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Germany, Europe and the crisis

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Abstract:

This paper will put forward a number of economic considerations raised by the Russia-Ukraine conflict with the external strong participation, on the side of the latter, of the United States and its NATO allies. We begin with some observations regarding the United States, followed by the evaluation of the European context. The essay ends with a discussion of Eurasia, Russia included, in the framework of the dynamics opened up by the BRICS countries. Points of view rather than conclusions are offered, because the future cannot be predicted in any meaningful way.

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This paper will put forward a number of economic considerations raised by the Russia-Ukraine conflict with the external strong participation, on the side of the latter, of the United States and its NATO allies. We begin with some observations regarding the United States, followed by the evaluation of the European context. The essay ends with a discussion of Eurasia, Russia included, in the framework of the dynamics opened up by the BRICS countries. Points of view rather than conclusions are offered, because the future cannot be predicted in any meaningful way.

In June 2022 the journal *Moneta e Credito* published an issue dealing with the economic implications of the Russia-Ukraine-NATO conflict as it sprang out of the preexisting one which began in 2014 (*Moneta e Credito*, 2022). The essays hit the targets for three reasons. First, no credit was given to the then prevailing view that the Russian economy was bound to collapse or, as the French minister of finance Bruno Le Maire (2022) announced at the time: "nous allons donc provoquer l'effondrement de l'économie russe" ("we are therefore going to cause the collapse of the Russian economy"; my translation). Second, the essays appropriately understood the problematic position of the US currency when the impact of the shift away from the dollar had not yet been grasped in Western countries. Indeed, the sentiment among government bodies – and among political figures who should have known better – was quite the opposite and in line with the desired scenario of an economic Armageddon in Russia leading to a change in its internal political leadership. Third, the essays presented a rather critical picture regarding the economic predicament of the European Union. A year later, the scenarios broached in the aforementioned issue of the journal must be supplemented by additional considerations related to the United States, the European Union, and BRICS.

1. The United States

In the case of the United States, the fragility of the banking and financial system, in a significant part caused by internal factors, reached such a dimension as to become a serious concern for analysts and economic decision makers for whom optimism means a soft landing. This fragility is connected to the deep crisis of the commercial real estate market, now plagued by a high vacancy rate that has been building up during and after the 2020-22 pandemic. The state of affairs has been exacerbated by the increase in interest rates, which depreciates the value of existing Treasury bills that banks have accumulated ever since the Great Financial Crisis of 2008 while reducing the overall demand for mortgages from financially strapped average households.

Looking at the problem from the standpoint of the potentialities of the United States productive system, including that related to the military sector, we will realize that the US no longer has the same capabilities as in 1940-41, when it went on a war footing in the span of a little more than two years; this was accomplished by combining the utilization of the unused capacity it got saddled with during the Great Depression with the reorientation of production towards military output both directly and indirectly through the expansion of the capital goods industries (Kennedy, 1999).

During the 1960s – the heyday of postwar American economic growth combined with military expenditure and actual warfare in Vietnam – there was an author who put forward a set of crucial analyses that viewed that constellation not just in Keynesian terms but in a profoundly critical manner. The writer was Seymour Melman, professor of industrial engineering at Columbia University in New York, who in 1965 published a book titled *Our Depleted Society,* which explored underneath the macroeconomic data of the time. From the outset it argued that:

> A process of technical, industrial, and human deterioration has been set in motion within American Society. The competence of the industrial system is being eroded at its base. [...] This deterioration is the result of an unprecedented concentration of America's technical talent and fresh capital on military production (Melman, 1965, pp. 3-4).

But why should such a large military economy go well beyond and against its initial Keynesian effects which turn out to be ancillary to the structural malaise?

> Economic growth has been widely trusted as a yardstick of well being with too little attention given to quality of the growth to economic health. Growth can include parasitic and malignant processes, as well as those that are healthy and productive. Depletion in America, like the increasing inability of many industries to hold their own in competitive markets, is mainly the result of parasitic growth (Melman, 1965, p.4).

That book was followed by others, in which Melman provided a portrait of the US economy as governed by the intertwined relation between the permanent war economy and corporations whose objective was to focus on short-term profits with only secondary considerations for long-term capital and productive development (Melman, 1974, 1983). Importantly, in the author's analysis, the roots of the decay lay in internal and managerial factors. Melman also saw that the bloated cost-maximizing character of US military expenditure would backfire on the efficiency of military production itself and would become an objective in its own right, thereby generating an ever-increasing gap between budgets and actual capabilities.

The 1980s began with a new sociological book that laid out all the major long-term implications of the industrial crisis that was by then unfolding in a rather virulent fashion (Bluestone and Harrison, 1984). It correctly identified the degree of community abandonment that, in a non-reversible manner, was in the process of gripping many US urban and suburban areas (though still far from the depth of the decay that is being reported today all the way from Los Angeles to Philadelphia). A few years later a work of an eminently economic and technological nature appeared that showed the importance of the manufacturing sectors as the backbone of a country's economic and social strength, with positive impacts also on services. It furthermore offered a number of policy guidelines to restore the industrial capacity of the United States (Cohen and Zysman, 1987). By the end of the century, James Galbraith (1998) published a remarkable book titled *Created Unequal: The Crisis in American Pay.* Using an oligopolistic framework, he showed how the majority of the sectors not connected to the protected ones – those eminently in the military-industrial complex – suffer from systemic persistent crises. In the consumption goods branches of the economy, Galbraith depicts large-scale plant closures and a free fall of workers into lower-paid unstable jobs. The downgrading process invades the equipment sectors servicing the consumption goods ones. Also, what appears to be a dynamic upcoming branch, the electronic high-tech industry, is subject to job instability, and this is of relevance for the military industrial complex. Conceptually, there is nothing more to add to the aforementioned studies; one can only measure by how much the decomposition of US industries, and the technical-engineering applied know-how that goes with them, has progressed further.

The systematic degradation of domestic production by means of extended value chains has engulfed industries crucial to the military complex itself. US corporations cannot do without the web of value chains whose main impact has been to move the economy from a 'profit without production' sub-system to the full financialization of capital in virtually every aspect of the American economy (Hudson, 2015). The political and economic leadership that has emerged under these circumstances is itself professionally and culturally divorced from the technical and material dimensions of production. The international political and military condition that enabled such a domestically unchallenged transformation of the US economy and society – with its direct impact on Europe, always rather weak politically except for some brief instances in the 1960s (DeGaulle) and the 1970s (Willy Brandt) – was the end of the Soviet Union. As early as 1992, Washington initiated a dynamic aimed at occupying the spaces made available by the rapid withdrawal of the USSR in 1989-90 and by its subsequent institutional disintegration.

From a wider perspective, the US ruling circles are trapped in the 'end of the Cold War' syndrome, as Palley (1998) aptly put it. Such a posture has created the delusion that there are no obstacles, nor should there be any objections, to US activities: be they related to the dismantling of their own national industrial system or those of the rest of the world. It also led to the overt proclamation of America's hegemony as a natural right, echoing the 19th century theses about the country's 'manifest destiny' (with, however, a much wider negative impact). It is highly unlikely that the US authorities will be able to either undertake any substantial reshoring of industrial activities or find meaningful alternatives to their linkages with China. Policy makers in Washington and the states have no real alternatives to China, at least not in a remotely significant measure, having lost, qua political elites, the structural and scientific-engineering capabilities to think, plan and coordinate productive developments on a national scale. The frantic attempts by the US government to hamper the technological developments in the People's Republic of China (Sachs, 2023), now deemed inimical to US interests, are bound to create further disruptions to the supply chains, which for the United States are more vital than ever. Moreover, attacking the links with China cannot help but have a blow-back effect on the confidence in regard to the holding of US government securities, not just in the eyes of the People's Bank of China but also in the minds of the central banks of other countries. For the United States the stability of the international circuit of US Treasury securities — on which the largest holder, Japan, is also wishing to reduce its dependency — is as crucial as are the value chains with China.

2. Europe without Russia leads to Europe without China

Economic cooperation – and indeed integration – between Europe and Russia is the natural outcome of geography and of the location and production of energy resources. The post-1945 economic ties with the Soviet Union were developed particularly after Willy Brandt launched in 1969 the *Ostpolitik* dictated by West Germany's security interests, then fully coinciding with those of the rest of Europe. In 1955 Chancellor Konrad Adenauer visited Moscow to establish diplomatic relations between the Federal Republic and the USSR, leading to a trade agreement in 1958. Mutual commerce expanded quickly, as has always been the case between Germany and Russia, in whatever respective institutional forms. A crucial component of those trade flows was the fact that Germany made large heavy pipes. Indeed, the Federal Republic, through the production of those pipes, was contributing to the construction of the Druzhba oil pipeline linking the Soviet Union to Eastern Europe. Completed in 1964, it is still the longest and most ramified in the world. And here we go: the Kennedy Administration, operating through NATO, succeeded in imposing an embargo on West Germany's pipe exports to the Soviet Union. It is an interesting item of information: the United States had to marshal NATO in order to force Bonn to yield: they did not have the power to force the German government directly, the Cold War notwithstanding. In 1973 came the gas-duct from the Soviet Union to both German countries (Sullivan, 2022). Willy Brandt's political leadership, and the boldness of Italy's fiat management prior to the *Ostpolitik*, paved the way to the growth of Europe's economic relations with the USSR. This development materialized in a series of large industrial projects, such as the automotive plant in a specially built city on the Volga named Tolyatti, the Russian transliteration of the name of the historic leader of the Italian Communist Party Palmiro Togliatti. The Avtovaz started operating in 1970, while in 1976 a truck and bus complex opened near what was then a small town on the Kama River in the Russian republic of Tatarstan. These projects involved a multitude of firms from both Europe and the USA, while using the heavy industries of the Soviet Union.

Soviet policies were developmental, orientated towards expansion of the domestic market. Thus, they were never meant to encroach on effective demand and employment in Western countries. In 1984 a Soviet agreement with Italy made headline news because it stated that the surpluses earned by the USSR in selling energy inputs to Italy would be kept in the country and spent by the Soviet Union in purchasing products of Italian industries.

The current separation of Europe from Russia is likely to alter permanently in a negative manner the economic profile of the former, leaving very little room, if any, for an escape route.

Let us now focus on Germany.

The present situation is grim, the future is, in my opinion, extremely dark, in particular if we look at the issue in terms of the role of exports in the process of capitalist accumulation. The European Union is simply not institutionally configured to undertake Keynesian policies for domestic purposes. Beginning with the 1950s, the distinctive feature of post-WWII Continental Europe is represented by positive net exports, though not for every country. Germany became the main exporting country and the main accumulator of net exports, and here is where our story starts.

If we focus on the export flows and the net exports of the Federal Republic after the end of post-war reconstruction, we can appreciate the role that the whole of Western Europe played for the Bonn republic. This stems from the fact that Western Europe has been the main recipient of German exports and trade surpluses, while, as a single country, the United States is the most important source of net balances. First the Common Market, then the EEC and now the European Union, constitute the space of German capital. This was explained beautifully in two Italian volumes published in 1981 (Parboni, 1981; Valli, 1981). West Germany, owing to its capital goods industries, acted as the gravitational center of the European economies, becoming both the largest exporting and the largest importing country. During the most dynamic phase of European integration, 1950-1965, German imports were crucial for upgrading the industries of countries such as Italy and France – and later also Spain. This is because the composition of Germany's demand required more advanced products, compelling the modernization of the industries in countries exporting to Germany (Milward, 1992). Such a transformation was made possible by the heavy flow of German capital goods exports to the rest of Europe.

Hence, although Germany had a persistent surplus against the Continent – and against Britain to a smaller extent due to its slow growth – its exports to, and imports from, the rest of Europe gave rise to a strong cumulative causation. Yet this process was bound to end as all the net exporting economies – Germany, Scandinavia, the Netherlands, Belgium, Switzerland, and Austria – attained full employment by the mid 1960s.

The center of the whole process was Germany; the other net exporting countries were becoming so integrated with the Federal Republic that their export performance depended on German dynamics.

In principle, at full employment a country should not aim at persistent surpluses unless it finds itself involved in big development projects in not fully capitalistic areas. In this case, the country could more or less maintain the level of production of capital goods, steel and the like, while exporting its excess output to the developing areas, provided loans are made to them. However, we know from Kalecki (1971) that net exports are part of net profits, which become all the more important when the economy is at full employment. In the latter case, growth, and therefore the expansion of profits from production, can take place only at the rate at which productivity grows, with some allowance made for population growth, which in mature economies tends to be minimal. But such a downward adjustment subordinates profitability to a balanced full employment growth, which is likely to be low. There are no mechanisms to bring about such an adaptation except by means of investment planning, entailing quite complex interrelations between sectors – also involving the mothballing of the unused capacity arising from the required changes (Lowe, 1976).

In the context outlined above, the Federal Republic of Germany fought quite successfully to keep the external surplus going. It started in 1965-66 with a mild recession engineered by the Bundesbank precisely when (and because) the full employment conditions prevailing in the country whittled away most of the trade surplus. Germany could sustain its net export position as a paramount economic objective since it had the power to do so. It featured the largest oligopolistic industries in Europe and it produced the most important capital goods for the whole of the Continent. Had France and Italy been equipped with the same industrial capabilities, they would have behaved in a similar manner. However, the French state, while always imperialistic towards Africa, has never been keen to raise its national industry to the level of Germany's. Italy was still two-thirds of the way out of underdevelopment. The only clout Italy would later discover was in the form of competitive devaluation. This is a weak type of neomercantilism, as it rests on out-competing the European partners through the monetary cheapening of products. It worked under the inflationary conditions of the 1970s following the end of the fixed exchange rate regime centered on US dollar parity with gold, which led to nominal revaluations of the Deutsche Mark.

The Italian gimmickry was cut short in 1978 by an alliance between Bonn and Paris, leading in 1979 to the creation of the European Monetary System (EMS); this stabilized exchange rates throughout the 1980s by raising the real exchange rates of the weak currencies, hence Italy's, relative to the Deutsche Mark. The EMS created a strong protective belt around Germany's export position, so much so that the country's commerce was very effectively sheltered from the turmoil caused by US monetary and budgetary policies and the consequent clash with Japan (Halevi, 1995).

By the end of the 1980s Germany had achieved, by combining low growth with the shield provided by the EMS, the highest share of current account surplus in national income relative to the previous four decades.

After the *interregnum* due to the collapse of the EMS in 1992 and 1993 – caused precisely by the weak countries' inability to cope with the EMS exchange rate mechanism, especially after the interest rate increase decided by the Bundesbank in the wake of German unification – the protective belt was recreated in 1999 with the formation of the European Monetary Union. The Bundesbank opposed it, as it had opposed the EMS. Yet a couple of years later the EMU proved to be an even stronger protection for Germany and the other net exporting countries, especially as the EU was expanding toward Eastern Europe.

Martin Wolf's article in the *Financial Times* showed how the creation of the EMU has allowed Germany to accumulate both foreign and fiscal surpluses. Wolf compares the German situation with that of Japan, where, in the absence of a monetary area to protect it, foreign surpluses were accompanied by growing fiscal deficits and public debt (Wolf, 2019).

In the middle of the first decade of this century, the composition of the EU changed. The Eastward enlargement involved a number of industrialized countries that underwent restructuring, shaped in an important way by German firms' policies of mergers, acquisitions, relocations of production lines, and subcontracting. This area became, in no uncertain terms, the inner space of German capital, though not necessarily entirely a zone of net German exports due to the preexisting level of industrialization and to the aforementioned restructuring in countries like Czechia, Slovakia and Hungary. German industries were perfectly aware of the situation, since, during the Socialist era, the Bonn Republic exhibited by far the largest share of external trade with the Eastern Bloc's Council for Mutual Economic Assistance. A synergistic set of relations developed in which the Germany-China axis featured prominently. Its viability depended on energy imports from Russia, as they enabled the new Germany-centered system of international linkages to function.

At the same time, the China pull engendered a rise of German exports to Beijing by more than 4 times (for Italy the value is 2.5 times and for France it is slightly above 3 times, data are from the UN database Comtrade). We know that China has been absorbing imports from the world over. In the European case the interesting phenomenon consists in the rhythm at which the process has been occurring in the East in connection with Germany. All the Eastern countries quickly joined in the wake of the expansion of Sino-German economic relations. Taking again 2005 as the starting year, by 2019 exports to China from Slovakia grew by 15 times, from Czechia by 8 times, from both Hungary and Slovenia nearly 7 times and from Poland and Romania more than 4 times. The picture is that of a virtuous Eastern-European-German-Chinese-Russian circle: growing exports to China irrigated by the energy flows from Russia without which the circular cumulative causation would break down, as it now seems to be doing.

The enlargement of the direct overland rail links to the Peoples Republic of China was in the books of Berlin, as well as of Moscow and Beijing, judging by the rail routes that were expanding from China to Russia and Germany. Down the line they would have implied the creation of transportation hubs in Russia, since, without building economic geographic proximity and continuity, trade between two very far-away areas is subject to limitations due to the contingent conditions that stimulate it (Pepe, 2021). The hubs could have become growth poles entailing further capital goods exports and technologies from both Germany and its connected Eastern partners, especially Czechia, Hungary, and Slovakia. The trade with China was not bringing surpluses to Germany nor to its strict associates in Eastern Europe. However, the making of a Eurasian economic area would have enabled Germany and its associates to expand their footprints all across that space, where German corporations stood to make solid profits through the selling and installation of productive physical capital goods. In this context, I believe that Germany would have produced surpluses even in the Eurasian space. At any rate, since the German economy cannot exist without external surpluses, it is preferable to drown them in the Eurasian transformational growth dynamic rather than have them squash the already stagnant European demand (Lucarelli, 2011).

3. Eurasia and BRICS

The foregoing discussion may appear redundant because the issue has now moved from the German, Dutch and Scandinavian surpluses to that of the current German deep crisis. In fact, it highlights the *cul de sac* in which Europe finds itself. Europe, guided first by the United States and later by its own institutions, has been shaped and structured in a functional manner to the economically hegemonic surplus country – that is, Germany – at the eventual cost of freezing most of the Continent. The prospects for capitalist accumulation had to be sought via external channels in which the virtuous circle between China, Germany, Russia, Eastern Europe and China again represented the most dynamic aspect. Month after month the situation worsens, without any idea on how to come out of it, because a group of countries, totaling 450 million people, does not seem capable of exerting political leadership that is intellectually autonomous and politically independent from the United States. The latter has ceased long ago to be the enabling factor for Europe to recover and gather speed, mostly through the growth dynamic of the Federal Republic of Germany, which for about 20 years took everybody else in tow. The United States policy is seriously unbalanced. Thus, in order to gain a rational perspective, European politicians, as well as business managers and trade union leaders, should read and study the recent writings and presentations by American professors Jeffrey Sachs, whom many European leaders know personally, and John Mearsheimer. In particular trade unions should apprehend those studies and ideas lest they end up playing second fiddle to a very misleading and Manichean view of the international political situation and of its historical origins (Dumford, 2023) that is diametrically opposed to the interests that unions are said to represent.

The objective of engendering the collapse of the Russian economy – an irresponsible proposition increasing the danger of direct confrontation – turned out to be outright wrong in practice. However, few among us would have predicted the developments that took place in the wider world during the current year. Until early 2022 the yuan played a small role in the exchanges between China and Russia because the US dollar was used instead. After the US imposed sanctions, cut Russia off from dollar-based financial channels, and seized its foreign bank accounts, Russia trade shifted massively to China, being denominated in yuan. Later during the year, the same transition occurred between Saudi Arabia and China, while, between India and Russia, trade is now being conducted in rupees. This is the context in which BRICS met in Johannesburg in August 2023. Fantacci, Gobbi and Luciani (2022) have masterly addressed the issue of the dollar as a financial weapon and I can only refer the readers to their work. The success of BRICS depends as much on its ability to set up a system of settlement not based on any national hegemonic currency as on the range and size of the development projects it will jointly manage to launch. These will inevitably be centered to a very large extent on China. China has the strongest capacity to implement projects that go well beyond the technical engineering capabilities of the other countries, let alone of the United States. In its international projects China tends to involve and work with many foreign companies. For example, in building the innovative high-speed rail between Mecca and Medina that opened in 2018, China cooperated with Spanish firms. Central Asia and Western Asia are becoming the focus of a rather intense infrastructural activity in which, within the BRICS framework, China, Russia and India will play leading roles. However, the EU, which has already largely cut itself off from Russia, is ceding to US pressures aimed against China. The EU, I believe, will play a minor role in Eurasia and Western Asia.[1] The European Union is also likely to be a marginal factor in large segments of Africa. As more countries become members of BRICS, intra-BRICS non-dollar trade and investment will rise at the expense of the European share. To this we must

[1] On 10 September 2023, at the G20 meeting in Delhi, a memorandum of understanding was made public between India, Saudi Arabia, United Arab Emirates, the European Union, France, Germany, Italy, and the United States regarding the creation of a corridor from India to the Mediterranean viewed as an alternative to China's BRI. The trajectory of the India-Middle East-Europe Economic Corridor (IMEC) would involve a sea route from Bombay to Dubai followed by a railway system from Dubai to Saudi Arabia to Jordan to end up at the Israeli port of Haifa. From the latter the cargos are to be loaded onto ships bound for Piraeus in Greece. Setting aside the political issues involved, the IMEC project rides on the back of China. The UAE and Saudi Arabia already have new rail lines, built by China, but they are not integrated with each other. It stands to reason that their integration will be developed by China. The same goes for the Jordan desert stretch. Few if any companies have an expertise in building rail lines in the desert capable of matching China's. Furthermore, the ports of Haifa and Piraeus are under China's administration. The IMEC cannot therefore be implemented without China. As a final remark it is worth noting that IMEC MOU is just a diplomatic document, whereas the Chinese projects are in their implementation phase; to these one must add the North-South corridor linking Russia from Murmansk on the Barents Sea and from Chelyabinsk at the Southern tip of the Urals to the Iranian port of Bandar Abbas on the Gulf's shores.

add the demise of France's influence in a number of central African countries whose governments are likely to look more towards China and Russia.

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