

Magdalena Kinga Stawicka

University for Economics in Wrocław

ECONOMIC CRISIS IN THE FEDERAL REPUBLIC OF GERMANY 2008-2011. EXAMINATION BASED ON A THEORY OF THE KEYNES AND A THEORY OF THE MONETARISM

Preface

The financial crisis which appeared in 2008 in the United States of America converted itself into the largest world economic crisis since the time of the Great Depression dated 30's of the twenty century, and it resulted from three factors: too expansive monetary policy imposed by the FED, too large production of complicated financial instruments characterized by faded responsibility as well as wrong governmental regulations on the mortgage loans market. The first effects of the crisis were obviously observed in the USA, however, because of a serious globalization level of the world economy ("connected vessels") other states also felt effects of the crisis to a some extent. In particular the crisis was observed in states which had been main trade partners of the USA for years, including the Germany. Most of states followed the American economy in order to overcome the crisis. However, the Germans chose their own "path" which presently is rated more effective than the American one. Nevertheless it should be remembered that the starting position of the Germany was much better than situation of other states because of a moderate debt rate of national enterprises and households. German authorities also used economic tools of different natures. From one hand there were used direct investments in the infrastructure (Keynes stimulation), and from the other hand the tax system and the labor market were subject of liberalization which aimed at a decrease in the unemployment rate and to increase the domestic demand. German export was re-organized in such way to enable a quick reaction of German entrepreneurs to needs of develo-

ping markets such as Brazil, India and China, where the growth is mostly promoted by products originating from German export.

The goal of this paper is examination of effects of the financial crisis and undertook anti-crisis measures, exemplified by the Federal Republic of Germany. Opinions of economists on the causes of crises and the ways of overcoming them are very different and it is impossible to present this phenomenon at a one universal level. Therefore, the author will present the phenomenon in relation to the Keynesian theory and the theory of monetarism as two main (and opposing) ideas.

Keynesian economics and monetarism vs. economic crisis

Keynesian revolution is a criticism of a liberal economic thought and a reaction of J.M. Keynes to the Great Depression dated 1929-1933. For a very long time there was observed the laissez-faire principle acc. to which it was believed that correctly acting markets would ensure the best possible results and there is no necessity to observe their mutual relations. It does not mean that the significance of conjuncture cycles was excluded from observation, however, the cycles were perceived as accumulated effects of such phenomena as: epoch-making discoveries, inventions, occurrence of very good or very poor crops or incorrect predictions of companies regarding value of sales or a change in preferences of consumers. On the basis of the Great Depression dated on 30's the J.M. Keynes presented a significant role of the total demand in relation to prosperity fluctuations¹. Observing economies of the Great Britain and the United States of America he concluded that the principles accepted by the classic economics are incorrect since despite existence of a good prosperity, an increase in investments and efficiency of labor, the unemployment rate was growing up while it should have been going down. Therefore, he proposed an approach called "economy of demand" which stated that an economy is not limited by quantity of resources but the "size" of the demand. Acc. to J.M. Keynes the most significant measure of stimulation of an economy there is the investment demand since expenses, instead of savings, result in increase in the national product². He showed how to use an autonomous stream of capital expenses not related with savings, and to use a fiscal multiplier in order to generate new savings. Moreover, the Keynes

¹ M. Burda, C. Wyplosz, Makroekonomia. Podręcznik europejski (Microeconomics. European course book), PWE, Warsaw 2000, p. 24.

² J.M. Keynes, Ogólna teoria zatrudnienia, procentu i pieniądza (A general theory of employment, interest and money), PWN, Warsaw 1956.

promoted active economic policy of states. In his opinion authorities should use some direct and indirect intervention measures in order to have an impact on the course of the economic prosperity. Such conclusions were absolutely different from opinions promoted by classic economics and the theory of the A. Smith, who established a theory of the “invisible hand of the market”. J.M. Keynes believed that the generally accepted theory of the A. Smith had to be replaced by the theory of a “visible hand”, that is a national interventionism. In his opinion, in situation of a crisis a state - apart from implementation of a progressive taxation of large incomes in order to use such resources to finance social benefits - should also become an “entrepreneur” and organize public works of socially useful investment nature (even socially non-useful ones if necessary). Acc. to followers of the afore-presented opinions the employment grows up and even if the budget deficit goes up, a fight against the unemployment must be a priority. Public investments should be financed in form of a public debt since issuance of bonds and sales of bonds to citizens enables a state to keep their savings.

The concept of the J.M. Keynes became an ideal tool for governments which could decide on economic policy on the basis of a simple pattern: fight against the unemployment by decreasing or increasing of the inflation rate, and it meant a hope for permanent economic prosperity. Opinions of the J.M. Keynes were confirmed by so called Phillips’ curve established in 60’s, which by picturing of a direct relation between the unemployment rate and the inflation rate proved that an increase in the inflation rate results in a decrease in the unemployment rate. In 70’s some new theories became popular, in particular the monetarism since economists observed a phenomenon of a stagflation which was not considered by the theory of the J.M. Keynes; what is more, increase in the inflation rate and the stagnation (or economic recession) at the same time contradicted with the Phillips theory.

Monetarism, as a trend of the economics, was established in 50’s. However, its success was observed in 70’s after a defeat of the theory of the J.M. Keynes. The monetarism assumes maximal freedom in the field of the economy and minimal interventionism of a state, aiming at the budget balance and stabilization of value of a currency. Contrary to the followers of the Keynes’ theory, the followers of the monetarism considered the inflation to be the most serious threat for an economy instead of the unemployment. Obtaining of a stable level of employment is conditioned by a stable inflation rate which enables entrepreneurs to operate under stable conditions and a ‘war’ with the unemployment with use of the Keynes’ methods results just in a periodical decrease in the unemployment while increase in the inflation rate in a long term period has a very negative ef-

fects on the entire economy. The followers of the monetarism do not exclude the interventionism of the state totally. Nevertheless, they think that the state should mostly focus on regulation of a cash supply in order to assure desired level of liquidity of the economy. This theory was supported by a number of followers, in particular after the energetic crisis in 1973 and it is associated with a policy run in the USA by R. Reagan or by M. Thatcher in Great Britain.

Analysis of the bibliography devoted to the subprime crisis dated 2007 carried out by the author of this paper shows that the process of looking for persons responsible for the crisis stimulated a number of discussions among economists. L. Balcerowicz³ thinks that many of such opinions and judgments are effects of a very 'shallow' interpretation. Among them one may enumerate calling of the financial crisis to be a crisis of the capitalism. In the L. Balcerowicz's opinion there is no difference between a crisis in the capitalism and a crisis of the capitalism where causes of a crisis are looked for in a private sector. Moreover, this crisis is called to be a crisis of a neo-liberalism or a "greed crisis". The L. Balcerowicz states on the grounds of researches of Ch. Calomiris⁴ regarding the financial crises which appeared in the prior of recent 200 years that too excessive interference of public authorities, which limited or promoted a risk taken by the private sector in different ways and supported a discipline on the market, caused the crisis dated 2007. One may conclude that the ideology of J. M. Keynes is coming back. P. Krugman⁵ thinks that the theories of the Keynes, in the light of the subprime crisis, were not so significant. He compared the present situation to the crisis dated 30's when, in his opinion, the governmental aid was stopped too early. Such opinions attracted many followers and many economists state that an increase in expenses in economies and a trial of provision of aid for the automotive industry made a tendency for unemployment growth slower. Unfortunately, increasing debt of many economies destabilizes their economic situation and situation in other states. Governments of states, which are in difficult situation and those, which are afraid of occurrence of a crisis, are forced to reduce on expenses, reduce on budget deficit and to aim at increase in the economic growth.

Getting back to the M. Keynes's theory, which has presently a lot of followers, one may have a lot doubts. Financial crises are usually preceded with a 'credit boom' which causes that households and enterprises exceed safe limit of a debt rate and a re-

³ L. Balcerowicz, Kryzys finansowy czy kryzys myślenia? (A financial crisis or a crisis of thinking?), www.sgh.waw.pl (01.07.2012).

⁴ Ch. Calomiris, The Subprime Turmoil: What's Old, What's New, and What's Next, "Journal of Structured Finance" 15, Spring, p. 6-52.

⁵ P. Krugman, Keynes. The Return of Master by Robert Skidelsky, "The Observer" 2009, www.guardian.co.uk (01.07.2012).

cession appears. Additionally, researches emphasize that very hazardous booms are those when prices of assets grow up (especially prices of real properties). Therefore, a reason for the financial crisis dated 2007 there is too intensive credit campaign and credited life of citizens, which is contrary to the concept of J. M. Keynes, who stated that insufficient demand is an impulse for a crisis. J. Stiglitz thinks that occurrence of a general world-scale recession is a result of asymmetry of information which is inseparable part of the global market. The market is not perfect and both parties of a transaction has a better or worse knowledge on their partners which causes making irrational decisions by one of the parties at least. Therefore, there is a need for an interference of a state in order to minimize risk of operation on the market, which is recognized to be imperfect.

To reduce on effects of the crisis in the economy of USA the central bank was appointed. Thus, in this case the approach characteristic for the monetarists may be found. The FED, at the turn of August and September of 2007, started decreasing of the interest rates from 5,25% to 0 and it intends to maintain the main interest rate for the federal funds at the 0 to 0,25% level by 2014. An alternative for such an expansive monetary policy was the Paulsen's plan which consisted in provision of capital to banks (bailout) and the FED would be supposed to purchase toxic assets and consequently - to rescue the bank system. This planned called Quantitative Easing was supposed to grow the supply of the money in the economy up, to enhance liquidity of banks and opportunity to obtain credits by entrepreneurs, increase in the employment rate and the consumption. In this plan there is observed a relation to the demand theory of J. M. Keynes. Unfortunately, the aid aimed at banks did not result in their extended credit campaign for entrepreneurs but caused a serious quantity of money in trade without cover. Operations of the FED were accordant with guidelines of the M. Friedman regarding the Great Depression, who claimed that one should not let to fall the supply of cash in economy down and to occur a deflation. Printing of money without a cover, which was supposed to protect the USA from problems referred to above, made the American dollar weak and it in turn increased in incomes generated by the export.

Federal Republic of Germany and the subprime crisis

The Federal Republic of Germany belongs to highly-developed states and it is one of leading economies in the world. In 2004 the German economy generated 6,4% of the world GDP which was the third result in the world after the USA and the Japan. In 2010 the GDP value amounted to 3,28 trillion USD and made

that Germany came fourth; growth of the GDP was equal to 3,7%⁶. It is a highly developed state which is oriented to innovative solutions. From 2003 to 2008 it was the largest exporter in the world. In 2009 export of Germany decreased by 22%, mainly because of the financial crisis, however, it does not stop this economy to maintain a positive trade balance. Acc. to data of the Eurostat⁷ this state exports mostly machines, industrial appliances, metallurgy sector products, chemical products, electronic appliances, precise apparatuses, paper and agricultural articles. Significant role in the import is played by fuels, metal ores and concentrations, machines and industrial appliances, cars, planes, wood, cellulose and agricultural products.

In 2011 the GDP value per capita amounted to 37.900 USD which means 29th position in the world and 7th in the European Union. Worth of mentioning is the fact that since 1998 only in 2009 – during the epicenter of the crisis - a decrease in the tempo of growth of this rate was observed. Nevertheless, in Germany since beginning of 90's the economic growth has been observed. It is a result of unification of the Republic of Federal Germany and the German Democratic Republic in 1990 and necessary investments in the area of the Eastern lands. Cost of the unification of the Germany were estimated from 1990 to 2009 to be equal to 1,3–1,6 trillion USD and a consequence of such expenses was an average annual increase in the GDP rate at a relatively low level, that is 1,5%.

The risk of the crisis was noticed in Germany relatively late since still in 2008 in September it was considered to be the problem of Americans only and there was no need for any aid plan. There even appeared an opinion that the Germany may have benefits from problems of the American banks⁸.

The first noticeable symptom of the financial crisis appeared in the German economy in July 2007 when the IKB Deutsche Industrie Bank AG, which specialized in long-term funds for business (for middle-size enterprises) informed on some problems. What is interesting, this situation was in practice ignored and the bank was supported from the national treasure in amount of nearly EUR 5 billion. In October 2008 the 'borderline' of the bankruptcy was reached by bank consortium – Hypo Real Estate which business was concentrated mostly on the mortgage loans market. Then a credit guarantee program for the Hypo Real Estate in amount of Euro 35 billion was designed in order to prevent a collapse of the entire financial sys-

⁶ The World Bank Group, www.worldbank.org (01.07.2012).

⁷ Eurostat, <http://epp.eurostat.ec.europa.eu> (01.07.2012).

⁸ I. Romiszewska, Kryzys bankowy w Niemczech – rozmiary strat i podejmowane interwencje do 30 października 2008 roku (Bank crisis in Germany – losses and interferences by 30 October 2008), Biuletyn Instytutu Zachodniego 2008, No. 6.

tem of the Germany. It was a common initiative of the government and private institutions which withdrew from this aid plan as they recognized it to be insufficient one. After negotiations held between the government and representatives of private financial institutions there was developed a second aid plan which concerned guarantees in amount of EUR 50 billion. Similarly like in case of the first project the amount of 26 billion was supposed to be provided from the national treasury. Moreover, in cooperation with other central banks the prices of credits for commercial banks were decreased in order to encourage such banks to maintain the credit campaigns for enterprises and households. German financial sector's situation was different from situation of the American economy. A problem of the American economy resulted from not-repaid credits whereby in Germany a problem was a decrease in trust to the bank system as well as limited number of inter-bank operations⁹. Worth of mentioning is the fact that before occurrence of the crisis in the German economy some disadvantageous factors were observed which, together with incoming crisis, increased their negative affection on the German economy. They should be enumerated: strengthening of the Euro (currency) and worsened price competitiveness of German products resulting in a decrease in the export, growing prices of raw materials and energy and consequently, an increase in costs of manufacture, growing inflation rate and insufficient internal demand.

German counter-crisis operations

As it was mentioned before, measures undertaken by the Germans to overcome the crisis were different than the American ones. There were used both, operations characteristics for Keynes, of intervention nature, and monetaristic ones at the international level because of membership of the Germany in the European Union. On 20 October 2008 a stabilization package for Germany was implemented. The aim of the package was establishing of instruments enabling liquidity on the inter-bank market and increase in the German financial market. In the framework of the aid package there was established a stabilization fund. Financial means of the fund originated from issuance of promissory notes up to the amount of EUR 100 billion. The fund must not give guarantees to banks for time exceeding 36 months in order to simplify re-financing for them. In exchange for issued guarantee the banks must pay (maximally) 2% commission which level depends on the risk assessment. The fund

⁹ R. Żmijewski, Niemcy w obliczu światowego kryzysu finansowego (Germans in time of world financial crisis), BESTOSW, Ośrodek Studiów Wschodnich im. Marka Karpia No. 33(67), 15 October 2008, p. 5.

may also obtain shares of credit institutions which have financial problems in order to transfer new capital to them and this process was called a “re-capitalization”. In the aid package new rights were awarded also to a minister of finances who obtained a right to purchase “low quality” shares which are based on non-secured American mortgage loans. Also some significant amendments were implemented, frequently “close” to ideas of the liberalism in the bankruptcy law, balance sheet law and the law regarding shares¹⁰.

Additionally the Germany implemented a business plan which superior goal was provision of the support to enterprises, private institutions, communes and households. The amount of EUR 50 billion was allocated (from the national treasury). It significantly increased in the debt of the public sector. Unfortunately, despite plans of long-term support for consumption, investments, export and reduction on an increase in the unemployment (rate) in Germany, there appeared a decrease in consumption demand which dramatically worsened situation of German enterprises. In order to prevent a series of bankruptcies the government decided to accelerate realization of infrastructural investments using at the same moment the theory of J.M. Keynes and expecting the GDP growth and better situation on the employment market. Also the second anti-crisis package for years 2009–2010 was passed, worth EUR 50 billion. Apart from continuation of realization of the infrastructural investments the fiscal policy of the state was amended. The first tax threshold was reduced from 15% to 14% level and at the same time, the amount free from taxation was increased. The second aid program was mainly oriented to automotive industry where a significant role was played by so called “ecologic bonus” (bonus for scrapping) and, in the framework of the anti-crisis operations there was made a decision on liberalization of the labor law and implementation of principles of “flexible” employment. In the framework of the monetary policy similar tools like in the USA were used, that is the interest rate was very seriously reduced.

Effects of the anti-crisis operations – conclusions

Despite the quick reaction of the German government to the phenomenon of the economic crisis some time was necessary to observe effects of implemented changes. The 2009 was the year of the most painful recession in the post-war history of the Germany, resulting mostly from collapse of the German export and a decrease in the real GDP by 5,1%. The crisis packages implemented by the government may

¹⁰ I. Romiszewska, op. cit., p. 8-9.

be recognized to be appropriate since in the fourth quarter of 2009 the GDP value started to grow up. Obviously, the financial aid in the framework of the aid packages did not manage to protect all entrepreneurs from bankruptcy, however, many of them avoided the insolvency. A consequence of the multi-billion national anti-crisis programs and decreased tax inflows was a growth in the budget deficit in 2009 up to 4,3% of GDP, and in 2010 – 3,2. It meant for Germany that, for the first time since 2005, the state exceeded the deficit level stipulated in the Maastricht. In 2011 it decreased to the 1,7% GDP level. In 2010 a serious growth in GDP by 3,6% took place which resulted most of all from growth of governmental expenses in form of infrastructural investments and consumption related expenses. The biggest success was achieved on the labor market which negated the concept of J.M. Keynes, who opted for rigidity of remunerations. The Germans made the labor market more flexible and decreased its costs. Consequently, the unemployment rate started to decrease. In statistic data of 2011 there were also observed positive changes. The GDP grew up by 2,8%, however, growing of the public debt up seems to be alarming. Acc. to the latest data published in June 2012 it exceeded EUR 2 trillion. J. M. Keynes accepted such a phenomenon in situation when an economy wins a crisis. More alarming than the debt itself is maintenance of low interest rates by the EBC since it may – in turn – cause other bubble, but this time on the German market.

Summary

Generally, an economic crisis is a complicated sequence of mutually related circumstances which have causes and effects. The financial crisis which had appeared in the USA in 2008 converted itself into the largest economic crisis and spread to most of developed states. The goal of the paper is examination of effects of the financial crisis and undertaken anti-crisis activities, exemplified by the Federal Republic of Germany and based on the theory of the Keynes and the theory of monetarism. The author tries to prove that the measures undertook by the Germans to overcome the crisis were different from the measures undertook in the United States of America and moreover, that they were more effective.