A MIRROR IMAGE OF THE EUROZONE BALANCE OF PAYMENTS PROBLEM: USING THEORIES OF INSTITUTIONALISM TO EXPLORE THE INTERNATIONAL MONETARY FUND'S POLICY PARADIGM SHIFT DUE TO GERMANY'S CURRENT ACCOUNT SURPLUS

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ABSTRACT

Justin Chandler Wilcox: A Mirror Image of the Eurozone Balance of Payments Problem: Using Theories of Institutionalism to Explore the International Monetary Fund's Policy Paradigm Shift due to Germany's Current Account Surplus
(Under the direction of Liesbet Hooghe)

This paper serves as an exploratory look into how Germany's current account surplus triggered a policy paradigm shift in institutional response to the persistent imbalance of payments problem during the eurozone crisis. It creates a narrative of how Germany's current account balance came into political focus and why international institutions, in particular the International Monetary Fund, shifted policies away from placing the burden of financial rebalancing on debtor countries toward a more equal policy of assigning some blame to creditor countries. The paper makes use of the concept of policy paradigm shifts and how these changes can occur within international institutions. It also discusses the measure of the current account and later argues that the burden of financial rebalancing is unfairly applied to only Germany, rather that the blame and burden is better assigned more widely to the North of Europe which also has high current account surpluses.

To Johanna, who listened to these ideas far longer than she should have, and who showed me the countries on this continent are more than the sum of their parts.

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I. INTRODUCTION

Global financial governance is a concept which seems too far removed from mainstream politics to garner much attention, just as the concept of European financial governance stirs the pejorative loss of nation-state sovereignty, bail-outs, and austerity measures. But such ideas are not as far from the mainstream in recent history, especially since the eurozone crisis of 2009. The frequency of the word combination "governance" and "financial markets" has increased in media six times since 2008 as compared to before. To what degree are sovereign nation-states accountable to one another in the world economy? To what degree are they accountable to one another in terms of global balance of payments?[1]

This paper serves as an exploratory look into how Germany's current account surplus has triggered a paradigm shift in institutional response to the persistent imbalance of payments problem during the eurozone crisis. It will create a narrative of how Germany's current account balance came into political focus and why international institutions, in particular the International Monetary Fund, shifted policies regarding creditor and debtor countries. It will look at how these institutions shifted away from placing the burden of financial rebalancing on debtor countries toward a more equal policy of assigning some blame to creditor countries, namely Germany, and how this, in turn, affects Germany's position in the Eurozone. The paper makes use of the concept of policy paradigms and policy paradigm shifts and how these changes can occur within international institutions. It also discusses the importance of the current

[1]Henrik Enderlein. "Global Governance der internationalen Finanzmärkte" in *Politik und Zeitgeschichte. Bundeszentralamt für politische Bildung*, 2009.

account as a measure of balance of payments and later argues that the burden of financial rebalancing is unfairly applied to only Germany, rather that the blame and burden is better assigned more widely to the North of Europe which also has high current account surpluses.

II. POLICY PARADIGMS AND THE CURRENT ACCOUNT

A policy paradigm is not only the product of a single actor, but the product of pluralist interests in democratic discourse. According to Peter Hall, organized interests, especially political parties, influence the policy paradigm even when they are not in government by challenging current policy and promoting their own policies which, when past policy is taken into account, creates the path-dependent pattern of policies called policy paradigms. [2] To borrow the adage, the whole is greater than the sum of its parts. While an individual policy can be studied in and of its own merit, a policy paradigm is a series of related policies which can have, for example, common long-term goals or some other form of consistency. These policy paradigms are quite often path dependent, aggregating and complementing one another as time progresses. Because of the factor of time, a path dependent policy paradigm is more difficult to break with the longer the paradigm has been established. It becomes the status quo—the starting point from which new policies must be measured. Using the concept of policy paradigms, this paper will look at the policy shift which occurred among international actors in 2013 in regard to the eurozone's balance of payments problem during the financial crisis.

Another important concept for this paper is the balance of payments measure called the current account. According to International Monetary Fund standards, the current account is a balance of payments measure comprised essentially of a country's exports minus imports, plus income earned outside of the country as well as transfers of money by private citizens back into

[2] Peter Hall. "Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain" in *Comparative Politics*, Vol. 25, No. 3, April 1993.

the country, such as remittances.[3] The measure has the importance of representing the overall money coming in to a country. What is 'current' about the current account is that it is more a measure of liquid capital. The other balance of payments measure, called the capital account, is a measure of the change in illiquid assets during a certain time period, measuring how much of a country is owned by outside investors or how much investors in a country own of another country. The current account and the capital account together make up the balance of payments. This paper will focus on Germany's current account surplus because of its significance in the mid 2013 IMF policy paradigm shift.

[3]Balance of Payments and International Investment Position Manual". *International Monetary Fund*. Sixth Edition. 2008.

III. THE PRE-CRISIS POLICY PARADIGM AND THE EURO

This section summarizes the policy paradigm in the eurozone before the 2013 shift. It first takes a historical look at the necessity and creation of the eurozone by going back to the Maastricht Treaty. It also shows that the lack of fiscal integration at the European level was made up for by the enshrinement of hard German monetarist principles into European-level institutions. Finally, this section explores the creation of the International Monetary Fund in the Bretton Woods System and the development of its competencies an international institution.

History of the Eurozone

The difference between monetary and fiscal policy, as well as these policy's varying degrees of implementation on the EU level, is an important distinction in the logic of this paper. Firstly, monetary policy was permanently institutionalized across participating EU member states by the Maastricht Treaty. This created the eurozone, but it was not the first time that EU member states coordinated monetary policy. The EU undertook economic and monetary union because of the problems associated with fluctuating exchange rates, creating problems for businesses, individuals, and even the EU as a centralized economic entity. Coordination of the Common Agricultural Policy (CAP), developed very early on into the EU's existence, is one such example of the difficulties that multiple currencies caused the EU in its early years.[4] To tackle such exchange rate problems, a common monetary policy was needed. But fiscal integration was not added to the monetary integration. The German Bundesbank's tough

[4]Barry Eichengreen. *Globalizing Capital: A History of the International Monetary System*. ebook. Ch. "After the Bretton Woods System: Floating Exchange Rates in the 1970s". Princeton University Press, 2008.

monetarist approach was embedded in the Maastricht Treaty and is institutionalized at the EU level in the form of the European Central Bank.[5] The ECB's original mandate of price stability and low-levels of inflation were paramount while unemployment rate reduction was not made a priority. Erik Jones' summary of the Maastricht Treaty's convergence criteria takes five points required by each member state:

1. enactment of legislation ensuring the independence of the member state's central bank from political pressure;
2. participation in the Exchange Rate Mechanism of the European Monetary System without the realignment of currency or experiencing unusual volatility for two years;
3. fiscal deficit of 3 percent or lower, or to show evidence that the deficit will be as such, and that public debts are below 60 percent of GDP, or are declining to such levels;
4. inflation rate within 1.5 percentage points of the "three best performers in terms of price inflation"
5. long-term interest rates within 2 percentage points of the "three best performers in terms of price inflation".[6]

Many of these criteria were modeled after the German Bundesbank and its tough approach to curb inflation. But all of these criteria were not met by the member states. The third point, providing for the guidelines for the prescribed fiscal deficit and amount of public debt, was enshrined in the Stability and Growth Pact which brought oversight and enforcement mechanisms to these criteria when the members were already participating in the Eurozone.

The Stability and Growth Pact (SGP) in 1997 imposed a "political and legal obligation" on eurozone members to participate in a peer review system of budget surveillance, serving as a sort of ersatz-fiscal union. While a French proposal once suggested an 'economic government'

[5]Philip Arestis and Georgios Chortareas. "Monetary Policy in the Euro Area" in *Journal of Post Keynesian Economics*, Vol. 28, No. 3. 2006.

[6] Erik Jones. "European Economy and Economic Governance" in *Europe Today*, Third Edition. Ronald Tiersky and Erik Jones, eds. Rowman and Littlefield, 2007: 299.

to serve instead of a true fiscal union, the Maastricht Treaty and the SGP ultimately included a 'no bail-out clause' which removed obligation from eurozone countries to bail out one another.[7] The SGP and the Maastricht Treaty are policed by the finance ministers of the member states (Ecofin) and are also monitored by the European Commission, which can impose sanctions on the offending member state.[8] As is evident because of the financial crisis, the Maastricht Treaty's commitment to creating economic and monetary union was insufficient in creating a eurozone strong enough to weather balance of payments crises. The financial crisis pushed the EU more in the direction of fiscal coordination, but still resulted in the EU's rather characteristic informal coordination and flexibility in regard to fiscal matters.[9] Although the impetus for fiscal union existed at one point in the discourse of EMU, steps toward it have not been pursued very hard by EU member states.

History of the International Monetary Fund

On the global stage, the International Monetary Fund was created in 1944 as part of the Bretton Woods system in order to achieve global exchange rate stability. Barry Eichengreen explains that the Bretton Woods system "dispatched with payments problems, permitting the unprecedented expansion of international trade and investment that fueled the postwar boom."[10] He goes on to emphasize that the Bretton Woods system was part of the Washington Consensus, the United States-favored agreement in post-WWII international finance and economics. The IMF played was very integral role in that postwar order, providing stability to

[7]Amy Verdun. "The EU and the Global Political Economy" in *International Relations and the European Union*, Second Edition. Christopher Hill and Michael Smith, eds. Oxford University Press, 2008, pp. 256-7.

[8]Desmond Dinan. *Ever Closer Union*. Fourth Edition. Lynne Rienner Publishers, 2010: 402.

[9]Daniela Schwarzer. "Zehn Jahre Governance der Eurozone : ökonomische Bilanz und institutionelle Dynamiken jenseits der Vertragsrevisionen" in *Integration: Vierteljahreszeitschrift des Instituts für Europäische Politik in Zusammenarbeit mit dem Arbeitskreis Europäische Integration*, Vol. 32, No. 1, 2009, pp. 26-9.

[10]Eichengreen. 2008. ebook Ch. "The Bretton Woods System".

international exchange rates due to its power to “sanction governments responsible for policies that destabilize the international system and compensate countries that were adversely affected”.[11] But Eichengreen is in part incorrect in this last sentence. The IMF has not always sanctioned countries which disrupt international balance of payments, rather it has sanctioned debtor countries rather than creditor countries simply because of

a) the perception that debtor countries are those countries which disrupt international balance of payments, and

b) debtor countries are usually the only countries which apply for IMF funding, through which the IMF can use its conditionality powers to influence policy change.

These points are elaborated further in the following section. But the changing nature of the IMF, especially the competencies it has given itself since its founding, should not be ignored. At its founding, the IMF had fewer competencies than it has today. Michael Barnett and Martha Finnemore write that “today’s International Monetary Fund is not the organization anticipated by the states at its founding in 1944”.[12] The changing nature and expanding competencies of the IMF are examined in further detail in the following subsection.

The Autonomy of International Institutions

There are two views on international institutions. One view is that international institutions serve the common needs of their member countries and are products of state agreements, meaning that the aligned interests create the institution to increase efficiency. The second view is that international institutions can develop policies of their own, and this may leave room for inefficiency as is true with any large-scale organization-- bureaucracy or

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[11]Eichengreen. 2008. ebook Ch. “The Bretton Woods System”.

[12]Michael N. Barnett and Martha Finnemore. *Rules for the World: International Organizations in Global Politics*. Cornell University Press, 2004, p. 45.

corporate actor. These distinctions will provide a good starting point in determining the original intent and the current practices of the IMF.

Prominent state-centric/realist theories of international institutionalism owe a great deal to John J. Mearsheimer. In his 1994 paper "The False Promise of International Institutions", Mearsheimer distinguishes between realists and institutionalists, writing that realists see institutions on the sidelines while state actors affect international affairs. [13] If institutions do anything, in the realist view, it is minimal in comparison to state actors. Institutionalists, Mearsheimer writes, vary in their conceptualizations and degrees in which institutions aid state actors in cooperation with the end goal of peace. But what is common to these theories of institutionalism is an assumption of their significance in international affairs. Mearsheimer finds this assumption to be false, and that the promulgation of institutionalist theories to be a paradox because of their optimistic fashion even without supporting evidence to their validity.

Retorting Mearsheimer's state-centric theories were Robert Keohane and Lisa Martin who, in their 1995 article "The Promise of Institutionalist Theory", champion the effects of international institutions in the wake of the collapse of the Soviet Union.[14] Mearsheimer, they write, predicted the weakening of NATO and the European Community following the end of the Cold War. Keohane and Martin write that Mearsheimer "could have added that [governments] invest material and reputational resources in NATO, the EU, and also in organizations such as GATT [(now the World Trade Orgnization)], and NAFTA". [15] What Keohane and Martin show is that state actors are institutionalists themselves, promoting common interests at the international level to manage expectations from other governments and eliminate or downplay

[13]John J. Mearsheimer, "The False Promise of International Institutions" in *International Security*, Vol. 19, No. 3 (Winter, 1994-1995), p. 47.

[14]Robert O. Keohane and Lisa L. Martin. "The Promise of Institutionalist Theory" in *International Security*, Vol. 20, No. 5 (Summer 1995), pp. 39-51.

[15]Robert O. Keohane and Lisa L. Martin, 1995. pp. 39-51.

informational asymmetries in global affairs. While Mearsheimer focused primarily on state motivations such as survival and security, Keohane and Martin show that when survival needs are met, states use international institutions very regularly to meet long-term and wide-reaching policy goals.

Barnett and Finnemore discuss the shortcomings of the state-centric theory of international institution creation by explaining the "power of [international organizations] and their propensity for dysfunctional, even pathological, behavior."[16] They note that the realist perspective assumes that states create international institutions in areas in which there is inefficiency in policy coordination in which mutual gains can be made and Pareto optimality achieved. This sort of approach to explaining why and in which policy area international institutions are formed by states can be compared to economists' theories on why firms appear. Rather than customers in cities conducting business directly with farms, for example, supermarkets are formed to create more efficiency in the agricultural/food industry. This same principle is applied to the creation of international institutions in areas in which states agree to common, general policy goals, meaning at minimum a base level of agreement that continued cooperation will increase the welfare for states involved.

Barnett and Finnemore criticize this view, writing that "mainstream approaches in political science that are informed by economic theories have tended to locate agency in the states that comprise [international organization] membership and treat [international organizations] as mere arenas in which states pursue their policies".[17] After creation, they write, there is little attention to subsequent developments within the institutions in respect to how

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[16]Michael N. Barnett and and Martha Finnemore. "The Politics, Power, and Pathologies of International Organizations" in *International Organizations*, Vol. 53 No. 4 (Autumn 1999) p. 699.

[17]Michael N. Barnett and and Martha Finnemore. "The Politics, Power, and Pathologies of International Organizations" 1999. p. 726.

their day-to-day functioning morphs from the intended mandate of their state creators and their actual effects.

Instead of relying so heavily on the realist approach, Barnett and Finnemore argue that international institutions gain autonomy and different competencies as they change and develop a sort of sentience on their own. They argue that treating international institutions as their own independent actors is a better approach than assuming they are always serving their member states' interests.[18] While inter-state bargaining is the cause of these institutions' creations, an institutional autonomy develops. This is especially true at the IMF because of its budgetary structure and its expertise in its competencies which gives its staff agenda setting power. The IMF is not funded by annual state allocations, rather staff salaries and other operating costs are paid for by the interest it collects on loans to member states.[19] These factors contribute highly to the IMF's gains in autonomy.

The unique history and organization of the IMF accounts for its rather high level of autonomy from its member state founders. By assessing the institution's changing competencies in comparison to its original mandate, the IMF can be seen as an autonomous actor in and of itself. Barnett and Finnemore argue that changes made at the IMF cannot be attributed to new demands by the states, but that the IMF actively created its own policy goals and helped to set its own agenda. Many of the staff experts at the IMF, they write, drove many developments solely because of their expertise in economics. The changing of the institution's competencies undertaken by the IMF itself were in response not to the institution's success, the authors write, "but because of [the IMF's] persistent failure to stabilize the economies of the

[18]Barnett and Finnemore, "The Politics, Power, and Pathologies of International Organizations" in International Organizations, 1999. p. 704.

[19]Barnett and Finnemore. *Rules for the World: International Organizations in Global Politics*. 2004, p. 49-50.

member states."[20] The IMF's original competencies were much more limited than they are today; had these original competencies sufficed to stabilize exchange rates and alleviate balance of payments problems, it would have had little reason to expand the tools it used to achieve those goals. The ever-expanding competencies of the IMF lead to the argument that the institution is a decision-making actor autonomous of state control.

[20]Barnett and Finnemore. *Rules for the World: International Organizations in Global Politics*. 2004, p. 49-50.

IV. A POLICY PARADIGM SHIFT IN CRISIS RESPONSE

There occurred in the last half of 2013 a paradigm shift in how international actors and institutions saw Germany's position in the eurozone crisis. These international institutions could be said to have allied themselves with the economic policies of the German government, promoting its example to the periphery economies. This was the paradigm. But Germany found itself on the opposing end of the accuser/accused dichotomy in 2013 when the issue of its current account surplus was raised. Germany is now no longer seen as the austere model to follow, and its requirements of austerity measures in periphery countries have lost their traditional support from the IMF.

This policy paradigm shift can be described as a Third Order Change, according to a rubric laid out by Peter Hall in an article on the economic reforms of Britain's conservative government in 1979. First and Second Order Changes deal with policy changes that still follow the paradigm, that is the pattern or policy legacy, and are therefore not such radical changes.[21] But a Third Order Change is in essence a more marked upheaval in policy change that is unique and requires a more in-depth look. Hall writes that Third Order Changes, while still policy changes that use new tools because of dissatisfaction with older policies, are so markedly different in that they disregard policy legacies by completely changing the goals of the original policy changes in the first place. Applied to the situation with Germany in 2013: Germany and its favored austerity measures were promoted to the crisis periphery, then there was a policy

[21]Peter Hall. "Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain" in *Comparative Politics*, Vol. 25, No. 3, April 1993, p. 281-4.

change. Although eurozone recovery is still the ultimate policy goal, austerity measures have thus far proved to be insufficiently satisfactory in crisis resolution. Instead of forcing austerity measures on crisis countries and promoting the interests of creditor countries (like Germany), the IMF broke with this policy legacy and began criticizing Germany's high current account surplus as a major source of hindrance to eurozone recovery.

The IMF itself has admitted to the policy change, citing mismanagement in its response to the bailout of Greece which led to the now European-wide sovereign debt crisis. An internal policy communication was cited by multiple news organizations as saying that the IMF had "badly underestimated the damage that its prescriptions of austerity would do to Greece's economy".[22] The IMF document also said that the institution's own criteria for aid qualification was manipulated so that Greece could receive loans, as Greece failed on 3 out of 4 of the main criteria to qualify for aid. The criteria manipulation was defended by the IMF as a way to alleviate the short-term shock of the Greek debt crisis so that its effects on the rest of the euro zone could be better managed. IMF criteria were changed in 2010 to allow countries "exceptional access" to credit lines, but even Greece failed to meet these new criteria for credit access. But do IMF measures targeted toward the periphery-in-crisis help or harm? The answer requires a step back to assess eurozone balance of payments problems.

[22]Matina Stevis and Ian Talley. "IMF Admits Mistakes on Greece Bailout" in *The Wall Street Journal*. 5 June 2013.

V. CAUSALITY OF GERMANY'S CURRENT ACCOUNT SURPLUS

This section draws on two contrasting opinions of experts, each expert serving as a motif for two ideological camps which align more or less with the views that either German policy created the current account surplus predatorily or that the current account surplus is unconnected with German policy. The two opinions serve as articulations of the two camps forming to explain the significance of Germany's current account surplus, whether the surplus has negatively affected eurozone recovery, and what or even if policy can be changed to rectify its negative effects. The difference in opinion can be generally expressed as a disagreement over the a) causality of the surplus, and b) whether the surplus is a causal factor in the financial imbalances within the eurozone or simply a product of them.

Niall Ferguson, a Harvard historian who has also written extensively on economics, posits the more general assumption that Germany is to blame for the current euro savings glut. He writes that the current account surplus is simply an effect of Germans' low consumption and high savings, an opinion shared by perhaps the majority of popular commentators. But Hans-Werner Sinn, an economist at the University of Munich, writes a direct retort to Ferguson's blame of Germany. Sinn writes that Ferguson is off the mark by falsely attributing the causation of the current account surplus to low consumption and high savings, when in fact the current account surplus is reflective of the greater problem of imbalance of payments. In Sinn's view, periphery economies proved to investors that they were insecure investments, causing capital to fly to the more secure North of Europe and the low-inflation stronghold, Germany. Sinn is quick to point out other economic indicators show that Germany is far from a so-called 'winner' of eurozone membership.

So these two dichotomous viewpoints offer different solutions because of the different conceptualizations of the problem. Looking at the Ferguson argument, if Germany's current account surplus is a result of low consumption and high savings, then the fiscal policies of the German government are to blame for at least some portion of the long continuation of the instability of the eurozone periphery. This comes from the assumption that Germany's high rate of exports, which lend a positive number to its current account balance, are not offset enough by German consumption of foreign imports. Consumption of imports is a negative number in the current account balance; but because of low rates of consumption of foreign-manufactured products, this negative number is much smaller than the positive number representing German exports. So the equation remains positive, thusly called a current account surplus. But this balance is seen by those of the Fergusonian line of thinking as being too great of a surplus. The surplus represents capital which could be invested in the periphery economies, or money which could have been in the periphery economies since before the crisis if Germans would consume as much as they manufactured. So in the Fergusonian view, the German current account surplus is a sort of siphon, removing and hoarding German profits in Germany and not returning them to the periphery. Fergusonians portray Germany a sort of "Euro Winner", the country which benefited most from EMU.

But directly contrasting this opinion is the view of Hans Werner Sinn. Writing a criticism of Ferguson in The Financial Times called blatantly "It is wrong to portray Germany as the euro winner", Sinn reverses the causality argument. It was not German policy which caused the current account plus, rather the combined influence of policies of the periphery countries and the start of the US financial crisis which sent capital flying back to more stable Germany. Sinn emphasizes this point about the measure, noting that balance of payments is actually a measure of capital flows. The country with the surplus experiences a boom/influx of capital, wages rise because of it, and therefore products become internationally less competitive thusly reducing exports and rebalancing the current account.[23] The periphery economies simply suffered from cheap access to credit brought along with EMU and are experiencing the pop of a bubble. Investors pulled money out of these countries and invested it into safer Germany.

Because the two camps differ primarily on the causality of the surplus, policy approaches to relieve the persistent capital imbalances across the eurozone differ wildly, especially when based on the two starkly contrasted interpretations of the current account surplus. The Fergusonian view calls for actionable policy change, believing that Germany can and should change policy to increase domestic consumption in order to correct the current account imbalances in the eurozone.

Those of Sinn's view believe that Germany cannot effectuate change in eurozone imbalance because the current account surplus is a symptom of factors external to Germany and therefore no German-specific policy change is needed. Sinn cites the US financial crisis as the trigger for the European debt crisis, which primarily affected member states in the periphery of the eurozone. These periphery member states' policies are more to blame than Germany's, and Germany's resilience throughout the Euro Crisis is not reason to assume that its policies are predatorial. In a working paper for the National Bureau of Economic Research, Sinn attributes eurozone payments imbalances to the Target international payment system used between eurozone member states' central banks. [24] When adjusted for different account practices used by periphery central banks, current account deficits in the periphery can be traced to credit from other eurozone countries. Sinn writes that "while the printing presses in the periphery overheat,

[23]Hans-Werner Sinn. "It is wrong to portray Germany as the euro winner," in *The Financial Times*, 22 July 2013.

[24]Hans-Werner Sinn and Timo Wollmersshaueser. "Target Loans, Current Account Balances, and Capital Flows: The ECB's Rescue Facility" Working Paper 17626. *National Bureau of Economic Research*. November 2011.

the printing presses in the core have been converted to money shredders".[25] This emphasizes the point that wider access to credit in the periphery was unsustainable. Governments of the periphery as well as private firms benefited from cheap access to credit when joining the EMU—cheap credit brought on because of the stability of the currencies and economics of German and other Northern European eurozone member states. Access to such cheap credit created an influx in capital, which is evident in hindsight with examples such as the popping of the Irish and Spanish housing market bubble collapses. Sinn writes that once these capital markets proved to be unstable, investors retreated and kept their funds in euros in more secure countries in Germany and the North of Europe. Capital flows, in this respect, are important to understanding the changing value of current account balances within the eurozone.

Explanation by Capital Flows

Bank loans across member state borders are important for equalizing interest rates across the EU. Restrictions on capital movement in Europe have long been liberalized. A German company can easily take out a loan from a French bank as if it were a domestic loan. But since the crisis, inter-European lending is at a low point. Before 2008, funds held by foreigners in member state banks had been rising, but totals in Q1-2013 had dropped to mid-2005 levels.[26] In a speech to the European Forum in Alpbach on 9 July 2013, Yves Mersch, member of the Executive Board of the ECB, commented "We do not yet have the right powers at the European level to support a Single Market in capital".[27] He continued, "When placed under stress, financial markets in Europe have renationalized, with negative effects on the Single Market in goods and services, as well." The renationalization of capital negatively affects the current account balance of countries in the periphery, and positively affects eurozone countries

[25]Hans-Werner Sinn and Timo Wollmersshaueser. 2011, p. 17.

[26]*Financial Times*, "Bail-in fears grow for big depositors". Christopher Thompson and Ralph Atkins. 1 July 2013.

[27]Yves Mersch. *Speech to the European Forum* at Alpbach. 29 August 2013. Retrieved from the website of the European Central Bank.

which did not experience such turmoil in their financial markets. This means that countries already in debt crisis experienced a compounded effect because capital was withdrawn from these markets, making credit more expensive.

The circular problems created from this retrenchment of capital out of crisis countries when they experience crisis is obvious. But the outflow of capital from Country A means an inflow in Country B. For country A, this leads to a current account deficit. Other economic indicators for Country A are also negative, including government spending, perhaps GDP growth, and others. Country B, which experiences in inflow of capital which left Country A, experiences a current account surplus. This should not be confused with increased living standards, but it can be associated with cheaper capital. Cheaper capital can create temporary booms, leading to increased wages. But increased wages lead to exports which are less competitive on the global market, which decreases Country B's exports and leads to a current account rebalancing. So the causal relationship between current account and other economic indicators can be confused. A negative current account can stem from economic crises which cause a decrease in exports as in the eurozone periphery, but it can also stem from structural differences. The United States and United Kingdom, for example, have higher current account deficits than every OECD member, but are huge financial service centers and whose economics are less export-oriented, so the measure of current account is less important for such countries.

Falling Import Prices affecting Current Account

Another explanation for an increase in German current account surplus is falling prices on key imports. The German Federal Bureau of Statistics (Statistisches Bundesamt) notes that prices of German imports fell by 2.3% in January 2014 compared to January 2013.[28] Falling prices of Germany's main imports also contribute to a surplus in the current account, especially when export prices are held constant. So a portion of Germany's rising current account surplus

[28] Statistisches Bundesamt. D-Statis. *Press release 068,* 27 Feburary 2014.

comes from the mere fact that the prices of goods imported into Germany are falling on the average. The significance of drops in import prices may be low, but this illustrates the idea of incomplete information being used to form new policy decisions because of Germany's current account balance. Rising prices of German exports and falling prices of German imports contribute to a current account surplus just as much as a fall in import consumption, or perhaps persistent low levels of import consumption as Niall Ferguson suggests.

VI. 2013 POLICY PARADIGM SHIFT EXPLANATIONS

One major question to address in such a paper is the timing of such a shift—the 'why now?' question. Why did a cohort of institutions, each of which representing creditor and debtor countries alike, suddenly in mid 2013 change their prescriptions for handling the crisis? The Commission, ECB, and IMF count countries in both the periphery and core of Europe as stakeholders, of course to varying degrees. It can be argued that the ECB and Commission both have political mandates to equally represent each country within the European Union, so these institutions are much closer to the European debt crisis than the IMF, whose members are not exclusively from the EU. The IMF, on the other hand, is an international institution which assigns voting rights by share quotas, i.e. votes are assigned by how much money is contributed to the Fund. Perhaps a larger stakeholder in the IMF could influence policy more so than a smaller stakeholder. Or perhaps a policy shift was always on the table and only came to fruition in 2013? Such questions are explored in this section.

Policy Shift due to Change in IMF Voting Weights

The IMF assigns votes based on contributions to the Fund from its members, meaning that a country which contributes more money to the Fund and therefore is a larger stakeholder gets a larger percentage of votes determining the Funds decisions. Because of historical reasons, a majority of the Fund's votes are controlled by advanced Western economies, the largest shareholder of which is the United States. Changes in the assignment of voting weight have been made regularly throughout the history of the Fund. But do the most recent changes in voting weight account for a change in the Fund's change in policy toward debtor countries?

The IMF instituted a voting change, agreed upon in 2008, to readjust the voting weights of countries to more accurately reflect the changing global economic landscape in respect to the emerging and developing economies. Looking at an official IMF document summarizing a review process of the changes implemented in 2011, entitled "Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review", IMF Board of Governors members were split on their opinions regarding the new voting weights, saying that the changes were sufficient or insufficient in reflecting the changes in the global economy.[29] Voting shares, however, did not change drastically due to the 2010 reform.[30] A change in IMF decision making because of this change in voting weights can be safely ruled out.

Institutionalist Explanation for the Policy Shift

The autonomous actorness of the IMF can account for new policies which do not conform to the wishes of the IMF's member states. The IMF does have agenda setting power, so its staff controls which potential decisions the IMF Board of Governors can make simply by adding or leaving off a topic from the agenda. Because of the IMF's perception of expertise in the area, and because it is staffed almost exclusively by highly trained economists, the Fund is deferred to regularly on the international stage as having more and better information than many other international actors. Its expertise has moved the IMF to take on new competencies during its history for which it did not have the mandate at its founding. Conditionality and technical assistance were the original two tools expressly permitted to the IMF, i.e. creating certain standards before a loan could be administered and offering technical advice to member states.[31] The IMF, however, has expanded from these original competencies and incorporated

[29]"Report of the Executive Board to the Board of Governors on the Outcome of the 2010 Quota Formula Review". *International Monetary Fund*. 2013.

[30]"Quota and Voting Shares Before and After Implementation of Reforms Agreed in 2008 and 2010". *International Monetary Fund*. 2013.

[31]Barnett and Finnemore, 2004, p. 46.

structural reform into its arsenal. Historian Mike Mazower writes bluntly on the IMF's structural reform competencies, "If borrowing countries could not be trusted to carry out the necessary internal adjustment by themselves, the IMF would tell them how."[32] He continues, calling the IMF the "cruel doctor of fiscal health" as it became "not merely a funder but an engineer of domestic policy changes". The IMF slashed public spending, set targets for fiscal and monetary policy in borrowing countries, and embarked on neoliberal policies such as lower tariffs and fewer capital controls. Barnett and Finnemore also write that the IMF promoted the Washington Consensus of neoliberal economic policy. [33] The IMF clearly pursued its own policy agenda with tools it added on its own to its portfolio of domestic policy-influencing tools.

Does the institutionalist view of seeing the IMF as an autonomous actor explain the 2013 policy paradigm shift? It explains quite well the development of the policy paradigm before the crisis, but it does not lead to a justification of why the policy paradigm shift occurred. It can be argued that a policy paradigm shift occurred in IMF economists' thinking, but there is no evidence of this and can only be speculated. After several years of an ongoing eurozone financial crisis, the IMF could have decided to break with its policy paradigm of debtor-side-only burden with a policy of burden sharing between debtor and creditor countries. Peter Hall writes that such policy changes do not come from nowhere, rather that these ideas exist in the institution and are brought up because of changing factors not only outside of the institution but also from within.[34] The changing factors which could be the impetus for the IMF policy paradigm shift are the

1) longer-than-expected duration of the crisis as well as

2) the unprecedented level of debtor countries located in Europe.

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[32]Mazower, Mark. *Governing the World: The History of an Idea*. Penguin Books, 2012. ebook, Ch. "The Real New International Economic Order".

[33] Barnett and Finnemore, 2004, p. 46.

[34]Hall, 1993, p. 283-4.

Traditionally, the IMF's core of creditor countries were located in the Western world and its debtor countries in the developing world. This dichotomy was shuffled, perhaps causing some IMF economists to critically assess the policy paradigm of assigning burden to only the debtor countries. In terms of current account, assigning blame and burden to only one side of the balance of payments mirror can be shortsighted.

Barnett and Finnemore write on this mirror image of balance of payments in their 2004 book to show the problem on focusing on solely debtor countries:

> There are other ways of conceptualizing balance of payments issues that locate cause and solution differently, and therefore create different foci for policy and different intellectual justification for assigning the burden of adjustment. For example, in theory every deficit has a mirror surplus somewhere in the system. Analysis of these relationships would entail construction of systemic models of payments rather than country-by-country models. Such a framework would suggest some different methods for managing payments imbalances, notably inducing adjustments in surplus states. In the Fund's intellectual and policy framework, adjustment is compulsory only for deficit countries; for surplus states it is voluntary. Theoretically, one obvious direction that the Fund's work could have taken would have been to expand Fund influence over surplus states in some way as a means of promoting systemic adjustment. [35]

The mirror image of the balance of payments problem was not historically accounted for by the IMF. Countries in need of assistance applied for loans, and these loans were the policy tool of the IMF to set its terms of conditionality and structural reform. Creditor countries did not apply for loans and therefore were immune to the IMF's policy tools.

Summarizing, the IMF, an international institution, went beyond its original mandate by adding new competencies to its portfolio of available policy tools while also undertaking a distinct agenda of its own. Its method of funding itself through interest rates on loans to member states as well as its agenda setting ability for the IMF Board of Governors overseers led to its increasing autonomy and actorness-capability. But attributing the 2013 policy paradigm shift to the IMF as an autonomous actor cannot be done with certainty because of the speculation to what happens in the IMF behind closed doors. The paper now attempts to

[35] Barnett and Finnemore, 2004, p. 55.

explain the policy change through the possible factors, first looking at the state-centric realist explanation.

Realist Explanation of the Paradigm Shift

The conceptualization of international institutions as policy avenues or arenas for state actors is considered as the mainstream in political science; institutional actorness is rather new in comparison. But ruling out the influence of the IMF's member states in the Fund's decisions making process is shortsighted. IMF decisions are still taken by a Managing Director, chosen by a Board of Governors representing the member states which meets a handful of times per year. Although the case for the historical autonomy of the IMF has been laid out in this paper, state influence cannot be entirely discounted. Even after voting reallocations previously discussed, post-industrial economies remained the primary stakeholders in the IMF, the largest of which is the United States.

Has the IMF been used as a policy avenue or even a policy microphone by its majority stakeholders? The case for state influence in the IMF is as strong as its autonomous actorness. As previously discussed, the IMF promoted the Washington Consensus of neoliberal economic reforms in its conditionality and structural programs—policies championed by the United States, the IMF's largest stakeholder. Quoting a Republican senator, Mark Mazower quips "If the United States were to embark on a very heavy-handed effort to try to change domestic policies within recipient countries, we would be viewed as the ugly American. But when the international community as a whole does so, then I think real changes can be put into place, and that is what is needed in a lot of those countries." [36] Mazower adds that the "IMF had a better chance of persuading South American or East Asian governments to push through unpopular political domestic reforms than the U.S. Treasury".[37] The potential use of the IMF as a policy

[36]Mazower, 2012. ebook, Ch. "The Real New International Economic Order".

[37]ibid.

avenue of the United States is evident. But this alone does not prove policy coordination between the Fund and the United States government.

The timing of policy shifts by the United States and subsequent policy paradigm shift by the IMF should not be seen as entirely coincidental. The United States Treasury released its "Report to Congress on International Economic and Exchange Rate Policies" on 30 October 2013. In the report, the Treasury places a burden of action on countries "with large and persistent surpluses" as needing to "take action to boost domestic demand growth and shrink their surpluses".[38] The Treasury report singles out Germany as having a nominal current account surplus larger than that of China, calling German domestic demand growth "anemic" and that German dependence on exports has "hampered rebalancing at a time when other euro-area countries have been under severe pressure to curb demand and compress imports in order to promote adjustment." The report also blames Germany for a deflationary bias for the eurozone as well as the global economy.

The day following the release of the 30 October U.S. Treasury Report, IMF First Deputy Managing Director David Lipton spoke in Berlin regarding Germany's role in the world. Lipton also agreed with the U.S. Treasury report saying that a "significantly smaller current account would be useful".[39] The timing of such a radical policy shift surely had been coordinated at some level among U.S. Treasury and IMF staff, if not among top managing directors.

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[38]"Report to Congress on International Economic and Exchange Rate Policies". *United States Department of the Treasury, Office of Internal Affairs*. Report dated 30 October 2013.

[39]David Lipton. Speech entitled "Transitions in an Interconnected World and Germany's Role" at the American Academy in Berlin, Berlin, 31 October 2013.

VII. GERMANY'S CURRENT ACCOUNT HYPE

The criticisms of Germany's fiscal policy cited the country's growing current account surplus as a problem in the balance of payments between eurozone member states. Germany's current account was by far the greatest in Europe, far higher than the Netherlands, which had the second greatest current account surplus when looking at OECD data from 2012.[40] Norway, Switzerland, and Sweden followed; all of these countries belonging to the North of Europe, or the 'Core' in the Core-Periphery dichotomy of the eurozone. But when controlled for these countries population sizes, Germany no longer takes the top position. Dividing current account balances for each of the OECD member countries by their populations controls for differences in GDP per capita. This measure gives in effect the average current account surplus or deficit per capita. By this view, Germany comes in 6th on the list (see *Figure 1*, p. 28). This measure does not necessarily mean that the average citizen of each country saves the amount listed in the chart, rather it is a figure best used for comparison. Norway has the highest per person contribution to the current account balance, followed by Switzerland, the Netherlands, Luxembourg, and Sweden. Norway's current account surplus can be explained because of its hydrocarbon exports. The current account surpluses of Switzerland and Luxembourg come mostly from their large financial sectors. These countries are all located in the North of Europe, have populations much smaller than Germany's, but also have higher current account surpluses relative to GDP per capita. So why is Germany the target of international condemnation for its current account surplus? Because it is the biggest.

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[40]Organization for Economic Cooperation and Development. Data on current account and balance of payments. *OECD StatExtracts / iLibrary*. Updated to Q2-2013.

Figure 1: Countries Sorted by Current Account per Capita

Country	CA 2012 in $	Population 2012	CA as % GDP	CA per Capita in $
Norway	71,863,000	5,019,000	21.652%	**14,318.19**
Switzerland	70,240,000	*7,912,398	16.512%	**8,877.21**
Luxembourg	3,802,000	530,946	8.004%	**7,160.80**
Netherlands	72,582,000	16,754,960	9.996%	**4,331.97**
Sweden	31,384,000	9,519,374	7.690%	**3,296.86**
Germany	**243,419,000**	**81,913,000**	**7.088%**	**2,971.68**
Ireland	9,307,000	4,585,900	4.628%	**2,029.48**
Slovak Republic	4,357,000	5,407,579	3.119%	**805.72**
Austria	6,295,000	8,429,990	1.693%	**746.74**
Slovenia	1,455,000	2,056,262	2.483%	**707.59**
Hungary	1,142,000	9,919,000	0.509%	**115.13**
Italy	-11,285,000	60,514,850	-0.543%	**-186.48**
Estonia	-411,000	1,329,301	-1.265%	**-309.19**
Portugal	-3,325,000	10,514,840	-1.218%	**-316.22**
Spain	-14,914,000	46,163,120	-0.993%	**-323.07**
Czech Republic	-4,754,000	10,509,290	-1.643%	**-452.36**
Poland	-18,245,000	38,534,000	-2.078%	**-473.48**
Greece	-6,095,000	11,092,770	-2.110%	**-549.46**
Finland	-4,429,000	5,413,971	-2.087%	**-818.07**
France	-57,778,000	63,556,190	-2.391%	**-909.09**
Belgium	-10,566,000	11,128,250	-2.341%	**-949.48**
United States	-440,417,000	313,914,000	-2.711%	**-1,402.99**
United Kingdom	-94,867,000	63,705,000	-4.175%	**-1,489.16**
Iceland	-748,000	320,716	-5.984%	**-2,332.28**

**Population figures for Switzerland from 2011*

Germany received international scorn for its current account surplus because it has the largest population, largest economy, and promotes export-led growth and low domestic consumption. Looking at total current account surpluses for the five countries ranking above Germany in the calculation, the sums of their current account surplus are nearly equal to

Germany's current account surplus on its own. This means that a potential policy change by the German government alone could affect 50% of the current account surpluses of the top six eurozone surplus countries. Even though it contributes per person a lower degree to the overall current account surplus of the North, the German government's policy affects the eurozone's largest economy and the largest share of the North's current account surplus. Any European-level policy changes made to address persistent eurozone imbalance of payments would also disproportionately affect Germany mores so than the other, smaller countries in the North.

VIII. CONCLUSION

Germany's current account surplus triggered a paradigm shift in institutional response to the persistent imbalance of payments problem during the eurozone crisis. The IMF shifted away from placing the burden of financial rebalancing solely on debtor countries and moved toward a more equal policy of assigning at least partial blame to creditor countries. Although the IMF has gained much autonomy from its member states since its inception, the impetus for the policy paradigm shift is likely to have come from the United States. This paper found that a mix of institutionalist and realist theory was needed to assess the IMF's policy paradigm shift to garner a well-rounded understanding of the IMF as an autonomous international institutions which does not depend on state contributions for its yearly budget, but also the realist understanding of the IMF as an intra-state fund with state-actors as stakeholders. The timing of the US Treasury report citing German current account surplus as a persistent threat to eurozone payments rebalancing and economic recovery was followed soon after by the IMF's own admission that its pro-creditor policies were in need of reevaluation.

While ideas for a more equal approach toward debtor and creditor countries had most likely always been in IMF staff discussions, this prompting by the United States Treasury, dissatisfaction with the longer-than-expected duration of the eurozone crisis, as well as the unprecedented number of debtor countries in Europe led the IMF to enact new policies which were a shift in its policy paradigm. This policy change broke with the IMF's traditional policy paradigm of debtor-burden only in terms of balance of payments problems. But this leaves still the open question of how the IMF or other institutions can influence German economic policies when the German government is not in need of IMF loans and the conditionality they bring with them. An exploration into other international institutions' attempts to influence German economic policy could also be undertaken in the future, namely exploring the EU-Germany nexus in respect to economic policy, but such a relationship is also one-sided due to the strength of Germany within the EU in terms of economics as well as voting rights.

In regards to the targeting of blame on Germany for its current account surplus, this paper found that such targeting is unfair because of the higher share of current account surplus per capita in other, albeit smaller, countries in the North of Europe. While it is the most pragmatic to focus policy criticism on the country with the largest current account surplus, other Northern European countries can also enact policies to join Germany in boosting domestic demand growth in order to alleviate the eurozone balance of payments problem. But the policy tools of the IMF are also incapable of structurally reforming these creditor countries because of the absence of their need for IMF loans. Whether the current account surplus is a measure that can be actively changed is also debatable, as scholars and economists continue to argue about the cause of Germany's current account surplus and whether the German government should or even can enact a new unilateral policy to rebalance payments in the eurozone.

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