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From the Mark to the Euro: Germany and the Financial Transformations of Monetary Union

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Table of Contents

- **Introduction**
- **Chapter 1** The Memory of Inflation and the Birth of Ordoliberalism
- **Chapter 2** The 1948 Currency Reform and the Making of the Deutschmark
- **Chapter 3** Building the Bundesbank: Independence, Rules, and Reputation
- **Chapter 4** The Deutschmark in Bretton Woods and Its Collapse
- **Chapter 5** Anchor of Europe: The EMS and the Deutsche Mark Zone
- **Chapter 6** Reunification and Monetary Union with the East
- **Chapter 7** From Maastricht to Monetary Union: Terms of Entry
- **Chapter 8** Convergence Criteria at Home: Politics of Austerity and Reform
- **Chapter 9** Designing the ECB: German Ideas, European Compromises
- **Chapter 10** Launching the Euro: 1999–2002
- **Chapter 11** The Stability and Growth Pact: Rules, Breaches, and Revisions
- **Chapter 12** Culture Clash? Bundesbank Orthodoxy vs. ECB Pragmatism
- **Chapter 13** Germany’s Banking Landscape: Savings Banks, Cooperatives, and Landesbanken
- **Chapter 14** Global Finance Meets Rhineland Capitalism: 1990s–2007
- **Chapter 15** The Global Financial Crisis and German Banking Stress
- **Chapter 16** The Eurozone Sovereign Debt Crisis: From Bailouts to Conditionality
- **Chapter 17** Courts and Crisis: Karlsruhe, OMT, and the Politics of Legitimacy
- **Chapter 18** Toward a Banking Union: SSM, SRM, and Resolution Regimes
- **Chapter 19** Capital, Liquidity, and the New Rulebook: Basel III in Practice
- **Chapter 20** Target2 and the Geography of Imbalances
- **Chapter 21** Negative Rates, Savers, and the Politics of Monetary Normalization
- **Chapter 22** Industry, Exports, and Competitiveness in a Common Currency
- **Chapter 23** Pandemic Policy Turn: PEPP, the Recovery Fund, and German Fiscal Change
- **Chapter 24** Green Finance, Climate Risk, and the Transformation of German Banking
- **Chapter 25** Digital Money, Payments, and the Prospects of a Digital Euro

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Introduction

This book traces a story that is at once national and continental: how the Deutschmark became a pillar of German identity and how Germany then helped build, and continues to shape, the euro. The transition from the Mark to the euro was not a simple currency swap. It was a profound reordering of institutions, ideas, and incentives—within Germany and across Europe's monetary union. By following this transformation chronologically, we illuminate the political bargains, the economic doctrines, and the institutional engineering that carried Germany from postwar currency reform to today's debates about eurozone governance and banking regulation.

The Deutschmark's reputation was forged in the long shadow of interwar inflation and in the postwar commitment to stability. Independence, rules, and credibility were not abstract principles; they were living elements of a social contract that tied monetary order to democratic renewal and export-led prosperity. As a result, the Bundesbank became more than a central bank: it was a guardian of price stability and a symbol of national reliability. Understanding this legacy is indispensable for interpreting Germany's stance on the design of the European Central Bank, the Stability and Growth Pact, and the broader operating code of the monetary union.

Adopting the euro demanded that Germany translate a national stability culture into a supranational framework. That translation involved compromises and contestation—between ordoliberal instincts and the pragmatics of a diverse currency area; between legal constraints and crisis exigencies; and between domestic politics and European commitments. The early years of the euro tested these balances, while the global financial crisis and the sovereign debt crisis exposed fault lines in fiscal rules, banking supervision, and lender-of-last-resort arrangements. Germany's responses—often incremental, occasionally decisive—left a deep imprint on the architecture that followed.

Banking is the other axis of this narrative. Germany's distinctive three-pillar system—savings banks, cooperatives, and private institutions—both stabilized local credit and, at times, amplified systemic risks. Case studies of Landesbanken strategies, restructuring episodes, and supervisory reforms reveal how national legacies interacted with European initiatives such as the Single Supervisory Mechanism and the Single Resolution Mechanism. The evolution of capital and liquidity standards, from Basel III to macroprudential tools, illustrates the interplay of global rulemaking and eurozone-specific vulnerabilities.

For economists and finance professionals, the book offers a careful sequencing of

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events, paired with policy critique anchored in evidence. Each chapter integrates data, institutional detail, and comparative perspective to assess what worked, what failed, and why. We examine the legal challenges that shaped central bank discretion, the politics of negative interest rates and balance-sheet policies, the geography of Target2 balances, and the tension between rules and discretion during emergencies. Throughout, we ask how Germany's preferences—rooted in history but responsive to shocks—have influenced outcomes for the entire currency union.

Finally, we look forward. The euro area now confronts structural transitions: decarbonization, digitalization, and demographic change. Germany's financial system—facing climate risk, evolving capital markets, and the advent of a potential digital euro—must adapt while preserving stability. The choices made in Berlin, Frankfurt, and Brussels will determine whether the next phase of monetary union remains tethered to a stability paradigm forged in the age of the Deutschmark or evolves toward a framework capable of sharing risks and mobilizing investment at scale. This book equips readers to evaluate those choices with historical perspective and analytical clarity.

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CHAPTER ONE: The Memory of Inflation and the Birth of Ordoliberalism

Germany's monetary journey begins not with numbers, but with memory. In the years after the Great War, prices spiraled in ways that seemed to mock arithmetic. The familiar rituals of everyday life—groceries, rent, wages—became unpredictable theater. By late 1923, the German mark had become a curiosity in its own country, wheelbarrows of banknotes traded for bread, and the moment a café order arrived the price might have risen. Survivors learned to distrust the abstract promises of currency and to prize the tangible: property, foreign exchange, gold trinkets, whatever held value through the chaos. These lived experiences cast a long shadow over debates about money, independence, and the limits of state discretion.

Out of the crisis came myths, lessons, and a politics of monetary caution. The technical causes of the hyperinflation—war reparations, the occupation of the Ruhr, the Reichsbank's accommodation of fiscal deficits—became part of a moral narrative about discipline. Policymakers drew the conclusion that the central bank's first duty was to preserve the value of money, not to finance government or smooth business cycles. This was more than an economic doctrine; it was a social promise that the state would not again erode savings and wages. For decades afterward, the specter of 1923 would surface in speeches, editorials, and legal provisions governing the future of the Bundesbank.

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The Weimar era also taught that stability is not only a matter of central bank resolve. Fiscal authorities, wage bargainers, and financial institutions all play roles. In the late 1920s, Germany briefly tasted stability under the guidance of the Rentenmark and the Dawes Plan, which tied reparations to loans and foreign capital inflows. But the fragility of that equilibrium became clear in 1931, when a banking crisis and capital flight forced a suspension of convertibility. Political turmoil followed. The Reichsbank's independence collapsed under the Nazi regime, and the bank's functions were subordinated to the demands of rearmament and war finance. Monetary policy became an instrument of political priorities rather than price stability, with profound consequences for the postwar settlement.

After 1945, defeat and division forced a rethink of institutions from the ground up. The Allies' occupation policies created both the intellectual and practical space for new rules. In the Western zones, the Economic Council in Cologne experimented with market-oriented reforms even before political sovereignty was restored. A currency reform was urgent: the Reichsmark was widely considered worthless, barter had returned, and the incentives for production were broken. In 1948, the Deutsche Mark

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replaced the Reichsmark at a conversion rate that, while controversial, signaled a decisive break with the past. The reform's architects viewed it as a foundation stone for a new economic order, not merely a technical relabeling of money.

These architects were not only technocrats; they were intellectuals shaped by the experience of interwar disorder. The tradition that came to dominate German economic thought—ordoliberalism—offered a distinctive recipe for a functioning market economy. Ordoliberalism was not laissez-faire. It argued for a strong state that sets and enforces clear rules of competition, protects property, and anchors money in a framework of predictability. The "ordos" in ordoliberalism refers to a well-ordered economic constitution, within which prices can perform their coordinating role without being distorted by monopolies or discretionary interventions. The state's task is to maintain the order, not to steer outcomes from day to day.

A core element of this view was the independent central bank. In the ordoliberal imagination, the central bank's role was to guarantee the stability of the currency, insulated from short-term political pressures. That ideal stood in direct contrast to the memory of Reichsbank subservience and the emergency decrees of the 1930s. The architects of the postwar system, like economist Wilhelm Röpke and Alfred Müller-Armack, articulated a vision of a "social market economy," which sought to combine dynamic competition with a social safety net. But money was special: its stability was the bedrock on which competition, savings, and investment all rested. If the currency was a public good, its steward needed independence.

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Debates about central bank design were not academic exercises. The German currency reform of 1948 occurred amid rationing, price controls, and shortages. The reforms abolished most price controls on June 20, 1948—the same weekend as the currency conversion—unleashing a burst of supply and a wave of price increases that shocked consumers and tested political resolve. For a brief period, it looked as though the reform might falter. Retailers were accused of gouging, workers protested, and political voices called for a return to controls. Ludwig Erhard, the Economic Director in the Bizone, famously defended the liberalization, arguing that prices would align with supply if the monetary foundation was sound. The currency reform, combined with the lifting of controls, became the decisive moment in launching the West German "economic miracle."

Institutional choices followed the intellectual turn. In 1948, the Bank deutscher Länder was established as a central bank for the Western zones, marking the first step toward a permanent central bank with a stability mandate. It operated under a federal structure that reflected Germany's regional organization, with state banks (Landesbanken and regional central banks) participating in decision-making. This architecture was designed to diffuse power and reduce the risk of a single political center controlling monetary policy. The memory of centralized authority under the Reichsbank made German reformers wary of concentrations of power, even within the

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central bank itself.

As the Federal Republic of Germany took shape, the Basic Law of 1949 embedded the principle of rule-bound governance. While the Basic Law did not prescribe every detail of monetary institutions, it established the foundations for a state operating under law, with checks and balances. The idea that the state should be bound by clear, publicly known rules—rather than by discretionary fiat—aligned with ordoliberal preferences. This legalistic culture influenced not only constitutional design but also the technical architecture of what would become the Bundesbank. Even before the Bundesbank existed in name, the idea of its independence was taking root in the political soil of West Germany.

Banking culture in Germany also evolved in response to historical memory. Local institutions—savings banks (Sparkassen), cooperative banks (Volksbanken and Raiffeisenbanken), and private banks—resumed their roles in channeling credit. Savings banks, rooted in municipal ownership, emphasized stability and local development. Cooperatives were member-owned, with governance structures tied to communities and sectors. Private banks pursued higher-risk activities and international business. This three-pillar system developed alongside, not in place of, a central bank. The diversity of institutions created resilience but also set the stage for future tensions between local relationships and modern risk management.

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One practical consequence of inflation's memory was a strong preference for fixed rules over discretion. German economists and policymakers leaned toward predictable frameworks: clear inflation targets, transparent operations, and limited emergency interventions. The Bundesbank's later reputation for orthodoxy—"the Bundesbank has no other policy but to preserve the value of money"—was rooted in this tradition. The rule of law extended to the realm of money. If citizens could trust that the currency would hold its value, they would save, invest, and plan for the future. That trust was the social contract that made the market economy viable.

The intellectual currents of ordoliberalism were not static. They evolved in dialogue with international developments. The Bretton Woods system, established in 1944, provided a framework of fixed exchange rates backed by the US dollar and gold. Germany joined this system, but its success soon created a new dilemma. As German exports surged, the Deutsche Mark appreciated, and the Bundesbank faced inflows of foreign currency that threatened domestic price stability. The experience of the 1950s and 1960s exposed the limits of a rules-based approach within a fixed exchange-rate regime. Yet the underlying belief—that money must serve stability—remained firmly embedded in the country's political economy.

This belief was reinforced by education and public discourse. Newspapers, radio, and later television carried lessons about the dangers of inflation and the virtues of savings. Labor unions and employer associations, while often at odds on wages,

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converged on the importance of price stability. This consensus created an environment in which central bank independence was politically feasible and socially supported. Citizens did not demand that the central bank fund job creation; they demanded that it protect their purchasing power. The Bundesbank's independence was, in this sense, a democratic mandate rooted in lived history.

In practical terms, the memory of inflation shaped everyday choices. Households favored safe deposits and low-risk investments. Companies valued stability in planning and often held conservative balance sheets. Banks emphasized collateral and long-term relationships. The financial system was not a place for rapid, speculative gains; it was a mechanism for funding production, homeownership, and public infrastructure. This culture had downsides: it could slow innovation and reduce risk appetite. But it also created resilience against financial volatility, a trait that would be tested in later decades.

As the 1950s unfolded, the path toward an independent central bank became clearer. The Bank deutscher Länder laid the groundwork, but a permanent institution was needed. In the background, political negotiations were underway that would culminate in the creation of the Bundesbank in 1957. These debates were technical and political, reflecting both the ordoliberal commitment to rules and the pragmatic need to integrate Germany into European and Atlantic alliances. Money was no longer merely a tool of trade; it was a symbol of recovered sovereignty and a pillar of the new republic's stability.

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The legacy of this period is often summarized as the "stability culture," but the term can obscure the complex interplay of ideas, institutions, and interests that shaped it. Germans did not simply prefer low inflation; they built a system designed to deliver it. Independence was not an abstract ideal; it was a safeguard against political abuse. Rules were not a fetish; they were mechanisms to bind state and society to predictable behavior. The memory of inflation provided urgency, but ordoliberalism provided a blueprint. Together, they guided the transition from the chaos of the early 1920s and the ruins of the 1940s toward a new model of money and governance.

What emerged was not a pure theory but a practical synthesis. The Bundesbank's design incorporated federal representation, transparent decision-making, and a legal mandate prioritizing price stability. It was insulated from direct political control but accountable to legal and democratic norms. Its tools—open market operations, minimum reserves, discount policy—were employed within a framework that valued predictability. This framework did not guarantee perfection, but it did foster credibility. And credibility, in monetary policy, is a precious asset that is earned by discipline and reinforced by institutions.

Thus, the birth of ordoliberalism in Germany cannot be separated from the lived trauma of inflation and the institutional lessons drawn from the Weimar and Nazi eras.

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The German approach to money after 1945 was both a reaction and a construction. It reacted to historical disasters by rejecting discretion and constructing a rule-based system with an independent central bank at its core. The result was a monetary order that, while rooted in German experience, would soon become a model for Europe and a crucial element in the architecture of the future euro.

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