Germany, The Eurozone and Mercantilism

Keith Rankin, 29 September 2015

Of all the naughty isms in the world, mercantilism is so high in the economist's bad books that this m-word is barely mentioned today. One reason for this is that mercantilism is so widely practised, that any serious discussion of the topic would expose a somewhat hypercritical profession.

Mercantilism is actually short for 'merchant capitalism' which itself is short for 'the commercial or mercantile system'. "Of the Principle of the Commercial or Mercantile System" is the title of the first chapter of Book 4 of Adam Smith's 1776 economic classic '*The Wealth of Nations*'. Book 4 represents the central polemic of Smith's magnum opus, and it's a critique of what might be called (oxymoronically) 'classical mercantilism'.

(For Adam Smith, Dutchmen were the archetypal mercantilists. And when we look at the workings of the Eurozone today, anything one observes about Germany applies equally – if not more than equally [!] – to the Netherlands. Indeed the European discovery – and subsequent naming – of New Zealand represented a mercantilist project of the Dutch East India Company.)

Mercantilism is a variant of capitalist political economy – perhaps better known as business political economy – with most emphasis on the word 'political' and least emphasis on the word 'economy'. It represents a predominant theme of political thought in Britain and Europe in the sixteenth to eighteenth centuries, and today is most commonly associated with China's business-political nexus.

A name that I have coined for mercantilism is '***gold mountain economics***', because the central theme of mercantilism is the accumulation of 'treasure', on the assumption that treasure equates to wealth. (We may also note that many people use the word 'money' today in the way that classical mercantilists might have used the word 'treasure'; we also note that 'investment housing' today falls within the rubric of 'treasure'.)

It was due to the dictates of mercantilism that Europeans plundered the Americas in those centuries (1500 to 1800). And it was in these years that economic growth, an emphasis on manufacturing over agriculture, and high levels of employment (indeed exploitatively high levels) came to be understood as the principal means to the nationalistic end of accumulating more treasure than other nations. It is the doctrine that unbalanced international trade is better than balanced trade; that trade surpluses are good and trade deficits are bad. And the idea permeated into government; a successful government was a government that had a Treasury full of treasure.

Protestant German (and Dutch) princes always had the reputation for being strongly committed to mercantilist principles. And, following the unification of Germany around 150 years ago, Germany became an economic polity strongly committed to rivalrous mercantilist development; to the exploitation of its resources for the purpose of gaining economic power through the making of money, and through spending as little of it as possible.

Mercantilism is also commonly called 'economic nationalism' (even 'economic imperialism'), although this depiction leads modern economists to dismiss mercantilism as protectionism; in the process they have lost track of just how much modern economic thought is infused with mercantilism.

The central concepts of both classical and modern mercantilism are that making money is the end purpose of economic activity, and that consumption spending is censured as 'unproductive'. A corollary is that inequality is praised, because the poverty of the employed helps to minimise 'unproductive spending', and consumer debt is 'bad' because it facilitates such spending. (The irony is that consumer debt, when spent, enables the gold mountains of businesses like Volkswagen and countries like Germany to be constructed. Mercantilism is not a coherent prescription; when applied universally it represents a 'race to the bottom'.)

One of the classic methods of modern mercantilism is to run an undervalued exchange rate. While this is the easiest way to skew world trade, for every country that has an undervalued exchange rate, another must have an overvalued exchange rate. So it's a strategy that works for some – China for example has used this strategy – it's a strategy that can never work for all. In a world in which most countries' policymakers advocate variants of gold-mountain economics, it's only the most committed mercantilists who achieve these undervalued exchange rates.

The Eurozone has been the perfect vehicle for German mercantilism. By having a single currency through most of Europe, that currency represents an undervalued currency in some Eurozone countries and an overvalued currency in others. The Euro is worth less against the $US than the German Mark world be today, had the Eurozone not formed. Likewise, the Euro is worth more today (against the $US) than the Greek Drachma or the Spanish Peseta or the Irish Punt would have been worth today had these currencies still existed.

The result is that the German economy acts like a giant vacuum cleaner within Europe and near-Europe; sucking both money and labour to its bosom, while leaving its neighbours financially impoverished and being forced to adopt deflationary policies to counter this. Germany's growing golden mountain of pseudo-riches is matched by (indeed built upon) the rising red peak of debt and poverty in Germany's growing regional hinterland. The red peak that supports a gold mountain may indeed be interpreted as the magma that will eventually destroy that mountain.

It is in this context that we should understand the present scandal at Volkswagen. For too many German businesses, having an undervalued exchange rate is not enough. (It's not only German businesses, of course, who are committed to the accumulation of thalers. Apple may be the most notorious gold mountaineer.) Volkswagen's commitment to making money extended to cheating. Indeed VW's antics may represent just the tip of the geldberg.

The solution to this problem lies in two parts. The first part is a change in attitude to money that must be led by public debates: one a more general debate about the end-purpose of economic activity; and one a debate within the economics profession about the mercantilisation of a discipline that was founded upon a rejection of mercantilism.

The second part of the solution – the narrower European part – is the conversion of the Eurozone into a 'United States of Europe'. Even the majority of Greeks – representing one country very much in the red part rather than the gold part of the Eurozone – do not want to retreat from the process that the Eurozone is a part of. (Greek voters favoured austerity over departure from the Eurozone.) Thus the process must advance.

In this regard, an interesting article on *Project Syndicate* – We the People of Europe, by Laszlo Bruszt and David Stark, 11 August 2015 – notes the similarities of the Eurozone today with the situation in the United

States in the last two decades of the eighteenth century, and how it was resolved over time through the creation of a fiscal and overarching political union. By no means does the USA represent equality between its member states – much fiscal power remains with the individual states (eg compare USA to Australia). Yet a Eurozone-like monetary suffocation of the south by the north could not happen within the United States today.

Mercantilism infuses our economic thinking today. And labourism is at least as mercantilist as capitalism. Economics as an intellectual and scholarly discipline was founded on the rejection of mercantilism. While economists should take a lead by re-examining the intellectual foundations of their discipline, we need to broaden this discussion. Economics – whether capitalist or labourist or something else – lies at the core of the intellectual foundations of market societies.

In the meantime, as we foster such debates, we should stop looking to countries like Germany as successful economies that all can and should emulate. To Olympic athletes, the attempt to accumulate gold makes good sense. The majority of athletes of course fail. We should stop thinking of economic success through sporting metaphors such as 'competitiveness'. In the Olympic Games most participants are losers and some winners are cheats. The contrast with economics' vision of a prosperous and sustainable global market economy without losers could not be greater.
