Flight From Risk

Unified Germany and the Role of Beliefs in the European Response to the Financial Crisis

Abraham L. Newman
School of Foreign Service, Georgetown University

Abstract

Since the end of World War II, scholars have attempted to make sense of Germany's insistent multilateralism. Many concluded that this sacrifice resulted from a deeply ingrained political identity that stressed international cooperation and shunned parochial national politics. More recently, however, German leadership has suggested a willingness to weaken its role as global altruist and reassert its interests in Europe and abroad. This article argues that core German attitudes towards regional and global cooperation have changed. But rather than a shift to "national self-interests," I argue that the unification process elevated long-held beliefs about policy conservatism and caution that now compete with the postwar multilateral policy frame within the foreign policy elite. In addition to the pro-European, multilateralist agenda, a second powerful lesson of the interwar period emphasized the dangers associated with sudden change and the benefits of incrementalism. Owing to the uncertainty associated with sociopolitical events, decision makers must rely on their beliefs about how the world works to guide their decisions. To explore the relationship between beliefs and Germany's regional policy, the paper examines the government's regional response to the post 2008 financial crisis and the banking crisis in Eastern Europe.

Keywords

foreign economic policy; European Union; financial crisis; beliefs

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Introduction

Since the end of World War II, scholars have attempted to make sense of German policy makers, who repeatedly sacrificed their nation's sovereignty for highly ambiguous and uncertain goals of multilateralism and European integration.[1] Many concluded that this sacrifice resulted from a deeply ingrained political identity that stressed international cooperation and shunned parochial national politics.[2] Since the end of the Cold War, however, German leadership has suggested a willingness to weaken its role as global altruist and reassert its interests in Europe and abroad.[3] A string of policy moves seem to signal this policy shift including German demands for a reallocation of the European Union (EU) budget, strict adherence to the Stability and Growth Pact, and most recently a refusal to bail out financially stressed member states in Eastern Europe. Several scholars have thus concluded that the role of German identity in European and global politics has waned, replaced by a more interest-based agenda.[4]

This article indeed concludes that German foreign economy policy towards regional and global cooperation has shifted. The identity/self-interest dichotomy, however, obscures the driver and character of this shift. In short, I argue that the unification process elevated long-held beliefs about policy conservatism that now compete with the postwar multilateral policy frame within the foreign policy elite. In addition to the pro-European, multilateralist agenda, a second powerful lesson of the interwar period emphasized the dangers associated with sudden change, loss of control and the benefits of incrementalism. This flight from risk is embedded both in the institutional logic of the Federal Republic (e.g., the five percent rule in parliament, the independent central bank, the requirement that a new government must be proposed before a vote of no confidence is possible, cooperative federalism) and in the public narrative concerning the Nazis' rise (e.g., hyperinflation, cycling governments, emergency rule). Such attitudes increasingly are finding their way into Germany's policy towards the EU, with the reverence for the Stability and Growth Pact probably the most infamous example.

This shift within German foreign policy is in part a product of the transformative effects of German unification. It is hard to imagine that an event as dramatic as reunification would not shape policy makers' beliefs about the world. In particular, unification has undermined the primary narrative supporting German multilateralism that stressed a resurgent German military threat to the continent. In fact, the economic drag imposed by unification severely weakened Germany's position within Europe and globally.[5] Dubbed a civilian power in the late 1980s,[6] the country retreated into high unemployment, low growth, and sizable deficits through the 1990s. Unified Germany faced the shock of sudden integration and, in response, has returned to a core belief in caution and policy conservatism.

Such beliefs matter because policy making is embedded within highly uncertain environments.[7] Leaders are frequently in a position where they are unable to calculate the probability that a particular action will result in a specific outcome. In the run up to unification, for example, an equal number of scholars predicted a resurgent German nationalism as those who predicted a continuation of cooperative multilateralism.[8] In a much more mundane, but equally important way, the prevalence of "unanticipated consequences" associated with public policy underscores the tenuous relationship between means and ends. Owing to this uncertainty, decision makers must rely on causal and normative beliefs about how the world works to guide their decisions. These beliefs are conditioned by sociohistorical experience and often compete with one another over time.

To demonstrate the importance of policy conservatism in Unified Germany's European and foreign policy, I examine two recent decisions by the German leadership–the role of economic stimulus as a European response to the global economic crisis and the need for a European initiative to resolve the bank crisis in Eastern Europe. The two examples initially seem to reflect a national interest story as Germany forgoes cooperative, regional solutions and asserts its preferences. Germany's foreign economic policy (blocking European stimulus efforts and regional support for stumbling Eastern European member states), however, stands in direct opposition to the cornerstone of Germany's primary economic engine–European export markets. Therefore, the empirical narrative must explain the puzzling insistence by the German leadership for a regional response to the post 2008 financial crisis based on stability instead of export market stimulus. Understanding the German position on these issues is not only critical to explain the specific policy maneuvers, but also lay at the crux of both resolving the global economic crisis and the future of European integration. Theoretically, the article contributes to a growing research agenda that examines the role of historical context for understanding causal relationships.[9]

The paper is organized around three sections. The first builds the core argument of the paper, emphasizing the role of beliefs in policy making and highlighting competing beliefs within German policy elite. The second section examines the argument within the debates on regional economic stimulus and the Eastern European banking crisis. The final section concludes by drawing out implications for German policy within Europe and the role of beliefs in international affairs more generally.

From Partner to Scrouge?

Scholars interested in the role of identity in international relations have frequently turned to the case of Germany as an important example. This was driven among other reasons by the German political elite's deep commitment to sovereignty-reducing strategies in the postwar period. Under the auspices of *Einbindungspolitik* (the policy of cooperative self-binding) Germany repeatedly pursued multilateral cooperation within Europe even though it constrained its ability to act independently.[10] Running counter to traditional realist predictions about state behavior, research examined the role of the German past in the creation of a distinct foreign policy identity to make sense of this empirical puzzle.[11]

Since unification, however, German European policy has subtlety shifted. Far from abandoning the European project, Germany has been more critical of potential free riding by other members.[12] In a series of high profile debates including EU budget negotiations and the Stability and Growth Pact, Germany has signaled its unwillingness to continue integration at any cost. This has led a number of scholars to conclude that the role of postnational German identity is waning and that it is moving towards a more self interest- based politics.[13]

Rather than positioning identity concerns in opposition to self-interests, the argument in this paper is that ideas and interests are largely inseparable. It would be difficult to construct a theory of politics in which actors repeatedly acted irrationally. This does not mean, however, that context does not pay a role in interest construction for two primary reasons. First, meaning is socially and historically embedded. An actor's understanding of her environment shapes how she calculates her interests and the factors that go into that calculation.[14] In the imperial era, for example, heads of state had to consider (and often preferred) direct colonization as a foreign policy tool. Similarly, rational economic policy meant very different things during periods dominated by mercantilism, Keynesianism, and monetarism.[15]

Second, in situations of uncertainty, beliefs play a critical role in interest construction.[16] Following work on the sociology of markets and recent research on constructivism in international relations, uncertainty refers to those situations where an actor is unable to calculate the probability that a certain action will produce a specific outcome. This contrasts to risk, in which probabilities can be assigned.[17] Given the complexity of social relations, decision makers frequently find themselves in conditions of uncertainty. Unlike the natural sciences, most policy debates center on contested cause and effect relationships. The empirical reflection of this fact is the widely documented (and often ignored) unintended consequences of policy actions. Given such high levels of uncertainty, decision makers must rely on beliefs and narratives about how the world works to adjudicate disputes and guide their behavior. In short, there are often multiple self-interested solutions depending on one's socially embedded self-conception. From this perspective, postwar German multilateralism should not be contrasted to interest-based politics, but rather should be seen as the product of a period when German preferences were embedded in a specific set of historically rooted beliefs. Faced with the daunting task of postwar reconstruction and managing its position on the front line of the Cold War, German beliefs about regionalism offered a straightforward path to make sense of a highly complex and uncertain environment.

It seems clear that unification has tempered the narratives that long supported and maintained the multilateralist frame.[18] On the one hand, militarism and nationalism have not been stoked by unification. There has been no debate about proliferation, still one of the key great power status symbols.[19] Nor has Germany attempted to develop an offensive military capability outside of the NATO or European defense architectures.[20] Economically, Chancellor Helmut Kohl's promise of "blooming fields" in the East never materialized. Instead, the economic powerhouse of the postwar period has been struggling over the last decade to manage rising public debt and high unemployment, producing serious reflection on the country's long term economic competitiveness.[21] The experience of unification, a product of geostrategic structural changes, has undermined the resonance of beliefs focusing on international law and regional cooperation.

At the same time, unification has reinforced another set of beliefs held by German elites centered on policy conservatism. A central narrative in German political debates rests on notions of caution and incrementalism. Reflecting the rapid downward spiral into economic chaos and fascism during the interwar period, societal and political lesson-drawing stressed the dangers of high public debt, rapid inflation, and quick political change. The founders of the Bonn Republic promoted reform-adverse decentralization that spread political decision making among a number of actors, fostering the diffusion of power.[22] These ideas are embedded in a host of political institutions such as the independence of the central bank, the five percent rule for parties to enter the parliament, cooperative federalism, rules on no-confidence votes, and strong judicial review.[23] In the private sector, similar beliefs prevail within the coordinated market economy privileging incremental change and gradual adjustment.[24]

These institutional sites of caution and conservative policy making are tied to a parallel set of economic ideas–ordoliberalism–with a long history in German policy making. Embodied in the economic policies of Ludwig Erhard and the work of the Freiburg School, ordoliberalism focuses on the critical role of the state in providing the necessary stability in society and the economy to permit the efficient functioning of markets.[25] Known under the rubric of *Ordnungspolitik*, economic policy in Germany has long privileged monetary and fiscal stability as important preconditions for effective capitalism. Clearly, this strain of economic liberalism buttresses a set of more general political beliefs that promote sociopolitical incrementalism.

In many respects, then, unification was quintessentially un-German. It happened with little preparation and proceeded in the most radical of forms. The painful reality subsequently has elevated the narratives surrounding policy conservatism to the top of the public policy agenda. With mounting deficits and escalating unemployment reaching their highest levels of the postwar period, triggers for these alternative beliefs reverberated through the public sphere. In terms of the role of ideas in politics, the unification process had the simultaneous effect of undermining self-reinforcing narratives of a revitalized Germany (which would necessitate further cooperation) and raising the salience of beliefs in caution and policy incrementalism.

The following section explores the role of beliefs in the German position vis-à-vis the European response to the post 2008 financial crisis. The crisis offers a useful set of cases to explore the argument for both empirical and theoretical reasons. Empirically, the German position has stood out as the key to the European and perhaps global response. Theoretically, the cases offer interesting examples that appear to conflict with both a standard explanation focusing on self-interest and an identity-based argument centering on regional cooperation. According to the former, one reasonably would have expected Germany to act swiftly to prop up this important export market, which accounts for roughly half of the country's GDP. Under the latter, one would have predicted that Germany would emphasize regional solutions to the problems, embedding its response within the institutional structures of the European Union. Instead, German elites have ignored calls for both and emphasized caution, even when such a policy could undermine its national economic interests and broader solidarity within Europe.

A Teutonic Approach to the Global Financial Crisis

German policy makers have repeatedly taken a strong and unique position with regard to the financial crisis that struck the global economy starting in 2008. Generally speaking, they have downplayed the domestic sources of the crisis, highlighted irrational lending promoted by the United States as its primary cause, and been reluctant to promote global economic stimulus via Keynesian economic policies as a plausible solution. On all accounts, German policy seems guided by a deep belief in the danger of quick action and loss of control. Importantly, much of this caution is focused on European decision makers outside of Germany, where institutional constraints are perceived to be weaker.

The clearest example of the role of risk aversion in German foreign economic policy came in the debate concerning the use of economic stimulus to revive the European and global economy. The United States and the United Kingdom, supported by projections from the World Bank and IMF, were strong advocates for large scale domestic spending packages as a means to kick start the global economy. These efforts were augmented by large spending packages in China and other developing economies.

By contrast, Germany repeatedly denounced the strategy as shortsighted with former Finance Minister Peer Steinbrück infamously denouncing British policy as "crass Keynesianism" and Chancellor Angela Merkel receiving the nickname "Madame Non" in the French press.[26] While the German government committed itself to a significant stimulus at home, it blocked large-scale European efforts at a stimulus and argued against similar policies by its neighbors.[27]

German opposition to European stimulus seemed particularly puzzling as Germany depends heavily on other European consumers to purchase its exports (nearly 65 percent of its products travel to other EU markets).[28] A persistent failure to reignite the European market will have significant ramifications for the German economy and bring widespread unemployment. By late 2009, German exports fell 20 percent from their 2008 level and over half a million workers had been placed on short hours (where the government picks up roughly 60 percent of the wage bill to prevent job cuts). Projections by Commerzbank expect German GDP to fall 6 percent because of the crisis and the World Bank expects global growth to fall by at least 2 percent. Given the immensity of the crisis for the German economy, it was at least a plausible argument that a broad-based European stimulus would be in Germany's self-interest.

The German argument against a regional stimulus solution rested on two basic arguments both of which are steeped in causal beliefs focused on caution. The first concerned the long-term macroeconomic consequences of pumping enormous amounts of money into the global economy–inflation. Merkel dubbed this the "crisis after the crisis."[29] In short, the economic meltdown was the product of loose monetary policy in the U.S. that led to an undervaluation of risk in the global economy. A European stimulus would have a similar effect by throwing money on the fire. Both the government's rhetoric and analysis seemed embedded within policy conservatism and the fear of losing control. Speaking in the Bundestag in November 2008, Merkel argued: "Excessively cheap money in the U.S. was a driver of today's crisis … I am deeply concerned about whether we are now reinforcing this trend through measures being adopted in the U.S. and elsewhere and whether we could find ourselves in five years facing the exact same crisis."[30] Steinbrück concurred: "So much money is being pumped into the market that capital markets could easily become overwhelmed, resulting in a global period of inflation in the recovery."[31] Far from a cynical move by Germany to free ride on U.S. policy, the German policy elite held a unified view that U.S. policy might in fact augment the crisis and vocally opposed further efforts in this direction. It is important to remember that while many bemoaned the German effort, between emergency spending and automatic stabilizers, the German government committed around 3 percent of GDP to stimulus spending in 2009. Merkel continued: "We were living beyond our means … After the Asian crisis and after 9/11, governments encouraged risk taking in order to boost growth. We cannot repeat this mistake."[32]

Second, the German government feared the potential loss of control that might result if other European governments became unshackled from the Stability and Growth Pact. Promoted by Germany as a condition of monetary union, the Pact commits EURO members to a 3 percent debt ceiling.[33] A pan-European stimulus would give countries like Italy and Greece free license to expand already bloated government deficits. Axel Weber, the Bundesbank President, warned that this would be the wrong time "to lose sight of the sustainability of public financing."[34] Once again, this scenario played on a deeply rooted caution within Germany to public debt and violated the commitment of Ordungspolitik to monetary stability. If other countries lost control of their budgets, the potential exists that the Euro could be destabilized. This would, in turn, realize German fears about giving up the D-Mark, the holy grail of postwar German stability.[35]

Finally, the German counter proposal based on expanded regulation of the financial services sector smacked of the more general set of conservative policy beliefs. Through new rules on hedge funds, credit rating agencies, and other non-bank alternatives, Germany hoped to bring a sense of renewed stability and calm to the sector. Banking (as opposed to securities markets) lies at the center of the German political economy. "Patient" capital focused on reasonable rates of return underpins a large small-to-medium-sized industrial sector, which plays a critical role in wage growth and job stability.[36] The financial services boom of the last decade placed tremendous pressure on German banks to increase their profitability or face acquisition.[37] Similarly, hedge funds, which take advantage of short-term shifts in market positions, further exacerbated such pressures. The German strategy to restrain non-bank activity deemphasizes a return to rapid economic growth through financial services and instead emphasizes the stability provided by a more traditional banking sector. *Der Spiegel* summarized nicely the German risk aversion approach to the financial crisis: "Mrs. Merkel is crawling across the slippery surface on all fours, slowly and cautiously."[38]

Trouble on the Eastern Front

German caution seemed to be playing a similar role in its response to the banking crisis in Eastern Europe. During the last decade, West European banks lent Eastern European citizens money in foreign denominated loans. This seemed like a good bet while Eastern European currencies were strong and their economies were growing at a brisk pace. The global slowdown, however, revaluated Eastern European currencies, instantly increasing loan payments. Western banks ignoring this danger offered an exorbitant number of these loans. Austrian banks alone made loans in the region equivalent to 70 percent of Austrian GDP. Over 50 percent of consumer loans in Hungary and Poland are foreign denominated. The first wave of loans has already gone bad and foreign investment has withered. Several new member states have seen double digit declines in GDP with Hungary, Latvia, and Romania negotiating rescue packages from the IMF.

Importantly, Germany took a rather aloof policy stance to the crisis, refusing a European bailout package promoted by Hungary at a spring 2008 European summit and waffling on its commitment to the region if the situation should worsen.[39] A chorus of German elites including the head of the central bank and the finance ministry denounced proposals that new members quickly rush to join the EURO.[40] Counter to the Germany-through-Europe identity, German policy rejected both European initiatives and direct bilateral aid to the new member states.

Some have argued that Germany's stance reflects the relatively small exposure of its banks to the crisis and thus supports a self-interest story.[41] While this might be the belief of German elites, it is difficult to imagine that the German economy truly is decoupled from what transpires on its eastern borders. In terms of exports, German sales in 2007 to just the Czech Republic, Hungary, and Poland surpassed exports to the United States. Additionally, a meltdown of the Austrian and Swedish banking systems would have severe repercussions for the Eurozone and two of Germany's main export destinations.[42]

Politically, the German position also undermines solidarity within the European Union for its newest members and stands in sharp contrast to traditional *Einbindungspolitik*. The idea that member states in the East must negotiate with the IMF stands in stark contrast to regional rescue packages negotiated in the early 1990s during the last currency crisis. It is hard to imagine Germany having pressed new member states Spain or Portugal into the hands of the IMF in the face of the European Monetary System crisis.[43] Already, Polish and Hungarian leaders have questioned the German position in such terms with Polish Prime Mister Donald Tusk arguing: "We see the biggest risk in crumbling solidarity in Europe, and in growing national egoism."[44]

Underlying German policy were concerns that a German-led bailout would reward risk taking by others. Over the last decade, Germany has dealt with the difficulties associated with unification by enacting a number of austerity programs and suffered slow growth and job loss. They emerged as the largest among a small group of economically responsible member states and attribute this success to their focus on stability and economic order. In order to check the potential of moral hazard, Germany turned to the IMF to oversee and manage the bailout of Hungary, Latvia, and Romania. While these packages limited the short term instability in the countries, they came with strict austerity packages. As a result, all three countries will see domestic spending contract in the coming years. While the IMF provides a useful institutional mechanism to externalize German risk aversion, this reverse stimulus will do little to jump start demand for German exports or deepen trust within the European Union.

Conclusion

German foreign policy, especially European policy, has long interested scholars of international relations. Upsetting standard realist logics, German elites repeatedly have sacrificed their own sovereignty for the potential long-term benefits of European integration. Whether due to a deep-seated postnationalism or an alternative path toward power, German policy makers believed in the slogan "Germany through Europe." In the face of a number of highly uncertain situations—postwar reconciliation, cold war reemergence, and unification—they returned to this regional identity to guide their behavior. This has led scholars of foreign policy to identify a unique German power resource based on international law and multilateralism (see Beverly Crawford's contribution to this volume).

Since unification, however, a competing narrative has been elevated, which emphasizes policy conservatism and stability. Long part of the German domestic policy discourse, it has emerged as a fundamental feature of its European policy. In both the case of the regional stimulus debate and the Eastern European banking crisis, Germany rejected European solutions and instead followed a politics of austerity, emphasizing monetary stability, moral hazard, and institutional constraints. They have pursued this policy strategy even in the face of dramatically falling exports, the lifeblood of the German economy. Rather than a free-riding strategy, German elites have cast the debate as an instance where they are on the right side of ambiguous economic terrain. While definitive proof of either a self-interest or identity explanation is difficult, policy makers in Germany seem to hold a clear set of beliefs that run through the narratives they chose to justify their actions: a narrative that relies on a flight from risk.

If this shift in ideas persists, it will mark an important turn for European politics more generally as Germany remains its largest and most economically powerful member. Above all, the country could become an important counterpole to those advocating a swift return to fast growth strategies. By contrast, Germany could push for a set of policies that prioritize stability and minimize business cycle fluctuations. This would set it on a different path than past U.S. and UK policy. It will be interesting to watch how the German position resonates with emerging markets that long privileged growth, but that recently have come to respect the violence of market volatility. The rise of risk aversion does not necessarily mean the end of multilateralist Germany. Rather, it indicates the values and concerns that will motivate German leaders as they sit at regional and international negotiations.

Theoretically, the article builds on a growing constructivist literature that stresses the role of beliefs in shaping national preferences. National preferences remain one of the least understood workhorses in political economy.[45] While the majority of research in this area relies on arguments stressing materialist claims of self interest, the literature on uncertainty argues that such self-interests are embedded within sociohistorical contexts. Far from static, the case demonstrates the role that major historical events–such as unification–can have in altering the resonance of competing belief sets. Now, in the face of a global financial crisis, as means-end relationships become attenuated, policy makers face conflicting explanations of the problem and the solution. They (intentionally and unintentionally) employ their beliefs to make sense of the world. Politics is thus not a debate about rational versus irrational or material versus appropriate, but distinct (and often competing) beliefs about what is materially and normatively appropriate.

Abraham L Newman is an assistant professor at the Edmund A. Walsh School of Foreign Service at Georgetown University. He is the author of *Protectors of Privacy: Regulating Personal Information in the Global Economy* (Ithaca, 2008) and the co-editor of *How Revolutionary was the Digital Revolution?* (Stanford, 2006). His research has appeared or is forthcoming in *Comparative Political Studies*, *European Journal of International Relations*, *Governance*, *International Organization*, *Journal of European Public Policy*, *New Political Economy*, and the *Review of International Political Economy.*

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