 2009 gave rise to converging yields between the sovereign bonds of Germany and France on the one hand, Portugal, Greece and Spain on the other (Ehrmann et al. 2011: 350). This made it dramatically easier for Portugal, Greece and Spain to access funds. It was not due to a sudden change in the spending patterns of peripheral governments, however. As early as 1998, the German Bundesbank noted that what was at work were self-reinforcing market dynamics (Deutsche Bundesbank 1998: 26). Thus, market lending to the periphery was based on an inference, not actually observed behavior. Expectations of peripheral long-term real inflation – and thus ability to repay interest and principal of Euro-denominated sovereign bonds – were judged by markets to converge with those of European core countries. 'Stability' underlies this assumption in two interrelated ways. First, the assumption is that countries in the Eurozone would converge towards the most stable (market-friendly or competitive) policies, i.e., those best suited for eventual debt repayment. These in turn correspond to the benchmark of European best practices, Germany (Lane 2006).

Backing up this tier 1 capital assumption was a second one: that liquidity provision for debt repayments would *not* correspond to the individual countries' fiscal capacities, but would be Europeanized in some form of fiscal solidarity (Cohen 2012: 690; Bastasin 2012: 96; Belke 2012: 675). Thus, market trust in some form of fiscal solidarity ostensibly relied on being backed by Germany. Yet, a closer analysis reveals another case of market self-referentiality. Since Germany, and other fiscally virtuous countries depend on debt roll-over just like peripheral countries, markets place trust not into the country, but into their own future ability (and willingness) to place trust into Germany. Fiscal virtue (austerity, prudence) is not a result of the benchmark's fiscal policies, but rather a self-reinforcement of market sentiment by market sentiment for market sentiment: trust into future trust; the discursive structure of 'stability.' Thus, what markets trusted between the beginning of EMU in 1999

and the beginning of the 'crisis' in 2009 is not Germany as such, but Germany as a special case of their own internal liquidity conditions; converted into solvency conditions for countries into which markets placed trust – i.e., into which they expected themselves to be able to place future trust.

As a result, market-endorsed lending systematically and deliberately exceeded the real fiscal abilities of peripheral countries, leaving time bombs on banks' balance sheets. Yet, few were troubled by this (Deutsche Bundesbank 1998: 26-29). On the contrary, governments borrowed according to the ability projected by markets, assuming that market projections were correct independent of their own data because “commercial banks and their interbank markets are more efficient at evaluating financial risks than central banks” (Lucarelli 2011: 215). (The bait-and-switch Blyth had diagnosed as the origin of the Eurozone crisis had evidently occurred a long time before 2009.)

To be sure, European Central Bank (ECB) policies were involved in covering up the time bombs of unsustainable government lending on banks' balance sheets. Prior to 2008, global liquidity conditions, encouraged by the ECB's interest rate policies and the fixation of European peripheral inflation assumptions at core levels, allowed peripheral governments to borrow beyond what would be sustainable if market assumptions about their fiscal ability (i.e., their debt roll-over ability, i.e., future market lending willingness) would ever unravel (Ehrmann et al. 2011: 213). Between 2008 and October 2009, i.e., between the U.S. subprime crisis shock waves and the Greek debt announcement, the ECB's provision of emergency liquidity through its LTRO<sup>3</sup> – while necessary – helped obfuscate the misfit between fundamental size and country size by sustaining liquidity conditions at 2003-2007 levels (Giannone et al. 2011: F471). Thus, it fatally obfuscated the self-referentiality of the market assumptions of 'stability.'

#### 4. Stability: after 2009

This self-referentiality became more obvious after 2009. Not only 'contagion' spread after 2009,

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3 Long-Term Refinancing Operations

but also 'stability' – as its simultaneously circulating flipside. Throughout the duration of contagious conditions in Europe, 2009 to 2013, Germany has been able to issue ten-year government bonds at very favorable interest rates profiting from so-called flights-to-safety (Pusch 2012: 2). That is, the panic-stricken movement of investors away from peripheral bonds is simultaneously a movement towards what markets consider sound investments – and it is as self-reinforcing: the cyclical movement of interest rate hikes and debt roll-over difficulty or inability for the European periphery corresponds to ever easier access to funds by the 'core,' allowing it to proceed undisturbed. According to Bloomberg market data, between May and September 2010 – during the peak of the Greek government's distress – German ten-year bond yields fell from 2.9 to 2.3 %. As markets seemed to settle down, between September 2010 and April 2011, bond yields rose again to 3.3 %; only to reach a new low of less than 2 % by September 2011 – a value they have since surpassed only on a few occasions (Bloomberg 2014). For maturities less than ten years, the effect is even more remarkable: in January 2012, German six-month bonds even reached a historical low as investors paid – lent money at negative interest rates – to be able to invest in German safe-haven assets (Phillips and Bartha 2012).

Thus, focusing on Germany here is not due to alleged plans of European hegemony (Galbraith et al. 2014). For example, it is very likely that German insistence upon supporting struggling nations as little as possible, and if at all, only under specific conditions after 2010 was not so much a strategic maneuver on the part of the German government as an attempt to appease German public opinion and particularly the German Constitutional Court (Bastasin 2012: 170). Rather, Germany exemplifies that 'stability,' far from being a market recognition of actual fiscal policies, is rather a self-referential dynamic within financial markets: low German interest rates made debt roll-over easier for Germany, maintaining its reputation and hence its low interest rates.

An analysis of Germany's concrete role in the European rescue facilities EFSF (European Financial Stability Facility) and ESM (European Stability Mechanism) shows that it is a combination of three

factors which allow its leadership in bailing out peripheral states: not primarily its status as Europe's largest economy, but rather the transposition of this status to so-called “firepower” in rescue packages (Belke 2012: 678), which is to say the trust of financial markets in themselves, i.e., their future ability to persuade themselves that Germany's 'fundamentals' are 'sound.' This gives its government bonds “safe haven” status as primary debt securities (Heise 2012: 60). This trust is not trust in Germany, but in a discursive entity 'Germany' which, whatever it does, however much it spends, however macroeconomically reckless its insistence upon austerity, will always remain the incarnation of 'stability.'

EFSF and ESM are funds dedicated to erecting a safety net for troubled debtors in the European periphery. EFSF, founded in 2010 parallel to the Greek bailout packages, consisted of € 60 billion contributed by the European Commission, plus € 440 billion advertised as contributed (and, after an enhancement in July 2011, actually contributed) by European countries (Cohen 2012: 695-696). The mechanism of EFSF acknowledged market self-referentiality: pooling money obtained from issuing bonds and financial instruments backed up by the fiscal contributions of its member states – subsequently lending this money to Greece, Portugal, and Ireland between 2010 and 2013 (Blankenburg et al. 2013: 469). Markets once again trust their own future trust: that EFSF was supported by the European core country's fiscal pledges gave it the necessary triple-A rating to do so (Bastasin 2012: 214).

At the end of 2010, when the Irish bailout occurred, the EFSF was supplemented with a larger fund, the ESM, with total resources of € 500 billion (Cohen 2012: 696). Through the ESM, bailouts of the Spanish banking sector and oversight over the Portuguese bailout package were orchestrated until 2013, and it still manages the bailout procedures of Cyprus as of 2014. The ESM's capital structure is even more based on market self-referentiality than that of EFSF. It is largely market-funded, with only € 80 billion contributed by Eurozone member states, and the remaining € 420 billion to be raised by

financial market instruments – hence, once again, the necessity of maintaining a triple-A rating – and only when this fails, by pledged money from Eurozone members. With an additional € 200 billion earmarked as capital reserve to maintain the triple-A rating (Cohen 2012: 696), the total capital of ESM is € 700 billion (ESM 2012: 2).

Crucially, 'stability' is maintained as the centerpiece of both facilities. Bailout operations funded by EFSF and ESM are subject to strict conditionality. On the one hand, the explicit goal of the bailouts is for countries to return to issuing their own government bonds at market conditions as quickly as possible (ESM 2012: 14): that is, to return to fulfilling their function as tier 1 capital producers again as quickly as possible. On the other hand, during the bailout disbursements, the country is subject to strict austerity memoranda (ECB 2012): reinforcing the 'crisis'/'contagion' duality discussed above, and thus benchmarked against Germany exemplifying 'stability,' the country bailed out must fulfill the obligations of its fundamental while remaining virtuous in contracting its economy.

ESM and EFSF are thus not instruments of German hegemony, but a transposition of Germany exemplifying 'stability.' This can be said because neither ESM nor EFSF, in their operative reality, depend on German payments and pledges as such. Rather, these real contributions are just one element of the 'firepower' sustaining the triple-A rating of EFSF and ESM. More fundamentally, EFSF and ESM depend on an assumption: that Germany unequivocally exemplified 'stability' (market conformity, debt service prioritization, growth despite or because of low wages). Only because it can be presupposed that it is a country with this ability which supplies crucial funds, and not merely because of the magnitude of its contributions, EFSF and ESM can be assumed by markets to be stable, and hence play their own stabilizing role for bailed-out countries and secondary sovereign bond markets alike. This can be shown for Germany's contributions to EFSF and ESM; for their modalities; as well as the form of legal and contractual nationalisms deployed in the rescue package negotiations and processes.



1. In its contributions. In terms of the capital structure of the EFSF (29 % of its capital) as well as the guarantees pledged for the ESM (27.1 % of its capital, in excess of € 200 billion pledged), Germany's leading role in Europe based on its economy's size seems evident (ESM 2012: 5; EFSF 2013: 2). In two crucial respects, however, Germany's credibility as a country capable of remaining 'stable' – of projecting “counterinflationary credibility” (Wolf 2002: 44) – supports both EFSF and ESM beyond its sheer material “firepower” (Schild 2013: 27). The first is Germany's specific position: of all countries in the Eurozone (including France, as its sovereign rating's downgrade in 2013 showed cf. Adam and Deen 2013), Germany alone has been conceived to be able to brave the Eurozone's collapse. Thus, it alone is capable of credibly (!) withdrawing its support for EFSF and pledges for ESM (Belke 2012: 678). Because of this, it is the only country whose support is indispensable: it is the only country whose support is not given by necessity and can hence be presumed to be independent of market movements (ibid).

By the same token, Germany's behavior is the only one in Europe which coincides with virtuous behavior by definition. Never mind that Germany violated ESGP deficit stipulations on a number of occasions (Heise 2012: 48; cf. Manganelli and Wolswijk 2008: 197), or that its economic policies have repeatedly been questioned with regards to their sustainability (most recently in late 2014, cf. Smale and Alderman 2014) – none of that can threaten its “safe haven” status because it is not a status of Germany at all, but a market internum. Germany's “firepower” as Europe's largest economy is structured by the terms of this credibility, not vice versa. As argued above, Germany is the only country in the Eurozone unaffected or only positively affected by the “crisis.” This means that Germany is the only country where the liquidity-solvency conversion is enabling rather than constraining its fiscal extension: unlike Italy, whose solvency was threatened by a liquidity dearth during the 2011-2012 years (Belke 2012: 685; Pusch 2012: 2), Germany's debt roll-over liquidity is guaranteed. Hence, it is the only contributor/pledger to EFSF and ESM whose ability to

contribute/pledge can only be compromised by its *willingness* to do so, not by market conditions. It is the focal point of market self-referentiality since it thus has the same position as a market actor; endowed with the ability to set its own terms of trust.

2. However, this also means that Germany's willingness to bail out other countries must conform to the standards set by its own benchmark status: its credibility as EFSF/ESM backbone is not a function of its economy's size alone, but as structured by its credibility: it is not 'Germany,' but 'stability' which anchors market sentiment: trust placed in future trust. The ideological surface of this is the oft-cited comparison of the German federal budget to that of a *Schwäbische Hausfrau* (swabian housewife) “who knows how to live within her means” (Young and Semmler 2011: 7). This stance directly reflects the existential value attributed to microeconomic saving and hence macroeconomic deflationary contraction in the German genealogy of the Bundesbank-ECB heritage (Eucken 1960: 319; Leaman 2001; Quaglia 2008). Yet, these ideological terms are mere surface phenomena; at work here is merely market trust placed in future market trust.

In the conditionality attached to EFSF and ESM, this stance is transposed to the level of European fiscal generalizations. As Cohen (2012) has pointed out, Germany's specific credibility (and “firepower”) gives it the necessary political clout to negotiate its terms when EFSF and ESM are activated. Thus, the modalities of Germany's contributions to EFSF and pledges to ESM are crucial. A characteristic example is the escalation traceable in the development from the ESGP to the “stability union” in 2011-2013. In 1994, the European Stability and Growth Pact (ESGP) contained procedures to curb excessive debt designed to ensure the fiscal austerity considered necessary to EMU (Deutsche Bundesbank 1999). However, these agreements had frequently been violated because of the ESGP's voting procedures (particularly a requirement of qualified majorities for sanctions) and exceptions (Germany and France each violated the 3% deficit-to-GDP rule on a number of occasions). In 2013, however, the TSCG (Treaty on Stability, Coordination and Governance in the EMU; also known as

Fiscal Compact) made sanctions automatic for countries violating a deficit-to-GDP ceiling of 3% per year (Arestis and Sawyer 2013: 45). This applied to all countries bailed out because “Germany and France followed a linkage strategy, making the ESM funds available only for countries signing the TSCG” (Schild 2013: 38).

Likewise, EFSF bailouts come with “memoranda of understanding,” making their disbursement conditional to measurements ostensibly designed to improve the state's fiscal situation and to make its corresponding national economy more competitive (Shambaugh 2012: 196). This comprises labor market reforms removing 'inefficiencies': employment standards, pensions, and bonuses as well as social security decreases and tax increases (IMF 2009). However, they are designed to improve competitiveness, i.e., market operationalizations of its trust into its future trust: tax increases, for example, exclude businesses whose tax load is rather lightened. The reforms are also socially unequally distributed: in Greece, for example, tax evasion is more widespread among the wealthier parts of society (Mitsopoulos and Pelagidis 2011: 126). “While the governing coalition was busy squabbling with international creditors over how many hundreds of euros can still be trimmed from teachers' and nurses' paychecks, and Athens continued slashing employee pensions, wealthy Greeks moved billions abroad with relative impunity.” (Heyer 2012: par. 3) Furthermore, since both EFSF and ESM have as their primary targets the consolidation of states' fiscal position insofar as it is necessary to uphold interbank market stability, EFSF requirements explicitly allow banking sector bailouts (EFSF 2013: 4) and ESM disbursements are targeted funds paid to the respective governments to be passed on to the country's financial sectors (thus in Spain; Shambaugh 2012: 196). This nationalizes the task of maintaining fiscal stability, reinforcing the role of countries as not just issuers of sovereign bonds, but also bailing out banks when deemed necessary.

In addition to funding conditionalities, direct oversight by the infamous Troika (a commission comprised of ECB, European Commission, and IMF officials) is implemented, enforcing EFSF and

ESM conditionalities directly within the countries in question (Belke 2012: 673). This enforcement mechanism mirrors the technocratically obfuscated adjustment power exercised by monetary governance in general and its 'stability'-oriented version in particular. On the one hand, the Troika can merely recommend “best practices” and issue non-binding commentaries about budget planning (Daianu 2012: 306). On the other hand, however, the country subject to this oversight will conform to the recommendations in question since its solvency depends upon EFSF and ESM disbursement which can be disrupted when the Troika sees fit, as has happened on some occasions in Greece (European Commission 2014: 7). This seems to have changed only in January 2015, when Greece terminated its cooperation with the Troika – only to have it resurrected in February under the name 'the institutions.' (Eurogroup 2015)

Further illustration that the point of EFSF and ESM bailout programmes is not growth as such, but 'stability' can be derived from observing that the internal German struggle over the constitutionality of rescue plans largely consisted of a legal and political discussion over the German government's emergency powers vis-à-vis the stipulation against member-state bailouts contained in the ESGP – not whether austerity can restore growth. Thus, the passing of an emergency law in favor of the first Greek rescue package in 2010 “resulted in a number of formal complaints to the German Constitutional Court arguing that the rescue plan breaks the 'no bail-out' clause of the European treaties,” (Young and Semmler 2011: 7). These complaints were rejected by the German Constitutional Court, but have returned a number of times thereafter (Schild 2013: 41). The centrality of the “no bail-out” clause of the ESGP, in turn, highlights that the EFSF/ESM conditionalities are in line with the Bundesbank/ECB/“stability” transposition discussed above, as the Bundesbank had made it abundantly clear that only a combination of fiscal austerity with a strict nationalization of liabilities could sustain the European Monetary Union architecture (Deutsche Bundesbank 1998; Deutsche Bundesbank 1999). The 'confidence channel' through which sovereign lending supposedly restores growth is not primarily

designed to engender a restoration of growth in the country supported by EFSF and ESM: rather, the assumption is that growth will automatically follow once confidence is restored (Demopoulos and Yannacopoulos 2012: 2).

Little argument is necessary to show the nonsensical nature of this idea. What it upholds is something else entirely. As Schiaffino (2013: 458) argues, fiscal contraction without monetary devaluation can only be sustained (let alone restore growth) if competitively priced and produced products can be sold to someone somewhere. Globally, such a “reserve demand” role has long been attributed to the United States (Cohen and DeLong 2010; Liang 2012). Germany, however, which would theoretically have the capacity – public and private – to consume above other country's levels refuses to do so because it ideologically understands itself as the morally virtuous primary example of 'stability.' In this case, existentially overdetermined public and private saving corresponds to German fundamentals which ostensibly represent nothing but an economy of pure production (pure saving, pure economic virtue) by its own logic, requires demand to be supplied from elsewhere: the United States or, prior to European austerity, the peripheral GIIPS countries (Schiaffino 2013). The question of demand does not play a role, however, in the economics of austerity. All it does is create and maintain the macroeconomic conditions corresponding to the trust of being capable of bestowing further trust. The real economy of Germany is altogether irrelevant to this, just like those of its GIIPS counterparts.

This shows that austerity – particularly in its rigidly misguided, one-size-fits-all implementation – is a result not of the actual virtue of austere policies which in any case neither restore growth nor confidence. Rather, austerity is a reaction to the classification – in turn indiscriminate – of European sovereign bonds to asset classes: the GIIPS class, radiating 'contagion,' and the 'core' class, exemplified by Germany, radiating 'stability.' Austerity has nothing to do with macroeconomic adjustments; it is merely the result of market self-referentiality as applied in Germany.

## 5. Conclusion

The European crisis is thus not a conflict between Germany and Greece or the core countries and the GIIPS periphery. It is a conflict between the conflicting demands imposed upon countries by the core tenets of two asset classes – by 'contagion' and 'stability.' However, 'contagion' cannot exist (conceptually or empirically) without 'stability.' It cannot exist conceptually since the benchmark is required to maintain aberrations from it: without a concept of virtuous fiscal policies – savings rate, growth rate, debt-to-GDP ratio – how could its aberrations be measured? Empirically, however, this results in lending patterns which exacerbate the problem – and create it: as described in this paper, 'contagion' is not primarily a result of government policies. It is a result of market-based interest rate mark-ups which make debt roll-over harder for countries, in turn giving rise to further mark-ups, and so on and so forth. It is not the case that the GIIPS government engaged in similar policies giving rise to the GIIPS asset category and its common denominator 'contagion.' Rather, this asset category and its central tenet 'contagion' lumped together the very different peripheral economies of these five countries, held together by asset 'contagion.'

The exact reversal of 'contagion' is 'stability.' Like 'contagion,' 'stability' circulates independently of country policies: it, too, creates a class of assets corresponding to 'virtuous' economic economic policies, but not being their result. Certainly, Germany's position as the exemplification of 'stability' is not accidental (nor are the GIIPS countries' statuses as a periphery subject to 'contagion'). Yet, what allows Germany to maintain this status is a market sentiment which is as self-referentially (un)founded as 'contagion' since it not only mirrors it, but is constituted by the same movement. The common origin of 'contagion' and 'stability,' their corresponding asset classes and fiscal policies, political arrogance and moralistic self-righteousness on the one side, virulent nationalism and human suffering on the other, is a simple portfolio readjustment across an asset class projected by the European banking system – away from the GIIPS countries and into the 'core.'

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