THE GERMAN MODEL

SEEN BY ITS NEIGHBOURS

EDITED BY
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Introduction and Summary

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This book is part of the larger project 'Labour Relations in Context' (LRC) undertaken by the Institute of Economic and Social Research (WSI) in Düsseldorf, Germany. The WSI has established an international network of researchers working on Labour Relations and organizes workshops on political, economic, and social developments, their impact on labour relations and on strategies how to increase room for manoeuvre for labour in times of globalization. One LRC Network workshop on the literature of Varieties of Capitalism and its relevance for future labour relations research took place at the European University Institute (EUI) in Florence in May 2014. During the workshop hosted by Prof. László Bruszt at the Badia in Florence and by emer. prof. Philippe Schmitter in his house in Monteloro, participants from a range of countries and nationalities commented–perhaps partly in politeness towards the German organizer of the workshop, WSI–on Germany. This inspired the following book.

Germany and in particular the German model or 'Modell

Deutschland' have been discussed widely in political science and economics. The Rhineland model as opposed to the Anglo-Saxon Model has been praised for being one specific type in the variety of capitalism which relies on solid political and economic institutions for long term economic performance. Germany was classified as a coordinated market economies as opposed to the liberal market economies in this literature (see Hall and Soskice 2001).

While in 1999 Germany was called the sick man of Europe due to its conservative banking system and rigid institutional structures by the Economist, 'troubled with sclerotic employment, sluggish growth, and severe fiscal problem', it outperformed the US after the financial crisis and became a European Superstar (Reisenbichler and Morgan). Krugman even went as far as talking about a German job miracle and praised Germany for its potency to create jobs and prevent unemployment. He suggested the United States should learn from this model (Krugman 12.9.2009 in NYT).

Since the Financial Crisis in 2008, Germany has performed economically far better than most of its neighbouring countries. What makes Germany so special? And is this sustainable? Is it only a last sand castle left, before the rough storm of globalization will sweep it away (Streeck 1995: German Capitalism. Does it exist? Can it survive?), or is it an immovable rock in turbulent waters, big and solid? Is it its strong political institutions, in particular trade unions, which by international comparison are a solid rock in turbulent waters, which still can influence politics and act rather than react (Schmitter during the workshop)? Is it its vocational training which guarantees high skilled labour and is a rock in the ocean preventing unemployment and in particular also youth unemployment? Is it social partnership agreements which showed large flexibility of working time arrangements during the crisis and turned the rock into a bamboo flexibly bending once the rough wind of globalization was blowing? Is it its wage policy which allowed for modest wage increases during the crisis? Is it its wage restraint combined with an undervalued exchange rate which allowed export surpluses, a pattern which goes already back to the 1940s (Scharpf) as a type of neo-mercantilism (Becker)? Is it simply luck, like the high increase in the demand for cars in China which allowed a booming car industry (Knuth)? Is and was Germany successful since the 2001 and particularly in overcoming the financial crisis or was its success due to a beggar-thy-neighbour policy relying on export and wage dumping (Sauramo)? Did it simply pick the more profitable parts in the value chain of global production focusing on special parts of manufacturing (Streeck)? Or did it sacrifice five million workers' jobs by almost making them working poor, in order to maintain high employment?

Did the core versus periphery success of Germany come at the expense of the less privileged workers, with severe cuts in welfare arrangements and dualization of the labour market with protected core employment and a non-protected periphery (Hassel)? Or rather a de-dualization (Reisenbichler and Morgan), as the German government recently passed a statutory minimum wage and labour market indicators for traditional outsiders (e.g. female, the old and young) are exceptionally positive.

Is there a special development at all? German firms have managed to moderate wages to boost international competitiveness since the mid-1990s, given the country's well-functioning and flexible collective bargaining system. Thus never a sick man, never a miracle, but a continuous development of solid political institutions which turn into a bamboo once in a while?

All along from miracle to fate to shame of the German model: Is there such a thing like a core of Germany, a core of political and economic institutions which are solid and robust, intact and not prone to sudden changes (Hassel, Behrens in this book)? Or did we reach the end of the German model (Seeleib-Kaiser)? Should and could the German model be emulated? Can the German institutions be copied to other countries and who would wish to do so? Would this bring the same result (see van der Linde in this book)?

The debate on the German model is controversial within Germany. Analyses of the German model from the United States on the other hand are by and large very positive: 'Germany is now a less egalitarian society than it once was and its rates of poverty have edged upward, but there are many people elsewhere in Europe who would trade their life circumstances for those of the average German' (Hall in this book).

Yet what do neighbours think about Germany? There seems to be more or less euphoria when it comes to Germany and its success in some of the neighbouring countries. The Nordic countries, for example, are very fond of the German model and want to copy in particular its labour relations and labour market institutions (see Hassel), yet some fear the negative effects of German low wages (see Sauramo). Boyer, one of the fathers of the 'théorie de la régulation' in this book sees a new German model rising when compared to France, severely shaken by the crisis. The Western countries admire Germany for its labour market flexibility within stable institutions (see critical on this De Beer and Van der Linde) and warn of its low innovative capacity (Kleinknecht and Kleinknecht). The Austrians have a similar model but question Germany's growth capacity (Ramskogler and Schuberth) and argue low labour supply to be a main reason for its success (Marterbauer). Many Eastern European countries are relatively silent about the German model. There is admiration for the German economic success, but at the same time not so much for its institutions and certainly not for its restrictive migration policy. The East seems to choose more in the direction of a liberal market economy (see Płóciennik and Łada). The Southern countries see the German success as a preposterous pain to Europe, and argue Germany is shaping EU policy and forcing austerity policy at the costs of its neighbours (see Schmitter and Todor, Calvo).

The workshop participants and additional authors from the LRC networks as well as recommended authors from abroad were asked to contribute to this book by answering the following questions:

- What makes Germany successful, if so, or is it not a success?
- Is there such a thing like a German model? What makes a model?
- Which theory stands behind the German model view? What is the cause of Germany's success?
- Is the German model sustainable?
- Can it be copied or emulated by its neighbours?
- What would you recommend Germany to do?

Not all workshop participants finally contributed, additional authors were invited by recommendation. Not all controversial opinions of each country could be covered, and not every author answered every question, but the book presents a variety of opinions on the German model from within Germany and from abroad and tries to sketch its future options.

The book consists of two parts. Part one shows Germany seen by some authors of the Variety of Capitalism literature hosted in the US, and by Germans themselves. Part two shows Germany in the eyes of its European neighbours.

What makes Germany successful, if so, or is it not a success?

'Janus Germany' (Tylecote)

'Germany's economic performance, its innovation capacity and its influence in EU debates means that the German model has featured strongly in academic and public policy debates' (Calvo). But Germany´s success has also casted its shadow. Its success was only in part a success. Growth rates were lower compared to certain other countries, luck contributed to successful export performance, poverty increased and working poor emerged and polarized society, and what was good for Germany at times turned out to be bad for its neighbours. 'The policies have produced severe recessions and – in some case – outright deflation' (Becker).

Germany's macroeconomic performance received most compliments, showing low (youth) unemployment, or what Krugman coined the 'German job miracle' in 2009. By 2014, German unemployment rates have dropped to 4.8% while youth unemployment rates are at 7.1%, opposed to the 21% EU average.

This success is usually attributed to labour market reforms and modest wages. The most important labour market reforms were the so-called 'Hartz reforms' of 2005 under the Social Democratic chancellor Gerhard Schröder. The reforms reduced the maximum duration of unemployment insurance, with regular benefits being limited to twelve months. Furthermore, the reforms intertwined labour market and social policy instruments. They integrated the former earnings-related and means-tested unemployment insurance program with the social assistance program for unemployed. Every employable person between fifteen and pension age will receive unemployment benefit II ('Arbeitslosengeld II' or 'Hartz IV'). In addition, a 'short-time work allowance' was introduced: a wage subsidy for workers which reduced working hours in times of business cycle downturns. When the financial crisis started, the German government expanded the short time work allowance duration from six to 24 months. 'At its peak 1.14 million workers were protected from unemployment through the scheme' (Seeleib-Kaiser).

The labour market reforms were only one side of the coin. Union wage restraints and booming exports due to an undervalued exchange rate were the other side (e.g. Hall, Schulten, Becker). Its undervalued exchange rate in combination with wage restraint, a combination of policies going back to the 1940s made Germany so successful as an export oriented country (Scharpf). Becker notes neo-mercantilist traits in Germany's export development.

'The conventional wisdom is that Germany is now reaping the benefits of its fiscal conservatism and structural labour market reforms of the early 2000s. Instead, we argue that this startling turnaround and continued success can be explained by successful adjustments in business and labour relations and wage moderation, which reinvigorated the competitiveness of Germany's export-driven industries' (Reisenbichler and Morgan).

Some authors question whether Germany's economic performance really was superior. While Germany did better than ageing Japan, the Anglo-Saxon economies experienced substantially higher GDP growth than Germany (Ramskogler and Schuberth), and its innovative performance for the future is endangered due to the low wage road it follows (Kleinknecht and Kleinknecht). Germany lost 22% of its capital permanently by saving in enterprises rather than investing (Ramskogler and Schuberth). De Beer does not agree with Germany's supposedly superior economic performance, in particular with respect to growth rates. 'Germany has managed the financial crisis better than many other EU countries. However, within the group of those who managed the crisis better, it performed worst. The Nordic European countries such as Austria, the Netherlands, Belgium, Denmark, and Sweden are more successful than Germany. In a longer-term perspective the German economic results are disappointing in comparison to the other economies of this successful group' (De Beer).

Uncontested is the high quality of production. 'Made in Germany' is another success feature of Germany. 'German engineering and product design has typically emphasized and excelled in customization and craftsmanship, making for flat hierarchies and close relations between design and execution even in the large firms of the Fordist era. This made it possible for German firms during the post-Fordist 1980s to switch without much difficulty to a pattern of diversified quality production without much difficulty' (Streeck).

Calvo sees the successful interactions between micro and macro elements as the reason for German success. 'The macroeconomic elements of the model deliver the type of socioeconomic stability that provides a sound basis for economic activity. The microeconomic features support a strong manufacturing sector characterized by the presence of numerous medium-sized firms, a preference for business strategies focused on high-quality production, and a thriving innovation system'.

Or was the German success simply luck? When the crisis years started, Germany entered it 'with a sectoral structure and a product mix ideally suited to serving international markets for high-end manufactured goods, such as luxury cars and advanced machinery. And the financial crisis helped to lower interest rates' (Streeck). The BRICS region has contributed roughly one-fifth to Germany's export growth since the crisis, with value added figures likely to be even higher. Of course, this regional concentration of German export growth limits the exportability of Germany's success and at the same time puts it on shifting grounds' (Ramskogler and Schuberth).

Marterbauer claims that part of the German success is due to its reduction in labour supply. 'The average number of hours worked per gainfully employed person has declined from 1997 to 2009, which reflects an increase in part-time work. On the other hand, the population aged 15 to under 65 has been shrinking since 1999 at accelerating rates, which has been compensated by growing activity rates only until 2006. Since then, the active workforce has also been on the decline which coincides exactly with the beginning of the decrease of unemployment'. Also Knuth finds this.

The decline in labour supply, including Germans who moved to Austria to study (see Marterbauer) can partly be seen as a factor of luck, contributing to low unemployment rates. It may however also be perceived as a policy, deliberately preventing increases in labour supply, restricting access for foreigners to the German labour market (Płóciennik and Łada) or old fashioned family policies, keeping women at home (Tylecote).

Some authors see only a comparative advantage of Germany, which goes at the costs of its neighbours, in particular the South and East (Becker). The export-led growth of Germany led to current account deficits in the South. 'The drive towards restoring competitiveness of German business put an enormous burden on the southern countries which were institutionally not capable of using bargaining institutions to keep wages low' (Becker). A similar argument can be found for Finland (Sauramo).

Historically, countries such as Austria, the Benelux countries and Northern Italy have been strongly integrated with German manufacturing. Since the late 1990s however, German export industries, particularly the car industry, have relocated parts of their production to the low wage economies in Eastern European countries, particularly to the Visegrád countries (the Czech Republic, Hungary, Poland and Slovakia). 'Research and development activities are almost non-existent in the Visegrád countries' (Becker). There thus existed no incentive and no German support for structural reforms in the East.

The German policies (focusing on strong export industries, low wages and undervalued exchange rates) put the other euro zone countries under enormous pressures. 'Some neo-corporatist countries, like Austria, could cope with the pressures. For France and the countries of the South European euro zone, the German policies of wage deflation put manufacturing production under considerable strain. Spain, Portugal, Italy and France displayed a particularly strong decline of the manufacturing share in the GDP between 1981 and 2007' (Becker). The current account deficits of EU member states were financed by capital inflows, particularly from countries like Germany and France. 'In countries like Greece, Spain, Portugal, the Baltic countries, Romania and Bulgaria, the capital inflows financed consumption and real-estate bubbles. The growth did not have any solid support in the productive sectors which tended to suffer from the existing monetary order' (Becker).

Tylecote sees a Janus head. The micro-components of the German model are successful. The medium sized enterprises end even large family owned companies invest in their own business and depend on a stable and predictable political environment, co-determination in Germany is strong, there is strong supervisory board representation of employees. The key characteristic of what he labels 'stakeholder capitalism' are thus intact. A category to which the Netherlands, Austria and the Nordic countries also belong. 'Germany has found many sub-sectors which play to its strengths. The German failure lies in the macro model, where it relies on beggar thy neighbour politics and it is still a very old fashioned model with regard to its welfare state arrangements, in particular women and family issues.'

'Whilst the changes in labour market regulations and social protection for the unemployed are very likely to have contributed to an overall increase in the employment rate and a decline in the rate of long-term unemployment, they have at the same time facilitated an increase in 'atypical' work, including (involuntary) part-time employment, temporary or fixed-term contracts, agency work and low-wage work' (Seeleib-Kaiser). 'Germany is no longer a high-wage country; wage dispersion has increased, and the low-wage sector has grown. Non-standard forms of employment with reduced protection have expanded. They have become the indispensable buffers of stable 'core' employment, and for those working in these jobs they have, in essence, turned out to be more of a trap than a springboard' (Knuth, see also Schulten).

Linking labour market and social policy reforms, subsidizing wages with social benefits, and leaving long term unemployed with a minimum social benefit of Hartz IV (a shamefully modest 399 Euro per month for a single household head plus housing subsidy) has accentuated the differentiation between workers and the non-working poor, which Leibfried characterized as an institutional dualism (Seeleib-Kaiser). Yet also within workers a polarization took place. More than 5 million German workers are in precarious jobs or even working poor (Schulten). The fact that low wages can be subsidized with Hartz IV has led to a deterioration in the low wage segment of the labour market. A hair cutter working forty hours a week could end up with a wage of 400 Euro per month which then had to be filled up with social benefits of Hartz IV. Using social policy for job subsidies became a working poor trap. Also its welfare state became again more dualistic, differentiating between social protection insiders and outsiders (Seeleib-Kaiser).

Is there a German model?

> *'Many European states have been declared superior, admirable or even miraculous at some point since World War II' (Schmitter)*

Over time there have been many successful models. The Swedish model, the Dutch 'Polder model', the Italian 'miracolo economico' in the 1960s, to name some. 'What is new, is the strong influence of Germany in the EU, which makes the German model not any longer a country model which can or cannot be copied, but a supranational model. That has an authoritative impact on the polices of its member-states' (Schmitter and Todor). For its neighbours, the German model has thus received a new dimension, which has to be studied more carefully.

Becker supports this when he finds that even in the 1950s and 60s Keynesianism was weak. German exports were better in line with ordo-liberal doctrines. This can be found again today, when Germany superimposes its model on Europe. 'On German insistence, the introduction of the euro was linked to rules for the budget deficit and public debt and gave a strong impetus to ordo-liberal policy rules which constrained the spaces for fiscal policies and disempowered national parliaments. In line with the German neo-mercantilist policy orientation and the more general international trend, EU policies gained an increasingly strong anti-inflationary bias' (Becker).

A model is something that can be emulated or imitated by others (Schmitter and Todor). Germany, being a dominant player in Europe, has always been typified and classified in all classification schemes. Classifid as something special or as a country with special outcomes that others should aim to achieve historically however was not always the case. The 'sick man of Europe' definitely was not a role model for others. Not all authors agree that there is something like a German model.

Some see many German models appearing and again disappearing. Germany's 'export-led economic miracle' of the post-World War II, the 'Modell Deutschland' in the early 1980s, due to its comparatively good socio-economic performance after the oil crisis, then the resurrection from the sick man of the Euro for its byzantine and inefficient tax system, a bloated welfare system and excessive labour costs, to a new Modell Deutschland (The Economist, 2012), based on a relative quick return to economic growth and comparatively low unemployment rates (see Seeleib-Kaiser).

The perception of whether and what is a German model largely varies within and among disciplines. Economists have less problems accepting a model than do political scientists and sociologists. Economists usually refer to the macroeconomic features of the model and are preoccupied by labour costs and export performance, including some indicators for labour relations. Welfare sociologists and political scientists on the other hand focus more on the various labour market reforms which affect social policy and poverty. Political scientists and organizational sociologists focus on micro-elements such as labour participation, industrial relations, corporate governance, and modes of collective bargaining. Depending on the eye of the beholder, the existence, desirability, exportability and sustainability of the German model differ. In this book scholars from different disciplines have contributed. The analysis of economists (see e.g. Kleinknecht and Kleinknecht, Marterbauer, Ramskogler and Schuberth, Becker), political scientists (see e.g. Boyer, Schmitter and Todor, Scharpf, Hall, Hassel, Knuth, Behrens, Calvo, Schulten, Reisenbichler and Morgan) and social policy scientists (see Seeleib-Kaiser and Tylecote) differ. Large variation is also within political scientists depending on which school they represent. This has to do with the fact that the German model consists of very different parts.

The ingredients that compose the German models are macroeconomic and microeconomic features that Calvo in this book summarizes very nicely: 'From a macroeconomic viewpoint, the German model involves a preference for current account surpluses, low inflation, well-balanced fiscal accounts, low levels of public debt relative to GDP, and a generous welfare state. From a microeconomic perspective, the basic features of the German model are a strong system of higher education and vocational training, consensual labour agreements, local banks with specialized business knowledge, and a dense and high- quality network of institutions devoted to industrial innovation'.

From a welfare state perspective Germany has changed dramatically with the Hartz reforms. Seeleib-Kaiser even goes as far as to say that one can no longer speak of a German model: 'Germany has converged towards a liberal approach to welfare, usually associated with policies in Britain and the United States' (Seeleib-Kaiser). However, as the country has made significant progress in reorienting its family policies towards a more employment-oriented approach, found in social-democratic Scandinavia, it should not be characterized as a liberal welfare model' (Seeleib Kaiser).

Behrens sees strong unions and employers associations as well as universal institutions such as multi-employer collective bargaining and establishment-level works councils as the backbone of the traditional German political economy or 'Modell Deutschland'. 'With the decline of trade union membership and weakening of labour relations, different interpretations occurred. The literature on disorganized capitalism argues that national wage arrangements break down under the pressure of world markets. Streeck talks even about a move from the German political economy moving away from 'centralized authoritative coordination and control toward dispersed competition'. Hassel sees a dualization in the core of large manufacturing firms, with high union density and collective bargaining coverage as well as the high likelihood of them having a works council, and a periphery, where those key institutions are mostly missing. Behrens argues that though institutions for the regulation of labour relations institutions have been weakened, structures of corporate governance have changed, and income inequality has risen, there is still a core – some of the major ideas which are associated with coordinated market economies are enduring or even gaining new ground. Behrens shows the acceptance of social partnership in multi-employer bargaining has increased during the financial crisis and that the establishment-level conflict resolution through works councils has declined. 'Codetermination can be re-activated and maybe even rejuvenated, albeit under very specific circumstances' (Behrens).

Schmitter and Todor cannot find a German model, but rather view it as the result of muddling through history which produces an outcome which at the moment is favourable in macroeconomic terms. Schmitter and Todor regret that the 'model' debate is mainly led by economists and see a bias towards overemphasizing economic institutions and variables. The favourable economic outcomes are contingent on the democratic performance of their respective political institutions and policies which economists often ignore. 'Competitive elections between credible political parties, the legitimacy accorded by citizens to those who win them, the stability and effectiveness of the government produced by these winners, the existence of stable and non-violent relations between representatives of capital and labour and, finally, an honest public administration and legal system that impartially implements policies and protects rights regardless of the party in power´ are important political variables that underlie economic success' (Schmitter and Todor).

Van Waarden sees the German legal system and the many built in checks and balances as an often overlooked feature of the German model. The German legalistic model as opposed to the Dutch pragmatic legal system explains major economic differences between Germany and other countries, like the Netherlands. Intercompany negotiations in Germany are very tedious and may take long due the legalistic culture, but the fear from being sued creates carefullness in inter organizational relations in the economy. The Dutch economic organizations are more pragmatic, flexible and fast, but less stable.

Which theory stands behind the German model view? What is the cause of Germany´s success?

> *"Western Europe" can be said to encompass social democratic economies in the Nordic world, continental coordinated economies elsewhere in northern Europe, liberal market economies in the UK or Ireland, and mixed market economies in southern Europe (Hall).*

Institutional economics, industrial sociology and comparative political science have emphasized the interaction between economic outcomes, institutions and micro organization of firms and sectors. With regard to typifying, industrial sociologists showed how production depends not only on the organization of the firm but also on institutions in its external environment. Studies of neo-corporatism have revealed that the organization of trade unions and employers influence the effectiveness with which countries manage inflation and unemployment (see e.g.Schmitter and Todor, Streeck and Scharpf). Traxler and Unger (1994) showed that corporatist countries like Germany were also able to perform better on dynamic efficiency. Whitley, showed that Germany belongs to a type of national systems of innovation which are better at incremental innovations rather than radical ones and tested this for different sectors (see Unger 2000).

The literature on the varieties of capitalism going back to Hall and Soskice (Hall, Hassel) classifies Germany as a Coordinated Market Economy (CME) as opposed to a Liberal Market Economy (LME). It claims that prosperity can flow from political economies that are organized quite differently and distinguishes several dimensions for the two types of capitalism.

1. **Industrial relations** Firms negotiate and coordinate with labour unions as well as other employers regarding applicable working conditions and wage levels. Germany is characterized by a high level or organization, coordination and centralization of industrial relations, whereas industrial relations in LMEs are decentralized. 'Many German firms have excellent capacities for making incremental improvements to their products and production processes, partly because works councils, backed by relatively strong trade unions, give the workforce some measure of job security and a voice in management decisions that makes it easier for firms to enlist their cooperation. This resulted in incremental innovation and high quality products'. (Hall)
2. **Vocational training** 'At the sectoral level the dual vocational training is outstanding and provides high skilled labour. Based on formal education and apprenticeships, built on collaboration between trade unions and employer associations that are well-organized at the sectoral level' (Hall). 'The German dual vocational training allows to form firm or industry-specific skills that cannot be easily transferred across firms, LMEs prefer the formation of general transferable skills' (Hassel).
3. **Corporate governance and interfirm relations** 'Firms choose their strategies and preferences in order to access finance and cope with shareholders. Firms distinguish amongst various kinds of supplier and client relations, as well as amongst different strategies to access technologies' (Hassel) There is 'cross-shareholding among firms, those associations are conducive to collaborative research and development because they support corporate networks

that allow firms to develop and monitor each other's reputations; and they shield firms from hostile takeovers that might threaten their close relationships with the workforce' (…) 'The result is a form of stakeholder capitalism, in which firms are responsive to the concerns of their employees and other firms as well as shareholders, as opposed to LMEs who focus only on the price of the company's shares' (Hall).

4. **Relationship with employees** 'The coordination and communication between firms and their workers are by referring to the latter's commitments and internalization of their firm's goals and interests, as well as their motivation' (Hassel).

"Western Europe' can be said to encompass social democratic economies in the Nordic world, continental coordinated economies elsewhere in northern Europe, liberal market economies in the UK or Ireland, and mixed market economies in southern Europe' (Hall).

Hassel shows that the German model has changed a lot and is in transition. Collective Bargaining institutions have changed. 'At the end of the decade, institutional and regulatory stability was combined with a far higher degree of flexibility of working practices at the firm level and an increasing weakness of employers' associations and unions'.

'The Hartz reforms I–IV changed the institutional structure of the Federal Labour Agency- The reform of the unemployment insurance system was comprehensive and involved a drastic cut of benefits for the long-term unemployed who moved to social assistance levels after a period of 12 to 18 months of unemployment. Previous measures to protect skills by not forcing skilled workers to take on unskilled positions were removed. At the same time, a kind of negative income tax was introduced by enabling workers with low-paying part-time jobs to fill their salary up with social benefits.

The rate of the working poor shot up and moved Germany to be among those countries with the highest proportion of the low-paid within the EU. Hassel sees dualization of the labour market as a consequence of the reforms.

Vocational training is still the dominant form of training after secondary education. As increasingly school leavers either drop out of low-quality training or cannot meet the expectations of high-quality training, a school-based training regime evolved alongside the firm-based training system (Hassel).

Changes to corporate taxes at the beginning of the 2000s gave incentives to firms to abandon the previous tight network of corporate cross-shareholding. Despite all the changes, Hassel however notes an intact core. 'The German model was a major factor as to why the German economy survived the great recession of 2009 in reasonably good shape. When the recession hit and GDP was in free-fall, firms, unions and the government resorted to the established policy instruments that were inherent in the 'old' German model to combat the crisis'. The main factor for this development was the initiative to reduce working hours which kept German firms able to keep their skilled labour and react quicker than liberal market regimes once the world markets showed the first signs of recovery.

Scharpf in most discussions on the German success misses a focus on the interaction between the domestic model and its international monetary environment. 'The Varieties of Capitalism needs to be complemented with an appreciation of the variety of macroeconomic regimes (Scharpf) and with a political-economy variant of Peter Gourevitch's (1978) reminder of the influence of international regimes on domestic choices' (Scharpf)

Schmitter and Todor argue the predominance of economists in this debate causes the role of politics and democracy to be neglected. Furthermore, he claims that the German good results seem 'more the product of improvisation and experimentation than the abstract logic of a 'coordinated market economy' or of 'social capitalism/democracy'.

Some authors argue Germany is experiencing dualization: a split of society into a core employment sector of insiders and a periphery sector of less protected outsiders (e.g. Hassel) or an institutional dualization between workers and non-workers (Seeleib-Kaiser). Other authors however argue Germany will manage to overcome this dualization. Reisenbichler and Morgan see a de-dualization, noting new efforts to integrate periphery workers, such as through the introduction of a statutory minimum wage which entered into force in Germany in 2015.

Another theoretical approach that created some types or models, of which Germany is one, is the French 'théorie de la régulation'. It focuses on ways in which institutions in some spheres of the political economy can enhance the operation of institutions in other spheres (Boyer). Regulation theory discusses historical change of the political economy through two central concepts, the regime of accumulation (for example of Fordism) and mode of regulation (for example mass production, full capacity full employment). A mode of regulation is a set of institutional laws, norms, and comprises usually a money form, a competition form, a wage form, a state form, and an international regime.

The régulation approach emphasizes 'the historical constitution of compromises at national level, out of which companies then developed and adapted their own strategies. One example is when German companies open new factories overseas, they rarely export the same kind of organisation like employment contracts, sub-contracting given the lack of institutional support in the country in question with regard, to the skilling of workers and the formulation of pay policy. This means that institutional constraints shape companies' organisational choices (…) There is a form of complementarity between institutional forms and company organization' (Boyer). Boyer sees a new German model on the rise.

Is the German model sustainable?

> *'Germany's success resembles a moment in time snapshot very much like a 16th/17th century Flemish still life painting capturing a beautiful moment but at the same time depicting the vanitas, the fugacity of that moment' (Ramskogler and Schuberth)*

> *'The German model has changed considerably since reunification, and it derives its resilience from an ability to reform without sacrificing its logic' (Boyer)*

The sustainability of the German model is judged very controversial in this book. Scharpf sees Germany's success due to its undervalued exchange rate, thinks that Germany's success is sustainable as long as the Monetary Union does not collapse and as long as the demand of BRIC economies for German investment goods and luxury cars remains strong enough to support the export-dependent German economy, yet argues Germany's success is unsustainable if either one of these conditions should fail (Scharpf).

Others, in particular Schulten, Ramskogler and Schuberth do not think that accumulated export surpluses are feasible in the long run. They would eventually mean bankruptcy in the import surplus countries. Ramskogler and Schuberth further argue that the German model will be politically unsustainable. Germany's success in expanding its current account was to a large extent attributable to private sector savings. But positive net savings on the part of firms is equivalent to investment restraint. Germany suffered major capital losses during the crisis, losing some EUR 600 billion of its net foreign assets, equivalent to 22% of its GDP. This means that a substantial part of capital saved through German consumption and investment restraint was ultimately lost. 'Hardly any population is likely to accept permanent frugality if the associated savings are lost' (Ramskogler and Schuberth).

Many authors note transformation in the German model. The assessment of to what extent Germany has undergone this transformation is controversial. Hassel writes that according to Streeck 'the distinctiveness of the model compared to other political economies has become largely irrelevant as the process of liberalization and deregulation has introduced market mechanisms in all advanced political economies to an extent that the peculiarities of the training system, wage setting and corporate governance are not much more than decorative features' (Hassel)

Others argue that the core features of a coordinated market economy based on non-market coordination have remained intact and continues to dominate the central features of the political economy (Hassel, Behrens).

In between these two main positions a third has emerged that recognizes the trends towards liberalization and deregulation but argues that these trajectories fundamentally differ in different kinds of political economies (Hassel). Seeleib-Kaiser sees the end of the German Bismarckian welfare state model and a clear direction towards a liberal welfare regime.

More concerns are about the micro developments. Some analysts argue the norms which encourage German firms to cooperate with one another, thereby enhancing collaboration and public goods, have eroded under intense pressure from foreign competition and liberalizing reforms (Streeck, Hassel, Behrens). But the German model has historically been flexible. 'Concertation is not always a smooth operation: producer groups sometimes move only under pressure from governments. Some arrangements provide the actors with considerable room for maneuver under broad guidelines, and firms have recently been defecting from some agreements in search of flexibility' (Hall).

Hassel sees the transformation of the German model towards a more liberal one 'but in essence it remains 'German' in the sense that many of its institutional characteristics define the process of liberalization'. For instance, the dualization of the labour market is not the same as a straightforward liberalization towards a liberal labour market as in the UK or USA. However, there is a dynamic process of change taking place. The German model is moving into a new era which combines coordination in the core features of the manufacturing sector with new liberal elements. Institutions are hollowed out while their formal structures remain intact, there is a different understanding of the role of work. For instance, while the 'old' German model gave a high premium to job tenure and life-long employment in major manufacturing firms, this model is not compatible with a workforce that is female and in the service economy and has a substantial share of migrant workers. The lower attachment to a particular employer makes it harder for them to attain and protect specific skills. The premium of skill specificity is therefore much harder to maintain when the workforce is more mixed.

Hall and Hassel see a challenge for sustainability in demography and sufficient migration. Also Tylecote finds that Germany still has a highly traditional male breadwinner model which assigns women the role of secondary earners. 'Low fertility is related to this as many qualified women are not prepared to play this role'. Schmitter finally points out that sustainability is the wrong question, especially for Southern countries: 'Seen from the Italian perspective, the key question is not how long will it last, but what will be its impact while it exists'.

Can the German model be exported?

A miracle cannot be copied; only prayed for at best´ (Knuth)

There is almost unanimity that the German model cannot be exported or emulated. The German model consists of an interaction between complex micro and macro level institutions, which cannot be entirely copied.

'Some have suggested that the solution lies in forcing the southern European countries to adopt the German model. But my analysis suggests that this vision is entirely unrealistic. The countries of southern Europe can be forced to adopt balanced budgets, a measure that the fiscal compact of the EU is now pressing on them. But the success of the German model depends as much on its micro as its macro dimensions, namely, on the organizational structure of its political economy; and it is unreasonable to think that it can be emulated in southern Europe. The structure of a political economy cannot be changed overnight. It is based on the organization of producer groups and capacities for cooperation that develop only over decades out of hard-won experience' (Hall). Hall sees this as the 'Fate of the German Model'. According to him the German model does exist, can also survive, but cannot be copied.

Scharpf adds that not all European economies have industrial structures that would facilitate an export-led growth strategy as pursued by Germany.

Van der Linde in this book argues that picking out one piece of the model that does not have the corresponding complementarities and does hence not match the rest of the political institutions of a country might even have opposite effects.

Also Knuth warns that the discovery of 'a "miracle" inevitably leads to it being regarded as a "model" for others to follow, although the logical paradox should be obvious: A miracle cannot be copied; only prayed for at best'. He warns against 'modacles', that is miraculously successful models to be transferred into a coercive political environment (Knuth). Germany cannot be a role model for Europe, especially not for the South, according to him.

The neighbours see Germany through different lenses. Boyer, with the théorie de la régulation analyses why the German model could not be exported to France or countries from the South. 'The German model, reputedly unchanged for decades, needs to be challenged; it has changed considerably since reunification, and it derives its resilience from an ability to reform without sacrificing its logic. This explains why attempts to import the German model have had so little success in modifying the French trajectory, but the reasons apply equally to the countries of Southern Europe, to which the German authorities very generously attribute an ability to adopt this model, if only partially, as a sure way out of crisis'.

In the evolution of capitalism, Germany developed a vocational training while France pursues generalist aims in its education system and makes vocational training a second choice, thereby 'reinforcing the hierarchical relationship between the ranks of wage earners, their technical managers and executives'. 'The result is a different way of sharing responsibility and remuneration on the opposite banks of the Rhine, even though companies are operating in the same market' (Boyer). Germany specializes in production, France on mass production. With this Germany could be price setter, while France became a price taker at world markets, which led to lower investments.

As a result of globalization, industrial relations in Germany became segmented, but competitiveness was preserved in the export sector. Specialised manufacturing in Germany comes out of this stronger, but the socio-economic regime has somehow changed (see Boyer, Figure 3). 'Other countries, like France, have not been able to modernise and do adequate reforms' (Boyer).

In Italy, German economic performance is admired. But – contrary to small countries' miracles in the past – the German model, due to the size of the country and its impact in the EU, is also feared. Schmitter compares both, the economic and the political institutions of the two countries and tests their complementarity. For this he chooses several variables in order to operationalize the economic dimension which ranges from 'social capitalism to liberal capitalism', and the political dimension which ranges from 'social democracy to liberal democracy'. Schmitter and Todor see many parallels between German and Italian institutions. They find that neither Germany's nor Italy's economic or political variables form the sort of complementarity that is supposed by Variety of Capitalism theorists to be the key to good performance. They claim that a second complementarity would be needed, namely complementarity between the economic and the political dimension, between forms of capitalism and forms of democracy. Italy and Germany are quite similar in many respects: both have a large number of medium sized firms and corporate governance which protects firms from hostile takeover. Major differences however exist in the political dimension: Italy's polity is much more centralized. Furthermore, the German systems relies upon '(1) a system of limited number of parties that compete centripetally for the support of moderate voters, but which nevertheless alternate in power over time, thereby, reducing the tendency for entrenched partisan oligarchy and corruption; (2) a regular and predictable arrangement of functional representation and interest bargaining among social classes and economic sectors that encourages mutual responsiveness, while tolerating differentiation in outcomes at the mesoand micro-level; and (3) a territorial distribution of authority that is decentralized in critical but limited aspects such that some competition between regions/Länder encourages competition between their respective authorities and, hence, innovation in political-economic policy'.

In Spain the German model was intensely discussed. The convenience of borrowing the 'Kurzarbeit' (short-time work) program to help diminish unemployment was suggested, yet the conclusion was that the program would not be suitable for the Spanish context, as it is designed to manage temporary demand shocks whereas the Spanish situation has a structural component. Spanish policies to stimulate exports and lower labour costs in order to bring Spain closer to the German model are unsuccessful because there remain large differences in certain dimensions, such as the share of manufacturing in GDP, the number and degree of obstacles to open a new business, worker qualification, and limited investment in research and development (Calvo).

The 'war of the models' is nowadays fought over labour markets institutions. Many Dutch economists argue that the German example shows how labour market reform during the crisis can pay for itself—while Dutch reform lags behind. While Germans came to the Netherlands to study the Dutch Polder Model, nowadays the Dutch go to Germany and think the Dutch failed to reform as the Germans did (de Beer). They however overlook a very important point: the complementarities of institutions. The same labour market reform will not produce the same results in another country and institutional setting (Van der Linde).

Paul de Beer questions the German and Dutch miracle by comparing the socio-economic performance of Germany and the Netherlands with the (unweighted) average of six other countries, including five prosperous North-Western European countries (Belgium, Denmark, France, Sweden and the United Kingdom), and the United States. The Dutch miracle, the Dutch 'polder model' was introduced to characterize the tripartite consensus amongst trade unions, employers and the government, which resulted in less unemployment, but also wage moderation, part-time work and a strong reduction of social expenditures without a significant increase of income inequality or poverty. Now Germany outperformed most other EU countries in terms of employment growth and the reduction of unemployment. Both success models were based on a combination of wage moderation and a flexibilization of the labour market, both were accompanied by strong export growth, both resulted in strong employment growth but relatively weak or modest productivity growth. Moreover, the success of both countries followed a period in which the countries performed rather poorly (De Beer). De Beer claims that the role of shorter working hours is overestimated in the miracle debate. In Germany and in the Netherlands, average annual working hours fell less than in the other countries. 'If one takes a longer time perspective, the Netherlands and Germany only outperformed the other six countries concerned with respect to employment growth. Over a period of 33 years, the Dutch and German performance regarding the unemployment rate and economic growth was rather mediocre'.

Austria has many institutional similarities with Germany. It has strong neo-corporatist arrangements, employees' and employers' organizations are relatively strong, encompassing and consensus oriented, a relatively high public expenditure quota, a longstanding tradition in manufacturing, combined with a well-established education and innovation system. In both countries Kurzarbeit helped to overcome the crisis without mass dismissal. 'A serious problem is that Germany and Austria continue to accumulate considerable current account surpluses. Inequality of income is rising, as indicated by falling wage shares, growing disparities in the personal income distribution, and expanding low- wage sectors. In Austria this is still corrected to a certain degree by a well–functioning, comprehensive welfare state. In Germany, however, this is no longer the case, especially in the area of pensions and low-wage groups' (Marterbauer).

Poland has been labelled a dependent market economy (DME), others called it a mix of the liberal model and the Southern-European model. For Poland, Germany is a big neighbouring country with traditionally strong ties. It is the buyer of one quarter of Poland's exports and several hundred thousand Polish migrants work in Germany. The Polish elites are not merely positive about Germany. They also associate their neighbour with protectionism, over-regulation and stagnation. Berlin's decision to keep the German labour market closed to the new EU entrants until 2011 seemed to confirm this and pushed many Poles to seek their fortunes in the more open, liberal economies of Ireland and the UK. Nevertheless, Germany's good work organization, low level of corruption, high standard of living and the outstanding reputation of German companies are admired in Poland. 'At the first glance, Poles would be happy with becoming more German. After all, Poland has added to its constitution the "social market economy" – banner (Art. 20), referring clearly to the German experience'. But this reference however was related more to the goal of a high standard of living, and not necessarily to the way Germany has achieved it. It was much easier for transition economies in Central Europe to emulate LME-patterns than emulating German institutions, as LME patterns are based on clear contractual relations enforced by formal institutions. In fact, Poland chose a more liberal pattern, which was in line with the Washington consensus standards (Płóciennik and Łada).

The export of the German model is witnessed with skepticism: 'In fact, the key to the success of the model may not depend on transplanting those particular nodes, but in importing the institutions that bind them together and keep the system running. However, institutions can be either explicit (codified) or tacit (rooted in experience and common knowledge), and normally an economic model will rely on a combination of both types. (…) Interpretations are rooted in shared values, principles, and habits that may not be shared across countries. This means that institutions transplanted from the German model will likely be reinterpreted by the recipient country' (Calvo).

What would you recommend Germany to do and not to do?

Is it not ironic to seek recommendations for Germany from a researcher whose country is suffering from an exhausted model unable to reform ? (Boyer).

The major recommendations that authors give in this book to Germany are:

'Germany is now locked in its present position. If exports amount to fifty percent of GDP, the economy depends on them. Export industries and their unions dominate political debates in the media and in all political parties'. 'For Germany, leaving or dismantling the Monetary Union is economically and politically out of the question. But if the Monetary Union is to continue, Germany ought to contribute to reducing economic imbalances by reflating domestic demand and increasing imports' (Scharpf). 'The governing coalition will likely tolerate some relaxation of austerity elsewhere in Europe and look for ways to expand public investment at home, in greater measure if economic conditions continue to deteriorate. But severe political reforms in Europe are still lacking. That will ultimately require institutional reforms, which are underway, but for which few in Europe have the requisite political enthusiasm' (Hall).

'On the part of Germany and the EU, a break with ordo-liberal recipes and for the creation of policy-spaces that would permit to the peripheral EU countries to rebuild their productive structures' (Becker). Germany´s wage policy should be reversed and, more generally, monetary mercantilism should be abandoned (Sauramo). This however does not seem very likely (Scharpf, Hall).

It is important to stimulate investment (Płóciennik and Łada) both in the public and private sectors (Knuth). It is crucial that Germany reinvests some of the proceeds of its success into its own economy (Ramskogler and Schuberth, Reisenbichler and Morgan, Schulten).

Wage growth together with expansionary fiscal policies could boost demand and help achieve euro area-wide price stability throughout the eurozone at the same time (Ramskogler and Schuberth).

It will also be necessary to closely monitor the ongoing transition of the vocational training system and, in particular, to eventually adapt it to necessities arising out of ongoing structural changes in production (Ramskogler and Schuberth).

Germany should also focus on renewable energy. The Energiewende – the switch from carbon and nuclear energy to renewable energy, is a very ambitious idea with the potential to induce growth and create job (Hall, Płóciennik and Łada)

Some countries need suggestions on how to transform their economic models and increase their sustainability: Here Germany could give help. 'Using the German model can be useful for this purpose even if the model itself is not transplanted. A sound macroeconomic environment, an industrial environment in which firms can develop a rich and dense network of relationships, and access to a full range of resources outside their walls are parts of the German model. Knowing that these are critical factors, a thorough analysis of the recipient country can help identify strengths and weaknesses in these areas' (Calvo).

Conclusions

Germany is viewed differently when seen from within and when mirrored from abroad. Within Germany, something of a 'German model' is broadly accepted, yet differences are noted in its transition over time. The German success is seen in its low unemployment rates, attributed to different causes ranging from German labour market reforms before the crisis and additional working time reductions during the financial crisis to the high exports into BRIC countries, luck, moderate wages, and the solid German labour relations which allowed for flexible change. Some in the latter see an untouchable core, dating back to World War II or even much further, to the formation of Germany's economic institutions, which makes the German model solid, yet flexible enough to overcome a crisis.

Social partnership arrangements were reactivated during the crisis, showing that the core of German economic institutions is still intact. Whether the German model is sustainable is a major concern to the authors of this book. Some authors argue Germany's strong export orientation is unsustainable, others see it as a historic trait of neo-mercantilism and therefore not likely to be changed. Some authors think that the German model is already at its end after having introduced very unsocial social policy reforms. From within Germany voices are emerging, criticizing levels of poverty the emergence of working poor, the numbers of which partly surpass liberal market economies like the UK.

Development in German labour relations are also perceived differently. Most authors note major transitions, yet an untouchable core. The exportability of the German model to other countries is unanimously rejected by all the authors of this book. The German model looks good when seen from its results in terms of high employment. But the results are based on economic and political institutions which differ in other countries. Institutional complementarities are missing, so that reform programs of austerity, budget consolidation, labour market flexibilisation, and vocational training might fail when imposed on other countries.

Its neighbours look at Germany with a very sceptical eye. Within the Eurozone, the austere and thrifty 'Imperativ' of Germany has had very different effects. Some of the Nordic countries and Austria, certainly with more institutional similarities to Germany compared to Southern and Eastern European countries, handled the recession and austerity measures better compared to the Southern countries. The Nordic countries and the Netherlands studied Germany in order to copy especially the German labour market reforms which aimed at higher labour market flexibility and reduced working hours. Denmark and Finland sought to copy German labour market arrangements as well. The Nordic countries however today mainly suffer from fierce competition and export losses due to the low German wages, and fear a deterioration of their wage bargaining system and labour relations. The West was also very positive about the manner in which Germany overcame the crisis. The Dutch for example very eagerly studied reforms of labour market flexibility in Germany. They however also warn about the route to low innovation and growth which Germany might have chosen with its reforms. France has historically chosen a different trajectory than Germany which is very difficult to change. One of the largest challenges facing Germany in the future will be ensuring the economic strength of its partners, particularly of France. The Eastern European countries admire and envy the German success, yet developed more into the direction of liberal market economies.

If one looks at the German model through the eyes of its neighbours, Germany has become quite lonely after the crisis. It was a winner of the financial crisis, though probably no German would perceive it as this. Its joint economic policy imposed at an EU level turned out to be at the disadvantage of its neighbours. One major finding of this book is that investments in the private and public sector are necessary, both in order to stimulate Germany's domestic demand and to stimulate demand in Europe. If Germany wants to maintain its strong export sector – and I personally have no doubt it does – it has to help both its own economy and its neighbours to increase their purchasing power in order to become economically strong partners.

The Juncker Plan to stimulate investment in Europe through public-private partnerships and loans to small and medium enterprises is certainly a step in this direction. His initiatives however aim at strengthening the private sector. Next to a strong private sector, Europe also needs a strong public sector. Especially for preventing unemployment, for research and development and innovation, a strong public sector is essential. If Germany wants to maintain its strong economic position in exports, it has to help Southern countries strengthen their public sector, initiating health and pension programs, school and education programs, and offering job guarantees for young people. Europe needs money generously distributed to those in need and to build up infrastructure. Germany also has to take the initiative to reform political institutions, in particular at EU level. If more than two thirds of EU citizens do not agree with what the EU does, isn't it time to politically change this?

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Part 1

The German Model Seen from the US and from Inside

The Fate of the German Model

Peter A. Hall

There is a German model, although it is not uniquely German in all respects, nor is it something all countries should try to emulate. If it is neither entirely German nor a model for most countries, why should we speak of a German model? The answer turns on what this phrase implies about the operation of modern economies. All too often, economic analysis treats capitalist economies as if they should all operate in the same way. From that perspective, the distinctive institutional features of a national economy appear as deviations from an ideal configuration, which inhibit rather than enhance national performance until structural reform erases them. The American economy has often been held up as the closest approximation to such an ideal. Today the German economy is sometimes presented as the ideal to which its European neighbours should aspire.

What these views fail to acknowledge, however, is that successful economic performance can be delivered by more than one type of institutional configuration. The concept of the German model is useful precisely because it reminds us of this fact and indicates how economic performance is influenced by the organization of the political economy. The organization of the political economy is the institutional infrastructure supporting coordination among firms and other actors in spheres such as those of industrial relations, corporate governance, technology transfer, standard-setting, and skill formation. Of course, some institutions stand in the way of economic performance, but others are intrinsic to the efficiency of an economy; and there is convincing evidence that prosperity can flow from political economies that are organized quite differently (Hall and Soskice 2001; Amable 2003). The problem becomes one of establishing which institutions contribute to economic performance or well-being and how various institutions work together toward such ends.

This problem has been the defining intellectual challenge for comparative political economy since the 1960s and many scholars have made fruitful contributions to it. The French regulation school drew attention to the ways in which institutions in some spheres of the political economy can enhance the operation of institutions in other spheres (Boyer 1990). Industrial sociologists showed how production regimes depend, not only on the organization of the firm but also on institutions in its external environment (Sorge and Malcolm 1986; Streeck 1992). Studies of neo-corporatism have revealed how the organization of trade unions and employers condition the effectiveness with which countries manage inflation and unemployment (Schmitter and Lehmbruch 1979; Scharpf 1984; Katzenstein 1985).

My own approach to these problems is influenced by joint work with David Soskice on varieties of capitalism (Hall and Soskice 2001). We see firms as agents of adjustment in the political economy whose success depends on how effectively they coordinate with other actors, including employees, trade unions and other firms. The coordinating capacities of firms are conditioned by the institutional infrastructure of the political economy within which they operate; and we emphasize the distinction between coordination that is accomplished via competitive markets and coordination that is based on strategic interaction or collaboration among smaller groups of actors. We describe economies in which market coordination predominates as liberal market economies and those whose firms rely more heavily on strategic coordination as coordinated market economies. This distinction allows for sub-types as well as some national distinctiveness, so that "Western Europe" can be said to encompass social democratic economies in the Nordic world, continental coordinated economies elsewhere in northern Europe, liberal market economies in the UK or Ireland, and mixed market economies in southern Europe (Amable 2003; Hall and Gingerich 2009; Pontusson 2011).

Is there a German model?

Seen from this perspective, the German political economy displays some distinctive features constitutive of a German model of economic development. It is important to note that this model has both micro and macro dimensions, whose effects flow from how they operate in tandem.

At the micro level, the organization of German firms and the institutional environment in which they operate is important, especially in manufacturing. Many German firms have excellent capacities for making incremental improvements to their products and production processes, partly because works councils, backed by relatively strong trade unions, give the workforce some measure of job security and a voice in management decisions that makes it easier for firms to enlist their cooperation (Thelen 1991). As a result, many German producers have a reputation for high quality, which allows firms to compete on quality as well as price in markets for goods. These results also depend on a workforce with high levels of industry-specific skills, which are delivered by a system of vocational training, based on formal education and apprenticeships, built on collaboration between trade unions and employer associations that are well-organized at the sectoral level (Busemeyer and Trampusch 2012). Along with cross-shareholding among firms, those associations are conducive to collaborative research and development because they support corporate networks that allow firms to develop and monitor each other's reputations; and they shield firms from hostile takeovers that might threaten their close relationships with the workforce (Goyer 2012). The result is a form of stakeholder capitalism in which firms are responsive to the concerns of their employees and other firms as well as shareholders, and hence more resistant than their British or American counterparts to an exclusive focus on the price of the company's shares (cf. Gomory and Sylla 2013).

At the macro level, parallel sets of institutions and policies enhance the operation of these institutions at the micro level. Although weaker than they once were, in tandem with works councils, industry-wide trade unions are capable of coordinating with strong employer's associations on wage levels that encourage skill formation and restrain increases in unit labour costs. However, effective wage discipline also depends on supportive macroeconomic policies; and, in keeping with this, German governments have generally been reluctant to implement expansionary fiscal policies, lest they encourage higher wage settlements. For many years, the Bundesbank also policed this system by threatening to impose restrictive monetary policies in response to inflationary wage settlements (Streeck 1994; Hall and Franzese 1998; Carlin and Soskice 2009). Efforts to hold down the external value of the currency have also been central to promotion of the export sector, initially under Bretton Woods and then the European Monetary System (Kreile 1978). Since 1999, the European monetary union has also served this purpose, as the weaker economies in the eurozone hold down the euro exchange rate. The combination of these institutions and policies at the micro and macro levels of the German political economy have given rise to distinctive patterns of economic performance, marked by a large manufacturing sector and levels of exports that now comprise almost half of German GDP.

Of course, over the years, German policies have fluctuated around these norms and the institutions of the German political economy have undergone various changes. The universal banks that once exercised considerable influence over the industrial sector pulled back from it during the 1990s in order to expand their international business (Höpner and Krempe 2004; Deeg 2010). Trade union membership has recently declined, along with collective bargaining coverage, and works councils have become correspondingly more important in wage negotiations (Silvia

2013). Partly in response to initiatives from the EU, various realms of the German economy have been liberalized, and in this some see the collapse of collaborative capitalism (Streeck 1999). In my view, however, the basic features of the German political economy continue to distinguish it from many others, including its Anglo-American counterparts.

What has changed, however, is the structure of the German labour market, largely although not exclusively, as a result of the reforms of the Schröder government in the early 2000s. At that time, the Achilles heel of the German economy was its limited capacity to create jobs, especially in services (Iversen and Wren 1998). Most of those who were employed had good jobs, but overall levels of employment in Germany were low by cross-national standards. Germany was sometimes said to have an economy that provided "welfare without work" (Scharpf 2000). By reforming social insurance to lower the reservation wage, discouraging early retirement, and making part-time work more feasible, a series of reforms in the 2000s vastly expanded a secondary labour market of part-time jobs, often occupied by women, and employment in services. The resulting dualism is a double-edged sword (Palier and Thelen 2010). On the one hand, it has helped Germany to one of the lowest unemployment rates in Europe. On the other hand, many more German jobs are now precarious, lacking in social benefits, and low-paid. In this respect, Germany now resembles Japan, another coordinated market economy that has long had a set of dual labour markets.

Is the model a success?

Should we deem the German model a success? There are always trade-offs relating to what a particular political economy can deliver, and much depends on the criteria used to make this judgment. On national income per capita, the most familiar indicator of economic success, Germany ranked ninth in Europe in 2012 and well above the OECD average. It provides employment for 73 percent of the adult population, among the highest levels in Europe. As already noted, however, that achievement has come at the cost of rising levels of inequality (Thelen 2014). Workers in the core manufacturing sector continue to benefit far more substantially from this economic model than those on its periphery; and increasing inequality has aroused resentment among Germans, who now report lower average levels of satisfaction with their lives than people in most other European countries (OECD 2013; Alesina *et al.* 2004). However, after taxes and transfers, inequality in disposable household income has not risen as much in Germany as in Sweden or Finland since the mid-1990s, and it still stands significantly below the EU average (OECD 2014: 65). In short, Germany is now a less egalitarian society than it once was and its rates of poverty have edged upward, but there are many people elsewhere in Europe who would trade their life circumstances for those of the average German.

Can the model be sustained?

Is this model sustainable? In the long run, there is no doubt that it faces some formidable challenges. A low birth rate will eventually reduce the size of Germany's labour force and its potential rate of growth, unless higher levels of immigration swell the population. But immigration is not politically popular and immigrants rarely come with the high levels of certified skills on which the manufacturing sector depends. Thus, while a palliative, immigration is unlikely to be high enough to assure the growth prospects of the economy.

Second, levels of investment, on which the future growth of any economy depends, have been low over recent decades in both the private and public sectors. Partly for this reason, the rate of growth of productivity has been slow since 2000. Paradoxically, the problem in the private sector is linked to the success of German firms in lowering the rate of growth of unit labour costs. When labour is expensive, firms are more motivated to engage in labour-saving investment (Manow and Seils 2000). In the public sector, the problem is linked to the expansion of social programs, which consume resources that might otherwise be spent on capital investment, especially when governments are wary of deficit spending (Schäfer and Streeck 2013). Social programs are politically difficult to cut back because they are often seen as entitlements, while capital budgets can usually be pruned below the public radar screen.

Third, energy costs are now considerably higher in Germany than in some competing countries, such as the United States which is extracting oil and gas using new techniques of hydraulic fracturing. In addition, the aggressive stance of Russia has called into question the security of Germany's energy supplies which are highly dependent on that country. Although Germany is exploiting new sources of renewable energy, the closing of its nuclear plants also puts pressure on its energy prices. Since energy prices affect the cost of German exports, these developments pose long-term problems that cannot be ignored.

Finally, some analysts argue that the norms which encourage German firms to cooperate with one another, thereby enhancing collaboration and public goods, have eroded under intense pressure from foreign competition and liberalizing reforms that have removed some of the institutional constraints underpinning those norms (Streeck 2009). If this is the case, the capacities for strategic coordination at the center of the German model may be threatened.

Challenges such as these mean that we cannot take the continued success of the German model for granted. In order to prosper, the country will have to cope with them, and that may require some adjustments in German institutions and policies. Based on historical experience, however, I am cautiously optimistic that Germany can rise to these challenges without a radical change in the structure of its political economy. After all, Germany has met such challenges in the past. Reunification was a remarkable accomplishment. Concerted action made it possible to incorporate the eastern states (*Länder*) into a reunified Germany without dismantling the overall German model. Of course, reunification involved some alterations to that model, but, as already noted, all national models undergo changes over time Hall (2007). In this case, the process was marked by some mistakes, real sacrifices and some suffering, but it demonstrated the striking adjustment capacities of the German model.

Those capacities are rooted in the organization of the German political economy, which provides producer groups and governments with considerable capabilities for concerted action. Concertation is not always a smooth operation: producer groups sometimes move only under pressure from governments. Some arrangements provide the actors with considerable room for maneuver under broad guidelines, and firms have recently been defecting from some agreements in search of flexibility (Thelen and van Wijnbergen 2003). But the capacity of the system to provide such flexibility is not necessarily a weakness: in some respects, it contributes to the long-term resilience of German institutions.

Can the model be exported?

In the short to medium term, the most serious challenges facing Germany stem from the on-going crisis in the eurozone. In the wake of that crisis, levels of unemployment have soared and rates of growth plummeted in the countries on the periphery of western Europe most affected by the crisis. The Greek economy is now 25 percent smaller than it was in 2008. But stagnant growth across the eurozone threatens deflation across Europe, and Germany's rate of economic growth is projected to reach only 1.3 percent in 2014. One of the most pressing problems facing Germany is how to restore growth in Europe, an issue with political as well as economic dimensions.

However, the possible responses turn on the nature of the crisis facing Europe. Many factors converged to produce this crisis, including fiscal imprudence in Greece, loose financial regulation, and the inflationary effects of cheap credit flows inspired by the inception of the euro. However, the crisis also has roots in institutional asymmetries within the eurozone (Hall 2014). EMU brought together a set of political economies organized in quite different ways, and the type of growth strategy a country can pursue is conditioned by the organization of its political economy. But EMU proved more propitious for some growth strategies than for others.

To put it simply and leave aside some national variations, EMU can be said to have joined together two types of political economies – coordinated market economies in northern Europe, including Germany, the Netherlands, Belgium, Finland and Austria, and mixed market economies in southern Europe, including Spain, Portugal, Italy and Greece. The coordinated market economies had institutional structures conducive to export-oriented growth strategies. Effective systems of wage coordination restrained the rate of growth of unit labour costs, while para-public systems of skill formation encouraged high value-added production and incremental innovation, which allowed firms to compete on quality as well as price. As a result, these countries were well-equipped to compete in the new monetary union; and EMU provided a favorable context for their export-led growth strategies. It prevented their principal trading partners from devaluing their currencies to enhance the relative competitiveness of their own products, and, by holding down the external exchange rate, it enhanced the attractiveness of exports from the eurozone in other markets. Not surprisingly, Germany soon built up large balance of payments surpluses inside the eurozone.

By contrast, the structure of the political economies in the mixed market economies of southern Europe was not conducive to export-led growth strategies. Wage coordination to hold down the price of exports was difficult because their trade unions were relatively powerful but organized to compete for the allegiance of the workforce rather than to collaborate (Hancké 2013). Employer associations were less deeply institutionalized than in northern Europe and ill-equipped to operate collaborative vocational training schemes. As a result, the workforce was less skilled and the continuous innovation and high levels of quality control that enhance the attractiveness of exports were more difficult to achieve.

Partly because they were ill-equipped to operate export-led growth strategies, the southern European nations tended to adopt demand-led growth strategies, which relied on expansionary macroeconomic policies and generous industrial or manpower subsidies to increase employment, notably in services. Because expansionary policies are inflationary, however, prior to EMU many of these countries relied on periodic devaluations to maintain their external competitiveness. For such countries, entry into monetary union posed serious challenges. Unable to shift to export-led growth strategies and encouraged by flows of cheap credit from the north, they continued to pursue demand-led growth, only to find their current account deficits ballooning because they could no longer use devaluation to depress their unit labour costs and restore their competitiveness. In the end, these imbalances in the current account were as important as government deficits to eroding confidence in sovereign debt within the eurozone.

What can Germany do to restore rates of growth in Europe? Although some have argued for dismantling the monetary union, the immediate costs of doing that would be enormous for Germany and the other member states (McKinsey Germany 2012). Other analysts have suggested that reflation in Germany should be used to address the problem. However, although some reflation may be desirable in the short term, the spillovers from German reflation would not be high enough for this step to have a major impact on growth in southern Europe; and, as I have noted, fiscal expansion over a prolonged period is incompatible with the German model, since it threatens the wage coordination on which exports are based (Ivanova and Weber 2011).

In this context, some observers have suggested that the solution lies in forcing the southern European countries to adopt the German model. According to that view, they can prosper by becoming more like Germany but my analysis suggests that this vision is entirely unrealistic. The countries of southern Europe can be forced to adopt balanced budgets, a measure that the fiscal compact of the EU is now pressing on them. However, the success of the German model depends as much on its micro as its macro dimensions, namely, on the organizational structure of its political economy; and it is unreasonable to think that can be emulated in southern Europe. The structure of a political economy cannot be changed overnight. It is based on the organization of producer groups and capacities for cooperation that develop only over decades out of hard-won experience (Streeck and Yamamura 2001; Thelen 2004). To impose contractionary fiscal policies on countries that lack the institutional infrastructure for export-led growth, thereby preventing them from pursuing demand-led growth, is a counsel of misery, based on a fundamental misunderstanding of how the Germany economy works.

The alternative approach implicit to some extent in the EU's enthusiasm for "structural reform" is to espouse radical deregulation of labour and product markets in the countries of southern Europe with a view to turning them into liberal market economies, like the U.S. and U.K. which rely largely on market mechanisms for economic adjustment. There is more promise in this approach. The Anglo-American economies can secure reasonable rates of growth, but it comes at the cost of relatively high levels of socioeconomic inequality which are unappealing to many Europeans. Moreover, because they are not well-suited to export-led growth, liberal market economies tend to depend on demand-led growth strategies of precisely the sort that the EU is now denying to southern Europe. There is a real risk that the countries of southern Europe may end up with deregulated economies joined to deflationary policies that doom them to low rates of growth and high current account deficits for many years to come.

What then should Germany do? There are no easy answers to this question, and the dilemmas are as much political as economic. The German government is caught in a pincer. On one side, the states of southern Europe, including France and Italy, are urging that they be allowed more room for fiscal reflation, ideally accompanied by expansion in Germany. They argue correctly that there is more than economic growth at stake. Hanging in the balance is the credibility of the claim that European Union advances the prosperity of all, rather than only some, of its member states, an issue currently fueling the rise of the radical right in many of them. On the other side of this pincer are those in Germany who believe, based on German experience, that fiscal rectitude is a necessary condition for economic prosperity, and who argue, with some reason, that German taxpayers should not foot the bill for economic problems occurring elsewhere in Europe.

Faced with this dilemma, the German government is likely to do what German governments almost always do, namely steer a middle way between Scylla and Charybdis. The governing coalition will likely tolerate some relaxation of austerity elsewhere in Europe and look for ways to expand public investment at home, in greater measure if economic conditions continue to deteriorate. Whether such steps will be enough to raise levels of growth and stave off populist electoral forces elsewhere in Europe remains to be seen. However, it will certainly not be enough to resolve the endemic problems of operating a currency shared by countries with very different political economies. That will ultimately require institutional reforms, which are underway, but for which few in Europe have the requisite political enthusiasm.

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The German Labour Market: No Longer the Sick Man of Europe

Alexander Reisenbichler & Kimberly J. Morgan

Introduction

While many European economies are still suffering the effects of the financial crisis, the German economy has emerged as a powerhouse. The country has not only experienced record-low unemployment and unprecedented employment rates, but also generated record tax revenues that have helped stabilize the budget. This turnabout is surprising given that Germany long was labeled the "sick man" of Europe,[1] troubled with sclerotic employment, sluggish growth, and severe fiscal problems. Today, German employment rates even outperform those of the United States, a country often admired for its fluid and dynamic labour market. Contrary to gloomy prognostications about the demise of the German economy owing to the eurozone crisis, neoliberal pressures, or geopolitical problems, the labour market is humming.

How can we explain this dramatic change? The conventional wisdom is that Germany is now reaping the benefits of its fiscal conservatism and structural labour market reforms of the early 2000s. Instead, we argue that this startling turnaround and continued success can be explained by successful adjustments in business and labour relations and wage moderation, which reinvigorated the competitiveness of Germany's export-driven industries.

Skeptics often object that any economic success comes at the price of labour market dualization, a cleavage between those with well-protected jobs and others in "atypical" work.[2] Yet, current labour market indicators illustrate that these characterizations may no longer fit a dynamically evolving labour market in Germany. For instance, the employment levels of traditional labour market outsiders (e.g., female, old, and young workers) are exceptionally high, the German government recently passed a statutory minimum wage, and trade unions negotiated higher wages in collective agreements. Dualization may not be an endpoint or the ordained direction of change, but rather a stop along the way to a robust labour market that can then become more inclusive.

If there is a dark spot on the horizon, it lies in the country's low level of public and private investment. German policymakers should do more to boost spending in infrastructure, education, and R&D, especially in times of record-low borrowing costs, deflationary risk, and a sluggish eurozone.[3] This would help stimulate demand within the country and the eurozone (and reduce some of the country's export-dependence), while at the same time increasing the country's long-term competitiveness.

From Sick Man to Miracle: The Resurgence of the German Labour Market

Several key economic indicators shed light on Germany's transformation from "sick man" to "miracle." The country's labour market is in exceptional shape, when compared with its European and American counterparts. In particular, the country's unemployment rate is half of what it was a decade ago, dropping from 11.3 percent in 2005 to 5 percent in 2014, far below the European Union (EU) average of 10.2 percent. Even more impressive is the employment rate, which rose from 65 percent in 2003 to 73.3 percent in 2013. Germany thus easily outperforms the disappointing employment rate of 64.1 percent across the EU-28, and even exceeds that of the United States (67.4%).[4] The performance of the German labour market is remarkable, especially given the current global economic climate.

The positive labour market performance also strengthens the country's fiscal situation, including the ability to borrow money at very low cost, generate tax revenues, and attract immigrants from abroad. One decade ago, demographic developments in the country were grim, with low fertility rates, an aging and shrinking population, skills shortages, and low immigration (in 2004, for instance, the net immigration surplus was only 82,000). These developments put enormous pressure on the German welfare state. While fertility is still low (1.4 in 2012),[5] net immigration numbers spiked to over 428,000 in 2013 as a result of economic stagnation elsewhere in Europe and Germany's strong economic performance.[6] Today, the country's population is growing again, mainly due to immigration. Increasing employment has also resulted in record tax revenues. For the first time in almost 50 years, Germany has been able to balance its budget in 2014, which contributes to stabilizing the country's debt (the debt to GDP level peaked in 2010 at 80.3% and fell to 76.9% in 2013).[7] Finally, Germany's status as a "safe haven" allows the country to borrow money cheaply in financial markets. All else equal, the country is planning to have a balanced budget and reduce its debt for the foreseeable future.

Explaining the German Miracle: Internal Flexibility and Wage Restraint[8]

Scholars and policymakers often point to Germany's strict economic management, austerity, and structural reforms when explaining the country's labour market success. While the Hartz reforms – a set of labour market and welfare state reforms that cut benefits and facilitated the creation of atypical jobs such as agency work – have encouraged more people to work, provided some flexibility for firms, and contributed to lower labour costs since the early 2000s,[9] they cannot explain the impressive labour-market turnaround. At best, the Hartz reforms mildly reinforced an existing trend toward growing competitiveness of the manufacturing sector that began well before the reforms as a result of wage moderation and the restructuring of business and labour relations.[10] Similarly, the idea that fiscal responsibility underwrote Germany's strong economic performance is questionable: while government spending has decreased from 47.6 percent of GDP in 2001 to 43.6 percent in 2007, it increased again as a result of the Great Recession to 48.2 percent in 2009.[11] When measured in absolute terms, German spending on social policy has increased throughout the 2000s.[12] Contrary to the widespread belief that the country has consistently balanced its budget, it produced budget deficits for almost five decades, with public debt peaking at 80.3 percent of GDP in 2010.[13] The German government is less fiscally responsible than often assumed, and there is little evidence that "fiscal consolidation" contributed to Germany's recent economic miracle.[14]

We argue that the German labour market miracle can be explained by both decades-long internal adjustments between labour and business relations and by wage moderation, both of which reinvigorated export-oriented industries. Faced with growing global competition in recent decades, German industries have negotiated more flexibility – especially at the plant-level – in adjusting working time and compensation since the late 1980s. The result of these adjustments is a "toolkit" of flexible labour market instruments that allow firms to adjust working time and pay while granting job security, which helped German industries successfully restructure themselves in recent decades. Concomitantly, German firms have managed to moderate wages to boost international competitiveness since the mid-1990s, given the country's well-functioning, flexible collective bargaining system.

Three intertwining institutional changes helped establish the internal flexibility toolkit. The first development started in the 1980s, when business and labour representatives in the manufacturing industries agreed on a compromise (the so-called Leber compromise) to flexibilize working time in exchange for the reduction of working time.[15] Initially designed to prevent an increase in unemployment, this tool was then used to tailor working time more effectively to the complex production flows of plants – that is, by increasing working time in good economic times or decreasing it during downturns. Second, firms flexibilized working time and pay through opening clauses from sectoral agreements between unions and employers. These clauses date back to German reunification, when collective bargaining structures were introduced in the former East Germany in the early 1990s and several companies were unable to meet collectively agreed upon wages and working time; hence, they were granted hardship clauses. Shortly thereafter, opening clauses were also introduced in the western parts of the country in order to cope with economic downturns, and later even in ordinary economic times, to preserve employment or increase competitiveness.[16]

The third component of the toolkit is the spread of company-level pacts between works councils and management.[17] These pacts involve job guarantees for an extended period of time in return for further flexibility in working time and pay. Often, reducing working time and pay is an effective (and more social) alternative to shedding highly skilled workers in whom these companies have invested, especially in times of widespread skills shortages. And for unions, preventing further layoffs through internal flexibility was a priority in times of budget and welfare state cuts. All of these tools then allowed firms to increase productivity by internal restructuring and flexibilization, enabling firms to optimize their highly complex production flows and adjust working time and pay to their economic situations. While several scholars argue that these developments undermine the German economic model of corporatism and manufacturing,[18] these institutional innovations have reinforced Germany's export-oriented industries.

Concomitantly, wage moderation has boosted international competitiveness since the mid-1990s. Germany's well-functioning, flexible collective bargaining system provides an advantage in restraining industry-wide wages when compared with other countries. This is because employers and unions can strategically moderate wages to boost competitiveness[19] and firms have gained ever more leverage to moderate wages (especially at the lower end of the income distribution) through opening clauses and employment-level pacts in times of declining trade union density and collective bargaining coverage.[20] As a result, unit labour costs improved relative to other eurozone countries such as France, Spain, or the Netherlands from the mid-1990s until the 2008-09 crisis, increasing German competitiveness by productivity gains that exceeded wage growth.[21] Moreover, wages in the service sector even decreased after the mid-1990s, which lowered input costs for the manufacturing sector.[22] The introduction of the European monetary union amplified this trend, as wage restraint in a common currency area, in which countries cannot devalue their currencies, functions as a form of internal devaluation. Relatedly, German manufacturers also benefited from the relatively weak common currency – compared with the influence a strong Deutsche Mark would have had in times of rising exports – allowing German manufacturers to export inexpensively to the rest of the world and generate extensive trade surpluses in recent years.

Internal flexibility and wage compression together helped preserve and even increase employment during and after the recent financial crisis of 2008-09. In 2009, the country suffered the most severe decline in economic output and productivity in its post-war history. Historically, it was not unusual for firms to respond with massive layoffs – if anything, the Hartz reforms should have facilitated their ability to shed workers. Yet firms instead adopted a wait-and-see strategy because they had built up financial reserves before the crisis that helped to tide them over; shedding highly skilled workers risked making it harder to find and train new workers in better times, and German exporters had been in decent shape right before the crisis hit.[23] Thus, they instead turned to the toolkit of flexible labour market instruments in an effort to save employment. In particular, firms tweaked working hours by reducing overtime or increasing deficits on working-time accounts (employees often have working-time accounts that keep track of the number of hours they have worked, including overtime or hour deficits); created short-time work (by which employees work fewer hours and receive some government subsidies for the foregone wage in return for job security); and temporarily reduced wages or social benefits, including vacation allowances.[24] Similarly, employers and trade unions agreed on relatively moderate wage increases during the 2008-2010 collective bargaining rounds, and collective agreements also included further provisions to flexibilize working time and short-time work in exchange for job security.[25] These developments demonstrate that core workers also had to make significant concessions in terms of working time and pay.[26]

The wait-and-see approach paid off, as growing demand from emerging economies enabled Germany to export its way out of the financial crisis of 2008-09. Together, internal flexibilization of business and labour relations and wage compression explain Germany's economic success in recent years.

Towards De-dualization?

A growing body of work has emphasized that Germany's economic transformation has come at the expense of labour market dualization.[27] Yet, the recent economic performance has helped counter dualization trends, which in the past have created some winners and losers in the labour market. In fact, previously disadvantaged segments of the population – the long-term unemployed, women, old and young workers – are now much more economically active than they were in recent decades. Standard employment has recovered to levels not seen in fifteen years and the grand coalition of Christian Democrats (CDU) and Social Democrats (SPD) just passed a statutory minimum wage. These developments are indicative of a dynamically evolving German labour market that has become more inclusive.

Many have argued that growing labour market dualization in Germany is the result of neoliberal and postindustrial pressures that have eroded the collective bargaining system. As a result, trade unions concentrate their resources on protecting a slowly shrinking core of workers while leaving outsiders – such as young people, women, and the long-term unemployed – behind.[28] Scholars often describe the phenomenon of dualization as an endpoint, at which the German economy has now arrived,[29] or as a path that is unlikely to change.[30] These characterizations of the German economy join those who have long predicted the demise of the German economic model.[31]

However, the resurgence of the German economy has helped counteract the forces of dualization. The number of jobs covered by the social security system recovered from its low point of 26 million in 2005 and climbed to an all-time high of roughly 30.7 million workers in 2014.[32] This also includes the revival of permanent full-time jobs – left untouched by the Hartz reforms – which increased from 37 percent of the working-age population in 2006 to 41 percent in 2012.[33] Permanent full-time contracts are still the most common type of employment (i.e., 60% of all jobs).[34] Moreover, the employment rate of women has increased significantly from 59 percent in 2003 to 69 percent in 2013, while that of older workers (age 55-64) rose from 39.9 percent to 63.5 percent. Youth unemployment rates of 7.9 percent are also exceptionally low when compared with the 23.4 percent EU average in 2013. Finally, long-term unemployment has declined from 6 percent in 2005 to 2.3 percent in 2013, and it is now much lower than the EU average of 5.1 percent.[35]

Policymakers also have adopted important policy measures to tame dualization. For instance, the grand coalition recently passed a statutory minimum wage of €8.50 per hour, designed to overcome some inequalities in the German labour market. Earlier last year, the coalition had also increased the minimum wage for agency workers. Trade unions, in particular, have been vocal proponents for the introduction of minimum wages and the re-regulation of atypical work, and they have started large-scale campaigns to improve the working conditions of agency workers. Recent collective bargaining rounds have also led to higher wages, which increased by 2.7 percent in 2012 and 2013.[36]

Certainly, atypical work (e.g., temporary, part-time, marginal, and agency work) has also increased in recent years, including many insecure, low-wage jobs such as agency work (in manufacturing) and mini-jobs (in the service sector).[37] The number of agency workers[38] rose from 200,000 in 1997 to 872,000 in 2011, but fell again to 815,000 in 2013, which amounts to less than three percent of all employees in jobs subject to social security contributions. More importantly, the number of mini-jobs[39] (as the only source of income) rose steadily from 4.3 million in 2000 to 5.1 million in 2009, but fell again to 4.9 million in 2015, while the number of mini-jobs as "side jobs" increased from 1.1 million in 2003 to 2.4 million in 2015.[40] However, increasing the number of atypical jobs does not always mean the rise of "bad jobs." Permanent part-time jobs, for instance, increased from 8% of the working-age population in 1996 to 11% in 2012, but part-timers often enjoy the same social benefits and protections as full-time employees. The same might be said about many fixed-term contracts, which increased from 4% of the working-age population in 2004 to 7% in 2012.[41] In sum, while there is undoubtedly room for improving the conditions of workers in atypical jobs, especially in agency work and mini-jobs, we should not lose sight of some significant *de*-dualizing developments in the German labour market, which has not arrived at a new dualized equilibrium, but is undergoing dynamic adjustments.

Conclusion

Not only has the German economy bounced back from its structural crisis in the early 2000s, but it has also emerged as Europe's economic superstar. We argue that this startling turnaround can be explained by successful readjustments in business and labour relations and wage moderation in recent decades that boosted the competitiveness of Germany's export-oriented industries. As a result, the country is generating record tax revenues and balancing its budget. Although policymakers could do much more to improve the conditions of many atypical workers, the positive labour market performance has also helped counter some dualization trends.

The German economy could be in even better shape if it increased public and private investment. In fact, the level of public and private investment in Germany is relatively low, as the German economy relies too heavily on export-driven growth.[42] Public investment barely increased from 2.1 percent in 2003 to 2.2 percent of GDP in 2013, a number much lower than the EU average of 2.9 percent. Similarly, household investment in Germany declined from 12.5 percent in 1995 to 9.3 percent in 2013. Corporate investments also plummeted from 20.6 percent in 2002 to 19.5 percent in 2013, far below the EU average of 21.7 percent.[43] Inducing German consumers, corporations, or the federal government to increase investments is a tall order, but more public investment in infrastructure, education, and R&D, especially in times of record-low interest rates and budget surpluses, is desirable to boost economic growth within the country and the eurozone.[44] This would increase demand and contribute to the country's long-term competitiveness. Such policy actions might cement the robustness of the German labour market.

Notes

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39. Mini-jobs are subsidized, marginal part-time jobs that have been significantly liberalized in recent decades, most notably with the Hartz reforms. The monthly limit for this type of job is 450€ and employees are exempted from paying income taxes and social contributions (although employees have to pay a small percentage of 3.9% into the public pension scheme), while employers have to pay social contributions and taxes. Employees may enter a mini-job as a second job to supplement their income, without having to pay additional social contributions or income taxes. Students, retirees, and second-earners are the most common groups in mini-jobs.
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The German Political Economy Today

Wolfgang Streeck

Germany has always had a trade surplus in manufactures. German imperialism in the nineteenth and twentieth centuries was motivated in part by a desire for stable access to markets for both German products and the raw materials needed to make them. European integration after 1945 helped secure both, which was an important reason why it was seen as essential by all German governments for the country's prosperity and its ability to live in peace with its neighbours.

From early on German manufactured goods were highly competitive not only with respect to price but also to quality. German engineering and product design has typically emphasized and excelled in customization and craftsmanship, making for flat hierarchies and close relations between design and execution even in the large firms of the Fordist era. This made it possible for German firms during the post-Fordist 1980s to switch to a pattern of diversified quality production without much difficulty. Demand for products of this kind is not highly price-sensitive, and the successive revaluations of the D-Mark after 1969 did not reduce the German trade surplus. In fact the result of the D-Mark becoming stronger was often an initial increase in the surplus, as demand remained unchanged or continued growing in spite of rising prices (J-curve).

The high international competitiveness of the German manufacturing industries accounts for Germany's relatively slow transition to a "service economy" in the era of structural change that began in the 1980s. De-industrialization proceeded at a much slower pace than in other countries, in particular the Anglo-American countries. To the extent that there was an increase in services, service-sector activities were often integrated into manufacturing – in the form of repair and maintenance and training tied to product sales – rather than consisting of an expansion of the financial sector. Thus for a considerable period, the comparative advantage of German manufacturing allowed for a stable pattern of labour inclusion, with strong trade unions, co-determination on the shop floor and in the enterprise, low wage dispersion both within and between firms, considerable "rigidities" in the labour market, and a surplus of high skills giving factories extensive internal flexibility and innovative capacity. For a while it was possible to describe the German system of production as one driven by "beneficial constraints" emerging from the presence of powerful unions and an extensive welfare state, forcing employers to invent advanced products, production technologies and marketing practices capable of underwriting high wages and superior working conditions.

With the progress of globalization, however, with the end of communism, and with German reunification in particular pressures mounted from employers for a liberalization of the German labour market, and for substantial concessions from unions and workforces. Such pressures were effective precisely because Germany was still highly industrialized, due to manufacturing jobs being easier to move abroad than services. Even though fewer jobs were relocated than threatened, and some of them came back when production in China turned out to be less profitable than had been thought, this was enough to make unions willing – over a period of several years – to forgo real wage increases and make a wide range of other concessions, including two-tier wage systems and less employment protection for workers with low seniority. Waning trade union power and rising unemployment also made for stagnating real wages and low inflation from the mid-1990s on.

European monetary union was not a German invention. In fact it was the price Germany had to pay for national reunification, in particular to France. As the Bundesbank had effectively been setting interest rates for all of Europe, there was a general desire among Germany's partners in the European Union to bring German monetary policy under joint control. With the final transition to the euro in 1999, German economic fortunes took a turn for the worse as European interest rates, now the same for the entire EMU, were too high for a country with low rates of inflation. By comparison, countries with high domestic inflation had low or even negative real interest rates, and as a consequence began to enjoy high economic growth. By the early 2000s, Germany, with low growth, high unemployment, rising public debt and exploding welfare state spending, was widely considered the "sick man of Europe" in need of fundamental institutional reforms, in the direction of profound liberalization (on the British model) and an accelerated transition from manufacturing to services.

It was to this situation that the "reforms" of the Red-Green Schröder coalition government (1998-2003) responded. Most of them were aimed at welfare state spending, in particular unemployment benefit and social assistance, knocking the floor out of the labour market in order to fund income tax reductions for high earners. As a result wage inequality increased significantly. Core manufacturing sectors benefited from deregulation of temporary employment, enabling firms to employ large numbers of workers loaned from temporary work agencies, at much lower wages than paid to their own workforce and for longer time periods than had previously been expected. In particular the automobile industry made extensive use of the new opportunity to cut its wage bill and adjust workforces flexibly to changing market conditions, against growing opposition from the union but with the more or less tacit consent of works councils.

When the crisis hit in 2008, Germany went into it with a sectoral structure and a product mix ideally suited to serving international markets for high-end manufactured goods, such as luxury cars and advanced machinery. By the time the crisis started to be felt, export industries had to a large extent been freed from social constraints, such as having to operate with excess skills under a compressed wage structure. They had successfully cut costs while still being able to take advantage of a traditional engineering culture that, unlike in the United States, had not had been deprived of talent and prestige by an expanding financial sector. They also benefited from the grossly unequal distribution of income and wealth in the United States and China, which made these countries ideal markets for the sort of automobiles German industry is particularly good at supplying. Moreover, the financial crisis made for much lower nominal interest rates while the decline of the euro, caused by the fiscal crisis of the European state system, further improved German industry's terms of trade. Clearly the present supreme performance of the German economy is highly vulnerable to a decline of demand in major export markets such as China. Also, it no longer underwrites political objectives such as social solidarity and economic equality. In terms of its skill supply, the German system may be living off its past, consuming resources that it is no longer replacing.

As to Germany's European interests and strategies, its export industries including their trade unions, in particular IG Metall, are adamant defenders of the euro. European monetary union prevents countries less used to a hard currency regime from compensating for their lower "competitiveness" through devaluation, which would make German exports more expensive abroad. Locking the European periphery into a common currency turns it into a captive market and serves as an ideal insurance policy for German export sectors dependent on secure market access. It is widely understood among economic interest groups and the major political parties that keeping Southern and South-Eastern European countries inside the monetary union will require Germany paying them some sort compensation, in the form of a "Marshall Plan" or of European Union "structural funds", through underwriting bank debts in the south, or through

"Euro Bonds" or some kind of non-repayable loans.

In essence this would mean continuing the policy of previous German governments, especially those under Helmut Kohl, who could be relied upon to pick up European bills in order to keep the European Union together. The debate among insiders is over how the tribute Germany will have to pay for the euro will be disguised, so that voters will not take offense at a time when a balanced budget amendment that Germany has imposed on itself at the behest of financial markets starts biting. What is clear is that export sectors want what amounts to an international competitiveness tax on German industry to be paid, not by BMW or VW or their workforces, but by the general taxpayer or pensioner, in the form of lower public benefits, fewer public services, or higher taxes on consumption. In terms of international negotiations, the issue at stake is how much Germany will have to contribute, first to the various rescue operations and later, on a continuous basis, to regional redistribution inside the eurozone. The current government is trying to bring down the price as much as possible while parts of the opposition, especially within the Green party, are doing their best to convince voters that there will be no price at all.

Is There a Successful "German Model"?

Fritz W. Scharpf

Brigitte Unger sent me a list of questions and asked for very brief responses. So here they are, even though one of my points took a little more space.

Has Germany been economically successful since the 2000s?

To the question of whether Germany has been economically successful since the 2000s I have two different answers:

The first answer is "No": From 2001 to 2005 Germany was the "sick man of Europe". German GDP per capita declined from 2001 to 2003, and unemployment increased from 7.9 percent in 2001 to 11.3 percent in 2005. The initial decline can be explained as a consequence of Germany entering the monetary union: the Bundesbank could no longer fight the German recession through an expansionary monetary policy. On the contrary, since Germany had the lowest rate of inflation in the eurozone, the average-oriented monetary policy of the ECB was too tight for Germany, further depressing, rather than stimulating, consumer demand and investment. At the same time, the government's capacity for fiscal reflation was severely constrained by the Stability Pact (on which the previous German government had insisted). As a consequence of rising social expenditures and a fall of tax revenues from 37.2 percent of GDP in 2000 to 34.8 percent in 2005; Germany violated the pact's 3-percent deficit limit from 2001 to 2005.

The second answer is "Yes": After 2005 Germany became economically successful. From 2005 to 2012, GDP per capita increased by 12 percentage points, and unemployment declined from 11.3 to 5.5 percent of the labour force. And while GDP fell steeply from 2008 to 2009 as a consequence of the international financial crisis, unemployment increased only slightly and continued to decline in 2010. At the same time, the German balance of current accounts, which had still been negative in 2000 and which became positive as a consequence of falling domestic demand in the recession, continued to rise after 2005 and amounted to a surplus of 7.4 percent of GDP in 2007.

Germany's recent economic and employment success is generally attributed to three beneficial policy choices: union wage restraint, the Schröder government's "Hartz" reforms of 2005, and the expansion of short-time wage subsidies in 2009. All three explanations have empirical support. Unit labour costs in manufacturing had begun to decline with the onset of the recession, falling by more than

12 percentage points between 2002 and 2007 which did reduce domestic demand but improved the cost-competitiveness of German exports. And while economy-wide unit labour costs increased on average in the eurozone after 2000, they remained stable in Germany and even decreased by 5 percentage points between 2005 and 2007. The latter effect may indeed be associated with the "Hartz" reforms which had reduced the reservation wage of the unemployed and liberalized the rules of atypical employment. The intended effect was a significant expansion of low-wage employment[1] – which was also associated with a rise in poverty and social inequality.[2] And there is no question that the expansion of short-time subsidies in 2009 helped to stabilize the jobs of the core labour force and allowed firms to benefit fully from the quick recovery of international demand in 2010.

Is there a "German model"?

On this question, I defer to the work of Wolfgang Streeck and his collaborators. In his seminal paper on "German Capitalism: Does It Exist? Can It Survive?" Streeck (1995) has summarized the economic, institutional, cultural and political characteristics of the German political economy and its beneficial social effects to explain how and why, at the end of the 1980s, Germany could be seen as "the internationally most successful of the major economies" – which managed to combine high wages with comparatively little inequality.

The main thrust of Streeck's paper is, however, pessimistic: considering the challenges of German reunification and, above all, the deregulatory and liberalizing impacts of economic Europeanization and globalization, the German model was unlikely to survive. Its "parochial" socio-economic structures and mechanisms could not be exported, and they were bound to erode under the pressures of economic and regulatory competition and ever-increasing capital mobility. These expectations were further explored and confirmed by the work of Streeck's associates and students examining the erosion of collective-bargaining agreements (Hassel 1999; Rehder 2003), the effects of liberalized capital markets and the dominance of shareholder-value orientations on corporate governance and industrial relations (Höpner 2003), the impact of European competition rules on the industrial-policy functions of public banks (Seikel 2013) or of European rules guaranteeing the free movement of capital on the institutions of German co-determination (Werner 2013). In a comprehensive review of such changes, Streeck (2009) did indeed conclude that the 1989 model of German capitalism that he had described was rapidly eroding, and that its beneficial socio-economic functions and distributional effects could no longer be maintained.

Yet if that is so, one may indeed wonder why, in 2014, Germany should once more be seen, at least by its neighbours and by European authorities, as the model of a highly successful economy. One presently popular explanation focuses on the liberalizing German "reforms" in the mid-2000s. And it is indeed true that some of the non-liberal characteristics of Streeck's German model were weakened or abolished over the past two decades. But liberal economies have not been generally more successful in recent years, and liberalizing reforms have not primarily affected the industrial core of the German economy. Thus Germany has not been transformed from having been the most typical "coordinated market economy" into a perfect "liberal market economy" (Hall/Soskice 2001). In short, liberalization by itself does not seem to explain the present success of the German economy.

In my view, what is missing in most discussions on the German success is a focus on the interaction between the domestic model and its international monetary environment. To discuss this effect, however, I need to answer a question that has not been asked:

Has the German model come to depend on undervalued exchange rates?

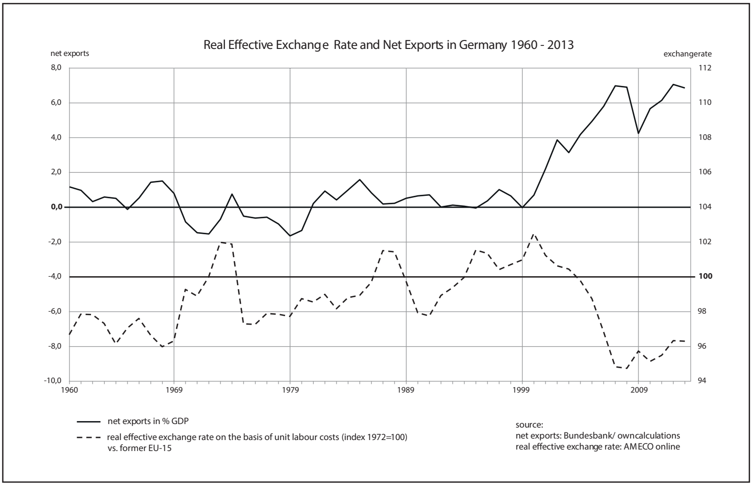
There is of course no question that Germany's success is related to its international *economic* environment. Even if it could never be described as a "small open economy" (Katzenstein 1985), its industry has long been export-oriented, emphasizing up-market consumer and investment goods (Streeck 1991). Hence German exports have recently benefited from the industrialization of former socialist and Third-World economies after the fall of the Berlin Wall. But other countries used to have internationally successful industries as well which, however, have withered away in the general deindustrialization of advanced industrial economies. In my view, it was its particular relationship to international *monetary and currency regimes* that has allowed Germany to buck this trend, and to increase its reliance on export-led growth and employment to such an extent that the share of exports in GDP rose from less than 10 percent in the 1960s to almost 50 percent in 2012.[3]

The present pattern has its roots in the late 1940s and early 1950s, when West Germany and its industrial base were in ruins and mass unemployment was extreme. For German industrial unions, therefore, jobs and profit-financed economic reconstruction (plus co-determination) were initially more important than wage increases. Moreover, the new D-Mark, which in 1948 had replaced the hyper-inflated *Reichsmark* at a discount of 10:1, was as yet untested; and after an initial devaluation of almost 30 percent,[4] the future Bundesbank was determined to establish and defend its external and internal stability without compromise.

Under the Bretton-Woods regime of fixed exchange rates, this combination of devaluation, wage restraint and stability-oriented monetary policy paid off when German industrial exports benefited from the rise of inflation in the United States during the Korea boom of 1950-51. More generally, the asymmetry of Bretton-Woods rules (which Keynes had argued against) favored stability-oriented national regimes. It allowed member states to ask for a devaluation of the dollar exchange rate if persistent current-account deficits resulted in a balance-of-payments crisis. But it did not oblige countries with a surplus to raise the nominal exchange rate – which then allowed them to benefit from the export subsidy of an undervalued real effective exchange rate (Bordo 1993, 55).

In general, of course, rising wages and prices would soon eliminate this comparative advantage. Not so in Germany, even though rapidly falling unemployment and rising real wages corrected the extreme distributional imbalance between capital and labour in the 1950s, German unions continued to realize that at least in export-oriented industries wage policy was not only about incomes but also about jobs. And in the domestic economy, the Bundesbank's hard-money policy continued to constrain inflationary wage rises that could have destroyed the competitive advantage of an undervalued currency. As a result, the real-effective exchange rate of the D-Mark remained undervalued against European competitors, and German net exports remained in surplus throughout the 1960s (Figure 1). As a side effect, the rising gold and dollar reserves of the Bundesbank allowed Germany to be among the first countries to liberalize capital mobility and currency exchange.

Figure 1: Real effective exchange rates and net exports



The value of real undervaluation was well understood by German industry and unions who jointly protested against even marginal exchange-rate adjustments at the end of the 1960s, when the undervaluation of the D-Mark had increased to such an extent that the Bundesbank was forced to re-introduce currency-exchange controls in its fight against “imported inflation” (cf. Germann 2014). Their fears proved more than justified when the Bretton-Woods regime finally collapsed, and was then replaced by floating exchange rates. Then the D-Mark/dollar exchange rates, which had been at the ratio of 4:1 from 1961 until 1968, fell by a third to 2.65:1 in 1973 and declined even to 1.83 in 1979. And while fluctuations of the real effective exchange rate against Germany’s European competitors were not quite as extreme, the steady surplus of net exports had come to an end in the 1970s.

In other words, German export industries had good reason to dislike volatile exchange rates, not only because of increased transaction costs but also because they eliminated the export subsidies of an undervalued real effective exchange rate. For the Bundesbank, by contrast, floating rates eliminated the need to use its monetary tools to stabilize an unrealistic fixed exchange rate, and exchange controls to fight imported inflation. Instead, it could now concentrate on restoring price stability in Germany. Ignoring the steep rise of unemployment caused by the oil-price crisis of 1973-74, the bank continued its restrictive monetary policy to fight cost-push inflation. At the same time, the unions were made to understand that wage increases above the line defined by the bank would be punished by an even more restrictive monetary policy and additional job losses

(Scharpf 1991, chapter 7). In effect, therefore, inflation rates in Germany were far below those in competing European economies – which in spite of currency fluctuations again reduced real exchange rates in industrial markets, whereas the export balance suffered from the steep rise of oil prices.

Right after the demise of Bretton-Woods, the social-liberal German government had started efforts to restore currency coordination at least in Europe. Initial agreements on a joint float of European currencies against the dollar (the "snake in the tunnel") soon disintegrated, however, as governments tried to cope with the oil-price crisis. But in 1979, Helmut Schmidt and Giscard d'Estaing were able to agree on the creation of a "European Monetary System" (EMS). It was meant to replicate the Bretton-Woods regime, except that individual currencies were pegged to a currency "basket", the ECU, rather than to a national currency. And there was also no equivalent to the International Monetary Fund (IMF) as lender of the last resort. In practice, however, the D-Mark was the largest currency in the basket – which also meant that the monetary policy of the Bundesbank had the largest influence on the course of the ECU. Hence central banks trying to keep their currencies within allowable margins needed to mirror its stability-oriented policies – which, however, continued to focus on conditions of the German economy, rather than those of the EMS area (Marsh 2009).

In general, the EMS was once more beneficial for German export industries. Currency fluctuations were reduced and upward revaluation was dampened by the deadweight of less stability-oriented EMS economies. As a consequence, real effective undervaluation of the D-Mark continued[5] and net-export surpluses reappeared. For Germany and countries with a similar stability orientation, like Austria or the Netherlands, the EMS was a near-optimal regime while other member states could use it as a "stability anchor" that helped to reduce inflationary dynamics without eliminating the possibility of devaluation or even exit as a last resort.

But devaluations were politically costly, and avoiding them by having to mirror the Bundesbank's monetary policy could damage the national economy if it was out of sync with conditions in Germany. In France and elsewhere, therefore, the Bundesbank's hegemonic role was increasingly resented. But instead of supporting proposals for EMS reform, the French government and the Delors Commission opted for a fully centralized and irrevocable European Monetary Union (EMU). Germany, which had been quite satisfied with the EMS, finally agreed as well to demonstrate that it was fully committed to European integration even after German unification. In order to allay fears of inflation, however, it insisted on tough conditions of admission in the Maastricht Treaty and on an additional Stability Pact to constrain public-sector deficits and debt.

The rest is history (Scharpf 2011; DeGrauwe 2012; Höpner/Lutter 2014).

What matters here is the fact that with the run-up to the monetary union the fluctuations of European interest rates were progressively reduced, and in 1999 they were completely eliminated. For the former soft-currency economies, that created a massive boost to credit-financed domestic demand, whereas for Germany, which in the turbulent years after reunification had been running current-account deficits and which had entered the monetary union at too high an exchange rate, the challenges resembled those of the early postwar years: Unemployment was high and rising, average-oriented ECB monetary policy was too tight for low-inflation Germany, and the Stability Pact ruled out fiscal reflation. And since the exchange rate was also fixed, the responses resembled those that had been successful in the 1950s: Jobs in industry were once more defended through union wage restraint.

In the corporatist literature it is generally assumed that the capacity to use wage-setting as an instrument of economic policy depends on the organizational power and economic sophistication of large, centralized and cohesive industrial unions (Scharpf 1991; Calmfors 1993; Höpner/Lutter 2014). That is indeed plausible when wage restraint is supposed to constrain inflation in tight labour markets. Under the threat of massive job losses, however, decentralized concession bargaining may be equally or more effective. In Germany, at any rate, industrial unions were urged to accept opening clauses that allowed works councils to negotiate cost-reducing agreements at plant-level (Hassel 1999; 2012; Rehder 2003). As a consequence, effective wage increases were below collective-bargaining agreements, and unit labour costs in manufacturing did not merely stagnate but actually declined after entry into the EMU.[6] And whereas in the EMS real undervaluation had been limited by the nominal devaluations of other member states, that corrective mechanism was now eliminated. Hence the overall weakness of eurozone economies also limited the impact of German surpluses on the exchange rate of the euro.

In effect, therefore, the monetary union allowed a dramatic fall of the real effective exchange rate after 2001 which then caused a steeper rise of German export surpluses than at any time since the end of the Second World-War (Figure 1).

Hence whatever was left of the German model that Streeck had described for 1989 has been supported and distorted by the perverse monetary regime of the EMU to such an extent that the share of exports in GDP, which had reached 25 percent at the end of the 1980s, continued to escalate to an incredible 50 percent of GDP in 2013.

And in present German and European debates, that is counted as "success".

Which theory underlies your argument?

In my view, no single general theory should be expected to explain the history of a specific and complex politico-economic configuration. If a plurality of theoretic perspectives were to be applied, it would include "Varieties of Capitalism" (Hall and Soskice 2001) which however needed to be complemented with an appreciation of the variety of macroeconomic regimes (Scharpf 1991) and with a political-economy variant of Peter Gourevitch's (1978) reminder of the influence of international regimes on domestic choices.

Can and should the German "success" be exported to other countries?

The German "success" does not have to be exported to some of the small open European economies inside the eurozone which are highly competitive in world-wide markets. But if some economies benefit from undervalued real exchange rates, others must suffer from real overvaluation, and if some achieve current-account surpluses, others must by necessity have corresponding external deficits. And in any case, not all European economies have industrial structures that would facilitate an export-led growth strategy (Wierts et al. 2013).

Is Germany's "success" sustainable?

Germany's success is sustainable as long as the monetary union does not collapse, and as long as the demand of BRIC economies for German investment goods and luxury cars remains strong enough to support the export-dependent German economy. And no, if either one of these conditions should fail.

What would you recommend Germany to do?

For Germany, leaving or dismantling the monetary union is economically and politically out of the question. But if the monetary union is to continue, Germany ought to contribute to reducing economic imbalances by reflating domestic demand and increasing imports.

In economic and political terms, however, Germany is now locked in its present position. If exports amount to fifty percent of GDP, the economy depends on them. Export industries and their unions dominate political debates in the media and in all political parties. And even though the government and the Bundesbank are presently recommending higher wage increases, not only employers but also industrial unions are unwilling to consider any action that might jeopardize sales and export-dependent jobs. And of course nobody has as yet suggested how the government could command private-sector wages to rise.

The public sector, however, could increase domestic demand through investments in the country's decaying public infrastructure and by expanding and improving under-financed public services in education and health care. But the present government has tied its hands by insisting on tough European rules on fiscal consolidation and balanced budgets for everybody, including the surplus economies. And the chancellor and her finance minister, who are still castigating Gerhard Schröder for exceeding the deficit limits of the Stability Pact in the recession of 2001-2005, are more likely to face another euro crisis than to confront the ridicule of European public opinion and the wrath of their own party for violating these rules. From a political-economy perspective, therefore, it is hard to see how Germany would soon accept the role of a good European citizen that everybody is asking it to play. And in terms of economic self-interest, it is hard to see why it should.

Notes

1. The share of low-wage earners with respect to hourly earnings rose from 17.4% in 2001 to 21.7 % in 2010. (Statistisches Bundesamt 2012, Niedriglohn und Beschäftigung 2010). https://www.destatis.de/DE/PresseService/Presse/Pressekonferenzen/2012/niedriglohn/begleitmaterial_PDF.pdf?__blob=publicationFile.
2. The share of population at risk of poverty or social exclusion increased from 18.4 % in 2005 to 20.1 in 2008. And the Gini-Coefficient rose from

26.1% to 30.2% in the same time span. (Source: European Union Statistics on Income and Living Conditions, SILC)

3. Exports in 1960: 8.9% in GDP, in 2012:49.7% in GDP. Source: Deutsche Bundesbank.
4. From 3.33 DM/US dollar to 4.20 DM/US dollar in September 1949 (Bidwell,1970)
5. After the Plaza Agreement of September 1985, however, the Bundesbank was asked to raise the nominal D-Mark rate to support the American economy – which was followed by a fall of German export surpluses.
6. When challenged on this point, industrial unions point to the principle of "solidaristic wage policy", explaining that their wage demands, though below productivity increases in manufacturing, were still in line with economy-wide productivity.

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The German Model in Transition

Anke Hassel

Over the last decade, the German model has seen a remarkable transformation and comeback. At the turn of the century, calls for a radical reform of the German market economy were heard everywhere. The change of government in 1998 was followed by the short boom and bust of the new economy, leaving the country in a most miserable situation. Unemployment reached five million in 2005 and Germany violated the deficit threshold of the European Stability and Growth Pact for several years in the early 2000s. The need for reform was ubiquitous in newspaper headlines, expert commissions and the international press. The country was constantly criticized for its failure to meet the challenges of reunification, globalization and demographic changes. 'Citizen' campaigns put newspaper adverts in German papers to call for reforms. Federal President Roman Herzog lamented in a well-received speech in 1997 the mental depression that had befallen Germany and called for a *Ruck* (a sudden jerk) to liberalize the country. Germany had become the sick man of Europe (Hassel and Williamson, 2004).

By 2014 the situation could not be more different. The 'sick man' has become the unchallenged economic powerhouse of Europe. Not only did Germany survive the great financial crisis of 2008–09 in much better shape than almost any other OECD country, it is the only one where unemployment levels today are substantially lower than before the crisis. The German economy was hit hard by the recession in 2009 when GDP contracted by more than 5 per cent. However, growth bounced back swiftly after that and its performance has been solid compared with other OECD countries but particularly within the eurozone. In the midst of the financial crisis, the economy showed a remarkable recovery of the competitive position of German firms, higher than average growth and the highest employment levels ever (Möller, 2010). The country's economic institutions and economic policy are almost unchallenged in the way they work for the economy. Today no major reform calls can be heard in the country. Within the eurozone, this is a different matter as German exports have out-competed all other trading partners, putting them into a permanent trade deficit.

Between 2003 and 2013 Germany witnessed a decade of fundamental change. The calls for reforms in the early 2000s did not go unheard. In March 2003 the then Chancellor Schröder outlined his Reform Agenda 2010 in an address to parliament. He announced far-reaching welfare and labour market reforms. Based on reports of several expert committees, radical reforms were implemented altering the German welfare state as it had developed over the years. Unemployment insurance, pension systems and social assistance schemes were all restructured while capital market regulation was relaxed and corporate taxation lowered.

These developments beg two questions. How far did the changes of the German model go? And can we still talk about a German model? These questions are not new. Already in 1995, Wolfgang Streeck posed the question: 'German Capitalism. Does it exist? Can it survive?' (Streeck, 1995). Were the changes of the 2000s the precondition for its current success? This chapter will address both of these questions and put the policy reforms in the context of wider institutional changes. It starts by characterizing the trajectories of continuity and change in the German model during the last decade and then discusses them with regard to the two major challenges of our time: the financial crisis and the crisis of the eurozone.

Fundamental features of the German model

The German political economy has long been identified as distinct from other market economies. In German political discourse, 'social market economy' is used to denote a concept that explicitly recognizes the limits of the market and thus defines the relationship between the market and the state by emphasizing that all liberal markets are embedded in a fundamental social order. As we know, neither the term nor the concept have much to do with the social dimension of a market economy, but it was a term coined by German economists to win political legitimacy and justification for the establishment of liberal markets in the climate of post-war Germany that was critical of capitalism. The general assumption of ordoliberal thinkers was that while the economy is based on markets organized by private businesses and consumers, the state is responsible for regulating those markets and for shaping the underlying social order. Defined in this way, the term 'social market economy' receives widespread approval from both the entire spectrum of political parties and the general public, since it provides legitimacy for the welfare state. In the academic literature, the distinct features of the German political economy have been recognized in a similar way by terms such as 'German capitalism' (Streeck, 1995), 'Rhenish capitalism' (Albert, 1993) and the 'coordinated market economy' (Hall and Soskice, 2001). These conceptualizations emphasize the special features of the non-liberal relationships of German capitalism, which is characterized primarily by a strongly organized civil society, regulated corporate governance and labour markets as well as an extensive welfare state. This is in contrast to liberal Anglo-Saxon countries where the organization of civil society is decentralized and takes the form of local welfare associations: the welfare state is minimalist and organized along liberal principles. Rather, trade unions and employers and other economic and political players, such as welfare and industrial federations, are highly organized and deeply institutionalized in public policy. In the past, strong civil society has replaced market mechanisms with other forms of coordination, as evidenced, for example, by the regulation of wages via collective bargaining. The Bismarckian welfare state brings together conservative, status-oriented principles and a far-reaching responsibility of the state for its citizens in the form of a social safety net.

Among the wide range of perspectives taken to analyse and categorize the German political economy, the 'Varieties of Capitalism' literature based on Hall and Soskice (2001) is the most theoretically advanced. In contrast to other institutionalist-based perspectives, they put the firm at the centre of their comparative framework and distinguish between two different regimes based on five different spheres of firms' interactions: liberal market economies (LMEs) and coordinated market economies (CMEs). According to Hall and Soskice, these five spheres of interaction determine the institutional framework within a regime:

- In the first sphere of *industrial relations*, firms negotiate and coordinate with labour unions as well as other employers regarding applicable working conditions and wage levels. CMEs are traditionally characterized by a high level or organization, coordination and centralization of industrial relations, whereas industrial relations in LMEs are decentralized.
- In the second sphere of *vocational training and education*, capitalist regimes differ with regard to the contribution and involvement of companies within the process of developing the skills of their workers. Whereas CME firms rely heavily on the availability and formation of firm or industry-specific skills that cannot be easily transferred across firms, LMEs prefer the formation of general transferable skills.
- In the third sphere of *corporate governance*, firms choose their strategies and preferences in order to access finance and cope with shareholders. • In the fourth sphere of *interfirm relations*, firms distinguish amongst various kinds of supplier and client relations, as well as amongst different strategies to access technologies.
- In the fifth sphere of *relationship with employees*, the coordination and communication between firms and their

> workers are analysed by referring to the latter's commitments and internalization of their firm's goals and interests, as well as their motivation (ibid.: 6).

In the Varieties of Capitalism literature, LMEs are contrasted with CMEs according to their differences in coordination of the relevant economic actors. The authors classify Anglo-Saxon countries as typical examples of LMEs, whereas Nordic and Continental European countries are classified as CMEs. The latter are predominantly characterized by non-market mechanisms which are present throughout the different spheres. The relationship between different spheres is characterized by institutional complementarities; institutional configurations are complementary to each other when one supports the other and reinforces the differences between regimes (ibid.: 17). For instance, the availability of specific skills is a core characteristic of firms' product market strategies in CMEs. As a consequence, these firms support vocational-training systems ensuring professional formation in line with their interests. This in turn feeds the demand for an industrial relations system that ensures job security for employees in order to protect these investments in specific skills. In addition, complementarities are supported by public policy in the welfare state. Social insurance-based welfare maintains: status and professions, employment protection legislation, job-specific unemployment insurance and earnings-related pension systems – all of which are geared towards the initial skill investment.

Firms in these institutional surroundings will take advantage of the high investment in skills. They will pursue strategies involving so-called 'diversified quality production'

(Streeck, 1991) due to the variety of specific skills in their firms. Product development based on innovation and skills-specific knowledge on the firms' side will be strengthened by the employees' side in their demand for social protection and training policies that maintain this skill level. Institutional complementarities evolve within the context of skill formation and employment protection, the latter being dismissal protection or welfare provisions for this group of (skilled) employees. The higher the level of skill specification within a firm or industry, the lower the level of transferability of these skills and the higher the need for protection and stability for workers (Estevez-Abe et al., 2001).

Concomitantly, the interest of firms to protect workers' rights increases with their skill value for the firm. In Germany the strong focus on the formation and protection of specific-skilled workers has paved the way for systems with strong employment legislation and life-long earning-related unemployment benefits while maintaining a specific set of skills. The need to alter one's occupation or acquire new skills in the case of unemployment or market changes, as in the Nordic countries, was not part of the evolving German institutional framework.

Continuity and change in the German model

For more than two decades now, advanced political economies have started to display rather strong evidence of institutional change, particularly in continental European non-liberal market economies. Governments have implemented reforms of labour market policies (Bonoli, 2010), unemployment insurance (Clegg, 2007) and pensions (Häusermann, 2010), as well as corporate governance and financial market regulation (Deeg, 2005). Capital markets and corporate governance regulations have been the subject of intense reform pressure. Beginning in the mid-1990s, many governments liberalized capital markets towards LMEs (Culpepper, 2011). In some cases, reform was radical and far-reaching, while in others it was more incremental. Corporate finance shifted towards equity finance and some large national champions defined themselves as value firms similar to their Anglo-American counterparts.

In the following, a brief summary of the most important changes of the German model over the last decade will be provided. I will focus particularly on the key institutions as identified in the Varieties of Capitalism literature and subsequently assess to what extent these changes have altered the underlying model.

Collective bargaining institutions

Given the high levels of unemployment, low growth rates and strong criticism of economic performance, collective bargaining institutions were under a lot of pressure in the early 2000s. However, no policy changes were initiated, even though a reform of collective bargaining reform was mentioned in the Agenda 2010 proposal and was heavily discussed. The government announced its expectation that collective bargaining was to become more flexible if legal intervention was to be avoided. Such an intervention would have meant that plant-level bargaining would have been given priority over industry-wide bargaining. This would have led to massive decentralization of pay setting.

The threat of legal intervention took place in the context of an ongoing process of decentralization of bargaining, which had already been set in motion throughout the 1990s as a response to the shock of reunification and the recession in 1992–93 (Hassel, 2012). Big manufacturing plants negotiated plant-level agreements with works councils in order to cut costs, increase flexibility and productivity (Hassel and Rehder, 2001). This in turn increased flexibility at the level of regional collective agreements. At the same time the institutional structure of industry-wide agreements setting standards for an entire industry and region did not change. Pressures on employers' confederations, and in particular their membership losses that were prominent during the 1990s, came to a halt during the 2000s as collective bargaining became more flexible. However, on both sides of industry membership in associations continued to decline. Employers' membership rates declined from 63 to 60 per cent between 2000 and 2010. Particularly at the beginning of the decade, these associations experimented with new forms of membership which would not bind firms to collective agreements in order to pre-empt their increasing dissatisfaction. Union density rates, which had been in free-fall ever since reunification, declined from 24.6 to 18.6 per cent during the same period (Visser 2013). Employers' associations and unions thereby tended to consolidate in core industries and not expand into new areas of the service economy. At the end of the decade, institutional and regulatory stability was combined with a far higher degree of flexibility of working practices at the firm level and an increasing weakness of employers' associations and unions.

Labour market and social policy

Changes to labour market and social policies were at the heart of the government's agenda in 2003. The Hartz reforms I–IV changed not only the institutional structure of the Federal Labour Agency and the interplay between local level poverty relief and national unemployment insurance, but also the general policy approach towards mobilizing the long-term unemployed. While in the past skilled workers were largely protected from the expectation to retrain, and instead encouraged to keep their primary skills in a particular trade during spells of unemployment, the emphasis shifted to retraining and getting back to work quickly (Hassel and Schiller, 2010). In particular, the focus was on the activation of the (long-term) unemployed through a cut in benefits and an increase of pressure to search for a job. The reform of the unemployment insurance system was comprehensive and involved a drastic cut of benefits for the long-term unemployed who moved to social assistance levels after a period of 12 to 18 months of unemployment. Previous measures to protect skills by not forcing skilled workers to take on unskilled positions were removed. At the same time, a kind of negative income tax was introduced by enabling workers with low-paying part-time jobs to draw benefits so as to make ends meet. Different schemes encouraging early retirement were phased out and government subsidies for making elderly workers redundant were stopped.

As there is still no minimum wage, wages at the low end of the labour market declined and unskilled workers maximized their income by combining low-paid part-time employment with benefits. The rate of the working poor shot up and moved Germany to be among those countries with the highest proportion of the low-paid within the EU. While in the old German model, the labour market position of skilled workers was highly protected and wages were comparatively egalitarian, today a process of segmentation of the labour market is occurring. An increasing share of labour market outsiders work on fixed-term contracts for temping agencies or positions in marginal employment. Dualization of the labour market has emerged as a major trend of the transformation of the German model (Eichhorst and Marx, 2009a; Palier and Thelen, 2010; Hassel, 2012).

Training

The Vocational Training System (VET) 'appears to be undergoing a period of subtle but significant change' (Busemeyer and Thelen, 2012: 89). Vocational training is still the dominant form of training after secondary education with more than 50 per cent taking up some form of apprenticeship. It is a highly structured approach towards training in which firms employ apprentices to train them on the job; they then attend school for part of the time. The licensing of training and the content and the examination of apprentices are organized and supervised by the local chambers of commerce. German-style vocational training has always been seen as a highly successful way of training young school leavers below the level of tertiary education. It has consistently produced low levels of youth unemployment and high levels of specialized training. During the 1990s and 2000s three main developments created pressures within the vocational training system (ibid.: 76–8). First, the share of firms that engage in it declined from 35 to 25 per cent which reflected the downswing of business between the mid-1990s and the mid-2000s. Second – and related to the decline of firm participation – the demand for training by school leavers could not be met. Those at the lower end of school qualifications found it increasingly difficult to find training places. As the German government is committed to provide training until the age of 18, many of those ended up in a kind of 'transition system' (Baethge et al., 2007) of state-sponsored training. Third, the attitude of large firms towards the training needs of school leavers has changed. While in the past, firms increased training capacities beyond their business needs in order to meet demand, this form of corporate social responsibility has significantly declined over the last decade. Firms are more reluctant to train just to fill the demand for it. Outsourcing, restructuring and fierce competitive pressure has introduced a new emphasis on cost-cutting that did not allow for voluntary training. With regards to policy change, some incremental adjustments were made. In particular, shorter training courses (two-year apprenticeships) were introduced and some of the content was removed. The government also introduced short courses for school leavers with low skills. As increasingly school leavers either drop out of low-quality training or cannot meet the expectations of high-quality training, a school-based training regime evolved alongside the firm-based VET. The content of apprenticeships has also become more modular and flexible. Some of these developments took place in the context of the increasing Europeanization of training standards. Even though training is not part of core

EU competencies, the European Qualifications Framework has introduced a credit system which should make VET in Germany more compatible with other countries. While on the whole we can see institutional stability, many features and the content of training is markedly different today compared to the beginning of the period. However, given the current rapid demographic changes and rapidly declining numbers of school leavers, there is an expectation among policy-makers and firms that remaining school children will increasingly be pushed towards higher levels of training (Busemeyer and Thelen, 2012).

Corporate governance

Changes to corporate taxes at the beginning of the 2000s gave incentives to firms to abandon the previous tight network of corporate cross-shareholding. Since 1998 a series of laws has liberalized Germany's capital markets and the corporate sector as a whole. Four laws for the Promotion of the German Financial Market aim to provide a more transparent framework for stock trading. They have led to the establishment of a supervisory agency for stock trading at the federal level and to the setting up of rules of conduct for the participants (Hassel and Williamson, 2004). The Eichel Tax Reform in 2000–01 changed the laws on capital gains tax, enabling companies more easily to shed stakes in other firms. German companies were also enabled to apply international accounting standards (or US Generally Accepted Accounting Principles – GAAP) rather than German accounting standards (Handelsgesetzbuch – HGB). The system of interlocking directorships was loosened up. The Corporate Governance Codex adopted in 2002 encouraged executives to hold no more than five supervisory board seats. However, while the Vodafone–Mannesmann takeover did shake up the German corporate sector, the move towards a liberal market of corporate control has not developed further. There is still no active market for corporate control, and corporate finance is still less stock based than in LMEs. Compared to the 1990s when the trend towards an Anglo-Saxon corporate governance structure took off, the 2000s saw a backlash. Among the 100 largest firms in Germany, the share of firms who were owned by large blockholders increased, while firms with a majority in dispersed shareholders declined. At the same time, the ownership of firms has become more international. According to a recent study by Ernst and Young, about 55 per cent of the stock of DAX companies is held by foreign investors, as against only about 37 per cent by Germans (Wirtschaftswoche, 2013). Among the 100 largest firms in 2006, 28 per cent were owned by foreign investors compared to 18 per cent in 1996 (Hassel, forthcoming).

The German model and the great recession

Despite the changes over the last decade, there is evidence that the German model was a major factor as to why the German economy survived the great recession of 2009 in reasonably good shape. When the recession hit and GDP was in free-fall, firms, unions and the government resorted to the established policy instruments that were inherent in the 'old' German model to combat the crisis (Hassel and Schelkle, 2012). In comparison to its European neighbours, the financial crisis hit Germany relatively late. Until the autumn of 2008, economic outlooks were comparatively optimistic, with a 1.8 per cent growth forecast by the Council of Economic Advisors supporting the government's initial position that the crisis would affect the USA as well as other financial centres but would pass by Germany (SVR, 2008). The first economic consequences became visible in late 2008, leading to a collapse in what had been the country's economic main pillar: exports and manufacturing. Overall, Germany's total contribution to global demand was above the OECD average (Hassel and Lütz, 2010). By the second quarter of 2009 Germany experienced a drop of more than 6 per cent in comparison to the previous year, resulting in a worse situation than in those countries considered to be responsible for the crisis (Bodegan et al., 2009). However, the collapse was followed by a rapid recovery in relation to other OECD countries. The economy was supported by two closely spaced stimulus packages on 5 November 2008 of €11.8 billion and on 27 January 2009 of *c.* €50 billion, combined with the welfare system's automatic stabilizer initiatives. The German equivalent of the 'Cash for Clunkers' programme which gave subsidies towards the acquisition of new cars of *c.* €5 billion aimed to subsidize car manufacturers on a global scale with a particular focus on the protection of skilled workers in export oriented industries.

In addition another instrument helped not only to countervail unemployment in the short run during the crisis, but also to reduce it to below pre-crisis levels. According to the European Commission, the elasticity of employment relative to Germany's GDP was the second lowest among the EU member state countries (European Commission, 2010a). The main factor for this development was the initiative to reduce working hours (Lehndorff, 2010). This helped to disconnect business slumps from layoffs by adapting measures to reduce overtime, to implement working time accounts, to reduce the general working time and to use public shorttime provisions. Being used by approximately 20 per cent of all firms this package of initiatives was the most valuable tool to countervail the economic and social consequences of the crisis. With a total usage of *c*. 30 per cent of all firms, the implementation of working time accounts was the most important mechanism, followed by job rotation (14 per cent), extra holidays (13 per cent) and pay cuts (11 per cent) (Bodegan et al., 2009).

Through this strategy German firms were able to keep their skilled labour and react quicker than liberal market regimes once the world markets showed the first signs of recovery. Referring back to Hall and Soskice's concept of institutional complementarities, the enabling force for labour hoarding and the initiatives taken with regard to reductions in working time were enabled by plant level agreements between firms and their core employees during the late 1980s. From the employees' perspective, these measures helped to protect the skills of the workers. From the firms' perspective, it has had a long-term positive effect on unit labour costs. Whereas the latter increased first in 2009 as a consequence of the hoarding initiatives taken, they decreased in 2010. Subsequently, the German economy experienced the highest employment levels ever, combined with a recovery of the positioning of its firms on a global scale (Möller, 2010). The combination of public policies such as the implementation of 'short-term working models' with adjustment tools developed in dialogue between firms and labour during the postunification crisis fostered Germany's economic stabilization in the financial crisis.

Still, it remains to be shown how far the country's comparatively successful recovery refers to all sectors. In the absence of a national minimum wage and an increasing low-skilled service economy the continuous focus on export-oriented high-skill industry might lead to economic and social effects in the long run on bargaining institutions as well as on the sphere of vocational training and skill formation.

The German model and the crisis of the Eurozone

The German model plays an important role in the unfolding of the crisis of the eurozone but also in the attempts to overcome it. The model contributed to the crisis but is also seen as a benchmark for policy recommendations to combat it. In the following a short interpretation of the underlying mechanisms will be presented. The solution of the Eurozone crisis does not only depend on changes in the German model, which has itself been transformed by the eurozone.

European Economic and Monetary Union (EMU) imposed a unitary monetary policy to an economic area which is made up of different business systems. The German model is one specific business model in which wage setting is controlled by large wage-bargaining actors in which training is extensive and social policy has been reformed with the aim of lowering labour costs and improving competitiveness.

Other Northern European countries such as the Netherlands and Austria, but also the Nordic countries, have similar wage setting and training institutions. Other members of the eurozone have very different economic models. In the literature, Southern European eurozone members have been described as 'mixed market economies' which have similar elements of coordination but which are more heavily dependent on the state to sponsor coordination. In the course of the first decade of monetary union northern eurozone countries have developed very differently from southern countries. The incomplete and asymmetric currency area in which monetary policy is centralized but fiscal policy and wage setting is regionalized has systematically produced different trajectories of inflation and labour costs. Inflation differentials in a regime of standard interest rates led to negative real interest rates in countries with higher inflation and to high real interest rates in those countries with low inflation. For the German model, which was particularly specialized in delivering long-term wage restraint, the harsh monetary environment during the first decade of the eurozone gave even further incentive to restructure and to keep labour costs low. The setup of the eurozone therefore pushed the German political economy even further towards reducing labour costs and improving competitiveness.

On the other hand, the drive towards restoring competitiveness of German business put an enormous burden on the southern countries which were institutionally not capable of using bargaining institutions to keep wages low. In addition, a whole range of structural factors increased the vulnerability of these countries significantly. First, southern countries benefited from low to negative real interest rates; second, they also benefited from the credit ratings of the eurozone as a whole; third, the emerging credit bubbles led to a deterioration of competitiveness; and fourth, once the crisis had struck, these countries did not have the instruments to deal with the crisis.

Undoubtedly, the overarching challenge to the eurozone today is the diverging development of competitiveness amongst different regions which has led to major imbalances (Scharpf, 2011; Hancké, 2012). The one-size-fits-all monetary policy put a strain on economies with low inflation rates, such as in Germany, and did not balance overheated economies such as the Irish. In both cases, monetary policy that was oriented towards an average target for the eurozone as a whole had a pro-cyclical effect. Governments did not use the cheap credit they accessed for economic development but rather for consumption. Over time current account deficits and surpluses accumulated and competitiveness diverged. These problems with the EMU were known from the beginning and did not come as a surprise to policy-makers or analysts.

For most of the 2000s, the standard macroeconomic indicators gave little concern for most countries of the eurozone. This is even true for those which had problems meeting the convergence criteria. Both nominal wages as well as inflation differentials diminished over the first decade of the euro. Nominal wages rose faster in Southern Europe compared to Germany but the differences declined. The same is true for inflation differentials, which during the first half of the 2000s have remained unchanged (Scharpf, 2011). Greece, Ireland, the Netherlands and Spain all had significantly higher inflation than the eurozone average. Germany, on the other hand, had the lowest inflation and highest real interest rates and therefore was held back in growth. At the same time, lower prices in Germany in the long run benefitted the competitiveness of its firms.

However, higher nominal wages and higher inflation in peripheral countries led to a loss in competitiveness in Southern Europe and eventually expressed themselves in current account deficits/surplus and diverging unit labour costs. These came into full view after the financial crisis in 2008 and forced governments to bail out banks. The subsequent recession and lack of access to capital markets revealed the reduced competitiveness of Southern Europe vis-à-vis Northern Europe.

During that time, Germany had persistently the lowest nominal wage increases in the eurozone and the OECD. The institutional basis for long-term wage restraint consists of the capacity to coordinate wage setting through pattern bargaining or centralized control over wages (Hassel, 2006: 165; Johnston, 2009). Pattern bargaining describes the process in which unions and employers in export-oriented industries set the upper limit for wage negotiations. They then serve as an orientation point for non-traded and public sectors. The fact that in Northern Europe wage increases in the non-traded sector are generally not higher than in the export sectors is not a standard phenomenon – rather the opposite. In Southern Europe, the non-traded sector – fuelled by cheap credit – saw the highest pay increases in the 2000s. Private sector unions and firms were not able to hold down wage developments in the sheltered sector. This is a key factor for explaining the pay differentials within the eurozone and in turn the imbalances that emerged over the last decade.

The differences in wage setting institutions go directly to the core of the German model. Here, manufacturing firms have to stand the pressure of international competition, and labour costs are not only a major concern of these firms but also for the unions. Pay increases have been exchanged with job security in leading manufacturing firms through rounds of plantlevel concession bargaining.

The response of the Troika to the troubled countries of Southern Europe has been to request structural reforms in exchange for financial help. Structural reforms often attack those elements which are part of the German model: centralized wage bargaining, organized civil society, highly regulated labour markets. At the same time, the debate within the EU has also recognized that there are two sides to imbalances: the German trade surplus mirrors the deficit of the southern countries. Therefore, the German government has frequently been targeted by those seeking reforms to increase domestic demand and reduce the reliance on an export based growth model. For instance, the European Council published its country-specific recommendations at the end of May 2013 urging Germany to increase wages and lower high taxation for low paid employment:

> Policy action to reduce the high tax wedge for low-wage earners and improve the integration of the long-term unemployed into the labour market has been limited so far. Germany should do more to reduce the high taxes and social security contributions that they levy on low wages. Further efforts are needed to improve transition from certain types of contracts, like mini-jobs, into more sustainable forms of contracts, thus avoiding labour market segmentation. (European Council, 2013)

In other words: the German model as it is today poses a major threat to the internal balance of the eurozone as it has developed a model of economic restructuring in which competitiveness of industries is boosted by driving down wages and conditions for peripheral labour. It is very much in doubt how the eurozone can develop a sustainable growth model without major changes to the German model.

Conclusion

The assessment of how far the transformation of the German model has gone is hotly debated. Some authors, in particular Wolfgang Streeck (2009a), maintain that the distinctiveness of the model compared to other political economies has become largely irrelevant as the process of liberalization and deregulation has introduced market mechanisms in all advanced political economies to an extent that the peculiarities of the training system, wage setting and corporate governance are not much more than decorative features. Others – Iversen and Soskice (2009) and Carlin and Soskice (2008) – argue that the core features of a coordinated market economy based on non-market coordination has remained intact and continues to dominate the central features of the political economy.

In-between these two main positions a third has emerged that recognizes the trends towards liberalization and deregulation but argues that these trajectories fundamentally differ in different kinds of political economies. 'Liberalization' – a vague term in itself – takes place in different forms in different institutional settings (Hall and Thelen, 2009; Palier and Thelen, 2010). The transformation of the German model towards a more liberal one therefore is undeniable, but in essence it remains 'German' in the sense that many of its institutional characteristics define the process of liberalization. For instance, the dualization of the labour market is not the same as a straightforward liberalization towards a liberal labour market as in the UK or USA. Compared to liberal countries, labour market regulation in Germany for labour market insiders are still strict. However, strong protection for some workers co-exists with very loose protection and low conditions for labour market outsiders. Dualization is a feature of liberalization of CMEs. Continued coordination at the core and increasing liberalization and dualization at the periphery are two sides of the same coin (Hassel, 2012). The transformation of the German model is therefore not primarily a process of converging on a liberal, Anglo-Saxon, model. It is a transformation in its own right.

The two main challenges to the German economic model during the 2000s – the financial crisis and the crisis of the eurozone – has shown the ongoing importance of its distinctive features. The growth stimulus in 2009 based on short-term working and stimulating the crucial car industry fed into the core institutions, as has been outlined. The crisis of the eurozone can only be understood when taking into account the role of the institutions of the German model, which cannot easily be replicated elsewhere. The competitiveness of German industries that combines strict cost control and high-quality production is a major source for economic imbalances in the eurozone. Therefore, to dismiss the German model as just one version of universal capitalist market economies (Streeck, 2009a), means to give up a conceptual understanding of market economies which has given observers so far the most powerful theoretical understanding of different business systems.

However, there is a dynamic process of change taking place. The German model is moving into a new era which combines coordination in the core features of the manufacturing sector with new liberal elements. It is a combination of continuity and change, which is the key to understanding current reform processes: institutions are hollowed out while their formal structures remain intact. As with the modernization of a house, the walls remain standing but the wiring and plumbing is replaced. In that sense, many formal institutions of the German model are still the same as they were in the post-war period: centralized collective bargaining, legal works councils, a dual corporate board structure, insurance-based social policy and the vocational training system are all based on the same institutional structure. Very little formal change has taken place.

The second key element of change consists in the underlying expectations, attitudes and values in business, politics and society (Hassel and Williamson, 2004). While the protagonists of the liberalization literature assume that it is mainly driven by a coalition of ill-advised policy-makers and international investors who insist on high returns at the expense of the wider population, incremental change within formal institutions is often driven by a new and different understanding of the role of work. For instance, while the 'old' German model gave a high premium to job tenure and life-long employment in major manufacturing firms, this model is not compatible with a workforce that is female and in the service economy and has a substantial share of migrant workers. Both women and migrant workers are more likely to change employers more frequently and therefore have less specific skills. The lower attachment to a particular employer makes it harder for them to attain and protect specific skills. The premium of skill specificity is therefore much harder to maintain when the workforce is more mixed.

Modernization of German society, higher employment rates of women, increasing competitive pressure on firms, the rise of global investors as well as the continuing deindustrialization of the economy have all impacted on the effectiveness of the traditional institutions of the German model. The initial reform policies in the area of the welfare state at the beginning of the 2000s had an important effect on the structure of the labour market. The decline of protected jobs in contrast to precarious jobs and the increasing dualization were major changes of the model.

On the other hand, traditional policy tools were used to combat the crisis using labour hoarding and short-term working. In the context of the eurozone crisis, it is the traditional feature of highly competitive wage setting and micro-corporatist cooperation between unions and firms that have led to strong export performance and contributed to the imbalances.

On the whole, the picture is therefore decidedly mixed. The old model is revamped and appears in new clothes. The process of change is moreover far from complete and remains problematic as it has not even started to deal with imminent challenges. These are the commencement of rapid demographic change as the share of young school e same is true for the role of women in the labour market and in society as a whole. Compared to many other countries in Europe, Germany still has a highly traditional male breadwinner model which assigns women the role of secondary earners. Low fertility is related to this as many qualified women are not prepared to play this role. There are many challenges ahead and it is very likely that during the next decade the transformation of the German model will continue.

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Weakening Structures, Strong Commitment: The Future of German Employment Relations

Martin Behrens

Introduction

For several decades, German industrial relations and to be more precise, their key institutions have been perceived as the strong and durable cornerstones of the German political economy. Strong unions and employers associations as well as universal institutions such as multi-employer collective bargaining and establishment-level works councils were considered to be the backbone of the German political economy or "Modell Deutschland", as some have called it (Turner 1991, Thelen 1991, Markovitz 1986, Hall/Soskice 2001). Recent scholarship, however, has raised some doubt as to whether this picture is still accurate. From the perspective of advocates of the German model, the findings give reason for concern: collective bargaining coverage has been declining since the mid 1990s as is the percentage of the German workforce which is represented by an establishment-level works council (Ellguth/Kohaut 2014). In addition, union membership, which for decades had been quite stable, even increasing, has been continuously declining since 1991, shortly after German unions extended their jurisdiction to east Germany (Dribbusch/Birke 2013).

Different interpretations have been employed to explain this pattern of decline. To name just a few: The disorganization perspective, as put forward by Lash and Urry (1987), has predicted that, as a consequence of growing world markets, institutional structures and national wage coordination will collapse throughout the capitalist world. Connecting to this research Streeck observes a process of liberalization, whereby the German political economy is moving away from "centralized authoritative coordination and control toward dispersed competition, individual instead of collective action, and spontaneous, market-like aggregation of preferences and decisions" (Streeck 2009: 149). Proponents of the dualization perspective, in contrast, reject the notion of full disorganization/liberalization and see the German political economy as kind of equilibrium between a strong and well-institutionalized core and a periphery, whereby the core stabilizes itself at the expense of the periphery (Hassel 2014; Palier/Thelen 2010). In this perspective the core is represented predominately by large manufacturing firms, firms with high union density and collective bargaining coverage as well as the high likelihood of them having a works council. In the periphery, however, those key institutions are mostly missing.

While these three perspectives have some merit in that they correspond to major observations regarding the decline of key institutions, in the following I will argue that – at least so far – this decline has not substantially eroded the system's capacity to resolve labour-related conflict. True, in many respects the German political economy today is much different from what it was – even in the 1980s and 1990s. To remind us: key institutions for the regulation of labour relations have been weakened (Visser 2013), structures and policies of corporate governance have been changed (Höpner 2007), the much praised system of vocational training finds itself in stormy waters (Baethge 2010), the impact of European-level regulation on national decisions has increased significantly (in recent times more often harming organized labour rather than supporting it) (Seikel 2014), and the capacity of the economy to produce a comparatively high level of equality has been weakened (Spannagel 2013).

In the following I will argue, however, that despite such a rapid change of important features, key actors within the system are still holding on to some of the very virtues which are associated with the old system. Put differently: while structures, which are associated with the German variety of a coordinated market economy are showing signs of erosion, if not decline, some of the major ideas which are associated with them are living on or even gaining new ground. I will make this point by way of presenting two examples: the acceptance of social partnership in multi-employer bargaining and establishment-level conflict resolution through works councils. I will show the stubborn persistence of major ideas on which the German political economy is based.

Social partnership in collective bargaining

The term 'social partnership' has two major traits. First, scholars find it hard to agree upon what exactly social partnership ought to be; whereby many of those authors seem to share the view that partnership is somewhat based on mutual acceptance between key actors in negotiation, as well as a symmetrical distribution of power amongst those actors and the acceptance of collective rules for the regulation of the employment relationship (Haipeter 2012). Second, among those who are supposed to exercise 'social partnership' the term does not have too many friends, which is all too often true for both the unions and employers. As Tullius/Wolf (2012) argue, however, people refuse to talk about social partnership as long as it is alive and well but they appeal to its spirit once it is significantly weakened. Despite these difficulties social partnership is of particular importance for German labour relations because such orientations provide the normative 'glue' that sustains mutual acceptance between collective actors (Helfen 2013). As we know from organizational institutionalism, cooperation between organizations occurs not only because business is seeking efficiency, but also because there is a need to adapt to non-economic social obligations that require consensus-seeking behavior (DiMaggio/Powell 1983). In this sense, social partnership can be conceptualized as a form of normative commitment with economic repercussions (Behrens/Helfen, forthcoming).

When looking back on the developments of the past two decades, however, there are many reasons to expect partnership orientations to lose support among employers. It can be observed that bargaining coverage is on the decline: by way of establishing so called 'bargaining free' (OT)-membership status many employers' associations weaken their collective bargaining function (Behrens 2011), and several employers' representatives have publicly criticized multi-employer bargaining for providing too little flexibility and therefore keeping their companies from adjusting to changing market conditions. Just to take the most dramatic example, in 2003 Ralf Rogowski, at that time president of the Federation of German Industry (BDI), expressed the wish to burn all collective agreement on a huge bonfire just to make way for a new beginning (*Der Spiegel* 44/2003).

When Helfen (2013) conducted a survey amongst executive managers and chairpersons of 114 German employers' associations the results were quite striking. While in a previous survey, conducted 2005/06 only 24.1 percent of respondents had partially or entirely agreed with the statement "German social partnership is an advantage in international competition", by 2012 this share had increased to a stunning 66.7 percent. Employers in the metal-engineering industry, in particular, seemed to have re-discovered their support for partnership: between 2005/06 and 2012 approval rates for the statement increased by more than 50 percentage points from 21.6 (2005/06) to 75.0 percent (2012).

It seems that, at least those employers who keep their membership with employers' associations and thus are still part of the traditional institution, still hold on to this normative commitment. This is particularly true during times of crisis. The experiences made by respondents with employer-union collaboration during the years following the

Lehman crash in 2008 certainly informed their responses and thus strengthened their support of social partnership. Even though support, along with the fading memory of these crisis years, fell again, it just showed how deeply rooted partnership orientations are within the German system of employment relations and that they are to be renewed and reactivated in certain situations. So the lesson to be learned from this case is that from time to time normative orientations might be hidden or dormant – but they do not disappear. They are still available to be reactivated. To paraphrase a famous saying: you might get employers out of collective bargaining institutions but you can't get the institutions out of the employers!

Conflict resolution at the workplace

While industry-wide patterned collective bargaining is mostly reserved for employers associations and unions as key actors located above the establishment-level, most of the workplace-related interest representation is reserved for works councils and management. During the past two decades the share of the German workforce which is represented by a works council has been in decline, albeit less severely when compared to the development of collective bargaining coverage and union density during the same time period. While conflict over distributive issues such as wages and hours mostly occurs within the collective bargaining arena, conflict on a full range of issues such as working-time arrangements, work and company restructuring, work organization, safety & health and, probably most important issue – the safeguarding of jobs, is to be resolved in negotiations between local management and works councils.

With the arrival of the world financial crisis in 2007/08 one would expect economic hardship at the establishment level to increase, as well as conflict between management and works councils. With GDP declining by 5%, during the immediate crisis year, making it the most severe recession in German post-war history, many companies were facing shrinking revenues. Faced with economic hardship companies might be expected to lose patience and to engage in short-term crisis adjustment measures by way of bypassing the participation rights of works councils and the potentially time-consuming negotiations accompanying those rights. This is, however, not what happened.

According to data provided by the WSI Works Council Survey (Panel 2007/2010) conflict levels have decreased rather than increased. While in the 2007 survey 13.9 percent of respondents indicated that their employer "often" interfered with the works council's participation rights, this share had declined to 10.2 percent by the time the crisis was drawing to an end (Behrens 2014: 378). One important qualification deserves mentioning: While there has been a reduction in workplace-level conflict between works council and management in both groups of establishments; those affected by the crisis and those not affected, the decline has been larger in the group of establishments that have watched the crisis from the sidelines (1.9 percent reduction in the case of establishments affected and 5.5 percent in the case of establishments not affected by crisis). One possible reading of this data might be that workplaces with more collaborative labour relations (and thus a lower level of plant-level conflict) are better positioned to master the effect of the crisis and thus –when asked in the survey – considered themselves not to be affected by the economic downturn. This resonates somewhat with a finding made by Herzog-Stein and Zapf (2014), indicating that establishments with a works council have made extensive use of working time accounts, giving them a powerful tool to adjust to the economic crisis without massively cutting back their workforce.

Germany: A model for true believers?

As our previous analysis shows, one reason why it is often all too often difficult to describe the development of the German political economy in broad and consistent terms is that there are competing rationales at work. While this is not to dispute major findings, indicating that major key elements of German industrial relations are eroding, this brief analysis has also shown a remarkable strength in the major norms and orientations on which those structures operate. As our findings on normative commitment of management at the levels of collective bargaining and establishment-level governance structures have shown, social partnership and establishment-level codetermination can be re-activated and maybe even rejuvenated, albeit under very specific circumstances.

While the disorganization/liberalization perspectives in current scholarship capture one important aspect of the present development of major industrial relations institutions, namely the formal stability and strength, it misses out on the normative underpinning of those institutions.

While it would be hard to believe that plant-level codetermination lives on without the structures, resources and legal rights which come along with a works council, orientations with such structures have helped to exercise influence even when those structures are weakening. Also, as voluntary structures such as multi-employer collective bargaining and codetermination have weakened, the German state has stepped in to – at least partially – fill this void. The introduction of statutory minimum wages as well as the easing of the potential for the state to declare collective agreement universally binding is a way to compensate for decreasing voluntary coverage. It remains to be seen how effective such state intervention will be.

So far, there are no signs that the re-established commitment to social partnership and codetermination on the part of employers is restricted to the group of large, exporting companies in the manufacturing sector, as the dualization hypothesis would lead us to expect. The dualization view, however, captures an important aspect of current developments in that it suggests that we might need to analyze and understand competing models of labour relations within a national political economy, as Richard Locke suggested about 20 years ago (Locke 1992). In this sense, future scholarship would not just have to identify those parts of the economy which manage without the formal structures of multi-employer works councils; they would also have to investigate normative orientations of management which come along with such 'disorganized' sections of the German political economy.

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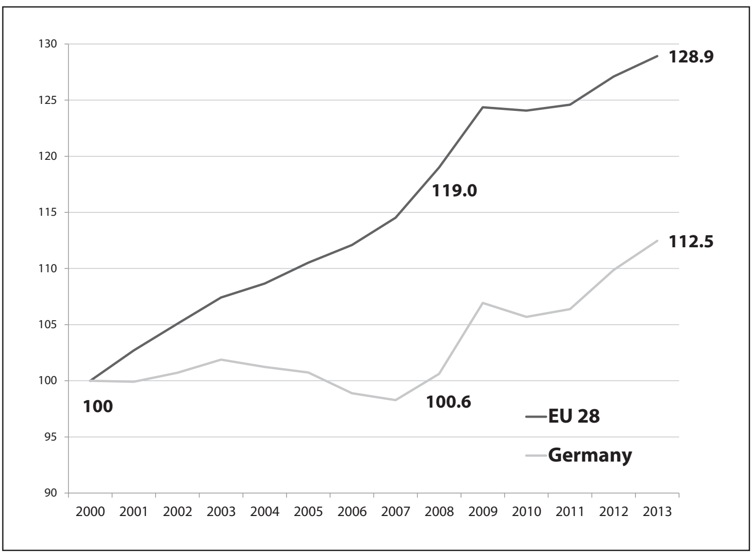
Wages, Competitiveness and Germany's Export-led Development Model

Thorsten Schulten

Current European and international perceptions of the German economic development model are rather contradictory. On the one hand Germany is admired for its successful management of the economic crisis, its high degree of international competitiveness and its comparatively good overall economic performance. On the other hand Germany is heavily criticized for its one-sided export-led development which has created a huge account surplus and contributed considerably to the development of large economic imbalances at both European and global levels. While the former view praises Germany as a model for other countries to emulate in order to become more competitive, the latter emphasizes the impossibility of generalizing the success of the German development model, as simply not all countries can have an account surplus.

Considering the current narratives about the German model, wages and other labour costs usually play a major role, probably *the* major role. The latter refers to the fact that the development of German unit labour costs has been rather unique (*Figure 1*). As the only country in Europe, Germany has seen almost stagnating unit labour cost leading per definition to a strong increase in its price competitiveness.

Figure 1: Nominal unit labour costs in Germany and EU 28 2000-2013, 2000 = 100



Source: AMECO Database

The stagnation of German unit labour costs was mainly the result of extremely moderate wage developments which, against the background of high unemployment, were enforced by a partial erosion and fragmentation of German collective bargaining (Schulten and Bispinck 2014) as well as by a deregulation of labour market and social security protection – promoted in particular by the notorious 'Hartz Laws' (Knuth 2014). For many observers the changes in collective bargaining and labour market regulation have been a successful policy to transform Germany from what was called the 'sick man of Europe' at the beginning of the 2000s to an 'economic superstar' at the end of the decade (Dustmann et al. 2014). Others criticized the same policy as a strategy of 'wage dumping' whereby Germany has followed a beggar-thy-neighbour approach and achieved its economic success mainly at the expense of other countries (Flassbeck and Lapavitsas 2013). Coming from different economic and political perspectives, both views are based on the same assumption that there is a direct link between wage developments, the increase of price competitiveness and the success of Germany's export industries.

Although the hypothesis of a close 'wage-price-competitiveness-nexus' is very common in many discussions on the German economic development model, more recent studies have fundamentally criticized that view for at least three reasons (Detzer and Hein 2014; Duval 2013; Storm and Naastepad 2014a). First, it is based on a rather narrow concept of competitiveness which mainly draws on prices and largely neglects the broad range of other non-price factors. Secondly and closely related to the first point, it widely disregards the specific sectoral composition of German export industries and Germany's particular integration into the international division of labour. Thirdly, the assumption of a close 'wage-price-competitiveness-nexus' draws only on a supply-side perspective and completely ignores the problem of demand. This holds true for the development of demand in the main target countries for German export industries as well as for the implication of restrictive wage developments for the domestic markets within Germany. All in all, the debate on the role of wages and competitiveness within the German economic development model needs a much more differentiated analysis, in order to come to a more accurate policy conclusion beyond the simple demand for lower or higher wages.

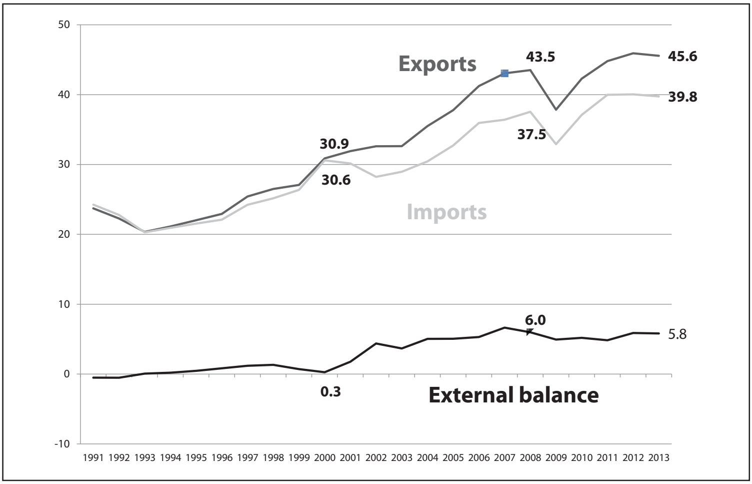
Germany's export-led development

The German economic development model has always been based on a strong export sector. During the 1970s and 1980s export industries accounted for between 20 and 30 percent of GDP, which was already a rather high value for a large economy such as Germany. After decreasing somewhat in the 1990s due to the economic effects of German reunification, the importance of the export sector increased again sharply in the 2000s, growing to more than 45 percent of the country's GDP in the years 2012 and 2013 (*Figure 2*).

Parallel to the growth of exports Germany also saw a strong increase in imports which reached almost 40 percent of the GDP in 2013. The increase in both exports and imports reflects growing integration into the world economy. Many German companies have (re)organized their production and value chains on a European and global basis, so that there is a growing element of intra-firm trade. While exports and imports were almost balanced during the 1990s, at the beginning of the 2000s exports started to grow much faster than imports, leading to a significant trade surplus of around 6 percent of GDP. In absolute terms Germany became the

'the world champion of exports' with a trade surplus of more than 160 billion euro in 2012 and 2013.

Figure 2: Exports, imports and external balance in Germany 1991-2013, in % of GDP

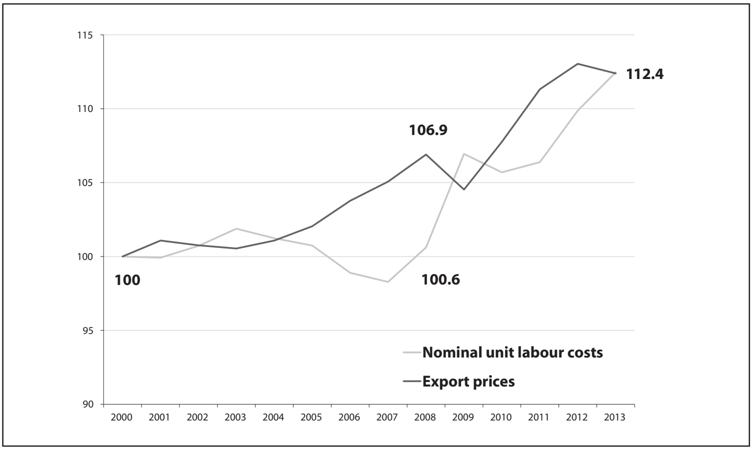


Source: Statistisches Bundesamt (Federal Statistical Office), National Accounts

The role of non-price competitiveness

Many studies suggest that the strong increase of German export industries in the 2000s was not primarily driven by developments in unit labour costs, but was mainly the result of strong economic growth in Germany's main export markets (European Commission 2012). A comparison of the development of unit labour costs and export prices (*Figure 3*) is also proof of the minor importance of wages. In the first half of the 2000s both figures showed an almost parallel development. In the second half, however, unit labour cost went down while export prices showed a strong increase. As the second half of the 2000s was also the period of Germany's fastest export growth, many German companies obviously saw no need to transfer the gained price competitiveness resulting from wage restraint into lower export prices (Herzog-Stein et al. 2013a). On the contrary, the companies could directly use moderate wage developments to realize some extra-profits.

Figure 3: Nominal unit labour costs and export prices in Germany
2000-2013, 2000 = 100

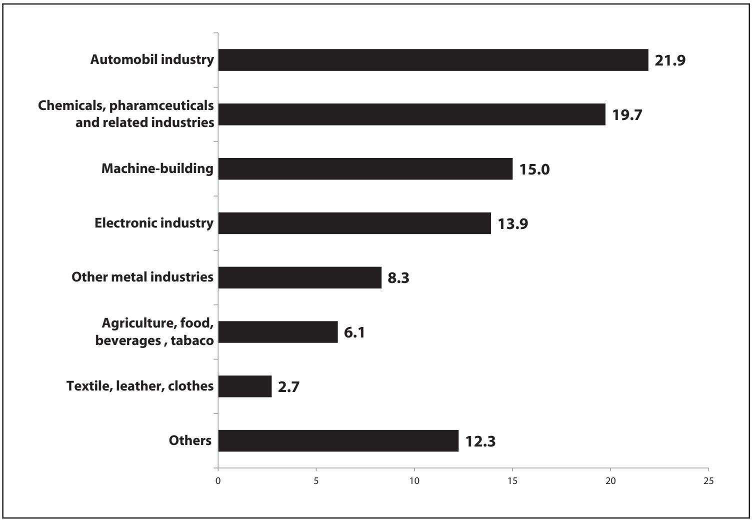


Source: AMECO Database, Statistisches Bundesamt (Federal Statistical Office)

The relatively low price sensitivity of export industries also reflects the specific sectoral composition of the German export sector (*Figure 4*). Of all European countries Germany has by far the largest share of world exports in the list of the 100 most complex goods (Felipe and Kumar 2011). The German export sector is largely dominated by automobiles, chemicals and machine-building which are all knowledge and technology intensive industries in which labour costs play only a minor role. Following calculations made by Storm and Naastepad (2014a: 8f.) unit labour cost made up only between 20-24 percent of the gross output prices in German manufacturing.

To sum up, several studies have found strong evidence that the large increase achieved by German export industries was mainly driven by a high degree of non-price competitiveness (European Commission 2012, 2014, Felipe and Kunar 2011, Storm and Naastepad 2014a, 2014b). Among the core elements of non-price competitiveness are, in particular, the provision of innovative and specialized products, an advanced standard in technology, the quality of goods and services, the accuracy and engagement of business relations. In a broader perspective, non-price competitiveness even includes basic societal framework conditions such as the technological and logistical infrastructure, the systems of skill formation and research and development or the culture of labour relations. Based on such a broader perspective, for example, the World Economic Forum developed a Global Competitiveness Index which recently ranked Germany worldwide in 5th place (World Economic Forum 2014).

Figure 4: Sectoral composition of German exports 2013, in % of all exports



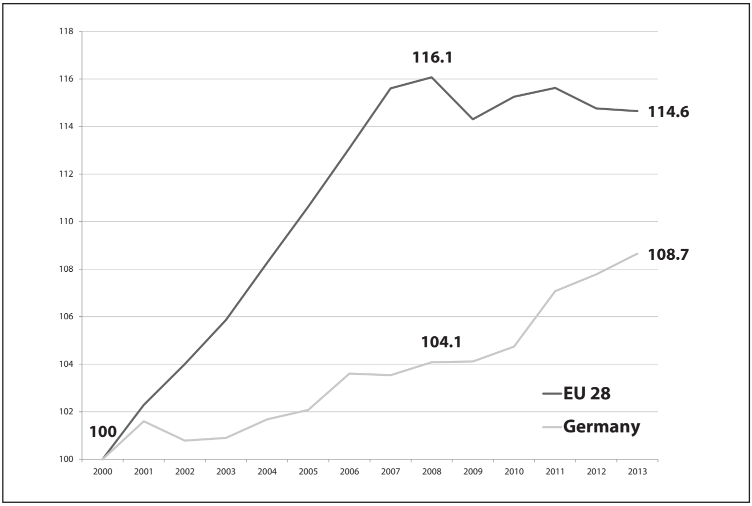
Source: Statistisches Bundesamt (Federal Statistical Office), Statistics on Foreign Trade 2014

The downside of Germany's export-led development model

While the restrictive wage developments have not been the main drivers behind Germany's flourishing export industries, they nevertheless have strongly contributed to the downside of the German export-led growth model, which is a largely underdeveloped domestic sector. In the 2000s German wage developments were basically characterized by two main trends (Schulten and Bispinck 2014). First, wage increases remained largely below productivity growth and were often even below the inflation rates which led to a further decline of the wage share and an ongoing redistribution from labour to capital income. Secondly, Germany saw a significant increase in income inequality promoted by growing wage dispersion and a fast expansion of the low wage sector.

Both trends in wage developments had a strong negative effect on the overall development of domestic demand as it significantly dampened private consumption (Sturn and van Treeck 2013). Between 2000 and 2008 the average private final consumption expenditure in the EU grew by 16 percent, which was four times faster than in Germany where it was only 4 percent (*Figure 5*). Only after the crisis in 2009 did a somewhat higher wage growth in Germany contribute to higher growth of private consumption, while wage cuts and wage freezes in many other European countries led to a stagnation of private demand (Schulten 2014).

Figure 5: Private final consumption expenditure in Germany and the EU 2000-2013, 2000 = 100



Source: AMECO Database

Although Germany has obviously gained from its flourishing export industries, the weak development of domestic demand has strongly undermined the economy's ability to realize its growth potential (Herzog-Stein et al. 2013, European Commission 2014). Moreover, the underperformance of the domestic sector was also – at least partially – responsible for the fact that import growth rates were no longer in balance with export growth (Detzer and Hein 2014). Thus, the restrictive wage developments in Germany have indeed contributed to the rise in Germany's account surplus and the increase in growing macroeconomic imbalances. However, this was primarily not due to a strategy of 'wage dumping' but mainly through the dampening of domestic demand.

Conclusion

The discussion of whether certain national economic development models are an example for other countries is often little more than a highly instrumental form of 'cherry-picking' where policymakers single out certain elements to legitimatize their own policies. This is exactly what is currently happening in Europe when references are made to the German model. Relying on the myth that it is the issue of labour costs, which have generated Germany's relative economic success, the German example is frequently used to justify a policy of wage restraint and labour market liberalization, in particular in the account deficit countries of southern Europe. Above all, it has been the German government itself which has strongly promoted such a policy through the institutions of the European Union and thereby has permanently reproduced that myth.

The economic reality in southern Europe shows very clearly that a policy of wage cuts and labour market liberalization might lead on paper to an improvement of price competitiveness. The impact on the export industries, however, has remained rather small as these countries lack many structural preconditions for an export-led development. Moreover, the restrictive wage developments have had – as in Germany – a strongly dampening effect on private demand and have thereby actually hindered an economic recovery (Schulten 2014). If there is anything to learn from Germany, it is definitively not the labour market policy but more the importance of well-developed industries which are specialized in certain market niches and are therefore able to provide a high degree of non-price competitiveness (Duval 2013).

However, the German export-led development model itself is far from being sustainable as it highly depends on the development of world markets and relies systematically on the existence of an account surplus which makes it necessary for other countries to continue with their deficits. Moreover, even for Germany itself the one-sided export-led growth strategy has become more and more problematic as it goes along with a systematic neglect of domestic sectors such as education, health, public infrastructure etc. (Rietzler 2014).

In the meantime, it has become more or less common place in international economic debates to state that Germany needs to rebalance its economic model through a strengthening of its domestic development (e.g. European Commission 2014). As far as wages are concerned, Germany has the potential for more expansive developments without losing its overall competitiveness. In addition to that, there is a strong need for more public investments to maintain the pre-condition of Germany's high non-price competitiveness. Both more expansive wage developments and more public investments could strongly promote domestic demand, which would be of benefit not only for Germany but also for the European and international economy.

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No German Modacle!

Matthias Knuth

"The Sick Man of Europe" – a travelling trophy

In 2003, a German economics professor was still describing Germany as "the sick man of Europe" (Sinn 2003). In the early 2000s, the German media were full of reports about labour market reforms in other EU countries and the German "reform backlog". At the time, Germany's political class was obviously looking for a different model, as was epitomized by Gerhard Schröder's and Tony Blair's 1999 manifesto "Europe: The Third Way/Die Neue Mitte". In 2002, the "Hartz Commission" was set up with the task of developing a roadmap for labour market reforms. The commission had reports drawn up on various countries and conducted fact-finding trips to some of them. Between 2003 and 2005, Germany enacted the most radical labour market reforms of all western European countries by simultaneously redesigning the benefit system and restructuring the public employment service (Knuth 2009). Miraculously soon, from

2006 on, the German labour market started recovering. The "sick man" trophy was passed on, first to Greece and then to France where François Hollande appeared with Schröder on television. Germany's unemployment rate is now far below EU average. France and southern European countries are urged to implement "structural reforms" in the vein of the German example. So has Germany now settled in a new and successful model?

The turn of the tide in the German labour market was publicly marked by Paul Krugman's discovery of a German "jobs miracle" (Krugman 2009). Though hit very hard economically by the 2008 financial crisis causing a 5 percent GDP slump in 2009, the German labour market proved itself resilient. Employment and unemployment levels were only slightly affected in 2009 and then continued their upward – respectively downward – trends. Paradoxically, however, all explanations of the 2009 miracle converge in highlighting features of the German employment regime that are strongly identified with Germany's "old model" of co-ordinated capitalism: statutory employment protection for core workers, internal flexibility of firms regulated by collective agreements and works councils, and a "preventive" use of the unemployment insurance fund for subsidizing short-time working.

The discovery of a "miracle" inevitably leads to it being regarded as a "model" for others to follow, although the logical paradox should be obvious: A miracle cannot be copied; only prayed for at best. The central motive of this article, then, is to warn against "modacles"[1], that is *miraculously successful models* about to be transferred into a coercive political environment.

Unravelling the "miracle"

From the early 1970s until 2005, German unemployment rates had been climbing from one economic cycle to the next. When growth was weak or even negative, unemployment surged, but when the economy picked up again unemployment did not return to its previous level. This pattern seems to have been broken for the time being. The change cannot be attributed to extraordinary economic success: Average growth rates since 2004 have not exceeded those of the previous cycle (1994 - 2002) which, however, did not reduce unemployment. Employment growth in terms of the number of persons employed has been only slightly higher during the current cycle averaging 0.7 percent per year as compared to 0.5 percent during the previous cycle. However, whereas the volume of paid work (the number of hours worked annually) decreased over the previous cycle by 0.35 percent per year, it has been slowly growing – with exceptions in 2005 and 2009 – throughout the current cycle, amounting to an average growth of 0.24 percent per year. Economic growth has thus become more labour-intensive which means that productivity increase has slowed down. This is favorable for employment but it is open to question whether it is a good thing in the long run.

There are two underlying long-term trends which have augmented the effect of an increasing volume of work. On the one hand, the average number of hours worked per gainfully employed person declined from 1997 to 2009, which reflects an increase in part-time work. On the other hand, the population aged 15 to under 65 has been shrinking since 1999 at accelerating rates, which was compensated by growing activity rates only until 2006 (Wanger et al. 2013). Since then, the active workforce has also been on the decline which coincides exactly with the beginning of the decrease of unemployment. It is amazing how demographic change is ever-present in debates about imminent skills shortages but totally absent in the depiction of the alleged German jobs miracle. It is mostly demographics that explain how employment and unemployment could grow parallel to each other in the 1980s and 1990s whereas now unemployment numbers are decreasing faster (by almost 5 percent annual average since 2005) than employment is growing. To sum up, a volume of work which has ceased to shrink (and has recently even grown) has been shared among more persons within a shrinking active population: This makes for increasing employment rates and decreasing unemployment rates.

Against the background of demographic aging, another part of the German success story can be unravelled. Employment rates of the population aged 55 and older have grown impressively since the turn of the century, and the ground covered exceeds that of any other sizeable European member state (Knuth 2012). In fact, total employment growth has mainly been to the benefit of the age group 50plus (Dietz and Walwei 2011). Whereas the relative chances of older workers being hired have improved only marginally (Brussig and Eggers 2014), incumbent workforces have grown older and stayed in employment longer than preceding cohorts. Between cohorts only four years apart (1941 and 1945), the median age of exit from employment has increased by almost one year (Brussig and Ribbat 2014), and the average age of pension take-up increased by almost 1.5 years in ten years (Brussig 2012).

The hitherto deeply ingrained pattern of early retirement via a period of unemployment followed by a premature pension (Knuth and Kalina 2002) has been broken through pension and unemployment benefit reforms. The demographic trend plus labour-intensive growth explain how these institutional reforms could be so successful.

These factors together also explain how the German labour market could be so resilient to the economic consequences of the 2008 financial crisis. Whereas in previous downturns firms used to adjust their payrolls by dismissing older workers (many of whom volunteered to "earn" their way into an early pension via a period of unemployment benefits plus severance pay), this was no longer possible in 2008/2009. It had still been allowed, however, in 2003 and 2004 when transitions from employment into unemployment peaked, partly as an anticipatory effect of the reforms to come (Dlugosz et al. 2009), relieving firms of part of their "demographic burden" which had not fully re-grown when the financial crisis set in. Since 2005, transitions from employment to unemployment have been on the decline, with exceptions in 2009 and 2010 which, however, remained well below the 2004 peak. The opposite flow from unemployment to employment has increased since 2003, resulting from a concurrence of the changes in the supply and demand relationship (see above: demographics, volume of work, employment growth) and the activating effects of the Hartz reforms. As flow levels between employment and unemployment in both directions came closer together, unemployment fell since there are always exits from unemployment into inactivity and retirement. However, transitions from unemployment into employment have decreased sharply since 2011, and if unemployment has hardly increased (a slight increase in 2013 went almost unnoticed) this is only because the opposite flow from employment into unemployment fell equally sharply after 2009. *The German labour market is holding its breath and awaiting the next recession* – forebodings of which are becoming more visible day by day as this is being written.

Looking at flows rather than stocks on the labour market – which is rarely done in public debates or international comparisons – also reveals limitations and paradoxes of the German reforms. The fundamental justification for the restructuring of benefits and institutional responsibilities had been to include recipients of social assistance into labour market activation and to increase the activation of unemployment assistance claimants, practically speaking, the long-term unemployed. However, the acceleration of flows from unemployment into employment is empirically confined to the very short-term unemployed with unemployment durations under 6 months. If anything, flows after long-term unemployment have slightly declined (Jaenichen und Rothe 2014). So the reforms have failed to achieve their major official objective.

Furthermore, labour market flows reveal a central paradox of the reforms. Beyond "activation" of the unemployed, the reforms also contained some elements aimed at increasing what is commonly termed "labour market flexibilization": Statutory employment protection was removed for employees in small firms having under 10 employees, the regulation of fixed-term contracts was eased for older workers, so-called mini-jobs with employees earning less than 400 euros per month (in 2013 – the threshold was raised to 450 euros) were made more attractive by making it possible to enjoy the tax and contribution privileges of a mini-job even if a regular job was held as well. Subsequently, mini-jobs underwent some expansion. Temporary agency work was deregulated considerably, resulting in an expansion of this type of employment as well. Even though the protection of "core" workforces remained intact, one would expect some increase in labour turnover from these institutional changes. At the "low end" of the labour market, one would expect more churning because employment becomes less protected, whereas at the "high end" it would be normal – in times when employers complain about skills shortages – that incumbent workers with highly sought-after skills would be poached and would have to be replaced, possibly again by poaching, thus creating vacancy chains and multiplying the churning effect of increasing demand (Schettkat 1996).

Empirically, however, the opposite can be observed. Since the reforms, overall turnover on the German labour market has shifted downwards (Giannelli et al. 2013). Despite reforms to encourage flexibilization, the German labour market's reallocation capacity has been thwarted. Two reasons for this can be identified. On the one hand, the perceived risk involved in quitting a job in favor of another one has increased since social protection in the event of lasting unemployment has been reduced. On the other hand, entry wages have declined, not only for unemployed job applicants but also for job-to-job movers, thus rendering job mobility less attractive (Jaenichen und Rothe 2014). In fact, with growing wage dispersion (Brenke 2007) and a growing low-wage sector (Kalina and Weinkopf 2013) but little likelihood of lowering wages in an ongoing employment relationship, a decline of entry wages is a logical precondition.

This leads to a discussion of the role of wages in Germany's alleged miracle. It is generally acknowledged that there has been a period of wage restraint since the turn of the century, even with losses in real wages being registered in some years (Brenke 2011). The German trend of per unit wage costs has been far below average in the eurozone, thus contributing to economic imbalances (Niechoj et al. 2011). It should be noted, however, that the share of German exports within the EU has sharply declined since 2008. Furthermore, controversies exist with regard to the role of the reforms for wage restraint and the importance of the latter for Germany's economic success. Certainly the reforms had an intimidating effect on workers (Kettner and Rebien 2009), thus reinforcing wage restraint which, however, had begun several years before, in conjunction with the decline of collective bargaining coverage (Ellguth and Kohaut 2014). Furthermore, it is unclear to what extent wage-cost advantage really is the main cause of export surpluses which, in turn, seem to be the precarious precondition for even modest economic growth. Wages in the export-oriented sectors are actually the highest. It is a tricky business to demonstrate through input-output accounts how lower wages in services and supply industries translate into cost advantages for exports (Dustmann et al. 2014) and it has not yet been fully convincingly accomplished. And even if we do assume cost advantages in producing export goods as a result of wage moderation, there are still the open questions about how price-sensitive global demand for Germany's export goods actually is and whether cost advantages are really passed on in pricing or simply used for increasing a company's earnings.

Perhaps Germany's renewed success in exports is simply a historical stroke of luck. The first three ranks in exports are occupied by automobiles, machinery, and chemicals (2013). This product portfolio, based on technological trajectories dating back more than a century and regarded as outmoded by many as recently as during the dotcom euphoria around the turn of the century, now perfectly fits the needs of newly industrializing countries and their new elites. This, of course, would not work unless German firms and their well-trained workforces had the ability to make the best of this window of opportunity. This window will not be open forever, and Germany can do little to keep it open. Quite the contrary, it has had to reluctantly take part in closing it somewhat as a response to Russia's expansive moves.

If not a miracle – still a success, but based on which model?

So is there still anything like a German model, and has it been successful? - If success is to mean more than just chance – e.g. demographics, manufacturing legacy, demand structure of the NICs, weakness of the euro – we would have to examine features that can be or even have been deliberately influenced by policy. In this perspective, one comes first to highlighting some virtues associated with traditional conceptualizations of a "German model": Flexibly specialized quality production with highly skilled and stable workforces; high degrees of negotiated internal flexibility of firms, both functional (task assignments) and numerical (working hours), which in large part replaces external-numerical flexibility; and all this supported by ongoing neo-corporatist co-ordination. Pension reforms closing work-to-retirement pathways, though in principle opposed by the trade unions, get absorbed into this model when unions negotiate mitigations of the extended work regime for some core workers. Even though the temporal coincidence of institutional reforms taking effect, coupled with a positive business climate may again be attributed to chance, the reforms did take strategic advantage of changes in people's attitudes about the duration of working lives (which the reform discourse deliberately sought to shape), and it used the tail wind of female cohorts with higher labour market participation moving into the older age categories. If Germany is now producing all-time export surplus records with the most aged workforces ever, this again points to the adaptability and flexibility of workers and firms, virtues of the "old" German model.

In contrast to the virtues of the traditional German production and employment model, new features have emerged – and have already been mentioned in the previous paragraph – that do not fit traditional conceptualizations. Germany is no longer a high-wage country; wage dispersion has increased, and the low-wage sector has grown. The percentage of the population at risk of poverty or social exclusion grew to 19.6 percent in 2012, which is still below the EU-15 average but above that of France, the Netherlands, Austria, Switzerland, and the Scandinavian countries (Eurostat data for 2012). Non-standard forms of employment with reduced protection have expanded. They have become the indispensible buffers of stable "core" employment, and for those working in these jobs they have, in essence, turned out to be more of a trap than a springboard (Gensicke et al. 2010;

Brülle 2013; Hohendanner and Walwei 2013). The combination of a sectoral collective agreement and the existence of an elected works council at plant level, traditionally conceptualized as the "dual model" of German industrial relations, now applies to merely 28 percent of employees in the private sector in the west and to 15 percent in the east (Ellguth and Kohaut 2014). Social protection in case of unemployment can no longer be regarded as generous: Periods of eligibility for wage replacements related to previous earnings are now in the lower range of European countries (OECD 2013), and requirements for job search and availability are among the strictest in the OECD (Venn 2012). Though not formally excluded from the social insurance systems, people in non-standard or discontinuous employment may never be able to earn adequate pension or unemployment benefit entitlements. The minimum income benefit regime that will support them during unemployment or will supplement their non-living wages has been characterized by some (e.g. Mohr 2012) as a "workfare regime". Though we contend that the term "workfare" should be reserved for even harsher regimes which are only too readily conceivable, there can be no doubt that the new minimum income benefit regime deeply violates people's perception of social citizenship as it was shaped by the Bismarckian tradition of insurance-based social protection. The new regime's disregard for claimants' vocational qualifications, previous status or earnings, its "any work first" orientation and its indifference to labour market regulation are in contradiction to the principles of a high-skills, high quality production system. The institutional split of the German public employment service into two tiers serving the "insured" and the "non-insured" claimants respectively, though being a politically unintended outcome of federalism and path-dependencies (Knuth 2009), epitomizes the division of the workless, underemployed or under-earning population into two classes.

Two models instead of one?

Attempting to reconcile the apparent contradictions, we might say that Germany possesses an export-oriented production model which still shows many of the traits identified in traditional regime modelling but also a growing undercurrent of a "liberal" market regime (very illiberal for those affected!) which is exploited by the coordinated export-oriented model for its survival. Whereas this functional connection is captured adequately by theorists of dualization (Palier and Thelen 2010, 2012), their theories display shortcomings, however, when it comes to social and political analysis. With regard to social structure, these theories tend to be tautological: "Insiders" are better protected, and a person's belonging to the insider group is determined by their degree of protection. An automobile worker's wife working in a mini-job while caring for children thus belongs to the outsiders. There is a conceptual challenge here in that employment and benefit status is *individual* whereas social class, even in an increasingly "individualized" society, is still shared among several persons at *household* level to relevant extents.[2] Dualization theorists are aware of this dilemma but they treat it as a purely political phenomenon (the automobile worker's wife politically supports the "manufacturing-based coalition" – Palier and Thelen 2010,

p. 129), not as a problem of social structure. If we choose to conceive of the "German model" as two contradicting but nevertheless complementary systems, these two systems interact not only in the realm of production but also in the sphere of re-production. And as far as derived benefits, tax privileges for mini-jobs and tax savings through splitting spouses' incomes is concerned, exploitation between the two systems goes the opposite way at household level. The real outsiders are those who lastingly lack any connection to the insider system. A dynamic and longitudinal analysis of social structure combining employment, benefit and household levels and identifying these true outsiders is still wanting.

At the political level, the dualization theory must ignore or explain away events of apparent crossover between the two systems. In the managing of the financial crisis, for example, temporary work agencies were for the first time included in generous provisions for short-time allowances. The metal workers' union has included agency workers in their collective bargaining strategies (Benassi and Dorigatti 2014). A floor for wages has been legislated by the current coalition, and possibilities for *erga omnes* declarations of collective agreements have been expanded. All this should not happen in a world of dualization. It can of course be explained in terms of vital interests also of insiders; however, political analysis is not about altruism but about whether solidarity between different groups can be politically constructed – and, as the aforementioned examples demonstrate, it can be constructed given the political will to do it.

Actually, what dualization theories flesh out as the "outside(rs)" of Germany's still existing coordinated market economy is not as new as it may appear. Thelen's warning not to conflate “coordinated capitalism” with “egalitarian capitalism” (Thelen 2012) is helpful in this context. Even though wage differentials were smaller when collective bargaining coverage was more universal, when the service sector was less developed and international competition made itself felt less strongly, the German model never was egalitarian or inclusive. Poverty was always a reality, and the rise in the number of social assistance claimants began to increase during the 1980s and even more in the 1990s while the various models of “good old Germany” were conceptualized. The rise in claimant figures triggered the reforms (Hassel und Schiller 2010) which were justified by neo-liberal arguments; however, it was not liberalization that created the claimants. Furthermore, much of what is now low-paid and precarious work in the market used to be, in the “golden age” of full employment, unpaid female work in households. Economic individualization, de-commodification and benefit re-categorization (Clasen and Clegg 2011) have made visible and topical what was already there even before “dualization” was discovered.

What should others, what should Germany do?

“Now Europe is speaking German”, the chairman of the Christian Democrat group in the German Bundestag boasted as early as 2009. It is normal that other countries should look up to what appears to be successful. However, there are four potential traps in model-borrowing or the import of “modacles.” First, insofar as Germany’s current success is simply historical chance, importing reforms observed shortly before the success but without thoroughly examining the supposed causal link may be as rational as importing storks in order to raise birth rates. Second, protagonists of modacles tend to include their own interests and ideas about what should be done into the package they are trying to sell, regardless of what really happened in the country of origin. For example, the "Danish story" hawked in Germany at the beginning of the century ran like this: "the Danes abolished employment protection and thus overcame unemployment". However, Denmark never had employment protection legislation, neither when unemployment soared nor when it eased off. Likewise, the "German story" brought to other countries now is one about deregulation though actually the deregulatory elements of the Hartz reforms were modest, in part only symbolic and marginal, and they do not contribute much to explaining what is now expounded as a success. - Third, institutional features that undoubtedly do have positive effects may be impossible to export. For example, the German system of vocational education is arguably strongly related to the country's performance in global markets. But this system was also in place when Germany was faltering, and repeated attempts to export it have failed for decades. - Fourth, and finally, even institutional features that are causal for success and that can, in principle, be exported may have different effects or no effect at all in the institutional settings of other countries. Examples from other countries can be used to stimulate ideas for reform, but they do not prove or justify anything.

Turning to the lessons Germany itself has to draw from recent experience, the nexus between employment and insurance-based social protection must be more carefully taken into account. If Germany is not to pull entirely away from the Bismarckian tradition in favour of a tax-based and universal system that would be "egalitarian" only in its lowliness,[3] then the crumbling of social insurance must be counteracted from three sides simultaneously. First, inclusion of different forms of employment must be extended. First steps towards optional inclusion of mini-jobs and freelancers have been made; their ineffectiveness demonstrates that there is no alternative to compulsory inclusion since human rationality is bounded especially with regard to foresight for individual old age. – Second, social protection based on contributions which are directly related to earnings is not compatible with a too-wide dispersion of hourly earnings and of hours worked. The introduction of a statutory minimum wage is a first step which will hopefully have a lifting effect not only for those directly addressed but also at the wider low end of the wage scale. As for hours worked, the abolition of tax privileges for couples without children to care for and the retrenchment of derived benefits would increase work incentives. – Thirdly, the "holy principle" of equivalence (of benefits to contributions) in the insurance systems must be relativized, allowing for more redistribution within the insurance systems. A curvilinear relationship between contributions and benefits will still be far more acceptable than the gradual submersion of large parts of the social insurance system into the supplementary systems of flat-rate minimum income benefits – which will be inevitable when growing parts of the population cannot earn sufficient living benefits from contributions derived from low earnings.

An infamous example of more or less coercive policy transfer is the constant pressure from the OECD for higher rates of tertiary education. Since the dotcom bubble burst, the once ever-present narrative of the "knowledge-based economy" has grown silent, but there has been no critical reappraisal of the "Lisbon strategy". Germany's system of qualified vocational education tends to be squeezed out between too high numbers of school-leavers not fit for vocational training, and rising numbers of tertiary enrolment. In order to match Germany's production system, its educational system must become more effective at the low end and not more inflated at the high end.

Finally, with or without all this, we can be assured that one day, the "Sick Man" trophy will return to Germany, and the modacles will again pop up elsewhere.

Notes

1. Unless proven otherwise, the author claims the rights to the invention of this synthetic coinage.
2. A single person receiving a survivor's pension is, of course, still sharing social class with the deceased.
3. The neo-liberal Trojan horse of an 'unconditional basic income' so popular in some left and 'alternative' circles – see Eicker-Wolf 2013 for a critical assessment.

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Part 2

The German Model – Seen by its European Neighbours

The (End of the) German Model

Martin Seeleib-Kaiser

Germany's export-led "economic miracle" of the post-World War II era was based on the concept of a social-market economy, achieving simultaneously relatively high economic growth rates and very positive socio-economic outcomes. Poverty, defined as less than 50 percent of median income, stood at 5.3 percent of the population in 1981 – similar to the level achieved in social-democratic Sweden. Overall inequality was also comparatively low – with a Gini coefficient of 0.244 in 1981, Germany had one of the lowest levels of income inequality in the OECD world (LIS, 2013).[1]

After having been identified as *Modell Deutschland, (Model Germany)* due to its comparatively good socio-economic performance after the oil crisis (Markovits, 1982), Germany was confronted with severe socio-economic challenges in the wake of unification a decade later. Subsequently Germany was identified as the "sick man of the Euro" (*The Economist,* 1999): "The social-market economy devised in Germany after the Second World War, with its careful blend of market capitalism, strong labour protection and a generous welfare state, served the country well for several decades. But it is now coming under pressure as never before. As economic growth stalls yet again, the country is being branded 'the sick man of Europe'. The main factors tugging down German (and indeed European) economic performance do indeed remain structural and microeconomic: a byzantine and inefficient tax system, a bloated welfare system and excessive labour costs."

However, after the sharp and deep recession of 2008/09 Germany once again became *Modell Deutschland* (*The Economist*, 2012), based on a relatively quick return to economic growth and comparatively low unemployment rates. Conventional wisdom is that the welfare state reforms of the early 2000s, especially labour market regulations and unemployment insurance, have been instrumental for the turnaround. Some economists, however, are much more cautious in attributing the recent economic development to the welfare state reforms; moreover, they argue that the positive economic development has benefitted from German labour market institutions and wage restraint. For instance Dustmann et al. (2014: 182) argue: "Germany's unions and works councils realized that they had to make concessions in order not to be further marginalized, and the specific characteristics of the German system of industrial institutions allowed the trade unions to adapt to the new economic realities and to make these concessions. As a result, the German labour market appeared to be far more flexible than many would ever have expected."

Nevertheless, significant welfare state reforms were implemented at the turn of the millennium that undermined the social dimension of the *social* market economy and the German welfare state model.

Historical overview

The German welfare state has a long tradition dating back to Imperial Germany and its chancellor, Otto von Bismarck. Historically it heavily relied on social insurance and earnings-related benefits, as the organizing principles of social protection for workers, social assistance for the non-working poor, and the concept of subsidiarity with regard to social services. The differentiation between workers and the non-working poor can be characterized as an institutional dualism (Leibfried and Tennstedt, 1985). Within the comparative literature the German welfare state has been characterized as the pro-typical conservative or Christian-democratic welfare state, coinciding with a strong male-breadwinner model (Esping-Andersen, 1990; Lewis, 1992). Important elements of continuity have characterized welfare state development from Bismarck to unified Germany. Major reform steps in this period were the 1957 pension reform and the 1969 Labour Promotion Law and the extension of the West-German welfare state to former East Germany after unification (Ritter, 2007).

The 1957 reform had as its leitmotif the public guarantee of the achieved living standard during old age. As a consequence of the reform and subsequent policies the net replacement rate for the standard pensioner reached 70 percent during the mid-1970s, which led to a significant reduction of poverty. A core aim of the 1969 labour market policy reform was to abolish "substandard" employment. This was to be achieved by the introduction of active labour market policy, largely focusing on further education and training, as well as a quite restrictive definition of "suitable work." Suitable work was defined in such a way that an unemployed worker did not have to accept a job which either paid less or was in a different occupational field to his or her previous job. A wage replacement rate of 68 percent of previous net earnings was introduced to ensure the achieved living standard. Thus, social protection for unemployed workers was achieved by provision of occupational status protection and generous income maintenance. The non-working poor, who did not qualify for social insurance schemes, had to rely on means-tested social assistance; however, benefit levels were increased significantly, and eligibility restrictions as well as work rules for the "employable poor" were liberalized (Bleses/Seeleib-Kaiser 2004).

As an ever-larger proportion of the population was covered through social insurance schemes, Leisering (2009) has argued that Germany had embarked on a route towards "quasi-universalism". This development coupled with low unemployment rates and benefits of social insurance schemes linked to rising earnings, resulted in low poverty and inequality until the late 1980s. As a result of low economic growth and the collapse of the economy in former East Germany after unification, unemployment increased quickly, reaching more than 12 per cent in the west and almost 20 per cent in the former East Germany in the mid-1990s. Without a change of the financing structure, the high unemployment rate necessitated increasing social insurance contributions to fund the welfare state, which reached a level of more than 40 percent of gross wages in the late 1990s. The high social insurance contributions were said to have a detrimental impact on employment growth and the overall competitiveness of the country as a place to do business in a globalized world. As a result, significant labour market and pension reforms were perceived as economic necessities (Seeleib-Kaiser, 2001). Subsequently, the German political economy underwent significant reforms, including paradigmatic changes of the statutory unemployment and pension schemes and an expansion of employment-oriented family policies (Bleses and Seeleib-Kaiser, 2004; Fleckenstein et al., 2011).

Pension and labour market reforms

The recent pension and labour market reforms have reversed the road to "quasi universalism" (Leisering, 2009) and once again reinforced the institutionalized dual structure of the welfare state, differentiating between social protection insiders and outsiders. Social protection insiders can be defined as individuals, usually workers in standard employment relationships (labour market insiders), covered either through comprehensive statutory social protection *or* by statutory entitlements, complemented or supplemented by private/occupational social protection to a level that maintains living standards. Outsiders are defined as the (working) poor that would have to rely on modest (largely means-tested) public provision, primarily intended to ameliorate poverty. Since welfare entitlements are mostly linked to labour market status in one way or another, there tends to be a clear correlation between labour market insiders/outsiders on the one hand and social protection insiders/outsiders on the other hand. Overall, social protection for pensioners and the long-term unemployed has converged toward a more liberal model of welfare, such as is mainly found in the USA and the UK (Seeleib-Kaiser, 2013; 2014).

Until the late 1990s, the German statutory old-age insurance scheme witnessed only incremental and modest reforms, the most important of which was the reversal of early retirement policies that had been used to smooth structural economic adjustment processes since the 1970s (Ebbinghaus, 2006). Nevertheless, the principle of guaranteeing the achieved living standard during old age, the leitmotif of social protection since the pension reforms of 1957, was not fundamentally questioned until the reforms following the turn of the twenty-first century, when the statutory old-age social insurance system underwent significant change. The reforms enacted since 2001 included major reductions in the net replacement rate, from about 70 to 52 percent, and a partial privatization (Leisering, 2011), which in effect put an end to the guiding principle of guaranteeing the achieved living standard for pensioners. By 2037 an average worker will have to have contributed 37 years to the statutory pension scheme to be entitled to a pension above the poverty threshold. Future pensioners will only be able to enjoy an old-age income with an approximate replacement rate level of 70 percent, if they are covered by additional occupational or private arrangements (Schmähl, 2007; Hockerts, 2011: 294–324). Although overall occupational pension coverage increased in all sectors after the pension reform of 2001, only about 50 percent of workers in the private sector are covered by occupational schemes; furthermore, coverage is very uneven between industrial sectors, with the lowest coverage rates in certain service sectors with a high percentage of female workers, such as the retail and hospitality sector. According to the German pension expert Schmähl (2007) the comprehensive pension reform will very likely once again lead to an increase in old-age poverty, especially among those not covered by occupational pension schemes. The depth of future social protection dualism can be estimated by analyzing prospective replacement rates derived from public and occupational pensions for current workers. Based on OECD simulations, the prospective net replacement rate of the public scheme will be 55.3 percent for a pensioner with an average wage, which is significantly lower than the EU27 average of 69.1 percent; the net replacement rate for workers covered by an occupational pension scheme will be 76.4 percent (OECD 2013: 143).[2]

With regard to labour market reforms and social protection for unemployed workers we can also identify a process of dualization, leading to a convergence of the German model towards a more liberal approach. Despite more incremental reforms, the degree of income protection, as well as occupational status maintenance, significantly declined with labour market reforms enacted and implemented since the late 1990s. The most prominent of these were the so-called Hartz reforms, which reduced the maximum duration of unemployment insurance from 32 to 24 months, with the regular benefit being limited to 12 months. Furthermore, the reforms integrated the former earnings-related and means-tested unemployment assistance with the social assistance program for the unemployed. Whilst short-term unemployed workers continue to receive an earnings-related benefit between 60 and 67 percent of their previous net income, depending on family status, even after the implementation of the reforms, long-term unemployed workers with an unemployment spell of more than 12 months are only entitled to a means-tested transfer at the level of social assistance; for them any job offer is deemed suitable (Seeleib-Kaiser and Fleckenstein, 2007). As a result of implicit and explicit disentitlement since the early 1990s a smaller percentage of unemployed workers in Germany receive *regular* unemployment insurance benefits than is the case in the US. The various reforms since the 1990s have clearly contributed to a deepening and widening of the dualistic structure of the German unemployment compensation scheme (Seeleib-Kaiser et al., 2012).

The key labour market policy that was crucial in mitigating the impact of the Great Recession on the labour market was the "short-time work allowance," which is basically a time-limited state subsidy to support workers with reduced working hours, due to a cyclical decline in demand. During the deep economic crisis of 2009 and 2010, the German government expanded the duration of benefit receipt from six to 24 months. At its peak 1.14 million workers were protected from unemployment through the scheme. Most of the workers receiving the benefit were employed in the manufacturing sector (see Eichhorst and Marx, 2009; Crimmann and Wießner, 2009).

Finally, it is worth emphasizing that for labour market insiders the various reforms of the unemployment insurance scheme have had only a modest impact on their social protection, as they are more likely to benefit from the short-time work allowance scheme or, if unemployed, are more likely to witness only a relatively short spell of unemployment.

Employment-oriented family policy reforms

Family policies have seen a more or less continued expansion since the late 1980s. The most important reforms in the 1980s and 1990s included: the introduction of parental leave with a maximum duration of three years, the introduction of childcare credits into the statutory pension scheme, the entitlement to days off from work to care for dependent sick children, and the introduction of an entitlement to publicly provided or subsidized childcare for children from three to six years of age. Nevertheless, the overwhelming structure of family policy continued to be biased towards transfers, including child allowance payments and joint taxation, supporting a somewhat modified male-breadwinner model.

Although the reforms of the 1990s, especially those introduced by the red–green coalition government, had already opened up a pathway towards more employment-oriented family policies, these policies reached their preliminary climax during the grand coalition government between 2005 and 2009. These reforms included: the introduction of an earnings-related and gender-neutral parental leave benefit (capped at a maximum of €1,800 per month) for the duration of 12 months (with an additional two "partner" months) and a massive expansion of childcare provision for children between the ages of one and three. Since August 2013, every child above the age of one is entitled to a place in publicly provided or subsidized childcare center. According to government data the percentage of children between the ages of one and three in day care has increased from 17.8 (2008) to 27.6 percent (2012) (BMAS, 2013: XIII). The introduction of the two main family policy reforms has marked a clear departure from the previous policy path (Fleckenstein et al., 2011) and can be interpreted as a move towards a more Scandinavian approach in family policy.

Socio-economic outcomes

Whilst the changes in labour market regulations and social protection for the unemployed are very likely to have contributed to an overall increase in the employment rate[3] and a decline in the rate of long-term unemployment,[4] they have at the same time facilitated an increase in "atypical" work, including (involuntary) part-time employment, temporary or fixed-term contracts, agency work and low-wage work. The proportion of workers with "atypical" jobs, or in other words the size of the precariat, has increased from 20 to 25 percent of the workforce in the first decade of the twenty-first century (BMAS, 2013: XXV). The incidence of low pay, defined as the share in total dependent employment of workers earning less than two-thirds of median earnings, has also significantly increased since the mid-1990s (see Table). Overall, we can characterize these developments as clear indications of significant recommodification processes within the labour market. Hence, it is not surprising that these developments have fuelled a political debate about the success of the labour market reforms and the overall assessment of economic performance (Kirbach, 2013).

Incidence of low pay (%)						
	1996	2000	2006	2008	2009	2010
Germany	13.6	15.9	17.5	21.5	20.2	20.5
US	25.1	24.7	24.2	24.5	24.8	25.3

Source: OECD (2008, 2010, 2011, 2012) Employment Outlook. Paris: OECD.

The economic and labour market changes associated with increasing deindustrialization and the various policy reforms have not been without consequences for the overall income distribution, as Germany has seen a significant increase of inequality and poverty since the 1990s. The Gini coefficient has increased to 0.28 and the poverty rate (less than 50 percent of median income) has reached 9.6 percent (an increase of more than 4 percentage points since 1980); using the now more common threshold of people with less than 60 percent of median income, the poverty rate stood at 15.2 percent in 2012;[5] and poverty among the unemployed has even risen to 69 percent, the highest level in the European Union (Ferragina et al. 2014).

Conclusion

From an economic performance perspective Germany might be considered to be once again a model, but considering social policy outcomes one can no longer speak of a German model. Key principles of post-World War II welfare state arrangements, such as occupational status protection and providing income maintenance at a level that protects the achieved living standard for the unemployed and pensioners, increasingly only apply to core labour market insiders, thereby once again reinforcing the institutional dualism historically inherent in the design of the German welfare state. In both policy domains Germany has converged towards a liberal approach to welfare, usually associated with policies in Britain and the United States. However, as the country has made significant progress in reorienting its family policies towards a more employment-oriented approach, increasingly along the lines found in social-democratic Scandinavia, it should not be characterized as a liberal welfare model. Moreover, these two reform processes constitute a dual transformation of the German welfare state model (Bleses and Seeleib-Kaiser, 2004; Fleckenstein et al., 2011).

Notes

1. The Gini Coefficient varies between 0, which reflects complete equality, and 1, which indicates complete inequality.
2. The theoretical calculations are based on national parameters and rules applying in 2012. They relate to workers entering the labour market in that year at age 20.
3. The overall employment rate has increased from 72.9 (2007) to 76.3 percent (2011), with significant increases in the employment rate among older workers (aged 55-64) from 51.3 to 59.9 percent (BMAS 2013: 482).
4. The rate of the long-term unemployed among the unemployed declined from 56 percent in 2007 to 48 percent in 2011 (BMAS 2013: 481).
5. Eurostat: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Income_distribution_statistics.

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The Success of Germany from a French Perspective: What Consequences for the Future of the European Union?

Robert Boyer

Why is it that in France, governments, companies and experts so often turn to Germany as a reference and source of inspiration for their policies, strategies and opinions? The reasons are many. Firstly, because the two countries hold a core place in the construction of Europe and show certain interdependences. Also, at a time of internationalisation, the German economy is garnering success after success in terms of exports, whereas the French economy is having difficulty maintaining its ranking in what is now a global competitive environment. Finally, and above all, whenever those responsible analyse why French industry is falling behind, they wonder what leverage there might be in adopting some of the supposed hallmarks of Germany's success, in particular the institutions and organisational structures of the social market economy.

The aim here is to present a brief review of the principal lessons that French analysts have drawn from this long history (I), then to underscore the scale of the economic disconnect that has come about since 2010 between Germany and the rest of Europe, especially the South (II). *Régulation* theory[1] will serve as a key to understanding, since it allows the re-siting of the two economies in terms of the diversity of their forms of capitalism (III), but also to showing that references to this "German model", reputedly unchanged for decades, need to be challenged; it has changed considerably since reunification, and it derives its resilience from an ability to reform without sacrificing its logic (IV).

This explains why attempts to import the German model have had so little success in modifying the French trajectory, but the reasons apply equally to the countries of Southern Europe, to which the German authorities very generously attribute an ability to adopt this model, if only partially, as a sure way out of crisis (V). The very notion of a model poses the problem of confusing an ideal typology with a configuration that is historically situated, and thereby minimising the possible sources of fragility and destabilisation. This is the case with the German model, as we need to diagnose its weaknesses as well as its strengths (VI). Finally, is it not ironic to seek recommendations for Germany from a researcher whose country is suffering from an exhausted model unable to reform (VII)?

Analysing the "German Model", a French tradition

The German and French economies emerged from the Second World War in a state of devastation, and the governments each side of the Rhine reached an agreement not to repeat the errors that had propelled them from the First World War to the Second. One important decision was to organise a form of cooperation destined to regulate economic competition between the two countries by creating the ECSC (European Coal and Steel Community). This was the point of departure for a succession of further international treaties which gradually gave rise to the European market. (Monnet, 1976). In this institutional context, the growing interdependence of the two economies certainly aroused interest within France in understanding the mechanisms behind Germany's "economic miracle". During the 1950s, it was the American model of mass production which served as a reference for the reconstruction and modernisation of France, but in the 1970s economic and political decision-makers in France began looking to Germany as their benchmark. From then on, as the years went by, both researchers in the social sciences and politicians reflected on the roots of the remarkable resilience and performance of the "German model".

Among the many French studies devoted to the German economy, we propose to examine three, which, although quite dated by now, shed light on the contemporary debate. They examine respectively the sociology of corporate organisation, the macro-economic regime of each country, and the characteristics that distinguish capitalism on the Rhine from the Anglo-Saxon model.

Do companies competing in the same great European market converge towards the same organisation of production and economic performance? A well-known piece of sociological research, the result of a Franco-German collaboration, concluded that corporate organisation is governed by specific national characteristics (Maurice, Sellier & Silvestre, 1977; 1985). In Germany, the dominance of vocational training over generalist education leads to broad skill sets and a versatility which has repercussions for the relationship between employment, company hierarchy and the system of remuneration. No such thing is observed in France, since the educational system pursues generalist aims and makes vocational training a second choice, thereby reinforcing the hierarchical relationship between the ranks of wage earners, their technical managers and executives. The result is a different way of sharing responsibility and remuneration on the opposite banks of the Rhine, even though companies are operating in the same market. It is national institutions, then, in particular those with a role in education and training, that frame the organisational choices of companies. This societal effect precludes the convergence of France and Germany towards a similar model of production. In 2014, the influence of this mechanism goes a long way towards explaining the divergence between the macro-economic trajectories of the two countries.

For a long time, the strong competitive position of German industry created a problem with respect to the widely accepted view that it is high technology – essentially defined as R&D effort – that is the source of competitive advantage and therefore of growth for the old industrial nations. Paradoxically, exports from Germany were focussed on mid-range technologies. In fact, researchers concur in concluding that this paradox is merely superficial. Thanks to the quality of their products (largely capital goods), their capacity to adapt to fluctuating demand, and the wide acceptance and uptake of technical advances, German manufacturers display a marked advantage in several sectors: the goods they provide are certainly expensive, but they have an unequalled price/performance ratio. Macro-economists were able to prove and formalise this from the 1970s onwards: clear specialisation gave certain exporters a command over their export prices, as opposed to the competitive nature of the way prices were set for standardised products, typical of Fordist mass production (Aglietta, Orléan, Oudiz, 1980). Germany falls within the first configuration, France within the second.

This structural difference might have been expected to fade over time under the twin pressures which saw Germany face competition in key sectors from emerging economies – Japan and South Korea, for example, for capital goods and the automotive sector – while French manufacturers adopted an alternative production paradigm, the Fordist one, understood here as the mass production of standard goods. However, from 2003, the polarisation between a structural trade surplus on the one hand and a slowly but steadily growing external deficit on the other confirmed that the trajectories of German and French industry were growing even further apart. Simulations performed for the two industries against the value of the euro demonstrated that the price elasticity of German exports was incomparably weaker than it was for France (Artus, 2010). The majority of German companies continued to occupy a position of oligopoly, which allowed them to fix their own prices, whereas their French counterparts were obliged to shadow world prices with margins serving as adjustable variables, which translated into a low level of investment in production (Artus, 2009). Diverging macro-economic trajectories, then, reflected the structural differences between productive specialisation and organisation in the two countries.

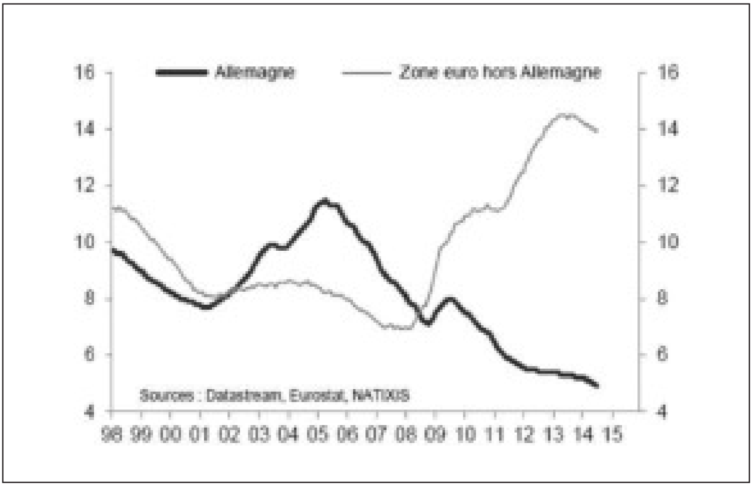
After the fall of regimes that had followed the Soviet model, would all societies now converge towards some variant of the American configuration, with its synergy of capitalism and democracy? In 1990, work by Michel Albert rejected this prognosis and advanced the theory of the coexistence of another kind of capitalism, based on a more cooperative approach to the organisation of production, the preponderance of a banking system with close links to a dynamic of networked manufacturing companies, and more focus on long-term strategy on the part of companies (Albert, 1990). This vision unleashed a trend in academic work, with the effect that in the Anglo-Saxon world, the German model of capitalism is largely recognised as an alternative to liberal capitalism dominated by market forces (Hall & Soskice, 2001; Hancke, 1999).

Are these three components of the German model sufficient to account for the success of the country over recent years? They provide a starting point, but they do not exhaustively explain the jerky trajectory that Germany has undergone since reunification.

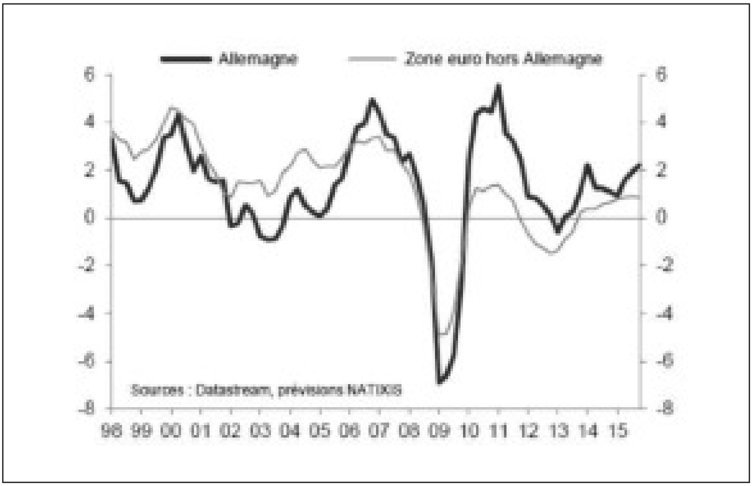
The 2010 decade: German renaissance amid European crisis

The years 2010 to 2014 add a fresh dimension to analysis of the German model, as they invalidate the hypothesis implicit in the launch of the euro that inflation control and monetary stability would favour a progressive convergence in terms of productivity, standard of living and macro-economic performance. What we see, however, is that most indicators evolved in the opposite direction (Artus, 2014). The most spectacular is without doubt the employment rate: since the European crisis openly erupted in 2010, German unemployment has fallen considerably, whereas it has increased dramatically in the rest of Europe (Graph 1). This is, in part, a consequence of a higher rate of growth in Germany since 2010, even though the decline in activity in the country was particularly marked in 2009 due to its strong dependence on a global market that was severely contracting (Graph 2).

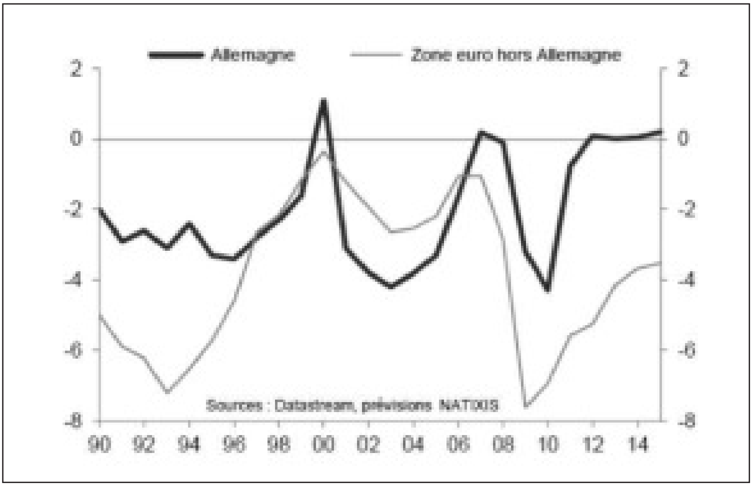
Graph 1 – Unemployment rate (%)



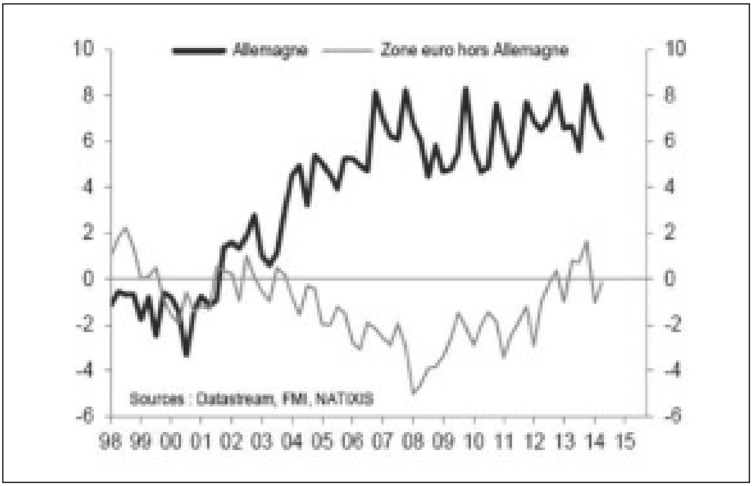
Graph 2 – Growth in GDP (by volume and year-on-year)



Graph 3 – Public deficit (% of GDP by value)



Graph 4 – Current account (% of GDP by value)



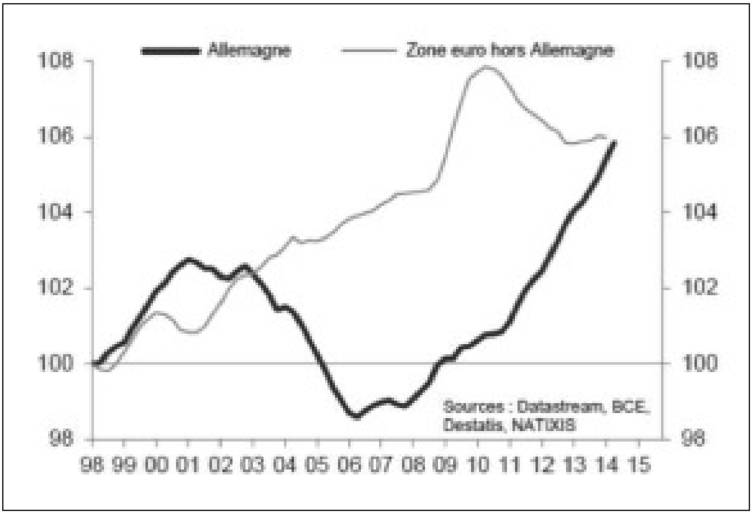
Source: Patrick Artus (2014): "Comment va vraiment l'Allemagne", *Flash Economie,* no. 698, 16 September, p. 2.

This return to growth facilitated a balanced budget, whereas in the rest of Europe, this re-balancing is only partial and has been obtained through severe constraints on public spending and social security (Graph 3). The evolution in the balance of trade has been no less than spectacular: if Germany was still suffering in the late nineties from the negative impact of reunification, the launch of the euro coincided with the restoration of a considerable trade surplus, accounting for almost 7% of German GDP from 2010. By contrast, the rest of Europe accumulated unsustainable trade deficits into 2008, as capital flooded out of countries that risked defaulting on their sovereign debt (Graph 4).

In the light of these indicators, the renewed interest in the German model is understandable. Firstly, it is German success that sustains the Eurozone even though the reforms designed to ensure its long-term viability are still incomplete, which the new direction of ECB monetary policy from the summer of 2012 onwards is seeking to offset. Secondly, Germany tends to be the benchmark for eurozone governments trying to redesign their economic policies and carry out structural reforms, in the hope of overcoming the weakness of their manufacturing base.

It is very tempting to overestimate the strength of the "German model" and to suppose that it always outperforms the other European economies. In fact, the pattern from 1998 to 2014 is patchy: in the initial years following the launch of the euro, the German employment rate was higher than that of the rest of Europe (Graph 1, above); this was the consequence of weaker growth (Graph 2). Furthermore, from 2001 to 2006 the public deficit exceeded 3% of GDP, and it was not until 2008 that control of public finances improved, and not until 2014 that the budget was finally balanced (Graph 3). This contra-cyclical evolution shown by German economic data could be interpreted as a consequence of its model of production and its emphasis on exports, but also of the different timing of labour policies and social security reforms in the various euro-zone countries. The German government imposed pay austerity in the first half of the noughties, but in 2014 real income in Germany is more or less catching up again with levels in other countries forced to implement their own austerity measures from 2011 onwards (Graph 5).

Graph 5 – Real wages (deflated by consumer prices, baseline 100 in 1988: 1)



Source: Artus (2014), ibidem p. 3

As a consequence, references to the German model are ambiguous in contemporary economic debate. For those who believe in a return to market-led mechanisms and the competition principle, the health of the German economy is explained in part by its earlier move to create low-wage employment and to apply tougher rules to accessing unemployment benefits (OECD, 2009). Other researchers underscore the diminishing returns of the successive Hartz I-IV reforms (Launov & Walde, 2013). For a number of French analysts (Duval, 2013 ; Colletis, 2014), what is essential is the quality of employment relations and industrial specialisation, which permits a structural competitiveness beyond the reach of other economies, where recourse must be had to unpopular, vigorous austerity measures. Finally, other writers doubt the very existence of a German model (Odent, 2013), raising once more questions already posed by some German researchers given the scale of the transformations to German capitalism after reunification and in response to internationalisation (Streeck, 1997a).

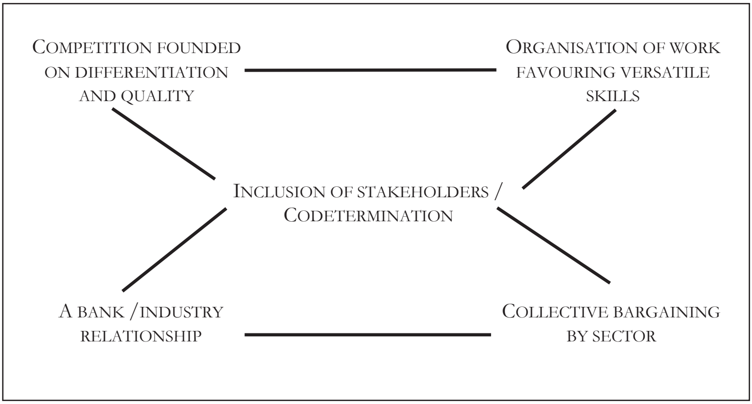
This article proposes a different interpretation: that a new German model lies behind the current upturn of the German economy.

Rhenish capitalism from the perspective of regulation theory

Régulation theory sets out to analyse long-term transformations in capitalism, but also the diverse types that may coexist alongside one another for some time (Boyer Saillard, 2002). According to this approach, the diversity of capitalisms stems from the cohesiveness of institutional configurations that each manifest a particular type of complementarity between their component parts (Boyer, 2005). It sheds light on the nature of German capitalism (Amable et al., 1997; Amable, 2000; 2003) and echoes the conclusions drawn by other socio-economic approaches (Streeck, 1991; 1997; Hall & Soskice, 2001). A related discussion has permitted the demonstration of differences between American and Japanese companies and, by extension, the capitalisms in these two countries (Aoki, 2000; 2001). Within each institutional configuration, corporate governance is the key link between micro and macro levels.

Until 1990, German capitalism was characterised by an original form of complementarity. The financing and, to a certain extent, the control of companies were the responsibility of banks, while rates of pay were as a rule established by collective bargaining. Capital was patient, enabling a compromise to be struck between the management of companies and the trade unions to which their workers belonged. At company level, versatility in the organisation of work encouraged specialisation that favoured sophisticated products distinguished by quality and service. A strong complementarity thus evolved between product strategy and the management of human resources (Figure 1).

Figure 1 – The German model before 1990: a form of complementarity between institutional forms and company organisation

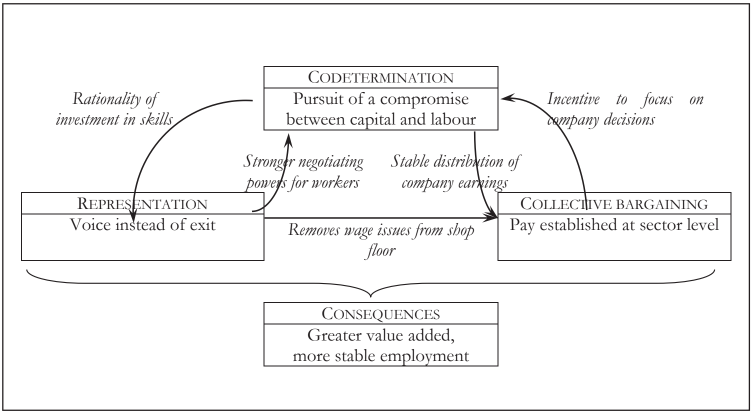


It is possible, however, to offer different interpretations as to the origin of the German model. For an approach focussed on the variety of capitalisms, it was companies which rationally developed a form of complementarity between their various management instruments, percolating into the national level through the institutional forms required for training, finance and innovation policy (Hall, Soskice, 2001; Hancke, 1999). The *régulation* approach, by contrast, emphasises the historical constitution of compromises at national level, out of which companies then developed and adapted their own strategies. For example, the history of industrial relations suggests that co-determination in companies and the institutionalisation of works councils resulted from workers' demands subsequently converted into law by governments (Boyer, 2006). Only ex post did the adaptation of company management generate a configuration that proved particularly favourable to the competitiveness of the German economy.

The imposition of these institutional constraints thus benefited both workers and the companies themselves (Streeck, 1997b). Another indication of the decisive nature of these constraints may be that when iconic German companies open new factories overseas, they rarely export the same kind of organisation (employment contracts, sub-contracting, distribution, etc.), given the lack of institutional support in the country in question with regard, in particular, to the skilling of workers and the formulation of pay policy. This means that institutional constraints shape companies' organisational choices (Boyer & Freyssenet, 2002). As a consequence, institutional complementarities become organisational complementarities (Crouch, 2005).

This complementarity can be observed in different forms at three levels of labour legislation. On the shop floor, works councils encourage workers to express their views and thereby facilitate the definition and application of more efficient working practices (Streeck, 1995). In companies with more than 2,000 employees, employee representatives have held 50% of the seats on the supervisory board (Aufsichtsrat) since 1976, although the chair, designated by the shareholders, holds the casting vote (FitzRoy, Kraft, 2005: 233). Finally, at the level of industrial sectors, at least until mid-1990, collective bargaining determined the pay increases which would apply to all companies in that sector (Figure 2).

Figure 2 – Workers' representation, codetermination and collective bargaining: complementarity in industrial relations in Germany



Rhenish capitalism in a new model since reunification

From the foregoing arguments, two major conclusions appear which are at the heart of *régulation* theory. First, capitalism is by its nature a socio-economic regime marked by ongoing transformations, generated by the effects of social and political struggle and trends that are driven by competition: it is impossible, then, to speak of a German model of production which remains strictly invariable over the long term. Second, there is a close interaction between company organisation and the forms adopted by national institutions. Of course, German history is not lacking in historic events, and so the model in 2014 is significantly different from that which prevailed before 1990.

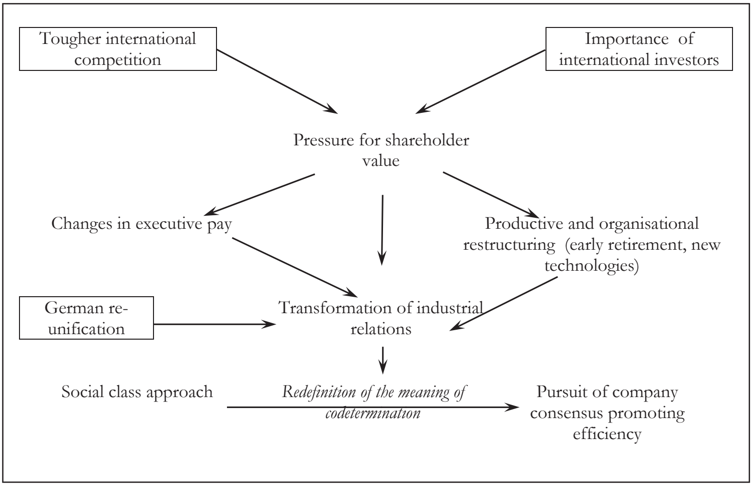
It is clear that between the wars there was nothing like the institutionalised compromise which, in the 1950s, was expressed by the pursuit of a social market economy. Similarly, the dynamic of internal demand created by military spending in the Third Reich gave way after the Second World War to investments associated with the reconstruction and modernisation of the German economy. From the 1980s onwards, it was largely exports that governed the German macro-economy. Reunification applied the brake to this competitive advantage for a while, but the acceptance of pay austerity by workers permitted a gradual revival of the export dynamic. Over the last decade, the emergence of China, India and Brazil has provided new territory for the export of capital goods and luxury cars. The steep fall in activity in Germany after the collapse of Lehman Brothers, as well as the vigorous recovery witnessed since, are consequences of this specialisation. This model can function as long as there are waves of industrialisation in new countries that require capital goods made in Germany to help them ramp up.

The success of specialised manufacturing implies ipso facto economic extroversion. Consequently, support for the "industrial compromise" implies, for example, that pay will be determined by the competitiveness of the export sector, even to the detriment of domestic consumption. A novel regime of growth results that is more like the model of a small, open Scandinavian economy than that of the United States or France, where internal demand is the dominant dynamic.

This structural nature of the process for determining pay in Germany was overlaid by the effect of the policies required to absorb the considerable costs of German unification. For one thing, the disparate levels of productivity displayed by the Länder in the East and those in the West forced the trade unions to accept pay differentials in order to limit job losses. This in turn introduced wide-scale decentralisation, and the pressure from increased competition significantly altered the logic of collective bargaining by industrial sector that had been dominant in West Germany. At the same time, social security benefits, and in particular unemployment benefit, were re-examined in the light of the clear imperative for German industry to restore competitiveness.

The conjunction of tougher global competition, the growing influence of the international financial markets, and the temptation to pursue shareholder value contributed to the transformation of industrial relations, which had in any case been affected by the impact of new technology and the need to restructure many mature industries. Common to all these structural changes was that they encouraged the decentralisation of pay negotiations in order to respond better to the competitive position of each company. In the same way, while the hard core of workers who helped to make German industry competitive continued to benefit from extensive social insurance, that was not the case for those working in the sheltered sector, who had to accept less protection in terms of unemployment insurance and minimum wages. Industrial relations thus became segmented, but competitiveness was preserved in the export sector. Specialised manufacturing in Germany comes out of this stronger, but the socio-economic regime has somehow changed (Figure 3).

Figure 3 – Changes since 1989: financial regime and industrial relations



To sum up, Germany's success from 2010 to 2014 is due to the reforms which successfully adapted Rhenish capitalism to the new international and European context, while still preserving or even reinforcing mechanisms that ensure the specialisation in high-end goods for many industrial products. In one sense, the Rhenish model resembles the Japanese configuration, characterised by a clear-cut dualism between the export sector and the sheltered sector, as much in terms of the organisation of production as in labour relations (Boyer & Yamada, 2000). The contrast is striking with other countries, such as France, which have not been able to modernise the sources of their past success, have not chosen an alternative strategy and have baulked at the social cost of major reforms, which have become more difficult in a period of recession then stagnation.

The "German model" is hard to export: The recurring failures of France

From time to time, French decision-makers find the economic organisation of their country deficient and look towards Germany, hoping to identify the sources of that country's success and to replicate some key institution which is thought to be the origin of that success. The speed at which the German economy recovered from 2010 to 2013 and its remarkable performance in terms of foreign trade and unemployment have only served to revive this "benchmarking".

Since the law on vocational training adopted in France in 1971, the import of the dual approach to training and a willingness to attach greater value to so-called "manual" work have continued to fuel reflection, laws and collective bargaining. The same is true for workers' representation at site and company level, which has been the subject of various laws from 1980 to today. Nevertheless, the elitist character of the French system has continued to hamper efforts to establish a stream that would provide vocational skills for a significant portion of each generation of school-leavers. Several partial successes, for example the shorter degree course at the University Institutes of Technology (IUT), have been insufficient to swing company strategies towards a permanent, universal upskilling of their workforce.

During the 2010s, French politicians expressed an interest in drawing on the German model to reform the tax and social insurance system, but they were blocked by a range of objections from every social group affected. Likewise, countless reports have underscored the idea that core industrial policy in France should focus on encouraging SME's to grow large enough to prosper within international competition. We might also recall how the imperative of monetary stability has become increasingly compelling, when the bylaws governing the Bank of France were revised and even more so when the euro was adopted and monetary policy was delegated to the ECB. In adding up all these reforms, we might conclude that France, like Europe, is actually converging towards the German model of capitalism.

This is not what is confirmed by almost all the studies and research on the subject. For one thing, the founding principles of each great form of capitalism have changed little since the 1980s. In France, this founding principle is that a centralised state will oversee everything, whereas in Germany the incentive for negotiation between partners is at the heart of the institutional architecture of Rhenish capitalism. For another, even if the two countries have moved to deregulate their financial system, it would seem that the management mode of German industrial companies has not been completely overturned (Höpner, 2001; 2003), whereas the dismantling of institutional complementarities peculiar to French capitalism, with its weighty state control, has been considerable (Amable, 2003). Indeed, no new coherent and viable mode of *régulation* has emerged over the two last decades in response to free marketers pressure (Amable et al., 2012).

On one bank of the Rhine, the federal government remains an arbiter, but on the other a very centralised state is compelled to intervene constantly to shore up an institutional edifice whose coherence and viability have become problematic. Whereas, during the 1960s, French capitalism was admired for its ability to organise a mixed economy that cared about the long term, financial liberalism has eventually brought about the dominance of a short-termism more pronounced than in Germany. Finally, international competition has never been fully accepted in France, whereas German companies and governments alike have regarded it as a basic fact necessitating the redeployment of domestic institutions (Table 1).

Table 1 – Some reasons for the divergence of the French and German trajectories

	Germany	France
Specialisation: Nature Evolution	Strongly industrial Maintained over the long term	Originally industrial, then service-oriented, with attempts in the finance sector
Type of innovation	Driven by quality and differentiation	Thanks to major public programmes, with a declining impact because they have not been renewed
Structure of institutions	Complex architecture of the social market economy	Erosion of institutional coherence inherited from Fordism, lack of construction of an alternative
Nature of the growth regime	Export-led	Led by domestic consumption and public intervention
Concept of public intervention	Complements economic and social negotiation	Omnipresent central state to the detriment of social negotiation
Balance between the short- and long-term view	Institutional stability permits the long-term view	Abandonment of planning and progressive predominance of the electoral calendar and short-termism typical of the finance sector
Views on international competition	Acceptance for being open to the international context. Rejection of protectionism.	Periodic temptation towards protectionism at the level of France and, by extension, Europe.

This tallies with a generic lesson from institutional analysis: there is no known example of a form of capitalism that has been imported one-to-one into another society governed by a different compromise and value system.

Is German success sustainable? Identifying and anticipating the limits

In the same way, research informed by *régulation* theory converges towards a second conclusion: every socio-economic regime starts, by its very success, a process of slow alteration in the institutional forms on which it is based, to the point where it enters into a zone of instability and/or can no longer respond to new social demands or to the changes implied by transformations in the international system.

In the first place, it is no longer possible to return to the international or European configuration that assured the renaissance of the German model. In Germany, for the whole of the decade following 2000, domestic demand increased by only 10%, whereas in the rest of Europe it had reached around 35% in 2008. If exports to the euro-zone are taken into account, the buoyancy of this demand was beneficial to the Germany economy, to the point where a remarkable complementarity between two growth models emerged: export-led in Germany, and driven by domestic demand in the rest of the euro-zone. When the American financial crisis spread to Europe, it provoked a sovereign debt crisis and a brutal reversal in access to credit for the banks, states and companies, not only in Greece and in Ireland but also in Spain, Portugal and in Italy. Policies aimed at mending public finances exacerbated the crisis in economic regimes led by consumer demand. Growth in Germany was affected by this, even if exports outside the euro-zone attenuated the negative impact of recession, even depression, in the rest of Europe. The application of European agreements on rebalancing public finances and recourse to internal devaluations – moderation or even decrease in rates of pay, reduction in some components of social security, public spending cuts – implied the eventual convergence of all countries towards a model where growth is founded on restoring competitiveness in order to underpin a return to equilibrium in the balance of trade and current account.

Under such conditions, the virtuous complementarity between German or, more generally, Northern European export-led growth and Southern European consumer-led growth has given way to the coexistence of two variants of the same strategy based on the pursuit of competitiveness, either via the quality of specialisation and innovation, or via a sustained moderation in pay demands and productivity gains in traditional sectors without moving into more upmarket products. Indeed, the extreme difficulties traditionally encountered by attempts to adapt/adopt the German model of production were exacerbated in a context where the players expected virtual stagnation in the European Union, the equivalent of Japan's lost decade of the 1990s. Given the rules that govern monetary policy and national public finance policy, the climate in the Euro-zone is becoming more and more dependent on the fortunes of the world economy… Germany has a system of production which allows it to redirect its exports to fast-growing economies, but this is rarely the case among Southern European countries. Germany, then, is shoring up economic activity on the old continent, but since 2008 the gap in the standard of living between the North and the South of Europe has been widening. This has triggered doctrinal conflicts over the course of economic policy and the reform of European institutions. And so the success of the German model, which initially boosted the resilience of the European architecture, could eventually precipitate its crisis, if not break-up.

A second limit to the new German model derives from the long-term consequences of the dual employment system with, on the one hand, a desire for high salaries and effective social security protection for workers in the industrial export sector, and on the other a rise in the population of low-income service workers, both public and private. This danger has been identified by the coalition government, which decided in 2014 to set a minimum wage in order not to hasten a social divide that might threaten political stability. However, managing such a dualist system is not easy, as witnessed by the experience in France. Should the minimum wage be indexed to the negotiated salaries in the competitive sector? Would this not run the risk of damaging jobs in the sheltered sector, where companies are far less competitive? If the minimum wage is subject to explicit legal provisions based on certain criteria, will there not be a risk that it will, in turn, influence negotiated rates of pay, even creating problems for the competitiveness of the export sector? Does rationing employment for less skilled workers not run the risk of introducing another source of inequality?

This dual work and employment will certainly have long-term repercussions for financing social insurance as the population ages and shrinks: how can retirement cover be afforded for employees who have worked in the low pay sector for many years? And how, parallel to this, can social security cover be provided for European Union workers who emmigrate to Germany and who want to stay permanently, given the absence of an industrial renaissance in their own countries? But then what prospects will there be for industrial recovery in crisis-ridden countries drained of the most dynamic section of their population? Certainly, the robust health of German public finances and social insurance holds out possibilities, but it is important to anticipate the problems which are now emerging and which, to a great extent, are new in comparison to the first version of the German model.

A third source of progressive destabilisation comes from the technological rise of Asian countries, which are going to reduce Germany's market share for capital goods and products for the luxury transport sector (China, Korea, etc.), and from the outsourcing of a greater proportion of production processes to Central Europe. Likewise, in the intermediate goods industry such as the chemical sector, high energy costs in Germany are likely to penalise employment, especially in comparison with the collapse of energy prices seen in the United States due to new techniques for extracting shale gas (Artus, 2014: 8). This is a new element for the coming period, because in the past emerging economies were not producers of capital goods and more sophisticated consumer goods. Given the scale of the research and development effort in China, and of course Korea, the long-term resilience of the German model of production is far from assured, even if the decrease in population might facilitate the downward adjustment of employment in the sectors in question.

What agenda can Germany pursue in Europe?

Any advice from external observers of economic and reform policy needs to be treated with caution, because they are not necessarily best placed to recognise the idiosyncrasies peculiar to a society and they risk proposing solutions in the light of experience gained in their own countries or derived from whatever theoretical model they use as a reference. Especially since, with the collapse of the Washington consensus, it is increasingly difficult to propose the same set of policies for all countries. Besides, for a French person this is a tricky task, because the days are long gone when Anglo-Saxon experts visited the country to discover the sources of its economic miracle, attributed to the quality of its mixed economy with its particular combination of public control and private initiative. In the Anglo-Saxon world, moulded by neo-liberal analysis, France seems in 2014 to be a good example of how not to go about things, and a bad student in matters of policies and strategies designed to exit the crisis.

Accelerating the processes of innovation to maintain a competitive advantage over emerging economies and focussing on a coherent social security system to limit/offset the emerging dualism of work and employment could be the two priorities for Germany, in keeping with the constraints identified above. In this respect, it may be instructive to perform another comparison of the Japanese and German trajectories over the same period (Yamura & Streeck, 2003), since it is Japan that has now spent the longest time exploring the social consequences of a segmented economy, with the line of divide drawn between the exposed and sheltered sectors.

The third suggestion is somewhat iconoclastic. It is inspired by a fear that attempts to export the mechanisms of the German model to the rest of Europe could precipitate a crisis in the European Union that would be even worse than that of 2010. Models of capitalism which succeed attract the attention of foreign entrepreneurs and decision-makers, who look to import this or that feature without full cognisance of cause and effect when it comes to the impact on economic performance. As an example, the "Japanissation" of models of production had a good innings, while the Lisbon Strategy that drew on the Nordic social-democratic economies as its reference proved unable to reduce the technological lag dividing Southern Europe from the North. The Rhenish model is indeed more complex than were these two forms of capitalism. It has at least three components whose impact on European policies merit successive examination.

In one sense, the philosophy of ordo-liberalism has been transposed at the level of Europe: it was appropriate to respect strictly the rules that were negotiated and inscribed in European treaties in such a way as to avoid any one country creating negative fallout for the credibility of the euro. The German reading of the origins of the current crisis is simple: it was the violation of the rule limiting public deficits that triggered the crisis, and so the rule must be redefined and imposed as a categorical imperative except in exceptional circumstances. Similarly, prohibiting the ECB from buying back state bonds is intended to guarantee monetary stability, an assumed prerequisite for balanced growth.

There is, however, another possible reading: certainly Greece did precipitate the European crisis by abusing the public deficit facility, but in Ireland and in Spain it was financial liberalisation that caused real estate bubbles so vigorous that a slight budget surplus was being posted on the eve of the 2008 crisis. The deficits that subsequently developed were the consequence of the recession and not its cause. By the same token, experience has proved that stabilising at a low rate of inflation in no way guarantees financial stability at a time of liberalisation and globalisation of capital movements. In fact, for a while the redeployment of financial portfolios within the European Union hid the fact that current accounts and public budgets were out of kilter. Once this factor is taken into account, it is clear that every central bank should act as the guarantor for a system of payments battered by financial speculation, and it is therefore dangerous to prevent these institutions from playing their part as the lender of last resort. Finally, it is not true that monetary stability is a sufficient condition for the stimulation of growth. In 2014, the very weak European rate of inflation is more an indicator of stagnation than of a return to vigorous growth. Back in the 1990s, Latin American countries provided many examples of very virtuous macro-economic policies without creating any impetus for growth, since growth depends on many other factors (profitability, the financial structure of companies, the buoyancy of demand, innovation, etc.)

If we can agree on this, we are bound to conclude that Germany's economic success imposes on its partners a cognitive framework and set of references that are invalidated by the data observed. This, incidentally, does not signify that Keynesian economists who want to stimulate the economy by accumulating a public deficit are by inversion correct, since everything depends on how public money is spent, in particular whether or not it is directed at investing for long-term growth, and the state is no substitute for entrepreneurs when it comes to generating innovation.

A second recommendation for Europe, drawn from the German experience, seeks a radical reform of labour law to allow for the creation of low-paid jobs and a cut in social benefits to encourage a return to work – in other words, the equivalent of the "Hartz" programmes to which the resurgence of the German model is often attributed. However, the world's economic climate has been much less favourable since 2010 than it was in 2003, when this policy was implemented in Germany. Besides, the directives from the European Commission are applying this strategy generally to most economies, with a negative impact on activity rates across the old continent. Indeed, it was not until after 2010 that the German economy began reaping the benefit of reforms undertaken in the previous decade. So a rapid reabsorption of unemployment cannot be expected, since the economic upturn provoked by a vigorous austerity policy resulted mostly from a notable internal devaluation, since membership of the Euro-zone does not allow a true devaluation (Boyer, 2012).

So we must return to the third component of the German model, the most essential one, since it relates to the nature of its model of production and its role in international competition. We have already highlighted that this is the crucial factor in the resilience of Rhenish capitalism. Indeed, joining the euro accelerated the specialisation of Northern Europe in luxury and high quality goods and encouraged Southern Europe into services which, in very general terms, operate within the sheltered sector, accelerating their de-industrialisation and increasing their current account deficit. Given the complementarity between training, the organisation of work, and the type of financial system required to foster a system of production with a high degree of added value, it is particularly difficult to reproduce the German trajectory in the current economic climate.

This is even more the case given that pessimistic views of the outlook make companies limit their investment, which in turn reduces potential production capacity and ultimately the pace of long-term growth itself. The trajectory would thus be very different from the one traced by Germany in the past. It is all the more worrying for Europe that China and the other countries of South-East Asia are massively investing in new technologies and the sectors of the future. The aim is therefore not so much to replicate German specialisation as to explore the potential for these sectors of the future, for example around the environment, energy efficiency or medical innovation. Too generously, no doubt, German decision-makers attribute to their European partners an ability to join their country at the forefront of technology. Paradoxically, this could worsen the divergence between levels of production capacity in the various member states and hence between standards of living around Europe, a source of future division in the absence of a transfer that would be possible in a context of fiscal federalism, currently beyond reach: in times of crisis, the doctrine of every man for himself tends to win out over the spirit of solidarity (Boyer, 2013).

Conclusion

The foregoing analysis converges towards a surprising conclusion: the resurgence of the German model initially permitted economic stability in the Eurozone, thanks to the control on inflation and a capacity to generate a strong trade surplus, but its triumph as a benchmark and strategic guide for other countries lacking the same structural advantages could well precipitate the systemic crisis in the European structure that the new trend in ECB policy, since the summer of 2012, has so far managed to contain. The question : for how long?

Notes

1. *Régulation Theory* originated in France, aims at explaining the long run institutional evolution of capitalism. It has no relation with the American Theory of regulation that analyses the methods available for State to control specific markets, especially public utilities.

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German Neo-Mercantilism: Contradictions of a (Non-)Model

Joachim Becker

The present crisis has revealed the strengths and weaknesses of the German model of development. In the German public debate, both the strong manufacturing sector and the strong export orientation are viewed as key strengths of the German model. The present crisis has confirmed the first perception, but has revealed the contradiction of the German exportism with its strong neo-mercantilist emphasis on achieving a surplus of the trade balance. The contradictions of German neo-mercantilism will be examined from the perspective of the theory of régulation. It is an approach of a medium level of abstraction which permits key features of the model of accumulation to be identified and of the accompanying mode of régulation. In this brief article, I shall deal particularly with two key dimensions of the model accumulation: the orientation towards financial or productive accumulation and the question whether accumulation is inward-looking or strongly export-oriented or import-dependent. From a regulationist perspective, economic strategies rely on specific forms of régulation – social and legal norms and policies. Two structural form of régulation – the wage relation and the monetary regime – have particular importance for the German neo-mercantilist model.

The enormous significance of industry has been a long-term key feature of the German development trajectory. German industrialization has been characterized by a long-term emphasis on exports. German reunification interrupted only briefly the strong external bias of German industry because the absorption of the German Democratic Republic provided a strong stimulus for domestic demand whereas a glut prevailed on German export markets at that time. However, German industry reverted towards its traditional outward orientation very rapidly.

The German export industries are at the core of EU manufacturing. Since the 1970s, German manufacturing has been increasingly internationalized. The neighbouring west European countries – like Austria, the Benelux countries, or northern Italy – are strongly integrated with German manufacturing. Since the late 1990s, German export industries, particularly the car industry, have relocated parts of their production to the low wage economies in countries of eastern Europe, particularly to the Visegrád countries (Czech Republic, Hungary, Poland, Slovakia). Export manufacturing in the Visegrád countries is almost completely controlled by foreign companies and is (except for Poland) extremely geared toward exports. Research and development activities are almost non-existent in the Visegrád countries. In countries like Poland and Slovakia, research and development expenditure is below 1% of the GDP. Core functions, like strategic decision-making or technological development, continue to be concentrated in the core economies. German export industries are at the core of an unevenly structured industrial export complex that stretches beyond the German border.

Monetary and wage policies have always been key supports of the export-oriented model. During the period of post-war reconstruction, German manufacturing industries could rely on an undervalued Deutsche Mark and German monetary policies were characterized by an extremely strong anti-inflationary bias. There seems to be a bias in the collective memory of the German population, too. The historical roots in the traumatic inflation experience of the early 1920s are kept alive very vividly, while the deflationary period of the Weimar Republic in the run-up to the electoral success of the NSDAP often seems forgotten. The German anti-inflation predisposition, however, has been sustained in view of furthering German exports. Wage policies have also been shaped to some extent by export interests. In the 1950s, the Federal Republic of Germany was one of the few West European countries where wage increases tended to lag behind productivity growth. In the late 1950s, wage growth picked up (though still in the context of rapid productivity growth). In the wake of strikes, wages increased substantially in the late 1960s and early 1970s. However, German trade unions faced restrictive legislation (and law interpretation) on strikes although they were partially compensated by limited co-determination rights (*Mitbestimmung*) at the company level. Asymmetrical neo-corporatist structures were an essential part of a post-war economic policy-making dispositive that favoured long-term industrial strategies and exports. Contrary to other West European countries, Keynesian doctrines played only a rather marginal role in West German economic policy-making in the 1950s and 1960s, except for a brief moment when the Fordist period came to an end. This should not come as a surprise since Keynes had come out strongly against strong export surpluses and had argued for anti-crisis policies that were primarily directed at the domestic market. In the Federal Republic of Germany, it was rather ordo-liberalism with its strong emphasis on rule-based policy-making and with its abhorrence of anti-cyclical policies that played a predominant role. Ordo-liberalism is much more in line with German export orientation than Keynesianism.

In the 1970s, the Fordist economic models became eroded and the post-war monetary order that had relied on fixed exchange rates and capital controls collapsed. Financial accumulation started to become more important in many countries – to some extent for West German banks as well. However, a key feature of the (West) German model has remained; the strong export manufacturing complex. The establishment of the European single market facilitated the outsourcing of production within the EU. This was one of the strategies of West German manufacturing companies. The collapse of the Bretton Woods monetary order changed the conditions for monetary policies drastically. With the establishment of the European Monetary System (EMS), the Deutsche Mark turned into the anchor currency for the continental EU member states. The policies of the German Bundesbank exercised a dominant influence on the monetary policies of the other countries. The German monetary policies were highly restrictive and, thus, restrained the space for expansionary policies in the other countries.

However, the EMS member states still retained the strategic option to devalue their currency, although they tended to be hesitant to exercise this option. With the formation of the monetary union which was a key objective of the financial sector and was aimed at establishing the euro as an international reserve currency, this option was abolished. German manufacturing corporations welcomed the formation of the monetary union because competitors from other member states could no longer increase their price competitiveness by devaluation. Particularly for industries in the peripheral member states, the loss of this policy option proved to be problematic. The peripheral countries of the eurozone hoped to be compensated by lower interest rates. This expectation was realized for a few years – and primarily stimulated real estate development and construction activities, but hardly local production. On German insistence, the introduction of the euro was linked to the institutionalisation of rule based policy-making, particularly in fiscal policies (rules for the budget deficit and public debt). Thus, the formation of the eurozone gave a strong impetus to ordo-liberal policy rules which constrained the spaces for fiscal policies and disempowered national parliaments. In line with the German neo-mercantilist policy orientation and the more general international trend, EU policies gained an increasingly strong anti-inflationary bias.

After the establishment of the eurozone, German labour market and wage policies became the key variable for stimulating exports. The red-green coalition massively cut the unemployment benefits and promoted the emergence of a low-wage sector. In 2010, the German low-wage sector encompassed 22.2% of the wage-earning workers and was relatively the largest in western Europe. Its relative size even slightly surpassed that of the British low-wage sector. It was particularly the workers in the service sectors who were relegated to the low-wage sector. Tax cuts and restrictive budget policies put wages in the public sector under pressure. Interestingly enough, the wages increased most in the chemical and metal industries; sub-sectors that were particularly oriented towards exports between the years 2000 and 2012 (cf. Lehndorff 2014: 137). Increasingly less numbers of wage earners were protected by collective wage agreements. While about 70% of them had been covered by a collective agreement in the early 1990s, this form of protection was only enjoyed by about 50% in 2013. In the early 2000s both German real-wage development and increases of disposable incomes lagged clearly behind both the eurozone and other EU member states. Between 2000 and 2009, German real wages fell by 5% whereas they increased by 10% or more in other eurozone countries. The German policy can be described as wage deflation. This translated into a German rate of inflation that was substantially lower than in the rest of the eurozone and lower than the EU average. Between the years 2000 and 2007, prices in Germany increased by 14% compared with a eurozone average of 19% and as high as around 30% in Ireland, Spain, Greece and Portugal. The German policies accounted for an "internal devaluation". This policy was clearly not conducive to GDP growth in Germany (cf. Posen 2007: 167 ff.). Between 2000 and 2007, the German annual real GDP growth rate was 1.6% compared with 2.2% of the then eurozone. In this group, there was only one country where GDP growth was as slow as in Germany: Italy. However, the German current account surplus went up very rapidly. Whereas the German current account was more or less balanced in the early 2000, it reached 7.5% of the GDP in 2007. High capital exports went hand in hand with the high current account surplus and German banks were able to finance financilaized growth in other countries, inter alia in the Mediterranean periphery of the eurozone.

The German policies put the other eurozone countries under enormous pressure. Some neo-corporatist countries, like Austria, could cope with the pressures – though at the price of minimally increasing wages and a stunted development of the domestic market. For France and the countries of the south European eurozone, the German policies of wage deflation put manufacturing production under considerable strain. Particularly, thecountries in south Europe with late industrialization: Greece, Portugal and Spain, had already suffered from phases of de-industrialization after joining the EU. As Ignacio Álvarez Peralta, Fernando Luengo Escalonilla and Jorge Uxó González (2013: 91) point out, Spain, Portugal, Italy and France displayed a particularly strong decline of the manufacturing share in the GDP between 1981 and 2007. In the early 2000s, imports grew much more rapidly than exports in the peripheral countries of the eurozone and in southeast European and Baltic countries where the currencies were strongly linked to the euro and growth relied very heavily on capital inflows. The current account deficits of these countries increased very rapidly between 2000 and 2007/2008. In Spain and Portugal the current account deficit reached about 10% of the GDP and in Greece up to about 15%. In the Baltic countries and southeast Europe, the current account deficits were even more dramatic. They surpassed 20% of the GDP in Latvia and Bulgaria in the pre-crisis years. The current account deficits in the EU periphery were the other side of the German surplus and a current account surplus on the one side is impossible without a deficit on the other side.

The current account deficits were financed by capital inflows, particularly from countries like Germany and France. In countries like Greece, Spain, Portugal, the Baltic countries, Romania and Bulgaria, the capital inflows financed consumption and real-estate bubbles. The growth did not have any solid support in the productive sectors which tended to suffer from the existing monetary order. The structural divergence between an export-oriented, partially financialized, bloc of countries around Germany and highly financialized countries with weak productive structures and significant current account deficits, particularly in the south-west and south-east European peripheries, increased significantly in the pre-crisis years (cf. Álvarez et al 2013: 131 ff., Becker/Weissenbacher 2014: 16 ff.). The present crisis laid bare the pre-existing fault lines of the EU.

The German economy was affected through several channels by the global crisis which had its starting points in the USA and the UK. Several banks suffered directly from the contagion effect, some of them severely, when exports started to plummet in late 2008. The strong decline of exports had a negative effect on the strongly extraverted German economy. The German real GDP contracted by 4.7% in 2009 which was worse than the 4.2% reduction of the GDP of the EU. The German government took several measures in order to attenuate the effects of the crisis, for example it adopted mild anti-cyclical fiscal policies. Temporary reductions of working hours (*Kurzarbeit*) were a widely used instrument in industry at the peak of the crisis. In the longer run, the relatively strong manufacturing base proved to be an advantage of the German economy. More generally, EU countries with a relatively strong manufacturing sector fared better during the crisis than those countries where manufacturing had been characterized by long-term weakness and had been rather strongly affected by de-industrialization in the previous years. Due to the austerity-induced glut on the domestic markets in the EU, German exporters have increasingly sought to re-orient their exports away from the EU. Likewise, the German government has stressed the importance of export markets outside the EU, for example in the BRICS countries, and accords high priority to EU (free) trade policies towards such markets. After a brief moment of mildly expansionary fiscal policies, the German governments adopted the so-called debt-break, i.e. defining rigid ceilings for budget deficits, as part of the German constitution in summer 2009. This constitutional device seriously limits the options for anti-cyclical policies, is a break on public investment and disempowers parliament at all territorial levels. The material infrastructure of Germany is already now suffering from lack of maintenance – and the infrastructural backlog will increase. Tertiary education is underfinanced – and the situation is likely to deteriorate. Thus, certain material and social infrastructural foundations of the German model are eroding. The budgetary policies constrain the development of the domestic market. Since 2009, wage policies have been more expansionary than in the pre-crisis years. Private consumption has recently played a slightly more important role for German growth than before the crisis. However, the German economy has remained strongly export-oriented. After a brief recovery in 2010 and 2011, strong export-orientation and slowly growing domestic demand have set the German economy again on the course of slow growth.

The countries of south and east Europe whose pre-crisis growth model was highly dependent on imports of goods and capital were shaken by the present crisis to their very economic foundations. Highly financialised east European countries with significant domestic foreign exchange debts were particularly strongly affected right at the beginning of the crisis. The eurozone countries in south Europe were shielded from the worst effects of the crisis for about a year, but they started to face strong external financial constraints from 2010 onwards. The German governments has promoted austerity policies in the EU that have shifted the burden of correcting the enormous imbalances in the EU to the peripheral countries, particularly to (public sector) employees and workers, pensioners and the poor. The German public debate has been very strongly focused on public deficits and debt in the periphery – and has been rather silent on the high current account deficits which mirrored the German current account surplus.

Creditor countries (particularly Germany), EU institutions and the IMF have been able to shape economic (and social) policies through the conditionalities that are attached to stabilization credits. These public credits have replaced the hitherto private credits and permitted banks within the core countries to reduce their exposures. The measures that have been imposed by the troika of European Commission, European Central Bank and the International Monetary

Fund (IMF) in the peripheral eurozone countries and before that imposed by the European Commission and the IMF in eastern Europe consisted primarily in budget cuts, various forms of wage cuts (particularly minimum and public sector wages), deregulation of the labour market and, where there is still something left to privatize, privatization. Thus, the measures have been focused on reducing mass consumption and, consequently imports (cf. Becker/Weissenbacher 2014: 24 f., Hoang-Ngoc 2014: 33 ff.). They were designed to bring price levels down. Euphemistically, the aim of the policy was defined as "internal devaluation". The creditor banks were abhorred by the prospects of peripheral countries leaving the eurozone or countries in east Europe devaluing their currencies. The "internal devaluation" is a discursive smoke-screen for deflationary polices.

The policies have produced severe recessions and – in some case – outright deflation. Deflationary policies have the inherent tendency to increase debt burdens. While the budget deficits in the peripheral eurozone countries declined, the relation of public debt to GDP rapidly deteriorated, as Liêm Ngoc-Hoang (2014: 58) observes. Problems of excessive – private and public debt – have been aggravated, not alleviated. The policies, however, brought the current account deficits and current external financing needs down – though at an enormous economic and social price. The underlying structural problems of the productive systems of the EU peripheral countries have not been tackled at all. Given the strong downward spirals and the prospect of – at best – long-term stagnation, exiting the eurozone has become a possible strategic option in peripheral eurozone countries. Some prominent progressive economists, such as

João Ferreira do Amaral (2013) in Portugal, have advocated leaving the eurozone as part of a broader pro-industrial policy package.

Though the anti-crisis policies of the troika have landed the eurozone peripheral countries in a developmental cul-de-sac, they have served as a more general blueprint for changing the EU economic governance and the more general outlook of EU economic policies. Ordo-liberal, rule-based policy-making has been expanded since the beginning of the crisis. The German government pushed through a pact that made most EU members adopt a debt-break which follows the German model. The consequence has been a deepening de-democratization of economic (and social) policy-making in the EU.

With the fiscal policy option having been systematically constrained, the EU has resorted increasingly to expansionary monetary policies – with the ECB lowering interest rates and adopting non-conventional expansionary measures. These measures have had hardly any positive effects on the productive sectors. They have, however, put the euro on a track of depreciation. This fits well into the more general increasingly neo-mercantilist orientation of the EU. However, other countries are likely to react to EU neo-mercantilism sooner or later. The EU version of neo-mercantilism suffers from the same contradictions and limitations as its German model. There is a need for countries willing to run a current account deficit in other parts of the world.

It can be concluded that the German neo-mercantilist model is not part of a viable solution, but is an essential part of the European economic (and political) problems. There is an urgent need for a more inward-looking and more ecological economic model both on the part of Germany and the EU, a break with ordo-liberal recipes and for the creation of policy-spaces that would permit the peripheral EU countries to rebuild their productive structures. Unfortunately the political and institutional obstacles for such a re-orientation are enormous.

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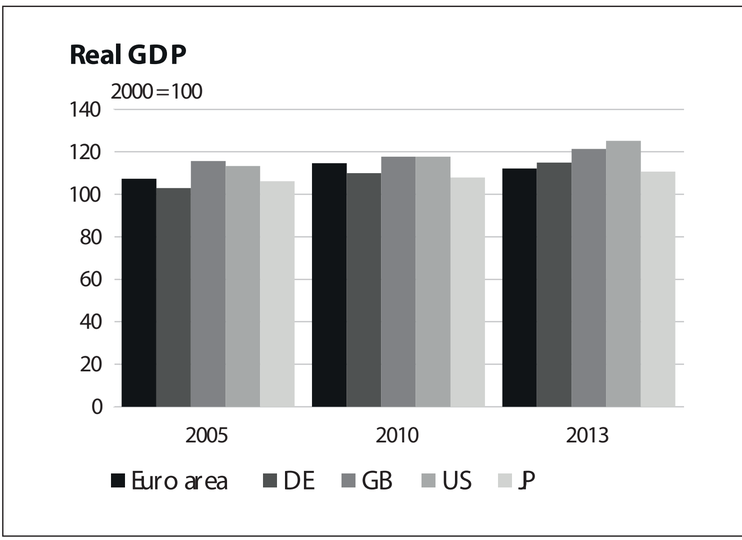
Is there a German Model?

Paul Ramskogler & Helene Schuberth[1]

Has Germany been successful (economically, institutionally or otherwise) since the 2000s?

The question whether Germany has been successful since the 2000s clearly depends on the perspective. When taking an economic perspective and looking at GDP growth, it is obvious that Germany has weathered the crisis better than most of its European peers. While real eurozone GDP has still not reached pre-crisis levels, it took Germany only three years to digest the initially very substantial crisis-induced blow to its economy. However, widening the picture and looking at international peers, we find that Germany's performance in this regard is not particularly outstanding (see graph 1). While Germany did better than aging Japan, the Anglo-Saxon economies posted a substantially better GDP growth performance than Germany. Moreover, Germany – despite its record low in unemployment – only stood some 3 percentage points above its 2008 GDP level in 2013. In addition, cumulative GDP growth in Germany since the turn of the millennium has been only slightly higher than the eurozone average (which of course is slightly more impressive when the catching-up needs of many of Germany's peers are taken into account).

Graph 1



Source: Eurostat.

The sequencing of Germany's somewhat disappointing long-term growth performance is mainly attributable to mediocre growth rates at the beginning of the period. Germany's *relative* success since the crisis has diverted attention from the fact that Germany had experienced a substantial setback at the beginning of the decade, signifying its worst moderation in growth since the Second World War (Koo 2009). Also, when seen in broader perspective, it has to be recalled that (West)German growth had experienced a trend decline averaging only 2½% during the 1970s and 1980s (Bornhorst and Mody 2013) and was not particularly spectacular in the 1990s, either. Consequently, the beginning of the 2000s is slightly more characteristic of Germany's long-term economic development than the most recent past. To some extent, the country's weak growth performance during the first half of the 2000s might be a sign of secular stagnation and thus simply the result of a long-term trend decline in growth. It is not clear whether the brief period of relative success that came after this period really signifies a reversal of this trend or an outlier attributable to particular historical circumstances.

Several factors have contributed to Germany's economic success in recent years; the determinants of these factors were heavily influenced by German reunification in 1990. The unit labour cost shock to former Eastern Germany, triggered by the exchange parity between the Deutsche Mark and the East German Mark, led to partial deindustrialization as well as a hike in unemployment in the eastern region and imposed substantial economic costs on the reunited country. Germany faced major problems, and it was against this background that the much discussed Hartz IV reforms were introduced. However, a number of other European countries initiated similar reforms at the time (Dew-Becker and Gordon 2012), and even the effect of Hartz IV on wage restraint has been called into question recently (Dustmann et al. 2014). In any case, certain institutional peculiarities (see below) allowed Germany to combine its relatively stable labour productivity growth with wage restraint, thus putting a downward pressure on unit labour costs.

The restraint of wage growth and unit labour costs had two effects, both of which fueled current account surpluses to different extents. On the one hand, import growth was suppressed given the mediocre development of internal demand. This effect was intensified by announcements of the effects of supply-side reforms that triggered a hike in precautionary savings and further slowed down the growth of domestic demand (Carlin and Soskice 2009). However, suppressed domestic demand could be partly compensated by export growth which was sustained by increased cost competitiveness that somewhat fueled export demand. However, at least during the early 2000s, this development was even more strongly determined by the growth of global export demand than by changes in Germany's real effective exchange rate (Danninger and Joutz 2007 and see below). Furthermore, especially in the post-Lehman period, Germany's membership in the eurozone protected the country from an excessive currency revaluation that likely would have occurred had Germany still had a national currency (Trautwein and Körner 2014). This effect was accentuated by the fact that while firms in countries on the periphery of the eurozone had to cope with a substantial interest rate increase during the crisis, German firms and firms in other core countries of the eurozone were sheltered from such effects (Neri 2013). On top of that, the federal state profited from Germany's role as a "safe haven" that helped save substantial interest payments on sovereign debt (Baysen-Hogrefe 2012).

As we can see, Germany has pulled through the crisis successfully, although in terms of GDP growth the country does not prove particularly successful when evaluated in a historical perspective or contrasted with the performance of its peers. The most successful aspect of Germany's economic development over the past few years has been its admirable labour market performance, which will be discussed in the next section.

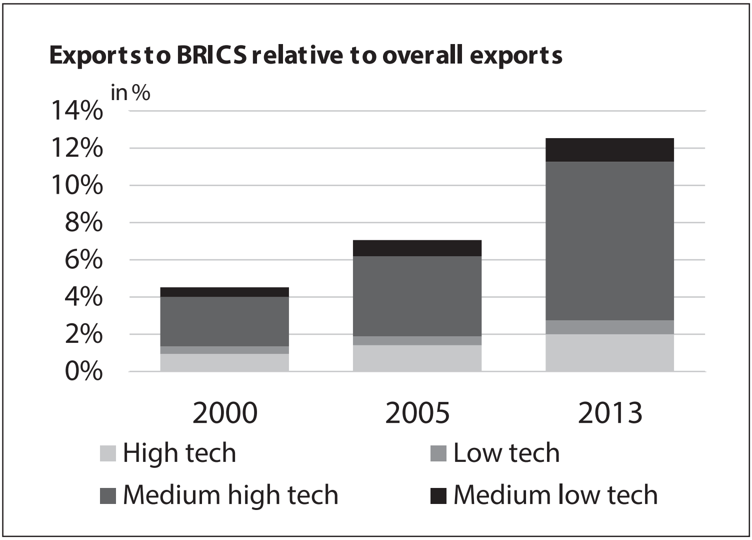
According to you, is there a "German model", and if so which one? And if not, why not?

A "German model" does exist but it has undergone major transformations in recent years, thereby triggering a combination of secular developments. These developments culminated into what might be referred to as a "German episode". During this episode, a number of international developments (such as the growth of the BRICS region) interacted successfully with some leftovers of Germany's institutional heritage, forming an accumulation regime that eased the adjustment that Germany had to make to the challenges of the crisis.

First, as already mentioned, the Hartz IV reforms arguably contributed to overall wage restraint in Germany. Second, while these reforms added a further spin to the erosion of Germany's corporatist system, it is crucial to note that some productivity-enhancing institutional effects deriving from corporatism have still remained effective during the past decade. These effects include, in particular, the inherent flexibility of Germany's industrial relations, where management and works councils tend to cooperate when challenged by extraordinary circumstances. This cooperation enabled Germany to react very flexibly to the massive negative impact of the recent crisis on GDP growth. Jobs were protected by reducing working hours and by introducing “labour hording”; which means that firms accepted a temporary reduction of labour productivity in order to keep qualified workers on the payroll (Herzog-Stein et al. 2010). On top of that, the increase of Germany’s labour force during the crisis was smaller than that observed in other economies (OECD 2012). In any case, the performance in terms of low unemployment was outstanding.

An important factor contributing to the remarkable labour market performance was the fact that the much acclaimed system of vocational training, which had been established as a key pillar of the corporatist system, has continued to be in place. This system allows for the formation of a reliable base of skilled workers; a prerequisite for Germany’s sectoral specialization in the production of industrial and investment goods. It is this qualification structure that has contributed to Germany’s export performance in recent years when demand from the BRICS region provided the most dynamic driving force behind the solid expansion of German exports (see graph 2). Provisional analysis of the new Trade in Value-Added (TiVA) database provided by the OECD[2] underlines this finding. It appears as if value-added in German exports to the BRICS region is higher, on average, than the value-added of exports to other regions. As a result, although other regions are still significantly more important when considered as an aggregate, the healthy growth of the BRIC region has substantially contributed to Germany’s dynamic export growth. Even more importantly, part of Germany's resilience during the crisis seems to have been attributable to the strong growth of the BRICS region, which – after the outbreak of the crisis – was sustained by significant expansionary fiscal packages. In the end, the BRICS region has contributed roughly one-fifth to Germany's export growth since the crisis, with value added figures likely to be even higher. Of course, this regional concentration of German export growth limits the exportability of Germany's success and at the same time puts it on shifting ground. We will address these two aspects below.

Graph 2



Source: OECD.

Can and should the German "success" be exported to other countries?

Germany's success cannot be exported to other countries. It is to be noted that Germany holds a very special place in international value chains and to some extent acts as a crisis transmitter but also as a regional anchor for European economies, in particular also for economies in emerging Europe (Elekdag and Muir 2013). Achieving such a degree of significance is necessarily only feasible for large and open economies. This also applies to the particular role that Germany holds in many value chains. Especially for smaller neighbouring economies, economic success is possible in terms of being more of a complement to Germany than an imitator.

In addition, and even more importantly, the institutional environment that made Germany successful is only present in a very small number of other countries (Brandl and Traxler 2012 and Brandl et al. 2012). A flexible and effective interaction of works councils and employer associations can only be achieved when the coverage of wage bargaining is high, when unionization is also high and when unions are not fragmented. The slow erosion of these core elements might already be endangering the sustainability of Germany's success (see below), and it will be impossible to install a comparable system in places with fragmented unions and low coverage ratios. Furthermore, these institutions are deeply rooted in Germany's ordoliberal tradition (Trautwein and Körner 2014), which limits their exportability. The problems encountered by Germany's Volkswagen AG in trying to introduce German-style works councils in its plant in Tennessee, United States of America (Wright

2014) clearly demonstrate that the exportability of German-style success might also encounter deep ideological and cultural limits that go beyond pure economic rationale.

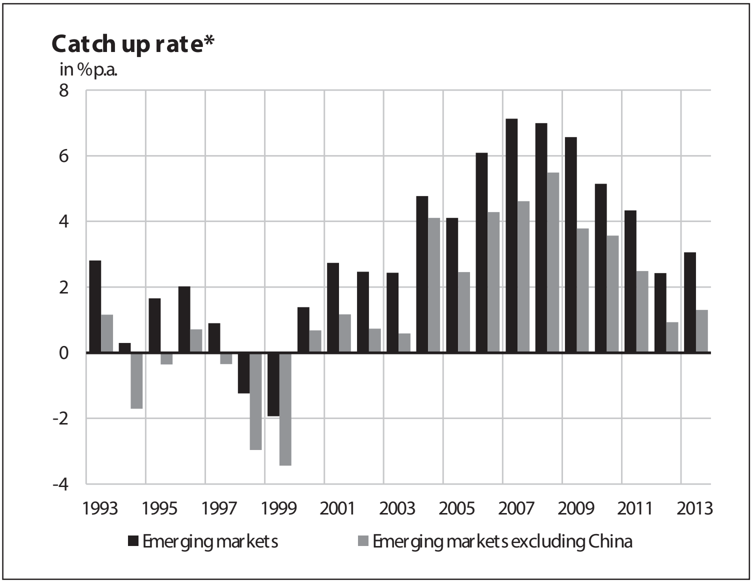
Finally, if German success is measured according to the current account, it is impossible by definition to export it on a higher scale since not all countries can be net exporters at the same time. Persistent current account surpluses are the equivalent of persistent net capital exports. It is likely that old age procurement has contributed to the evolution of Germany's current account (Cooper 2008) as Germany was trying to save abroad in order to accumulate capital reserves for an aging population. However, the demographic outlook is different in other countries, and the accumulation of assets abroad might be counterproductive for other societies. It is not even clear whether Germany really benefited from this strategy. We will discuss this aspect in the next section.

Is Germany's "success" sustainable?

By labelling Germany's success during the crisis as the "German episode" we have already implicitly answered the question of whether Germany's success is attainable for other countries. Germany's success resembles a moment in time very much like a 16th/17th century Flemish still life painting capturing a beautiful moment but at the same time depicting the vanitas, the fugacity of that moment. There are several reasons for this finding.

First, let us start with discussing Germany's current account. Germany's success in expanding its current account was, to a large extent, attributable to private sector savings.

Graph 3

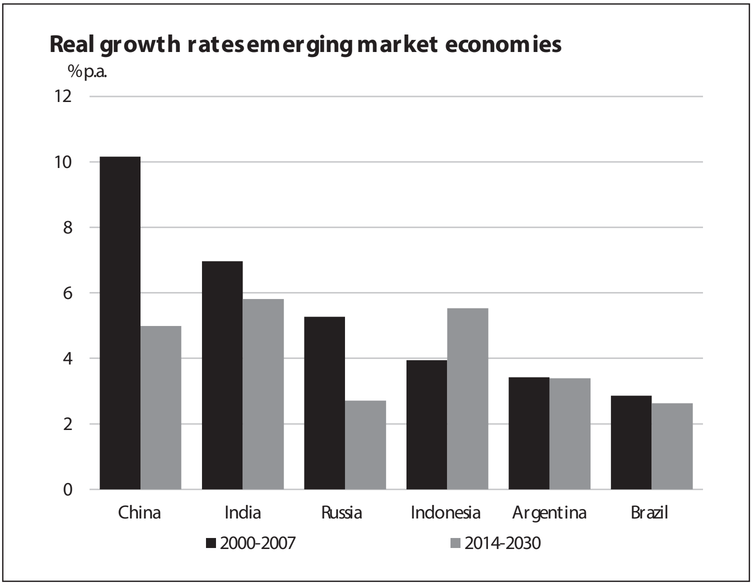


Source: World Bank. *GDP growth per PPP of EM minus GDP growth per U.S. PPP.

However, while these savings also resulted from consumption restraint on the part of domestic households, an important and growing contribution came from the corporate sector, which in the early 2000s had already become a net lender to the rest of the economy and abroad (Guonan and MacCauley 2013). However, positive net savings on the part of firms is equivalent to investment restraint, and in the presence of depreciations of the gross capital stock it thus is likely that Germany financed its success to some extent by the partial consumption, or at least by the substantially restrained growth, of its domestic capital stock. In principle, positive current accounts imply net capital exports, and thus Germany had been accumulating an ever-growing stock of net foreign assets over the previous years. With regard to aggregate national wealth, Germany therefore substituted the domestic accumulation of capital with capital accumulation abroad. This is rational from the angle of an aging society, as capital can be repatriated once the society has grown old. However, as it turned out, Germany suffered major capital losses during the crisis, losing some 600 billion euros of its net foreign assets according to some estimates (Bach et al. 2013), which is equivalent to 22% of its GDP. This means that a substantial part of capital saved through German consumption and investment restraint was ultimately lost. Our first concern, therefore, is of political nature. Hardly any population is likely to accept permanent frugality if the associated savings are lost. If political dissatisfaction leads to the loosening of investment and wage restraint, this might contribute to more sustainable growth that is more strongly directed toward domestic demand and toward the accumulation of domestic capital. However, in situations like this some heads of state tend to lean toward political extremists, and thereby endanger economic stability even further.

Second, Germany's export base is sound and diversified. However, as argued above, much of the dynamics in recent years originated in the catching-up growth experienced by emerging market economies in particular the BRICS. But this development has started to moderate (see graph 3). Especially China, the quantitatively most important country in this respect, is expected to experience a substantial decline in its growth rates (see graph 4). The fact that leverage (and concomitant the needs of deleveraging) has built up particularly strongly in the BRICS since 2008 (Buttiglione et al. 2014) might even accelerate this development over and above current expectations. Furthermore, as the emerging economies are approaching higher levels of income, their growth structure is likely to change. On the one hand, emerging markets might increasingly be able to substitute domestic products for some imported investment goods. On the other hand, growth in these economies might increasingly shift to the service sector. Our second concern is therefore export demand. It is likely that demand for German goods from those markets to which Germany has exported particularly strongly in recent years is about to slow down.

Graph 4



Source: OECD.

Third, the peripheral economies of the eurozone were forced to impose austerity while the private sector of the periphery was deleveraging (De Grauwe 2013). This development had deflationary implications for the affected economies and at the same time stimulus from the core economies was lacking that might have helped to compensate this deflationary impact on the eurozone aggregate. As a result, we now face a major lack of demand that is also starting to endanger Germany's growth.

Finally, it is not yet clear what effect Germany's reforms will have on its remaining corporatist structures in the long run. The dualiziation of the labour market is increasing (OECD 2014), and bargaining coverage has declined significantly, not least because of the higher applicability of opt-out clauses from collective agreements installed by the Hartz IV reforms. This development is structural and signifies a secular trend independent of the affected industry (Antonczyk et al. 2011), which reflects the gradual overall erosion of corporatist structures in the German economy. The current German government came to implicitly acknowledge this dualiziation as a permanent feature of the German labour market when implementing a minimum wage as of 2015 in order to partly compensate for the declining coverage ratio of wage bargaining. However, a high-level of wage bargaining co-ordination in combination with high bargaining coverage have long been regarded as being crucial determinants of the viability of an industry-wide training system such as Germany's vocational training system (Soskice 1990). This holds true, in particular, since only industry-level bargaining can avoid "hold up" situations in which firms invest in employees' skills and employees then push for excessive wages (Hall and Soskice 2001). Our last concern thus regards a core building block of Germany's past success. It cannot be ruled out that an unintended consequence of the erosion of wage bargaining might be the gradual erosion of the industry-wide commitment to vocational training.

What would you recommend Germany to do?

The flipside of Germany's austerity, in recent years, with regard to wage growth, consumption and investment has been substantial capital exports to other economies. It is remarkable that the business sector contributed substantially to economic frugality by becoming a net lender (i.e. by effectively saving) at an increasing pace, starting from 2002 (Guonan and MacCauley 2013). Moreover, Germany abstained from boosting public infrastructure investment – despite low or even negative real refinancing costs. Our first recommendation is therefore to stimulate investment both in the public and private sectors. It is crucial that Germany reinvests some of the proceeds of its success into its own economy. Given the performance of foreign investments in the recent past, it is not unlikely that domestic investment might turn out to be more productive than investment abroad. Of course, this will only be the case if the strengths that made Germany successful are also present in the future. In particular, it will be necessary to closely monitor the ongoing transition of the vocational training system and, in particular, to eventually adapt it to necessities arising out of ongoing structural changes in production (Koske and Wörgötter 2010). As already indicated, the changes brought by labour market reforms might have long-term downside effects on the educational system as regards vocational training activities. Finally, at the current juncture, a hike in wage growth together with expansionary fiscal policies could boost demand and help achieve price stability throughout the eurozone at the same time.

Notes

1. The views expressed here are solely those of the authors and do not necessarily represent the views of the OeNB.
2. Unfortunately the latest data provided by this database is for 2009.

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‘Made in Germany’: What about also its Legal Institutions?

Frans van Waarden

1. Models

The term ‘model’ is used in quite a variety of meanings: as a small version of something (much) larger (‘model of the globe’), or as something attractive, successful, admired, and to be imitated if not copied, thus becoming fashionable. This could be anything from a fashion model and a car model to a prosperous economy, a stable political system, an exemplary welfare state or a new political economy fashion such as neoliberalism.

Pertaining to my own country, the Netherlands, the term ’Dutch model’ has over the last decades become synonymous with what has become known as the ‘polder model’. The term was first coined by the Dutch media shortly after I used the concept of ‘dykes’ in my 1994 Utrecht inaugural lecture as a metaphor for market regulations and similar institutions, such as the then legal cartels and the social partnership – all characterized as consociational and corporatist – at the firm, sector and national levels. While dykes make life and economic activity in the polder possible, safe and prosperous, such market institutions do so for 'life in the market', reducing risks and uncertainties, including commercial and labour conflicts, thus facilitating and stimulating transactions, and so producing stability and growth of earnings, employment and economic prosperity. (van Waarden orig.1995; in English 2013). That 'polder model' has been admired abroad, notably by the Germans, as e.g. exemplified by the prize that its pivotal symbol, the Dutch tripartite Social-Economic Council (SER) got in the 1990s from the German Bertelsmann Foundation.

In addition to this 'Dutch model' there is also a Swedish model (a particular way of handling prostitution, or free university education), a Swiss model (federalism, standing army, international aloofness) and a Danish model (welfare state combining flexibility and security (coined flexicurity (Lykketoft 2009)). Perhaps as many models as there are countries?

2. German Model? What? For whom? Why?

In what meaning do we use the term 'German model'? Among others to denote a successful industrial nation, proud to advertise 'Made in Germany'. That expression usually refers to solid reliable engineering products. But it could also refer to the many other products of the German nation and culture. And indeed, in many fields Germany has stood as a model to be admired and occasionally copied. In the arts, e.g. painting: from medieval Albrecht Dürer via romantic Caspar David Friedrich to modern Joseph Beuys; but especially in literature, philosophy and law, all fields which in one way or another have to do with *words*. In literature from Goethe to Grass, and in philosophy from Hildegard van Bingen and Meister Eckhart to Heidegger, Hegel, Kant, and Marx. After all, Germany was, in the person of Johannes Gutenberg, in 1450 the inventor of typography, a very important means for spreading words. The downside is of course that arts (or broader 'ars,' a concept combining both arts and technologies) in the form of words limit the audience of admirers to those who master that particular language. And it does not make it easy to translate subtleties in other languages to foreigners.

German grammar allows for longer and more complicated sentences, making extensive and complex connections between rather different phenomena, expressed in words, possible. That has also facilitated the gradual development of an ever more detailed and precise legal system, building upon both the heritage of the centuries old Germanic case law (related to similar origins as that of current British common law) and the continental codification movement undertaken by kings and emperors (in order to increase their own power vis-à-vis the that of the nobility and the cities in the process), culminating in the Code Napoleon, which became a model for the Prussian rulers in their attempt to modernize their legal system. That new German legal system was by the way in turn adopted as a *model* and translated and modified by the Japanese in their attempt to modernize their society and economy near the end of the

19th century, and now perhaps again by the Chinese, given their interest in western, and especially German, law (e.g. Zhang Shi Ming 2012)

Different cultures excel not only in different industrial products, in different arts, but also in different cultural values having found their expression often in related societal institutions. 'Made in Germany' could hence also refer to specific economic, political and legal institutions and their societal support in related cultural values. These have been 'made in Germany', and they may have contributed to the production of those 'goods made in Germany' by creating a 'variety of capitalism' that apparently has made the output of those 'solid reliable engineering products' possible in the very first place.

3. Legalism

Befitting the importance of words is a strong importance of, and respect for, the rule of law in Germany. That has created a rather specific and important legal and political institutional framework for the economy. As in most other economic systems, the institutional, political and legal frameworks of the economy are important for its performance. That may exist and be important in many other countries as well, but in Germany they are taken particularly serious. The country has – or rather is – a highly legalistic system. There is quite a detail of legal rules, from constitutional to commercial and labour law. And it has a highly differentiated court system, with various specialized courts, including for corporate and labour relations issues. The availability of many litigation opportunities has stimulated a high frequency of litigation, which has only further increased the legal density by adding case law to codified law. The high litigation rate is nothing new but has a long history, as can be seen from table 1., which compares litigation rates in civil courts to those in other European countries in the years 1970/75 and 1900.

The contrast between the Netherlands and Germany is particularly strikingly large: Two close neighbouring countries, whose histories and economies have been closely intertwined – connected historically through the Rhine and the North and Baltic Seas – yet are quite different – e.g. Germany's economy being historical an industrial one, while the Dutch had and still has a strong base in commercial and trading services. More importantly, their political and legal institutions have been quite different and still are.

The difference in legal cultures can also be seen symbolically from something as trivial as a speeding or parking ticket. The Dutch rule enforcer puts a simple money-transfer-form behind the windshield wipers – or in the case of a speeding ticket a similar form in the mail – with the order to pay with it the fine that one has been given for the transgression of the law. And in the case of a parking ticket it may even be a fee 'for the temporary use of public space', so that is seems merely a transaction under economic rather than criminal law.

By contrast if one commits a similar disobedience of the rules in Germany, one is likely to get successively several thick packages in the mail at home. The first one with a lengthy 'Belehrung' of one's rights as a car-driving-citizen (rather than duties, e.g. decent driving or parking behavior), the road to follow if one wants to appeal the fine, etc. In the case of a speeding ticket it is possible that a photo made from the car is included as 'proof' of the transgression, and if made of the front of the car often with the location of the face of a side passenger blotted out, to protect the driver's privacy rights. Talking about German perfectionism! The request is not yet to pay a fine, but to admit that it was your car and you in the driver-seat. Only after that has been done one gets another thick mail package in which one hears what the fine is, and a 'Belehrung' of more rights, e.g. that and how one can object paying it or how to appeal the decision to impose the fine.

Table 1. National Legal Systems of 12 European countries and the US, ranked by Nr. of Civil Cases in 1970, absolute number, and corrected for population size of the countries

	Nr. of Civil Cases in Courts of First Instance				Nr. of Registered Lawyers 1970		Nr. of Judges 1975	
Country	1970 absolute (approx..)	1970 per 100,000 inhabit.	1900 absolute	1900 per 100,000 inhabit.	absolute	Per 100,000 inhabit.	absolute	Per 100,000 inhabit.
Finland	27,000	586	50,000	1,880				
Netherlands	83,000	637	12,000	235	2,063	16	325	2.39
Spain	280,000	829	170,000	913				
Norway	66,000	1,701	120,000	5,357				
France	1,100,000	2,118	640,000	1,643	25,000	46	3,676	6.98
Italy	1,150,000	2,137	2,400,000	7,279				
Sweden	280,000	3,183	60,000	1,167				
Belgium	310,000	3,219	150,000	2,242				
Denmark	195,000	3,955	38,000	1,551				
England + Wales	2,150,000	4,408	1,260,000	3,873	26,991	49	1,802	3.22
US (1975)	7,600,000	5,212			355,242	175	22,161	10.26
Austria	530,000	7,105	1,700,000	6,513				
Prussia/BRD	5,000,000	8,183	2,100,000	7,500	23,798	36	14,054	22.80

Sources:

Litigation data: Wollschlaeger 1989: 55-81 (based on readings of his graphs); population data, Geohive (http://www.xist.org/earth/census.aspx). US data from National Center for State Courts 'Court Statistics Project' 1975, data of 44 states on appellate and general jurisdiction courts

Legal Functionaries: various Bar Associations, Blankenburg 1997, Blegvad and Wulff. 1989; Second UN Survey of Crime Trends and Operations of Criminal Justice Systems 1975-1980 (http://www.uncjin.org/stats/wcs.html

(these data earlier published in Van Waarden and Hildebrand 2009)

4. Obedience

Germans have also respect for the law – and rules in general, be they public or private – and obey them easier. This can be nicely seen from the behavior on the German Autobahnen where a general speed limit is absent, a holy cow in Germany. This allows the German drivers to accelerate to 200+ km per hour, mindful of the German Autobahn adagio 'Freie Fahrt für Freie Bürger'. However, there are highway sections where there is nevertheless a speed limit. There one sees most German cars slowing down to precisely the allowed speed, while a slower Dutch car, before overtaken by the German 'racers', disregards these local speed limits and now passes all these obedient Germans who he saw just some minutes ago racing past.

Such experiences explain why in the eyes of some of their neighbours the Germans are an overly 'obedient' people, suffering from 'an authority complex'. It may be a bit of a cliché but it is true nevertheless. This difference in respect for rules and authority also affects inter-business and intra-firm labour relations, where workers on the whole obey authorities. This, often to the surprise in other (neighbouring) countries.

The Dutch quality newspaper NRC published an article (issue of 01-07-2006) about the different business cultures in Germany and the Netherlands under the heading 'A Dutchman is surprised that Germans do everything what the boss tells them to do'. It continues by pointing out that:

> Dutch businessmen see their German colleague squeezed in a strict hierarchy. He does not dare to take decisions alone and is perfectly happy if he gets commands. He loves details, his car, and his lawyer.

Even for the smallest difference of opinion legal advice is called in. Germans follow a different approach in negotiations and use a different leadership style. … Dutch businessmen are advised by KPMG-partner Aalberts to do their homework before they go to do business in Germany; “As regards the preparation of negotiations there is no difference between Germans or Chinese”. Aalberts continues: “Germans are tougher, fiercer. Dutchmen seek the compromise and hence behave more moderately. Dutchmen see the compromise as a win-win-situation. Germans are inclined to see the compromise as a loss.”

The German Dietrich Venn, who managed a quarter of a century Dutchmen in the Dutch subsidiary of the German company Alta Pharma : “In a German negotiation delegation one immediately sees who the boss is. In a Dutch delegation that is not immediately clear. Everyone participates in the discussion. Sometimes it becomes only near the end clear who pulls the strings. When the German boss speaks the rest remains in the background. … Germans are Befehlsempfänger. They love clearly demarcated responsibilities and tasks. The German wants before everything else to avoid mistakes. He is a bit timid. Dutchmen dare to take also independently decisions within their sphere of competence. The German does not. In Germany it can happen that the boss afterwards intervenes and corrects agreements of subordinates.”

… The hierarchy on German side contains two important lessons for Dutch negotiators. In Germany the quality of arguments may count, but in the end the hierarchy wins. Therefore, one should always ask oneself: does my interlocutor have the authority to take a specific decision? Venn warns Dutchmen not to exert too much pressure. “Dutchmen should be patient. You should never push negotiations. Otherwise the chance is great that the German loses face or falls down. You should leave him room for consultation.

> The Germans may be too anxious; conversely, in the eyes of the German businessmen their Dutch colleagues may be too direct, informal, badly dressed, and often too late. Still, Dutchmen are popular in Germany. Germans respect the classic Dutch merchant spirit and are charmed by the informal style of the Dutch. Aalberts: "Germans know that the Dutch are more informal. This you can use to your advantage. As a Dutchman you can permit yourself more in negotiations. Nicely loose may, but moderately."

A curious and paradoxical consequence of this difference in cultures of obedience is that German policemen have to use their weapon much less frequently to get respected and obeyed by citizens, including suspected criminals, than in neighbouring Netherlands, where there are as a result more shooting incidents: obedience has to be more frequently enforced with (threats of) violence.

5. Formalization of Social Relations: Hierarchy and Rational-Legal Authority

Hence quite unlike in the US (also a country with traditionally a high litigation rate) is the high German litigiousness related to a relatively strong formalization of social relations in society, especially, as already indicated, hierarchy. In the country of Max Weber does it go together with a great importance of 'rational-legal authority', i.e. social hierarchy on the basis of formal-legal criteria, such as what position one has in the state, or broader, in any organizational or social hierarchy.

In so far as there is any respect for authority at all in neighbour the Netherlands it is based less on 'who you are', nor on 'whom you know' – i.e. (relations to) formal rankings – but more on 'what you know' or 'what you say'. Knowledge and expertise – pragmatic criteria typical for a pragmatic utilitarian culture – can command social respect. A type of authority – 'technocratic-utilitarian' – that Max Weber (1964/1920) apparently overlooked in his famous triple typology of authority – traditional, charismatic, and rational-legal. Perhaps because it was then less present in his German surroundings?

Otherwise, Dutchmen are not so easily given to obey rules easily or per se. Top-down command and control by a hierarchy is likely to meet active or passive resistance. More effective is to organize 'overleg' (consultation). The Dutch appreciate it to be consulted in drawing up the rules and the enforcement means and strategies. This was among others confirmed in the 1989 study of the French sociologist Philippe d'Iribarne, who compared how managers motivated their workers in 3 different factories of the same company (aluminum producer Pechiney) in 3 different countries: in the US managers referred effectively to what workers 'voluntarily' had promised and agreed to do in their individual (detailed) labour *contract*; in France, workers could be motivated by managers appealing to their sense of collective *honor*, while in the Netherlands it was done by organizing 'consultation' sessions aiming for *consensus* with the workers, giving them a feeling of participation in decisionmaking. Too bad that Germany was not included in this comparative study. If it would have been, the motivation means there could very well have been *command*. In this law- and rule-abiding culture hierarchy and obedience might probably dominate over equality and consultation. There is of course a certain pragmatism in this logic: Why have laws and rules if one does not live by them? Doing so is in many ways efficient: strictly enforced rules leave no uncertainty about what the rules in practice are. It makes the rules certain and clear and transparent to everyone, which is also for all efficient. And it is also a form of equality: equal for the law.

Related to the egalitarian and authority-averse Dutch culture is the Dutch preference for collegiate governance. Who were important authorities in the Dutch Republic? Councils, groups of more or less anonymous persons. The difference becomes quite visible if one visits museums. German museums (and for that matter also Austrian, French or Spanish ones) are full with portraits of individual powerful rulers. By contrast in Dutch museums one rarely sees paintings of opulently dressed individual rulers but instead groups of trustees of institutions, like Rembrandt's famous Nightwatch.

6. Bureaucracy

The rule of law, together with some of its consequences, such as formal authority and formal hierarchy, make a specific type of organization: the 'bureaucracy'. This phenomenon, as well as its name are certainly not German inventions nor unique to Germany. But there is something to be said that it has developed there relatively early and probably into its fullest ideal-typical form, starting as the written formalization of a decisionmaking hierarchy. The Germans may not have coined the term 'bureaucracy' – that was done by the Frenchman Vincent de Gournay, who used it, or 'bureaumania’, in the pejorative sense of the word. But the Germans have certainly developed it to its later more elaborated form of organization: a formally hierarchic organization ruled by ‘the rule of the ‘bureau’, i.e.law’ and meant to be an effective and efficient group governing instrument. The importance and respect for rules has certainly facilitated the development of such formal bureaucracies, in public organizations as well as in private, profit as well as non-profit. Its development in reality, after its earlier introduction by Napoleon in the German lands, was observed by Max Weber who subsequently codified the concept.

7. The German State: Strong and Weak: lots of Checks and Balances

The rule of law and respect – if not awe – for it gives the rule-makers obviously a lot of societal and political power. But the ‘rule of law’ is that what it is. And not a ‘rule of people’. Still laws need to be made. Hence befitting the rule of law is not only the creation of formally defined centers of power, but also their subservience to the rule of law. In order to ensure that, also checks and balances have been build up around those positions of power. The rule of law itself is that for most formal organizations, but cannot be that so easily for the lawmakers themselves. Hence over time the German political model has eventually created a rather elaborate system of checks and balances on political power. In the past it started with the beginning of formally negotiated checks and balances between the emperor, the nobility, and the free cities in the *Hoftag*, later *Reichstag*, which was democratized after the First World War. The experiences of Nazi-Germany and the Second World War led to much further separation of powers. First vertical, by the introduction of federalism, i.e. separation and mutual checks and balances between the Bund and rather autonomous Länder. Further very strong horizontal separation of powers: within parliament between the directly elected Bundestag and the Bundesrat composed of the governments of the Länder. The presence of the regional governments here reinforces vertical checks and balances as it gives the Länder direct influence at the national level, which is different from the American Senate, where the senators are less explicitly representatives of their states, at least not of their governments. The German system reinforces the separation and mutual control between the governing parties and opposition as the latter can have a majority in the Bundesrat.

Furthermore Germany has now a very strong system of judicial review, with the German Constitutional Court, the *Bundesverfassungsgerichtshof*, having more formal powers than e.g. the US Supreme Court. Whereas the latter has only powers under concrete judicial review (some concrete case has to be brought to court in order to test the constitutionality of the ruling related to that case), the German Supreme Court has next to the right to concrete also the authority of abstract judicial review, i.e. ruling directly on the constitutionality of a law, without the necessity of a case being brought to the court. Hence a minority in parliament – the opposition to that law – can challenge the legislation for the court.

Then there is a separation of powers between state institutions and civil society organized in a plurality of organizations, which do not only organize and represent different interests but may have also statutory powers to regulate and govern their sector of society as well. One example is the constitutionally guaranteed 'Tarifautonomie', which reserves the right to determine financial working conditions to the representative organizations of employers and employees together, and keeps this outside the realm of government regulation.

This delegation of what elsewhere are public tasks to private organizations has a long history, from the emergence of guilds in medieval cities to the present Handwerkskammern and –innungen or the professional associations for doctors or lawyers (modern day guild-like organizations) and similar others which have the authority to regulate their sector of society. Other private organizations carry out typically public service tasks, authorized by the government, such as the Krankenkassen or organizations as *Caritas* and *Arbeiterwohlfahrt*, who finance or exploit health-care facilities. They do so either as alternative to state institutions, or as partners, cooperating in a division of labour between the public and private sectors.

Finally, the principle of legally required checks and balances on positions of power has also been imposed on corporate Germany, by the Law requiring German corporations to have Works Councils (*Betriebsräte*), which are modelled on a parliament, but now representing workers and controlling the management, just as real parliaments control government on behalf of citizens.

By contrast the Netherlands has a weaker separation of powers. As to the vertical one, the lower levels of government (province, municipality) have less authority. Rather than a federal country it is considered a 'decentralized unitary' state. And the regional governments have no direct formal influence on national government policy. The horizontal division of powers is also weakly developed. The executive power is dependent on the legislative power as in Germany, but unlike in Germany is has no domestic constitutional review. The Dutch constitution even forbids the testing of the constitutionality of legislation. As the British, the Dutch have cultivated the 'supremacy of parliament'. The one similarity to Germany as regards separation of powers which the Dutch have is that between the state and organizations of civil society. Both countries share a corporatist tradition, albeit that the Dutch version has been weakened over the past decades under the influence of neoliberalism.

However, the Dutch have undergone German influence via the EU. It seems likely that the German model may have stood model for some important European institutions, such as the European system of judicial review and the European law on works councils. Hence just as the British, the Dutch have acquired judicial review through European integration, with the primacy of European law and the EU having in that system a strong constitutional court, the *European Court of Justice*.

8. Conclusion

Could there be any relation between these legal-political institutional systems and a country's economic performance? That is a question that has already often been asked and investigated. The answer may depend on which political and legal institutions one focusses on. Thus e.g. studies have been made of the relation between economic performance and different systems of democracy (Lijphart 1999; Schmitter in this volume). Here the authors have claimed to find some relation. However, not many studies have focused on the relation between legal institutions and legal culture on the one hand and economic performance on the other. But one can at least conclude that both highly litigious countries (Germany, Austria and the US) – and low litigious ones (Finland and the Netherlands) perform well economically, with relatively high growth rates, stable financial systems, low unemployment, all over long periods of time. Apparently there are many different roads leading to Rome.

Surprising though. Would not an economy where many commercial and labour conflicts are fought out formally in court between expensive lawyers from both sides imply higher transaction costs for business, higher prices of their products, lower competitiveness and hence less transactions? Or is it that these highly litigious countries are so efficient and prosperous that they can even afford high lawyering costs? Or is it perhaps that the high growth and employment rates are due to a substantial contribution to both national income and employment by a prosperous and growing legal services industry? What could be the end of such a trend? A legal services economy replacing gradually an industrial economy? If the US may be an indicator for such a future: There the legal services industry is already larger than the whole transport industry (planes, trains, cars, bikes, etc.)

That prospect might attract the Asians. The German formal legal system stood already in the late 19th century model for the Japanese. However, Japan has so far been using the formal written rule system derived from that in practice in a rather different way. It is still known for a rather low formal litigation rate, befitting Japan's traditional culture of preference for informal conflict resolution and avoiding loss of face, at least among themselves. China may too. That could explain their interest in the alternative Dutch model, as exemplified by their translation and publication of my article on the alternative Dutch model of low litigiousness and alternative less formal and hence cheaper dispute settlement institutions in among others commercial as well as labour relations (Van Waarden 2009 and 2012).

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Lessons from the German and Dutch Job Miracles

Paul de Beer[1]

Two job miracles

During the 1990s, many German experts visited the Netherlands to unravel the secret of the Dutch miracle. It was a period in which the European economy was struggling to overcome a deep recession and the German economy was stuck in a depression after reunification, but the Dutch economy, and the Dutch labour market in particular, was performing remarkably well. The term "polder model" was introduced to characterize the wonderful Dutch tradition of conferring and consensus seeking amongst the trade unions, the employers and the government, which resulted in typical Dutch "inventions" such as wage moderation, part-time work and a strong reduction of social expenditure without a significant increase of income inequality or poverty. As a consequence, within a period of twenty years, the Netherlands progressed from one of the worst-performing European countries, with respect to unemployment and labour participation, to one of the leading countries. In 1997, the German Bertelsmann Foundation awarded the Dutch Foundation of Labour (*Stichting van de Arbeid*) the Carl Bertelsmann Prize as acknowledgment of the performance of the Dutch model.

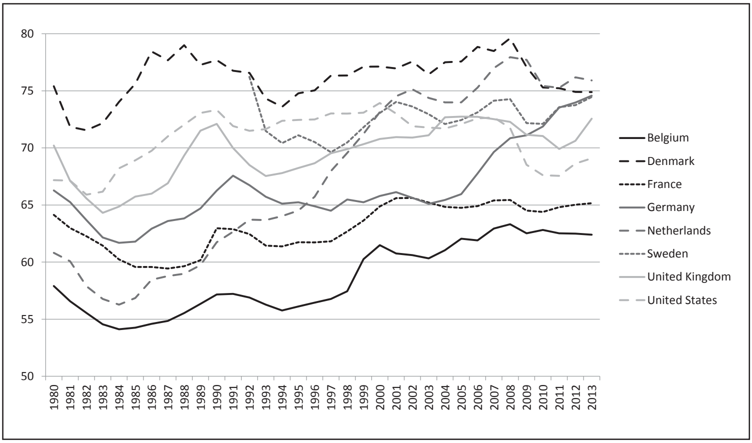
However, since the beginning of this century, the roles have been reversed. The performance of the Netherlands is faltering. Even though the Netherlands is still one of the best-performing EU member states in terms of unemployment and employment rates, no progress has been made in the past ten years. Since 2002 the leadership has been taken over by Germany. Especially during the Great Recession that started with the global credit crunch of 2008, Germany outperformed most other EU countries in terms of employment growth and the reduction of unemployment. Now, many Dutch experts are turning towards Germany to learn from their success.

On closer examination, the Dutch success of the 1990s and the German success of the 2000s share quite a number of similarities. Both success models were based on a combination of wage moderation and a flexibilization of the labour market, both were accompanied by strong export growth, both resulted in strong employment growth but relatively weak or modest productivity growth. Moreover, the success of both countries followed a period in which the countries performed rather poorly. This often-neglected fact already offers part of the explanation for the later success. After all, it is much easier to improve one's score if one has recently performed rather poorly from a historical, long-term perspective than if one's recent scores were excellent.

German and Dutch successes compared

Let us compare the Dutch success model of the 1990s and the German success model of the 2000s in more detail, including the performance of both countries in the preceding decade and, in the case of the Netherlands, also in the following decade.

Figure 1



Source: OECD Statistics

In this article the socio-economic performance of Germany and the Netherlands will be compared with the (unweighted) average of six other countries, including five prosperous north western European countries (i.e. Belgium, Denmark, France, Sweden and the United Kingdom), and the United States. As the main indicator determining whether a country performed better than the other countries, the change of the employment rate is used (i.e. total employment as percentage of the total population of working age, 15-64). Figure 1 shows the evolution of the employment rate of these eight countries from 1980 until 2013. The Dutch employment rate increased strongly from 1984 until 2008. However, since the employment rate of the other countries also increased in the second half of the 1980s, but declined after 1990, 1990 will be taken as the starting point of the Dutch success period in which employment growth significantly exceeded employment growth in the other countries. 2002 is considered to be the final year of the Dutch success, since employment growth stagnated for three years, before catching up again in 2006. From 1990 until 2002, the Dutch employment rate rose from 61.7 to 75.1 percent. The German employment rate started to accelerate in 2003 and continued rising until 2013. Therefore, this period is taken as the German success period, during which the employment rate increased from 65.1 percent to 74.5 percent.

Table 1 compares the performance on a number of socio-economic variables of Germany and the Netherlands with the six aforementioned countries in three periods: 1980-1990, 1990-2002 and 2002-2013.[2]

The upper panel of table 1 confirms that the performance of the Netherlands and Germany regarding the employment rate did stand out compared to the other six countries in the years 1990-2002 and 2002-2013, respectively. Notably, this outstanding performance was exceptional for both countries, since their employment growth in the preceding period lagged behind the average of the other six countries. Thus, their good performance can be partly considered a catch-up effect. Dutch employment growth in the most recent period, 2002-2013, equalled the average growth of the other countries, showing that high employment growth in the Netherlands did not continue after 2002.

Table 1 Performance of Germany and the Netherlands compared with six other countries, 1980-2013 (total change over indicated periods)

	Germany	Netherlands	Average BE, DK, FR, SE, UK, US	DE – other 6	NL – other 6
1. Employment rate (%-points)					
1980-1990	0.0	0.9	1.3	-1.3	-0.4
1990-2002	-0.6	13.4	0.3	-0.9	13.1
2002-2013	8.7	0.4	0.4	8.3	0.0
1980-2013	8.1	14.7	2.0	6.0	12.7
2. Unemployment rate (%-points)					
1980-1990	1.6	1.5	1.0	0.7	0.6
1990-2002	3.8	-5.1	-0.6	4.4	-4.5
2002-2013	-3.3	4.1	1.1	-4.4	3.0
1980-2013	2.1	0.5	1.5	0.6	-1.0
3. Real GDP (%)					
1980-1990	25.9	24.7	27.8	-1.9	-3.1
1990-2002	23.0	39.3	31.9	-8.9	7.4
2002-2013	13.2	10.7	13.8	-0.6	-3.1
1980-2013	75.3	92.3	93.0	-17.6	-0.7

4. GDP per head, constant PPPs (%)					
1980-1990	24.2	18.0	23.7	0.5	-5.7
1990-2002	18.4	29.0	24.3	-5.9	4.7
2002-2013	13.8	6.4	7.2	6.6	-0.8
1980-2013	67.2	61.9	65.0	2.2	-3.1
5. GDP per hour worked (%)					
1980-1990	32.6	18.2	26.7	5.9	-8.5
1990-2002	28.2	15.4	28.1	0.1	-12.7
2002-2013	10.5	8.4	10.1	0.4	-1.7
1980-2013	87.8	47.8	78.6	9.2	-30.8
6. Real labour compensation per unit labour input (%)					
1980-1990	4.5	-5.4	10.8	-6.3	-16.1
1990-2002	15.1	11.5	16.9	-1.8	-5.4
2002-2013	-7.8	0.4	3.1	-10.9	-2.7
1980-2013	11.7	7.2	34.3	-22.7	-27.2
7. Average annual hours actually worked per worker (%)					
1980-1990	-9.9	-6.6	-4.8	-5.1	-1.8
1990-2002	-8.7	-3.0	-4.6	-4.0	1.7
2002-2013	-3.7	-2.0	-1.7	-2.0	-0.2
1980-2013	-17.7	-9.3	-9.1	-8.5	-0.2
8. External balance of goods and services (%-points of GDP)					
1980-1990	4.8	3.9	1.9	2.9	2.0
1990-2002	4.6	2.7	1.4	3.1	1.3
2002-2013	1.6	3.6	-0.2	1.8	3.8
1980-2013	11.0	10.3	3.2	7.8	7.1

Source: OECD Statistics, Eurostat, The Conference Board (GDP per hour worked); calculations by the author

The changes in the unemployment rate largely mirror the changes in the employment rate. In their success periods, the unemployment rate in the Netherlands and in Germany dropped by about 4.5 percentage points compared to the other countries. However, for Germany this decrease just compensated for the large increase in the preceding period. Over the last three decades, the overall change in the unemployment rate of the two countries did not differ much from the average of the other six countries.

Causes of the Dutch and German job miracles

Let us now turn to a number of factors that may explain the varying labour market performance of Germany and the Netherlands over time. An obvious explanatory factor is economic growth. The third panel of table 1 shows that the success period of the Netherlands indeed coincides with a period of relatively strong economic growth, measured by the change of real GDP, while economic growth lagged behind the other countries in the preceding and the consecutive period. However, German economic growth was lower than the economic growth rate of the other countries in all periods considered, even in the last period in which the employment rate rose strongly. Yet, this underperformance of Germany is largely explained by the shrinking population. Indeed, if one calculates the average growth of real GDP per capita, Germany outperformed the other six countries in the years 2002-2013. Over the entire period 1980 until 2013, the growth of real GDP per head in the two countries did not differ much from the average of the other six countries. Thus, in the long run, neither the German economy nor the Dutch economy grew more strongly than that of the six reference countries.

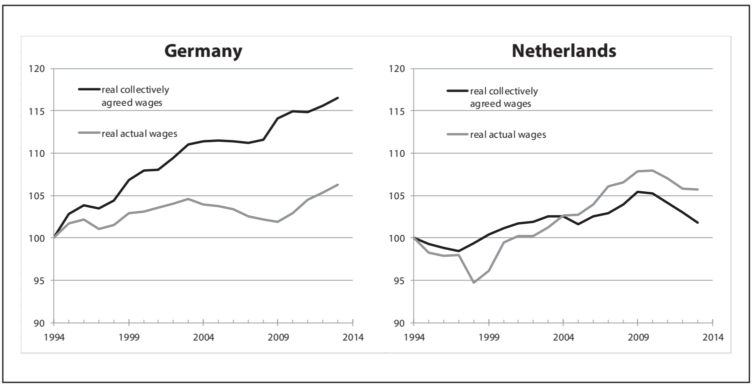
If one takes real GDP growth per head into account, Dutch employment growth in the period 1990-2003 was still remarkably high. This can be explained by the very moderate growth rate of labour productivity (GDP per hour worked) in the Netherlands compared to the other countries, in particular in the period 1990-2002. In this period, Dutch labour productivity grew only half as much as labour productivity in the other countries. Put differently, Dutch economic growth in this period was highly labour intensive. This component is not part of the explanation of the German performance. Since 1990, labour productivity growth in Germany just equalled the average growth in the other countries. As a consequence, a larger real GDP growth per capita in the years 2002-2013 in Germany compared to the Netherlands in the years 1990-2002 resulted in a smaller rise in the employment rate in Germany.

The sluggish productivity growth in the Netherlands is sometimes related to the continuing trend of wage moderation. The famous 1982 Wassenaar Agreement between the social partners is often considered to be the starting point of wage moderation in the Netherlands, although real wage moderation had actually already started three years earlier, in 1979. Indeed, since 1980, real wage increases have been consistently lower in the Netherlands than in the other countries, although the difference was, by far, the largest in the 1980s. Comparing panel 5 and 6 suggests that wage moderation translates into lower productivity growth only after a considerable number of years. This is plausible, since wage moderation will probably reduce investments in new labour-saving technologies only after older vintages of capital equipment are depleted.

Although real wage increases in Germany had lagged behind the other six countries since 1980, the difference was much smaller than in the most recent period. Only since 2002 have German real wages declined. In the event that this will affect investments in Germany in the same way as it did in the Netherlands, it will mean that German labour productivity will probably lag behind the other countries in the coming years.

It is interesting to note that the causes of Dutch wage moderation are different from Germany's, as figure 2 shows. In the Netherlands, wage moderation was the result of an agreement between the social partners on the desirability of labour cost reduction (a key element of the Wassenaar Agreement). As a consequence, real collectively-agreed wages have effectively stagnated for the past 35 years. From 1994 until 2013, real contractual wages increased by only 1.8 percent. Due to a positive wage drift, actual real wages increased a little more, by 5.8 percent. This is almost equal to the real wage increase in Germany from 1994 to 2013, which amounted to 6.2 percent. However, the causes of real wage moderation in Germany were quite different. Real contractual wages increased by almost 17 percent from 1994 to 2013. However, actual pay lagged significantly behind contractual wages. This large negative wage drift can probably be attributed to the declining bargaining coverage in Germany; from 76 percent in 1995 to 61 percent in 2010 (Visser 2014). So an increasing number of German employees are no longer covered by collective agreements and, apparently, their wages lag significantly behind the collectively-agreed wage levels.

Figure 2 Real collectively-agreed wages and real actual-wages in Germany and the Netherlands (index figures; 1994 = 100)



Source: OECD Statistics (actual wages and prices); Bispinck & Schulten (2012) (collectively-agreed wages Germany 1995-2011); Destatis (collectively-agreed wages Germany 2012-13); CBS (collectively-agreed wages Netherlands); calculations by the author

The overestimated role of shorter working hours

The Dutch job miracle of the 1990s is also attributed to the increase of part-time work. Indeed, after 1980, the share of part-time jobs increased more rapidly in the Netherlands than in the other countries. However, to assess the impact on the employment rate, one should also take into account the changes in the working hours of full-time workers. If one assumes, for the sake of the argument, that the total number of hours is fixed, a ten percent reduction of the full-time working week would have the same effect as an increase of the share of halftime workers with twenty percentage points. Therefore, panel 7 in table 1 shows the change of the average number of annual working hours per worker, which includes both the effect of the reduction of the fulltime working week and the increase in the share of part-time workers. In Germany, the annual number of working hours decreased significantly more than in the other countries. However, the largest reduction of working time occurred in the 1980s and the 1990s, when the German employment rate did not increase. In the most recent period, working hours have only reduced slightly more than in the other countries. Consequently, working time reduction cannot explain the good German employment performance since 2002. Apparently it was also not an important ingredient of the Dutch job miracle of the 1990s, despite the strong growth of part-time jobs, since average annual working hours fell even less than in the other countries.

Beggar-thy-neighbour policies?

Finally, it is sometimes suggested that the Dutch success story of the 1990s and the recent success of Germany are, at least partly, based on a beggar-thy-neighbour model. That is, the Netherlands and Germany would have created more jobs by strengthening their international competitiveness through wage moderation. Indeed, since 1980, the external balance of trade in both the Netherlands and Germany has improved compared to the other six countries. However, it is remarkable that this (relative as well as absolute) improvement was the smallest in the years in which both countries performed best in terms of job growth. There is therefore no apparent relationship between the improvement of competitiveness and employment performance and, thus, no evidence that the Dutch and German successes depend on beggar-thy-neighbour policies.

Conclusion

The main conclusion that can be drawn from the preceding analysis is that the Dutch success of the 1990s as well as the German success of the 2000s was an exceptional but relatively short-lived episode. If one takes a longer time perspective, the Netherlands and Germany only outperformed the other six countries concerned with respect to employment growth. Over a period of 33 years, the Dutch and German performance regarding the unemployment rate and economic growth was rather mediocre. Apparently, both countries went through a period of transition from a relatively low employment rate to one of the highest employment rates in the EU. This was mainly achieved by the massive absorption by the labour market of groups with a low participation rate, especially women and the elderly (aged 50 and over). Now that both countries have (almost) completed this transition, there is little room for further expansion.

In both countries the strong employment growth was facilitated by wage moderation. However, the causal relationship probably also runs somewhat in the opposite direction: the strong increase in labour supply exerted a downward pressure on wage development. In the Netherlands, wage moderation was the outcome of very moderate collectively-agreed pay rises, in Germany it resulted from a large negative wage drift in non-unionized industries and companies.

Just as the Dutch miracle ended around the turn of the millennium, the German success will probably not continue much longer. Recently, German economic growth has been faltering. Wage moderation seems to have come to an end, now that wage drift has become positive in the past four years. Moreover, increasing attention is being paid to the weak sides of German success, such as lagging investments (cf. Fratzscher 2014). Capital formation declined from 24 percent of GDP in 1991 to 18 percent in 2009 (source: OECD Statistics). In the longer run this will undermine the growth potential of the German economy.

Thus, there are not many reasons to recommend the German model of the past ten years to other European countries, just as there was no reason to believe that the Dutch "miracle" of the 1990s was a recipe for success. The most positive lesson that one can learn from the experience of both countries is that a country that succeeds in raising its labour participation rate and absorbing the new labour supply in the labour market, can temporarily increase its rate of economic growth. However, inevitably, after some time the increase of labour participation will level off and economic growth will slow down again.

Notes

1. Henri Polak professor of industrial relations at the University of Amsterdam, co-director of the Amsterdam Institute for Advanced Labour Studies, director of De Burcht, Scientific Bureau of the Dutch Trade Union Movement.
2. Since the German employment rate only started to rise in 2003, 2003-2013 might be the preferred period to compare the German with the Dutch success period, but then one calendar year would have to be left out of the comparison.

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Eroding the Made-in-Germany Model: What Germans Could Learn from the Netherlands

Alfred Kleinknecht & Robert H. Kleinknecht

Introduction

The variety of capitalism literature distinguishes two stylized models of capitalism: the *Liberal Market Economy* (LME), with the USA as the main example, and the *Coordinated Market Economy* (CME), such as Germany (Hall & Soskice 2001). The Netherlands is classified as a CME, although it has adopted several LME elements since the 1980s (Sluyterman 2005). For instance, apart from a decrease in the concentration of firm ownership (De Jong et al. 2010) and an increased orientation towards shareholder value (Bezemer 2010), the number of freelancers and employees with flexible contracts has substantially increased over recent decades (Dekker et al. 2012).

Similarly, German labour markets have adopted LME elements through the so-called Hartz Reforms (2002-2005). Such "structural reforms", guided by a supply-side view of economics, usually include cuts on social benefits, easier firing, a lowering of minimum wages and (often implicitly) attempts to reduce trade union power. The German Hartz Reforms have been praised as an important move away from rigid, CME-type labour market institutions towards more flexible, LME-type labour markets. For example, the Konrad Adenauer Foundation (2014) concluded that Germany had moved from being the "sick man of Europe" to the "poster boy of crisis management" (2013: 7).

We argue that supply-side deregulation of labour markets is harmful to innovation. The *Made-in-Germany* model is largely based upon a "creative accumulation" innovation model. More flexible labour relations undermine the accumulation of (tacit) knowledge, which is crucial for the success of such an innovation model. Furthermore, German wage policies after the year 2000 have similarities with the Dutch policies of voluntary wage restraint (*loonmatigin*g) over the past 35 years. The latter turned out to have a substantially negative impact on labour productivity growth.

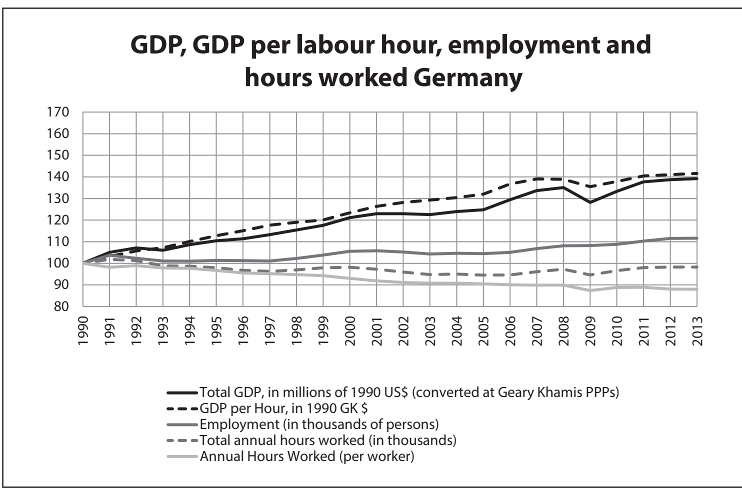
We first present some key variables, comparing German economic performance to the average of the EU-15, but in particular to the performance of The Netherlands. We then discuss arguments that explain why deregulation of labour markets can be harmful to innovation. We conclude that the German Hartz Reforms may have started a gradual erosion of the (still) strong *Made-in-Germany* model. Germans should be aware that imitating Dutch policies is no "free lunch".

Germany after "Hartz": heading for weaker innovation performance?

Over the last 35 years, Dutch trade unions were again and again ready to accept modest wage increases according to the principles of: "jobs are more important than wages" and "creating effective demand through exports".[1] At the same time, there was a substantial rise of poorly paid flexible jobs (Dekker et al. 2012), which supported the policy of voluntary wage restraint. Similarly, Germany showed a strong increase in flexible work after the Hartz Reforms (Schulze-Buschoff 2015), also accompanied by moderate wage claims. For these reasons, it is interesting to look at the long-term consequences of Dutch policy, since they can give an indication of the direction Germany may be heading.

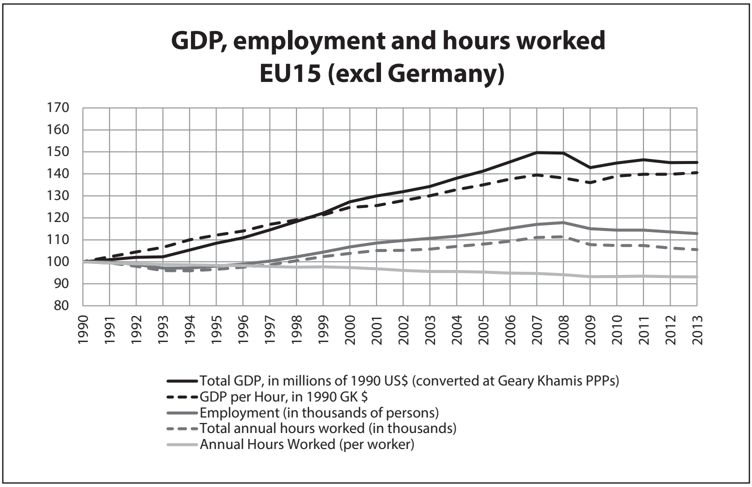
In Figures 1 and 2 we compare Germany to the EU-15 (excluding Germany and The Netherlands). Figure 3 covers the same data for The Netherlands. Figures 1-2 show that, in the long run (1990-2013), Germany deviates little from the EU-15 in terms of GDP growth, labour productivity growth and employment. However, in one aspect Germany and the EU-15 deviate remarkably from The Netherlands: The Netherlands shows substantially lower rates of labour productivity growth, in spite of a higher GDP growth. The latter is remarkable, as the *Verdoorn-Kaldor Law* predicts that higher GDP growth enhances labour productivity growth (McCombie et al. 2002). In spite of this, Dutch labour productivity growth is seen to reach only the value of 125 (1990=100), while German labour productivity grew to about 142 (the EU-15: to 140) on the same index. This is consistent with findings by Vergeer & Kleinknecht (2011, 2014). In analyses of panel data from 19 OECD countries (1960-2004) they found that a one-percent lower wage growth results in ≈0.4 percent lower growth of labour productivity (i.e. GDP per working hour). The rationale behind the mechanism that wages influence labour productivity relates to neo-classical factor substitution, induced innovation, vintage effects and (lack of) Schumpeterian creative destruction (see Vergeer & Kleinknecht 2014 for a detailed discussion).

Figure 1: GDP, GDP per hour worked, employment and hours worked in Germany (1990-2013, index: 1990=100).



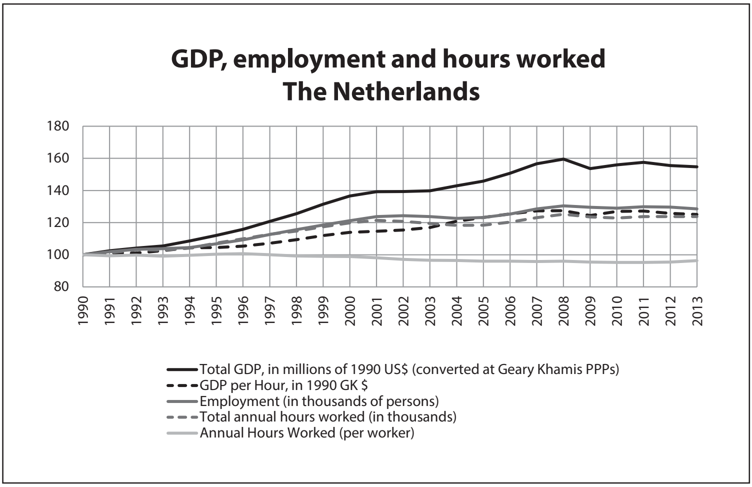
Data source: Groningen Growth and Development Centre (www.ggdc.net).

Figure 2: GDP, GDP per hour worked, employment and hours worked in EU-15 (excl. Germany and The Netherlands, 1990-2013, index: 1990=100).



Data source: Groningen Growth and Development Centre (www.ggdc.net).

Figure 3: GDP, GDP per hour worked, employment and hours worked in The Netherlands (1990-2013, index: 1990=100).



Data source: Groningen Growth and Development Centre (www.ggdc.net).

The upside of low labour productivity growth was that The Netherlands achieved an impressive growth in employment, which can only in part be explained by its higher GDP growth. In the above figures, employment in both the EU-15 and Germany went from 100 in 1990 to a little more than 110 in 2013, while The Netherlands reached the value of almost 130 on the same index. Such a low-productive and labour-intensive growth path implies a lower income growth per working hour. For example, Salverda (2014) reports that real gross income for the group of median income earners in The Netherlands almost stagnated over the period 1977-2012.

Coming back to Figures 1-3, we see that, after the Hartz Reforms (2002-2005), Germany does slightly better than the EU-15 in terms of GDP growth. During the period 2006-13 we see an average GDP growth rate of +1.42% per year, which compares to 0.37% in the EU-15 (excl. Germany). German employment figures also look relatively favorable when compared to the EU-15 (+0.8 in 2006-2013 compared to +0.0% in the rest of the EU-15). The question is, however, whether this is to be (fully) ascribed to the Hartz Reforms. There are at least two alternative interpretations:

First, Germany seems to have done better after the Lehman Crash of 2008 thanks to its system of co-determination (*Mitbestimmung*). From an economic viewpoint, co-determination tends to be opposed, the argument being that employees are "conservative" and this is damaging interests of shareholders who themselves are less risk-averse as they can diversify their risks by spreading their money over many firms (while employees cannot diversify their job risk). Comparing the stock market valuation of firms from 17 European countries (using Tobin's Q), it turned out that, before the Lehman Crash, investors indeed evaluated firms with co-determination significantly lower than comparable firms without co-determination. After the crash, however, this turned into the opposite: firms with co-determination lost relatively less value (Kleinknecht 2014). Obviously, thanks to "conservative" employee representatives on the board, co-determined firms had taken lower risks during the build-up to the financial bubble (resulting in lower ratios of Tobin's Q); as a consequence, they tended to be less troubled after the crash, resulting in relatively more favorable Tobin's Q values. German co-determination seems to protect firms against excessive risk-taking in times of great optimism.

Second, in most countries, the downturn after Lehman resulted in large job losses. German employment figures, however, look quite favorable (Figure 1). This has been ascribed to two German labour market institutions: the system of short-time work (*Kurzarbeit*) and the labour-time accounts. Both were used as a buffer that prevented large-scale firings (Möller 2010; Zapf & Brehmer 2010; Seifert & Herzog-Stein 2010; Zapf & Herzog-Stein 2011). Keeping people employed had favorable effects on effective demand: people suffered lower income losses and had less need for precautionary savings. Moreover, knowledge leakage as a consequence of personnel fluctuation had been prevented which was favorable for innovative market leaders.

These arguments may explain why Germany performed so well after the Lehman Crash. At the same time, however, Germany's moderate wage development (Figure 4) resulted in lower labour productivity growth. It is remarkable that during its "sick man of Europe" period (1991-2001) Germany still realized an average labour productivity growth (i.e. growth of GDP per working hour) of 2.16%. This figure went down to 1.08% in the period 2001-13 (or to 0,90% during the 2006-13 post-Hartz period). This is comparable to the experience in The Netherlands after the start of the long wage moderation period (Van Schaik 1994).

One could argue that German labour productivity growth deviates little from the EU-15 average. Indeed, in other EU countries, we also see a more moderate wage development and attempts to deregulate labour markets, followed by lower labour productivity growth. A dramatic example of this is Italy. After a series of labour market reforms during the 1990s that allowed for a more “flexible” Italian labour market, Italian labour productivity growth dropped virtually to zero during the 2001-13 period (see www.ggdc.net). Such a drop is historically quite unique. Micro-econometric analyses show that those firms in Italy that made most use of the new flexible options had the worst labour productivity performance (Lucidi & Kleinknecht 2010).

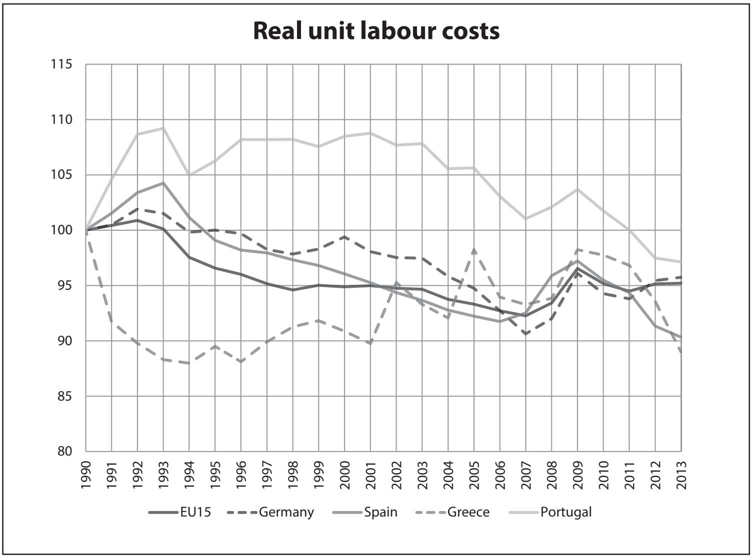
Germans should be aware of an important fallacy of wage moderation: once you have brought down labour productivity growth through low wage cost pressure, only modest wage increases are possible, simply because the room for productivity-oriented wage increases is reduced. So even with moderate wage claims, wage unit costs may easily rise since labour productivity is growing slowly. This explains why The Netherlands in Figure 4 show a wage unit cost development that is not far from the EU average, in spite of quite modest wage increases over many years.

Going Dutch: effective demand through Beggar-thy-neighbour

Figure 4 shows that around the year 2000, there seems to be a break in the development of real wage unit costs in Germany. While some downward pressure can already be seen during the later 1990s, wage unit costs declined persistently between 2000 and 2007. This decline almost perfectly coincides with a change in Germany’s current account. From having an almost balanced current account during the 1990s, Germany jumped to an export surplus of around 5% of its

GDP after the year 2000 (Figure 5). The latter happened well before the Hartz Reforms, and we see no further acceleration of export surpluses after the Reforms.

Figure 4: Real unit labour costs in the EU-15 (1990-2013, index: 1990=100).



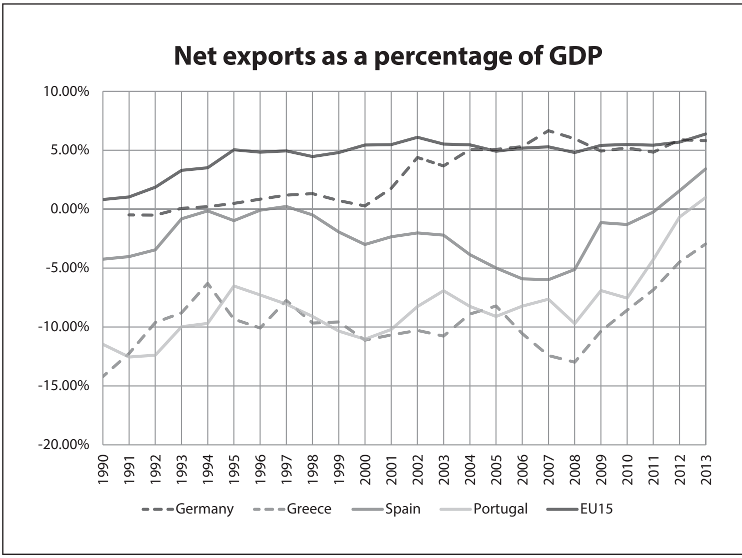
Data source: Annual macro-economic database, European Commission.

While there seems to be an almost perfect match between the decline of real wage unit costs and the rise of the German export surplus, one should be aware that such a one-to-one relationship often does not hold. We see, for example, in Figure 4 that both Spain and Greece had a moderate wage unit cost development, not quite different from Germany. They nonetheless booked high import surpluses (Figure 5). Such counter-intuitive movements of wage costs and exports are known as the Kaldor paradox (Kaldor 1976) and underline the role of non-wage factors for competitiveness (see Carlin et al. 2001).

As to the latter, classical and coherent strengths of the *Made-in-Germany* model should be mentioned, such as the long-term oriented family companies in manufacturing, a very good educational and apprenticeship system, strong links of (applied) research to business and the ease of accumulating (tacit) knowledge due to the long-term commitment of skilled workers to their firms, facilitated by social partnership and co-determination. Of course, these classical competitive strengths of the *Made-in-Germany* model could only be fully exploited once the Euro prevented periodic revaluation of the German Mark, i.e. devaluations of other European currencies.

It should be noted that, until the European sovereign debt crisis, German export surpluses were mirrored by large import surpluses in countries like Spain, Greece and Portugal (Figure 5). Their current account deficits were growing after their accession to the Eurozone when they could no longer devaluate their currencies. As these import surpluses were generously financed by credit from Northern European financial institutions, it opened the way into the financial crisis that threatened the Euro currency. So far, the German (and Dutch) "beggar-thy-neighbour" policy was (and still is) a threat to the coherence of the Eurozone.

Figure 5: Net exports of goods and services as a percentage of GDP, EU-15 (1990-2013).



Data source: Annual macro-economic database, European Commission.

How can the Hartz Reforms undermine the Made-in-Germany model?

Above we saw that after the year 2000, German wage unit costs declined, and so did German labour productivity growth. This was well ahead of the Hartz Reforms. Nonetheless, there are reasons to believe that the Hartz Reforms still added to this process as they reduced insider protection, but also allowed for the growth of outsider jobs (Schulze-Buschoff 2015; Tangian

2011). Several firm-level studies show the negative impact on innovation and on labour productivity growth of flexible work practices.[2] The reasons why labour market flexibility negatively impacts on innovation and labour productivity growth can be summarized as follows:

First, as far as the Hartz Reforms lead to shorter average job durations, firm-sponsored training becomes less rewarding. In addition, workers will first of all be interested in acquiring *general* skills that increase their employability on the external job market, but may be reluctant to acquire firm-specific skills if there is no long-term commitment to their employers (Belot et al. 2002). Second, as far as the Hartz Reforms contribute to a more unequal income distribution, this will reduce the "compression" of the wage structure (both within and between firms); this is relevant as Acemoglu & Pischke (1999) and Agell (1999) argue that wage compression is a reason for the provision of training by firms.

A third group of arguments relates to the role of social capital. Long-lasting working relations and fair protection against dismissal can be interpreted as an investment in trust, loyalty and commitment to workers. Svensson (2011) showed convincingly that flexible work practices reduce trust. In so far as the Hartz Reforms lead to more short-term and flexible jobs and lower insider protection, they come down to a divestment in social capital. Lack of trust increases transaction costs. Naastepad & Storm (2006: 170-191) show that firms in "flexible" Anglo-Saxon countries have much denser management bureaucracies for monitoring and control, compared to "Rhineland" countries.

Lack of loyalty on the part of workers also increases positive externalities, i.e. the leaking of technological knowledge and trade secrets to competitors, which reduces monopoly rents from innovation (thus reducing the incentive for risk-taking with innovative investments). From empirical research we know that personnel turnover is an important source of knowledge leakage. For example, drawing from *Community Innovation Survey* data, Brouwer & Kleinknecht (1999) report that innovative firms in The Netherlands judge "keeping qualified personnel in the firm" to be a crucial defense against imitators, being, on average, even more important than patent protection. This underlines the importance of "tacit" knowledge from practical experience that tends to be poorly documented (Polanyi 1966). Tacit knowledge is owned by workers rather than by their firms. The Hartz Reforms made firing easier, which is likely to increase job turnover rates amongst those employees who are carriers of crucial knowledge. Lower job security also reduces critical feedback from the shop floor for management. Powerful managers like to surround themselves with people who do not contradict them. If this is enhanced by a change of power relations due to easier firing, it can favor autocratic management practices.

Furthermore, people who are easy to fire have motives for hiding information about how their work can be done more efficiently. This means that under a flexible *hire & fire* regime, management is likely to make poor use of knowledge from the shop floor about how to organize work processes more efficiently. In this context, Lorenz (1999) offered an interesting hypothesis: protection against dismissal may enhance productivity performance, as secure workers will be more willing to cooperate with management in developing labour-saving processes and in disclosing their (tacit) knowledge to the firm (see Lorenz 1999). Acharya et al. (2010) provide empirical support for a similar argument: stringent labour laws provide firms with a "commitment device" to not punish short-term failures and this will encourage employees to pursue more risky and value-enhancing innovative activities.[3]

Finally, protection against firing and long job durations favor the long-term historical accumulation of (tacit) knowledge in a "creative accumulation" (or Schumpeter II) innovation model. The argument about "creative accumulation" (versus "garage business" or "creative destruction") innovation regimes is summarized in Table 1, which is inspired by the work of Breschi et al. (2000). Table 1 makes it clear that continuous accumulation of (tacit) knowledge in a "creative accumulation" innovation regime is favored by *continuity* in labour relations. In other words, a "creative accumulation" innovation regime gives incentives for the reallocation of work within internal labour markets through *functional* flexibility rather than via external labour markets through *numerical* flexibility. The historically *cumulative* nature of knowledge produces path dependencies, which give incentives to firms for employing protected insiders with long job tenures. Obviously, the strength of *Made-in-Germany* crucially depends on mastering the Schumpeter II model. The Hartz Reforms are not just labour market reforms; they also have an impact on an innovation model that has been crucial to the success of *Made-in-German* over many years.

Table 1: Stylized comparison of two Schumpeterian innovation models

Schumpeter I model: “creative destruction” or “garage business innovation”	**Schumpeter II model: ”creative accumulation” or “routinized innovation”**
Starters in high tech; niche players	Established firms with professionalized R&D labs
SMEs and young firms	Monopolistic competitors; oligopolists
High entry and exit rates	Stable hierarchy of (dominant) innovators
Properties of the knowledge base …	
Generally available knowledge → low entry barriers	Dependence on historically accumulated and often firm-specific (tacit) knowledge → high entry barriers
… and complementary labour market institutions:	
Recruitment through external labour markets	Internal labour markets through dependence on accumulated (firm-specific, tacit) knowledge → well-protected ‘insiders’

It should be added that two recent firm-level studies show that the employment of large numbers of flexible workers significantly reduces both labour productivity growth (Vergeer et al. 2014) and the probability of realizing innovations (Kleinknecht et al. 2014) in sectors that tend towards a Schumpeter II innovation model. In sectors that tend more towards the garage business model, flexibility variables are insignificant in both studies. This can explain why the USA, in spite of a *hire & fire* labour market, were quite successful with IT in the garage business phase in Silicon Valley, while, in the post-Reagan era, they failed when competing in classical Schumpeter II industries. The fact that Detroit (rather than Wolfsburg) is today a dying city has a lot to do with the American inability to master the “creative accumulation” innovation model.

Discussion and policy conclusions

High unemployment forced German trade unions to accept low wage increases, especially after the year 2000. It appears as if this had a similar effect to that which happened since the 1980s in The Netherlands: labour productivity growth went down. One of us launched in 1994 a criticism of the Dutch wage moderation strategy, hypothesizing that it had a negative impact on innovation and labour productivity growth (Kleinknecht 1994). At the time, there was a national consensus about the merits of wage moderation, as The Netherlands had achieved impressive employment growth and, naturally, trade unions were extremely happy with this. The Kleinknecht hypothesis unleashed fierce reactions in the media as well as in the national economic literature (see e.g. Jansen 2004). In the meantime Vergeer & Kleinknecht (2011, 2014) have demonstrated that the hypothesis holds: on average, in 19 OECD countries (1960-2004), a one percent change in wages causes ≈0.4 percent change in labour productivity growth. This can explain why German labour productivity growth declined following the relative decline of German wage unit costs between 2000 and 2007 (Figure 4).

Given fierce reactions to "Kleinknecht's Law" (Wouter Bos 2004) Vergeer & Kleinknecht (2011, 2014) have undertaken numerous efforts to check the robustness of their results. In the many versions of their model estimates, coefficients range between 0.32 and 0.49, with the most plausible versions being close to 0.40. For a good evaluation of the effects of downward wage flexibility, economists should include a coefficient of 0.4 into their models. Besides

Keynesian demand effects in favor of wage increases and neo-classical cost effects (against), wage growth also has a significant impact on labour productivity growth.

Advocates of structural reforms of labour markets have one strong point: from the perspective of the *Walrasian General Equilibrium Theory,* flexible *hire & fire* in the labour market enhances (static) allocative efficiency! In this view, every obstacle to the "free" working of markets causes welfare losses. A weak point of this argument is that Walrasians have no theory of "creative accumulation" innovation regimes. Moreover, they assume as an ideal the concept of perfect competition, considering market imperfections to be an undesirable exception. In the field of innovation, however, market imperfections are not the exception but the rule. One could even define innovation itself as an attempt at creating an imperfect market: if an entrepreneur introduces a unique product that others have difficulty imitating, the entrepreneur has a source of monopoly profit. Unique knowledge acts as a market entry barrier; and the higher the entry barrier, the higher the monopoly profits and hence the entrepreneur's incentive to invest in R&D.

The most important source of market failure is knowledge as a public good. Intellectual property rights are hard to protect – and weak property rights result in market failure. In addition, various sorts of information asymmetries and lock-in (e.g. due to the sunk costs character of innovative investments) can increase uncertainty and can leave innovative efforts far below the social optimum. Strong technical and commercial uncertainties lead to high failure rates; in order to make firms nonetheless ready to invest in R&D, they need to make high monopoly profits on those projects that succeed. And this is incompatible with the idea that "more competition", would enhance innovation. Giving simply more room to "free" markets is likely to result in stronger market failure with respect to bringing forth innovation. Summarizing, there is a significant trade-off between Walrasian static efficiency: *"how can we allocate scarce resources efficiently?"* and Schumpeterian dynamic efficiency: "*how can we make resources less scarce through innovation?*".

Applying this to the logic of Schumpeter's (1943) "creative accumulation" innovation model, we argue that labour market rigidities can be useful since longer job durations create trust and loyalty. This makes the long-term accumulation of (tacit) knowledge easier; it allows the knowledge from the shop floor to be used for the implementation of efficiency-enhancing investments; it helps against knowledge leakage and economizes on transaction costs for monitoring and control. Deregulation of labour markets such as the Hartz Reforms takes away labour market rigidities that are "bad" from a Walrasian viewpoint but useful for innovation.

The above may shed some light on the observation that, in spite of a highly flexible labour market, the USA were successful during the garage business phase of IT in the 1980s and 1990s. Our reasoning might, however, also explain why, after the Reagan era, many classical industries in the USA had hard times competing against Japanese and German suppliers. Obviously, as the new giants in Silicon Valley are gradually shifting towards the "creative accumulation" model, the liberal US *hire & fire* labour market is no longer a good institutional environment for them. The CME type labour market of Germany *before* 'Hartz' would now be a better place for them.

Notes

1. Officially, Dutch wage moderation is said to have started with the 'Contract of Wassenaar' in 1982. A look at the statistics (e.g. www.ggdc.net), however, suggests that already in the late 1970s, Dutch trade unions had negotiated increasingly modest wage agreements that remained well below labour productivity growth rates. The decline in Dutch labour productivity growth started around 1980.
2. Sànchez & Toharia (2000); Michie & Sheehan (2001, 2003); Kleinknecht et al. (2006); Lucidi & Kleinknecht (2010).
3. Exploiting time-series variation in changes of dismissal laws, they find that "innovation and growth are fostered by stringent laws governing dismissal of employees, especially in the more innovation-intensive sectors. Firm-level tests within the United States that exploit a discontinuity generated by the passage of the federal *Worker Adjustment and Retraining Notification Act* confirm the cross-country evidence." (2010: 1).

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Complementarity and Labour Market Institutions

Daan van der Linde

While Dutch public opinion, press and academia have generally favorably judged the German Hartz labour market reforms and called for similar reforms in Dutch labour market institutions, in this article it is argued that the *overall* effect of copying single elements from any model—be it German, Danish or Anglo-Saxon—may be detrimental, and reform should be implemented cautiously and slowly. While theory predicts that pressures of globalization and European integration will bring countries to develop similar structures, processes, and performance (Kerr 1983), recent reform in the Netherlands (labour market, healthcare, housing market and expected reform of the tax system) may better be understood as a set of oscillating policies responding to issues with oscillating urgency.

I interpret the "German model" as a model of labour market institutions, and by applying the notion of complementarity of institutions argue seemingly narrow reform on the labour market may have far-reaching implications throughout other spheres of the economy at different points in time. This challenges the ability of policymakers to play "institutional LEGO" (Amable and Petit 2001), picking and mixing labour market reforms to reach economic objectives. I conclude by arguing against the literature that claims complementarity gives rise to a self-reinforcing and stabilizing mechanism. Only by taking a wider perspective on reform can we tame the recent Dutch reform enthusiasm.

Complementarity and a "German model" of labour market institutions

While for some time economic woes were addressed by macroeconomists, the big issues in economic policy have become labour market issues. Freeman (1998) argues the "war of the models" is nowadays fought over labour market institutions. This reading seems in line with the "German success story", often presented in terms of its labour market institutions. Dutch economists, the press and public opinion have generally favorably judged German labour market reform which, by the stagnation of wages combined with (and following from) a trimmed social security system, caused Germany's export industry to flourish while reducing persistently high levels of unemployment (e.g. Eichhorst et al., 2010). Newspaper headlines and commentaries include "Germany is our great example" (Jürgens 2013) and "Frau Merkel, hilfe!" (Borst 2013) [1].

Dutch economists Bovenberg and Gradus (2013) and Eijffinger (Couzy 2012) argue that the German example shows how labour market reform during the crisis can pay for itself—while Dutch reform lags behind. Eijffinger compares economic growth in Germany and the Netherlands in 2012, claiming the difference could be explained by the fact that the Dutch failed to reform as the Germans did.

In many respects causally inferring the impact of such institutional reform is risky. Lacking a counterfactual, one may shed doubt on directly attributing an outcome to any reform. In the public debate counterfactual cases are often selected not on the basis of their similar features, but on the basis of differing outcomes—see this logic applied above by Eijffinger. Can we really explain lagging economic growth in the Netherlands or France due to the fact that their own "German" reform was absent? A more fruitful avenue seems selecting counterfactual cases not based on different outcomes, but based on similarities in all respects but the reform. This however introduces a methodological question: which similarities should one take into account?

Freeman (1998) claims this latter problem to be especially important. While differences in domains which are unaccounted for in a cross-country comparison may bias findings that link a reform to a specific outcome, a more fundamental issue is the fact that a similar institution in one country may function entirely differently across another, given differences in the overall institutional structure (or "model," if you will). Beyond the singular reform, it may indeed, to a large extent, be due to the *interactions* of institutions that produce certain outcomes. This clearly problematizes outright the copying of institutions or reforms across countries, decreasing the scope for what Amable and Petit (2001) call policymakers playing "institutional LEGO."

Hall and Soskice (2001, henceforth HS), following earlier work by Aoki (1994), articulate the idea of interactions between institutions in their Varieties of Capitalism (VoC) approach. In their terminology, *institutional complementarities* refer to institutions where "the presence (or efficiency) of one increases the returns from (or efficiency of) the other" (17). As complementarities may link different domains of the economy, HS predict clustering along dimensions within countries: The financial system or the type of industrial relations within a country is not a random draw from a range of alternative ways of organizing them, but the result of intricate linkages. Germany's system of co-ordinated wage bargaining is coupled to a system of corporate governance that allows long-term and patient financing, while American financial markets have a strong focus on short-term gains and shareholder value coupled with a largely deregulated and flexible labour market.

The Dutch market for mortgages serves as a useful illustration for this notion of complementarity. Mortgages at and over the home value at time of purchase are provided without down payment in the Netherlands, yet in order to decrease the risk of default the lender usually requires permanent employment contracts. Combined with unemployment insurance, such labour market institutions as permanent contracts thus are clearly complementary to (mobility in) the housing market. If this relationship is proven complementary, the introduction or increased use of fixed-term or zero-hour contracts in the Netherlands or the growing number of self-employed (zzp) may thus (unintentionally) transform other domains of the economy.

The *aggregate* effect of such labour market reforms is thus the sum of any direct effect (e.g. labour market flexibility) and the interaction between the new and existing institutions (e.g. the housing market). As these effects may crystallize out at different points in time, estimating an aggregate effect is troublesome. Depending on the relative strength of both components, outcomes may cancel each other out and give rise to new reform in other domains. This temporal issue forms an explanation for the oscillating nature of reform. "Fixing" the labour market today may require "fixing" the housing market tomorrow.

Complementarity and stability

Does a theory of complementarity allow for this type of oscillating transformation? While in agreement that *external* shock such as the financial crisis may disrupt an institutional equilibrium, HS pose an auxiliary hypothesis regarding the *internal* dynamics of transformation and claim complementarity has a stabilizing effect on the institutional order. As the theory of VoC is a firm-centric, it predicts firms may pressure governments to aid in the development of complementary institutions or the scope of existing institutional arrangements may broaden to other spheres. Within this framework reform is thus unlikely to be independent from the functionality of institutions (conditioned by its complementarity) (Höpner 2005). This dynamic can be expected to function as a stabilizing mechanism, reinforcing existing institutional arrangements[2].

With a similar reasoning, any policy proposal that may lead to institutions to stray away from their equilibrium is expected to be thwarted by firms which may be able to resist change in existing complementary institutions. HS (2001) underwrite this, suggesting "institutional complementarities generate disincentives to radical change. Firms and other actors may attempt to preserve arrangements in one sphere of the economy in order to protect complementary institutions or synergies with institutions elsewhere that are of value to them (64)."

The latest reform of the Dutch labour market in some respects seems to strengthen labour market protection and arguably reinforces the institutional equilibrium. The reform seeks to prevent further dualization of the labour market by decreasing the scope for employers to repeatedly rehire workers on temporary contracts, yet at the same time labour market protection is weakened by reducing the duration of unemployment insurance, easing regulation regarding the termination of contracts and lowering severance pay.

The wording of the reform package sheds little doubt on whether the reform constitutes reinforcement or a drift from an institutional equilibrium: The cabinet "strives for a new balance between flexibility and security on the labour market (…)" (Wet werk en zekerheid 2014 – The Work and Security Act). Only by considering the wider implications of reform by taking into account its direct and interaction effects may we be able to tame Dutch reform enthusiasm. It is exactly here we can and should learn from the experience of other countries or "models."

Notes

1. More recently however some have concluded less cheerfully about the German "success story" (Haegens 2012; Kretschmar 2013).
2. Contrary to the conventional view suggesting globalization will inevitably lead to liberalization, deregulation and convergence in economies throughout the world, VoC therefore predicts co-ordinated market economies (CME) such as Germany and the Netherlands will withstand this type of convergence in their economic institutions, able to exploit their comparative institutional advantage.

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Can and Should the German Model be Exported to Other Countries? An Institutional Perspective

Angela Garcia Calvo

Introduction

More than a decade ago, globalization became a driving force that reshaped production structures and changed business models around the world. Although globalization was once considered by many an unstoppable and positive process, the severe economic downturn that started in 2007 has forced advanced western economies to re-examine their economic models and to look for strategies that will ensure their sustainability. Germany's economic performance, its innovation capacity and its influence in EU debates means that the German model has featured strongly in academic and public policy debates. But is the German model exportable? And is exportability desirable? This article starts by describing the German model and framing the terms of the debate; the exportability of the model is then discussed before concluding with a recommendation.

The German model and the debate around it

Economic performance cannot be explained as a product of a ready-made recipe. Nonetheless, when academics and policy-makers discuss the German model they generally refer to a particular set of mutually reinforcing macro and microeconomic features. From a macroeconomic viewpoint, the German model involves a preference for current account surpluses, low inflation, well-balanced fiscal accounts, low levels of public debt relative to GDP, and a generous welfare state. From a microeconomic perspective, the basic features of the German model are a strong system of higher education and vocational training, consensual labour agreements, local banks with specialized business knowledge, and a dense and high-quality network of institutions devoted to industrial innovation. The macroeconomic elements of the model deliver the type of socioeconomic stability that provides a sound basis for economic activity. The microeconomic features support a strong manufacturing sector characterized by the presence of numerous medium-sized firms, a preference for business strategies focused on high-quality production, and a thriving innovation system that underpins the sustainability of the model.

Germany's economy has performed strongly since the 2000s and it suffered the effects of the 2007 crisis less than other western economies. In addition, the strength of

Germany's manufacturing sector and its capacity to generate innovation stands out in the midst of a generalized decline in manufacturing capacity among most advanced industrialized nations. Furthermore, Germany plays a pivotal role in Europe's landscape, and in funding critical bailouts for crisis-hit peripheral European countries. These circumstances have situated the German model at the center of scholarly and policy debates regarding the sustainability of different types of capitalism. Debate appears to have been more intense in countries which have lost a significant portion of their manufacturing capacity in recent decades such as the United States and Europe's southern peripheral countries affected by the crisis.

The German model has been analyzed as part of discussions about the decline of manufacturing capacity in the United States and America's ability to generate future innovation. Berger (2013) uses the German model to illustrate the idea of a sustainable industrial ecosystem in which medium-sized manufacturing firms can generate innovation and capitalize on it thanks to their access to a full range of public goods. Berger points to Germany's case to contend that the decline of manufacturing in advanced nations is neither natural nor inevitable. Instead, she contends that manufacturing decline is a consequence of the existence of gaps in the industrial ecosystem. Her research identifies the scaling up of innovation and commercialization as the two biggest obstacles for US manufacturing firms. She relies on a comparative analysis of the United States and Germany to contend that success in these two stages depends on the ability of firms to: (a) take part in close and continuous interactions among researchers, producers and clients, and (b) access a full range of external capabilities—especially qualified labour, flexible labour agreements, long-term capital, and research facilities—. Close interactions among researchers, producers and clients take place when research and manufacturing takes place in close proximity, as it happens in Germany, whereas the provision of external capabilities exceed the resources of individual firms, and require extensive coordination.

Breznitz (2014) also compares the US and German models in relation to innovation but attributes Germany's advantage to a difference in attitudes and preferences rather than the particular features of the model. He questions the conventional division between radical and incremental innovation and contends that Germany is as good as the United States at producing radical innovation. However, he points out that Germany innovates across sectors to generate widespread productivity gains rather than concentrate innovation solely in high-tech sectors. In addition, Germany's innovation, unlike the US' does not necessarily aim to reduce or eliminate the need for workers. According to this argument, the German model approach is superior to that of the United States in terms of adapting innovation for widespread industrial use and it explains the resilience of Germany's manufacturing sector. The German approach to innovation also generates a virtuous circle in which higher productivity generates employment growth and income expansion, ensuring the sustainability of the model.

References to the German model also take center-stage in discussions regarding the transformation of peripheral European economies severely affected by the economic crisis. There are two lines of discussion in this debate. The first revolves around the application of the macroeconomic features of the German model to crisis-hit countries. The second discusses the exportability of the German model's microeconomic features. Tackling the first discussion, Bronk and Jacoby (2013) contend that Germany's outperformance in the eurozone and its pivotal role in funding bailout programs have given Germany's current government a disproportionate role in shaping bailout conditionality mechanisms such as fiscal balance. They recognize that Germany's intention in supporting these mechanisms is to prevent some countries from free-riding on the fiscal prudence of their neighbours. However, these authors point out that fiscal balance represents a particular view on how fiscal policy works, which in turn shapes the interpretation of facts. Bronk and Jacoby also contend that in a context of high uncertainty and rapid change, the widespread application of what they call "the German consensus" will limit regulatory innovation across the EU, which will reduce Europe's ability to respond to unexpected shocks. They also point out that the macroeconomic features of the German model, in particular fiscal balance, may not be the most effective measure in all contexts. Wolf (2013) emphasizes this last point and argues that the imposition of fiscal austerity to crisis-hit European countries will likely prolong their stagnation, increase the risk of deflation in the eurozone, and contract the world economy. Despite these potential effects, Argandoña (2012), contends that peripheral economies will likely need to become more similar to the German model if they want to remain in the eurozone.

The second discussion debates the exportability of the German model's microeconomic features to crisis-hit, peripheral European countries. The discussion appears to have been especially intense in Spain. For instance, Fernández-Villaverde and Garicano (2009) discuss the convenience of borrowing the '*Kurzarbeit*'(short-time work) program to help diminish unemployment. However, these authors conclude that the program would not be suitable for the Spanish context because it is designed to manage a temporary demand shock whereas Spain's situation has a structural component. Fernández-Villaverde and Garicano also contend that implementation would likely be complex and costs high. Chislett (2014) points out that although Spanish policies to stimulate exports and contain labour costs since 2012 aim to bring Spain closer to the German model, Spain is far from achieving this goal because there remain large differences in dimensions such as the share of manufacturing in GDP, the number and degree of obstacles to open a new business, worker qualification, and limited investment in research and development.

Can and should the German model be exported?

A long-established practice is the examination of other countries; looking up to the considered leaders in a particular field, and examining their structures in search of best practices, frameworks or guides to apply at home[1]. However, there are positive and negative aspects to consider before taking the decision to transplant a particular economic model.

Berger and Breznitz highlight the strengths of the German model; especially its ability to generate innovation across the board and to support a flourishing manufacturing sector. The combination of these two features is essential for the sustainability of an economic model. Innovation fuels productivity increases, which in turn fuels growth. From Berger's work, it also follows that a country's capacity for innovation will likely decline if that country lacks a strong manufacturing sector because researchers will lack the necessary interactions with suppliers and clients.

The virtuous connection between innovation, manufacturing capacity, and economic sustainability makes the German model attractive from the perspective of leading innovative economies that have moved abroad a significant portion of their manufacturing capacity. This is the case in the United States, where questions regarding the long-term sustainability of their innovation model loom large. The connection between manufacturing capacity and innovation also makes the German model appealing in European peripheral countries that have seen their manufacturing sectors shrink due to their inability to innovate. This is the case in Spain, where the link between strengthening manufacturing capacity, innovation, and economic growth has been the main motivation behind industrial policy programs in the past decade (Trullén 2006, Soria 2013).

Despite its appeal, from an institutional viewpoint it is not clear that the German model can be transplanted to a different country, and even if it can, it is uncertain that it would generate comparable economic results in the recipient country.

According to the institutional point of view inspired by the varieties of capitalism framework, all economic models have an internal structure consisting of regularized, norm-like practices or institutions. Institutions make a model internally coherent. They also generate trust and send clear signals to firms as to what strategic paths of action are supported by the system, and which ones are not. This shapes the strategies of firms and lowers the costs and the risks of strategic decision-making.

This institutional perspective has several implications for the export of successful models like Germany's. First, it means that the German model is much more than the features or "nodes" mentioned in the first section of this article. In fact, the key to the success of the model may not depend on transplanting those particular nodes, but in importing the institutions that bind them together and keep the system running. However, institutions can be either explicit (codified) or tacit (rooted in experience and common knowledge), and normally an economic model will rely on a combination of both types. This combination makes transplanting an economic model difficult because tacit institutions are difficult to identify, define and therefore to transfer. The difficulty applies even to economic models like Germany's, where a high share of institutions are codified.

Even codified institutions are also abstract or general norms. Therefore, every time they are applied to specific situations they are subject to interpretation and fine-tuning. However, interpretations are rooted in shared values, principles, and habits that may not be shared across countries. This means that institutions transplanted from the German model will likely be reinterpreted by the recipient country. In the worst case scenario, these alternative interpretations can lead to misalignments in the system and economic underperformance. In the best case scenario, institutions will simply evolve along a different path than in Germany and so become something different. This implies that it is unlikely that transplanting the German model will generate the same economic benefits in the recipient country as it does in Germany.

Second, transplanting the German model may not be the optimal course of action for a country that wants to strengthen the sustainability of its economic model. Institutional solutions are the result of a negotiation process and of the agreement reached among the parties involved. This means that there is no assumption that institutions are necessarily Pareto optimal solutions to the problems they aim to solve. If this is true in Germany, the original environment in which the institutions behind the German model developed, then the likelihood that those institutions will represent an optimal solution for another country's situation is even lower. By attempting to import the German model, economic actors (governments, firms and social partners) in the recipient country forfeit the opportunity to develop a system specifically designed to fit their context and address their problems. Moreover, transplanting the German model would still be a long-term process of deep change that could not be imposed from above and executed solely through government fiat. If the operation were to work, it would require a broad political consensus, a guiding agreement that provides long-term focus and direction to the program of economic reforms, and active cooperation from social intermediaries and firms; especially leading firms. Consequently, a country facing such a major, long-term undertaking would normally prefer to develop a model specifically tailored to its circumstances, rather than to import one.

Third, institutions may remain in place long after the situation they aimed to solve has already changed. This means that by the time a country attempts to transplant Germany's institutions, they are unlikely to be the most up-to-date solutions to the situation at hand. This is true even if Germany and the recipient country are subject to similar environmental pressures—such as globalization—or if they share a common supranational structure—as is the case with EU countries—. This is because external environmental factors may cause different types of problems in countries with different underlying productive structures. This problem is particularly relevant for peripheral European economies, whose productive structures and economic fundamentals are significantly different from Germany's.

Fourth, as Bronk and Jacoby point out, in a rapidly changing interconnected world no single economic model can claim to offer the best suitable solution to all practical challenges. Confronted with new, turbulent or uncertain conditions, economic actors need to invent new ways to solve challenges that are not well addressed by existing systems and they need the flexibility to adapt those solutions rapidly as circumstances evolve. By importing the German model, the recipient country renounces its ability to generate regulatory innovation, and to benefit from "last mover" advantages.

Recommendations and conclusions

The previous section argued that from an institutional perspective, exporting the German model is a difficult, long-term undertaking that may not even generate the same results in the recipient country as it does in Germany. Furthermore, even if possible, importing the German model may not be the optimal solution for countries looking to change their economic systems and ensure their sustainability.

However, the problem remains that some countries need suggestions on how to transform their economic models and increase their sustainability. The German model can be useful for this purpose even if the model itself is not transplanted. As mentioned above, the analysis of the German model already reveals the types of things that manufacturing firms need to thrive and to develop a steady stream of innovation: a sound macroeconomic environment, an industrial setting in which firms can develop a rich and dense network of relationships, and access to a full range of resources outside their walls. Knowing that these are critical factors, a thorough analysis of the recipient country can help identify strengths and weaknesses in these areas.

Once the recipient country has identified the strengths and weaknesses of its existing model, it can start to develop a plan of action to correct them. Policy options should be tailored to the country's context, and should build on existing institutions to facilitate the transition between the pre-existing and the new economic model. This does not mean that the projected measures should not challenge the foundations of the pre-existing model. On the contrary, the weaker the pre-existing model, the more likely it is that reform proposals will need to challenge it in order to correct it.

The deeper the reforms to the model, the more likely it is that they will face opposition from entrenched groups. Implementation will also require the mobilization of significant resources over a large period of time. To minimize these obstacles, the recipient country will need to build consensusabout the main lines of reform. This will involve a process of negotiation and commitment from all relevant economic agents (political parties with government representation, social intermediaries, and leading firms).

A consensual agreement that provides focus and direction to the projected reforms will not necessarily lead to a Pareto optimal economic model that maximizes economic performance and ensures sustainability. However, a reform plan that emerges from the analysis of the national context, followed by a process of collective deliberation and agreement, will be specifically designed to address the country's current problems and has better chances of addressing its weaknesses than a transplanted model.

Notes

1. Japan's Meiji restoration (1868-1912) is a classic example. During this period, Japan sent scholars to industrialized Western countries to learn about their governance structures, postal services, military tactics, science and technology, in a race to accelerate its industrialization and avoid losing its independence to western colonisation.

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German Economic Success: Luck and Neglected Problems

Markus Marterbauer[1]

Germany within a group of relatively successful economies during the financial crisis

The deep financial and economic crisis of 2008/09 hit all European economies and has still not been overcome. However, the crisis has also laid bare the fact that there are diverse models within the European Union, which display quite different economic and social outcomes. Germany and some central and Nordic European countries such as Austria, the Netherlands, Belgium, Denmark, and Sweden are more successful. In this group, GDP has been rising after the deep recession of 2008/09, sometimes even surpassing the pre-crisis levels, unemployment rates are lower and employment rates higher, and income distribution is often less unequal than in the rest of Europe. Nevertheless, in a longer-term perspective the German economic results are disappointing in comparison to the other economies of this successful group. Since the mid 1990s, economic growth in Germany has been low, unemployment high and inequality has been rising markedly.

This group of more successful – or rather less unsuccessful – economies is quite heterogeneous in itself, but it also shares certain similarities. These similarities can be identified in well-established institutions, especially in the area of corporatism. Employees´ and employers´ organizations are relatively strong, comprehensive and consensus oriented, characteristics which express themselves in coordinated wage negotiations and sometimes also in a quite strong influence on economic policy in general (Leibrecht, Rocha-Akis 2014). In this context Germany is, however, lagging behind Austria or Sweden. This also relates to a second similarity in the area of relatively high public expenditure quotas, which are linked to well-functioning welfare states. This seems to have had a stabilizing influence during the crisis, not only through direct countercyclical state activities, but primarily by stabilizing expectations and reaffirming the trust of private households and enterprises. This prevented a dangerous increase in savings rates during the recession. A third common feature is a longstanding tradition in manufacturing, combined with a well-established education and innovation system. A fourth similarity is the apparent resistance of some of the more successful countries to suggestions from international organizations to deregulate their real estate markets. As a consequence, they were by and large able to avoid real estate bubbles and their pernicious economic and social effects.

The lowest rates of unemployment within the EU: Germany and Austria in comparison

In this group of successful countries, Germany and Austria are two important cases. On the one hand, despite their size difference of about 10:1 the two countries are very similar; sharing comparable institutions and economic structure, a history of economic policy and of course language, but on the other hand, they have recently been experiencing fairly different labour market developments.

In fact, Germany appears set to displace Austria as the country with the lowest unemployment rate in the European Union. In November 2014 the unemployment rate of both countries was around 5 percent of the workforce, well below the average of the eurozone (11.5 percent) according to Eurostat data. However, the two countries have been approaching this level from opposite sides: Whereas unemployment rates in Austria have been increasing: from 3.8 percent in 2008 to 4.9 percent in 2013, Germany has shown a decline from 7.5 percent (2008) to 5.3 percent.

The economic orthodoxy, which strongly influences public opinion and policy discussion in both countries, discerns the same fundamental causes for these opposing developments in the two countries: The low and declining unemployment rate in Germany is perceived as the outcome of a solid macroeconomic performance, characterized by high international competitiveness, low budget deficits and successful labour market reforms (Hartz IV) (Knuth 2014). Conversely, the rising unemployment in Austria is seen as a result of a weak macroeconomic performance, induced by declining international competitiveness, high public deficits, inflexible labour markets and institutional inertia. Essentially, therefore, the orthodox explanation is based on the demand for labour: In this competitiveness story, high growth and labour market deregulations led to a high demand for labour in Germany, and the opposite development took place in Austria.

German economic growth, in particular, should thus have been considerably more dynamic than in Austria, which should have been accompanied by a stronger increase in employment, and a concomitant decline in unemployment. The data, however, paints a rather different picture.

In Germany, the volume of GDP increased between 2007 and 2013 by 3.3 percent, compared to 3.7 percent in Austria. Both countries are thus well above the performance level of the eurozone (-2 percent). According to SNA data from Destatis and Statistic Austria, employment increased by 4.9 percent in Germany and 6.1 percent in Austria (Euroarea -2.8 percent).[2] As with GDP growth, the data does not show the stark difference in developments required for the competitiveness story.

However, unemployment rates declined by 2.2 percentage points in Germany and increased by 1.1 percentage points in Austria according to Eurostat. The number of registered unemployed declined from 3,130 million to 2.262 million in Germany (-25 percent) and increased from 162,000 to 215,000 in Austria (+33 percent). The story of a strong macroeconomic performance supported by liberalization of the labour market as the major reason for success in German labour market policy thus contradicts the data; both countries show a similar trend in GDP and employment, but markedly divergent patterns in unemployment. Labour demand cannot be at the root of this pattern.

	2000	2005	2008	2013
Population (15 to 64) (in 1.000)				
Germany	55,915	55,209	54,417	54,281
Austria	5,397	5,570	5,607	5,705
Employment (according to microcensus) in 1.000)				
Germany	39,792	39,220	40,805	42,226
Austria	3,686.0	3,824.4	4,090.0	4,175.2
Employment (according to SNA) (in 1.000)				
Germany	39,917	39,326	40,856	42,281
Austria	3,756.4	3,873.8	4,090.3	4,260.8
Unemployed (in 1.000)				
Germany	3,137	4,571	3,136	2,270
Austria	180.8	207.7	162.3	215.2

Instead, to talk about a story based on labour supply is much more in sync with the empirical evidence. In Germany, the potential labour supply has been shrinking markedly: between 2000 and 2008 working age population declined (by about 1 ½ million persons or 2.7 percent) and has stayed nearly constant since then

(-140.000). In contrast the working age population in Austria increased considerably by 200,000 persons (+4 percent) from 2000 to 2008 and by another 100,000 persons (+2 percent) from 2008 to 2013.

This is primarily an effect of diametrically opposed migration and commuting dynamics. In Germany, immigration has been weak and only increased slightly during the years of the euro crisis. Austria, in contrast, is an immigration country with a high influx of foreign labour from eastern European countries (especially from neighbouring Hungary), but also from Germany. In fact, German nationals constitute the most important group of foreigners working in the Austrian labour market and their number has increased considerably since 2008 (+21 percent). There are many causes for migration from Germany to Austria; chief among them are the higher Austrian minimum wages in the service and construction sector, the free access to university in Austria and the attraction of Austria and especially Vienna as a place of residence and work.

The significance of labour supply as a determinant of unemployment both in Germany and in Austria is further documented by the successful implementation of short-time work during the 2008/2009 recession (Herzog-Stein, Lindner, Sturn 2013). The two countries successfully balanced the slump in production in manufacturing by implementing short-time work, reducing overtime accounts and applying other measures to reduce working time.

To sum up, the relatively successful labour market development in Germany and Austria during the financial crisis is the result of a more stable macroeconomic development compared to other European economies. As a consequence, labour demand and thus employment showed stable growth both in Germany and in Austria. In Germany, however, unlike in Austria, unemployment declined during the crisis. This is an outcome of a favorable but unplanned decline of labour supply. For successful public policies, this episode is a clear demonstration that the regulation of labour supply, as for example through the reduction of working hours, is a powerful instrument towards reducing unemployment.

Neglected problems of the German and Austrian economic model

The two countries are thus very similar in their macroeconomic development, except for labour supply. A less successful element of economic development, which Germany and Austria also share, is the high and rising surplus in the current account. The current account surplus in 2013 exceeded 7 percent of GDP in Germany and reached 1 percent in Austria. This is a fairly recent development; the current account was roughly balanced in both countries at the beginning of monetary union. However, since then the surplus has expanded continuously and it reduced only temporarily after the recession of 2008/09.

The economic orthodoxy in both countries does not perceive the structural surplus as a problem. On the contrary, it is considered further proof for the high competitiveness of the export sector. This is of course a biased view: while current account deficits in southern Europe are seen as major macroeconomic problem, the corresponding surplus in Germany, Austria and other countries is not.

These are, of course, two sides of the same coin, and they point towards a serious disability to adjust the respective models to new institutional circumstances. Before the start of European monetary union, differences in the increase of unit labour and unit profit costs between the economies led to gains in competitiveness in the north and losses in the south. They were corrected at periodic intervals through exchange rate adjustments: Italian Lira and Spanish Peseta devalued, German Mark and Austrian Schilling revalued. This cycle of loss (gain) of competitiveness and devaluation (appreciation) is of course no longer possible in a monetary union, which has led to persisting disequilibria in intra-European trade. These imbalances played an important role in the crisis of the eurozone.

For a stable economic development, wage and price negotiation systems need to adjust to the new circumstances which means that growth of unit labour cost and unit profit cost has to decrease in deficit countries and increase in surplus countries. While the one side of this adjustment was forced upon deficit countries by EU austerity policy and high unemployment in the south, the adjustment in the north is not taking place. Germany and Austria continue to accumulate considerable current account surpluses. This persistence points beyond successful export industry: the surplus countries are plagued by a structural lack of internal demand. While exports have more than doubled in real terms since the early 2000s, private consumption and investment has been stagnating.

Germany and Austria have not been able to transform their exports into an increase of investment and consumption, indicating a major failure of macroeconomic policy. The surplus in the current account is also an outcome of growing inequality: There is an enormous and apparently rising concentration of wealth in the top 5 percent, top 1 percent and top 0.1 percent of households. Inequality of income is rising, as indicated by falling wage shares, growing disparities in the personal income distribution, and expanding low-wage sectors. In Austria this is still corrected to a certain degree by a well–functioning, comprehensive welfare state. In Germany, however, this is no longer the case, especially in the area of pensions and low-wage groups.

The distribution of prosperity is the major problem of our economies. A more equal distribution of wealth and income is the most important instrument for social fairness and macroeconomic improvement. This is closely linked to trade imbalances. The surplus in the current account has a dangerously destabilizing effect. A decline in inequality and an increase in internal demand and therefore in imports to Germany and Austria would not only improve macroeconomic conditions and welfare in the European south, but also for the majority of the German and Austrian population. In the end, wage policy, income distribution and savings rates have to adjust to the new macroeconomic framework of a monetary union in the north, as well.

Notes

1. I would like to thank my colleagues Kai Biehl and Miriam Rehm for valuable research assistance.
2. SNA data on employment account for jobs in the respective economy, including foreign commuters. This does not change employment figures in Germany in this period in relation to Labour Force Survey or micro census data. But it increases employment by about 1 ½ percent in Austria due to strong influx of commuters from neighbouring countries.

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Janus Germany: Micro Model, Macro Beggar-thy-neighbour

Andrew Tylecote[1]

Micro success: Stakeholder capitalism *works*.

At the firm level, Germany has a combination of old-fashioned capitalism and employee empowerment. In the Mittelstand and in many of the largest firms (e.g. BMW with the Quandts) there are recognisable capitalists – families which own and control firms, and do what capitalists are supposed to do: look for profitable ways of investing their capital, long-term. (As Table 1 shows, Germany is exceptional in the extent of family control of listed firms – and it has an exceptional share of unlisted medium-sized firms that are also family-controlled.) And one of the reasons that German capitalists usually find it convenient to invest within the firm, is the empowerment of the employees through co-determination – particularly through equal representation on the supervisory boards of large firms. Strong supervisory board representation of employees is a key characteristic of what I have called "stakeholder capitalism" (Tylecote and Visintin, 2007, 2008): a category also inhabited by the Netherlands, Austria and the Nordic countries. (See Table 2.)

There are, no doubt, a significant and increasing number of the largest firms which do not have dominant "insider" shareholders; but their managers do not, unlike those of UK listed firms, live in fear of hostile take-over bids. They have what managers of big UK firms used to have: autonomy to chart and implement long-term strategies for their firms with high and increasing spending on R&D. They are also accustomed to working with their rivals on industry-wide training arrangements and on industry-wide collective bargaining; and they tend to have close long-term relationships also with industrial suppliers and customers. This is stakeholder capitalism: capitalism built on relationships with employees and other firms.

Stakeholder capitalism works. It is not a recipe for success in disruptive/ transformative/ radical innovation – as Hall and Soskice (2001) point out. But there is a vast amount of medium-high technology industry in which Germany can and does excel: chemicals, machinery, motor vehicles. And (something Hall and Soskice missed) there is a lot of *high*-tech industry which does not depend upon radical innovation. Industries such as aerospace, and much medical and scientific equipment, revolve mostly around the cumulative improvement of technology (Tylecote and Visintin). Germany does well there too. Even in apparently spearhead sectors such as bio-technology and software, Germany has found sub-sectors which play to its strengths, as Casper and Whitley (2004) have shown. With 80 million people, to excel in *most* of the main sectors that have above-average R&D intensity is more than enough.

Macro failure: the terrible deficiency of aggregate demand.

As soon as the reunification boom was over, Germany began to confront inadequate domestic demand. Whenever international demand dipped, recession loomed. In the early 2000s it led to the exquisite embarrassment that Germany broke the Amsterdam Treaty rules for fiscal deficits, and the worse embarrassment that the rules were loosened *because* it (and France and Italy) broke them. (How many Germans remember? How many wince when Wolfgang Schaueble lectures the Greeks?). We shall see below what a disastrous course Germany took, to deal with this problem.

Let us consider the problem first: why did Germans not spend more? Most obviously, because they were not having enough children, those great generators of consumption and investment spending. The German fertility rate is below 1.4, significantly below that of their western and northern neighbours, and around that of the "back markers": countries of southern, central and eastern Europe (Italy, Spain, Hungary and Bulgaria, for example) and Northeast Asia (Korea, Japan).[2] (The fertility rate of native Germans is slightly lower still, the difference being due mainly to the higher fertility of the large ethnic-Turkish population – Wolf 2014.)

This is a little odd. It is a demographic cliché by now that countries enter a below-replacement fertility trough when women have achieved control over their own bodies, and some opportunities to work outside the home, but not much else. When feminism advances further, it makes it more attractive to combine child-bearing and –rearing with work. Is German sexism really to be compared with that of the 'back-markers'?

No. Germany appears to excel in treating women like men. Discrimination against women, as such, is forbidden, and the law seems quite well respected – as laws in Germany generally are. (What a triumph to have a female Chancellor, particularly such a respected one as Angela Merkel.) Is that not what feminism has been demanding? Some feminists no doubt have focused their demands on that; more's the pity. But Merkel has no children. (Thatcher had two.) She belongs therefore to the second of Germany's three genders: men, women and mothers. Look at Sweden, that paragon of near-replacement fertility, with an exceptionally high activity rate for women. There is a joke that the main occupation of Swedish women is looking after the children of the women who are looking after their parents. At any rate they – and specifically women with children – tend to do jobs in the public sector, while men gravitate to the more demanding jobs in the private sector. In Germany as in Sweden, some women – particularly those inclined to have children – may not want highly-competitive careers – at least, not while their children are young. During that time they want good, affordable childcare, and flexible part-time work. The more competitive ones just want the childcare.

Childcare and flexible part-time work; in those two areas, it would appear, Germany has been lacking. The most spectacular example of insensitivity to the needs of modern women is, or used to be, the German school day. Little "Dresi" and "Gabi" go off to school bright and early, and return early – not long after midday. Why not? Their loving mother will be there to give them lunch and oversee their homework: "Kinder, Kirche, Küche" – "children, church and kitchen". Or that is the implied expectation. The east went over to the all-day school many years ago. Now – shall we say a hundred years late? – western Germany, after much controversy, is inching towards what is taken for granted on most of the rest of the planet. It is likewise inching away from serious weaknesses in the care of pre-school children.[3]

Whatever the reason, the implications of the fall in fertility are even worse than the overall figures suggest. Eastern Germany had experienced a baby slump before the Federal Republic did. By 1990, a raft of child-friendly policies had not only mitigated it considerably, but had almost got rid of the tendency for the most educated women to have the fewest babies. Such a tendency is now pronounced in western Germany; less in the east (Sobotka 2011). This is clearly a matter of great concern, in the long term: whether through nurture or (more arguably) through genes, it cannot be good for the abilities of Germans. However, there may be a much more immediate problem. There is a high correlation between education and income, so the baby deficit is presumably associated to some extent with income: richer Germans having fewer children than poorer ones. If so, this must have consequences for aggregate demand. It would tend to divide the population into two under-spending categories: those whose consumption and investment in housing is constrained by low income and few assets – who have more children; and those who could well afford to spend and invest more freely – but, having one child or none, have little need to. The widening dispersion of household incomes over the last twenty years (see below) can only accentuate this problem.

The German "easy way out" after the move to the euro

As long as Germany had its own currency, whose value was set, in the last analysis, by market forces, it could not gain much in terms of aggregate demand by increasing its international competitiveness. Whether it did that through improvements in the quality and range of its products, or through cost-cutting; whether any cost-cutting was achieved by fast-rising productivity or through slow-rising pay; in the end any of these things would lead to a surplus on the current account of the balance of payments, and that surplus in the end would eliminate itself by causing a rise in the level of the currency.

But after 1999 there was the euro, the devil's tempter for a country such as Germany. A current account surplus would no longer be self-limiting. Raise exports (and perhaps curb imports), by whatever means, and the problem of aggregate demand would be solved – without fiscal excess or embarrassment. Given the micro quality of German industry, a modest current account surplus could probably have been generated without any particular attention to costs; but in the mid-2000s there was a characteristically German sense of urgency. Every thinkable measure was thrown at the problem. Would wage restraint help? The unions would, and did, understand. Not only did they let their own members' real wages fall, they, and their friends in the SPD, allowed the creation, or great expansion, of a 'precariat' of low-paid and vulnerable workers, mostly part-time (*The Economist* Sept.26th 2014). (And this helped to drive the widening inequality of incomes.) Did social charges for employers seem excessive? If they were cut, and the fiscal deficiency made up by an increase in VAT, the German consumer – and voter – would understand. These things were done.

There was however a small problem of morality and perhaps even law. The current account surplus could only be gained, in a sense, at the expense of the other euro economies: if they did not run, in total, roughly a matching deficit, then the eurozone would have a surplus. Over time that would force the euro up – and then Germany would face much the same negative feedback loop as under the Deutsche Mark. The architects of the euro had foreseen the danger of payments imbalances, and the convergence criteria of Maastricht and Amsterdam addressed them in some measure. In particular, inflation rates were expected – required – to converge on a low level: 2%. Now some euro countries, for whatever reason, ran inflation rates well above that level, for example Greece, Italy and Spain, and were thus largely architects of their own misfortunes. They have been roundly condemned for that. But the obligation was symmetrical: go neither above nor below 2%. And on the crucial measures of producer price and cost inflation, with the help of that cut in social charges, Germany went for some years significantly below 2%. See Figure 1.

The huge current account surplus, and matching deficits, duly came (Figure 2). The effect was to make it much easier for Germany, and much harder for the deficit countries, to hold down the fiscal (budget) deficit to acceptable levels.[4] It is notable that the French, on unit labour costs, met the inflation target almost exactly – but since they came nowhere near matching Germany's under-target performance, their current account slipped remorselessly into deficit, and their economy into crisis.

The large current account deficits of the southern European countries, increasingly matched by fiscal deficits, drove them into debt, and that drove them into deflation. With great suffering, they began to improve their current account positions – but not at Germany's expense. They bought less from it, indeed; but their parlous situation caused the euro to fall, so that Germany, having done nothing to reduce its own super-competitiveness, could sell more to the rest of the world. Thus the improvement came at the expense of the rest of the world, while Germany maintained and even increased its surplus (Figure 3). (To be fair, the Dutch surplus has been even higher as a proportion of national income.)

Conclusion

Germany is a micro model of steady and productive innovation; and it is a malfunctioning macro machine whose current account surplus (together with that of the Dutch) is beggaring some of its neighbours, and weakening the whole European continent. The German public, including their chancellor, have belatedly discovered one element of inadequate aggregate demand: low investment, particularly in the public sector. However, the diagnosis is partial, and the likely remedies will be feeble. It is hard to see how the eurozone can long survive the profound imbalances within it – the recent depreciation of the euro cannot last indefinitely, and when it is reversed the competitive position of the weaker economies will weaken further. A return to the Deutsche Mark would force Germany abruptly back into current account balance, and thus again reveal the underlying demand deficiency which the export surplus has covered up.

Poor Germany: it only wants to earn an honest living.

Notes

1. Emeritus Professor of the Economics and Management of Technological Change, University of Sheffield, England.
2. http://data.worldbank.org/indicator/SP.DYN.TFRT.IN
3. http://knowledge.allianz.com/demography/population/?2657/Fewer-babies-born-in-Germany
4. Arithmetically, if there is a current account deficit in a given economy, it must be matched by a deficit somewhere within the economy: the state sector or private sector (the latter being divided into households and firms). If the private sector is willing to run a large deficit (as was the case in Spain up to 2008), the state sector, that is the budget, will be in surplus. Otherwise – as everywhere after 2008 – the state must run a deficit.

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Table 1: Ultimate control of publicly-traded firms, 1996-99.

Country	Number of firms examined	Widely held	Family-controlled
UK	1953	63.1%	23.7%
Switzerland	214	27.6%	48.1%
Japan	1240	79.8%	9.7%
Sweden	245	39.2%	46.9%
Germany	704	10.4%	64.6%
France	607	14.0%	64.8%
Korea	345	43.2%	48.4%
Italy	208	13.0%	59.6%
Taiwan	141	26.2%	48.2%

Source: Tylecote and Visintin 2007 Table 7.

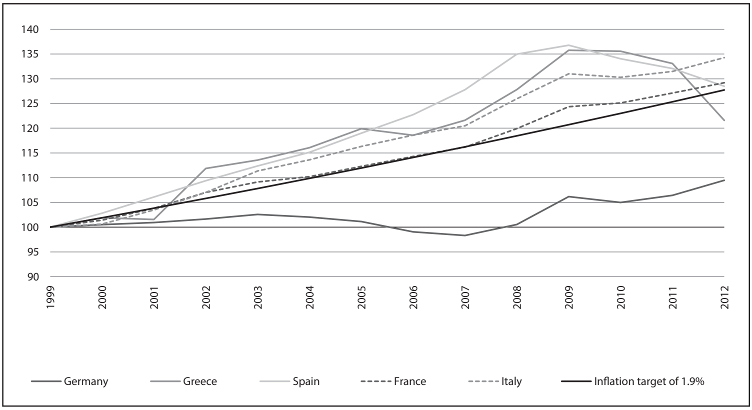
Table 2: Enterprise-level Co-determination: Employee Representation on Company Boards[1]

Equal representation	One-third representation	Other representation
Germany (>2000 employees)	Germany (<2000 employees)	Finland[3]
Denmark[2]	Austria (>300 employees)	Sweden[4]
	Luxembourg	Netherlands[5]

1. Either main board or supervisory board, depending on whether the board system is 1-tier or 2.
2. If employees vote for it; otherwise at least two directors.
3. 1 employee-director (up to a maximum total of 4) for every 4 shareholder-directors.
4. 2 employee-directors for between 25 and 1000 employees; above that, 3; always a minority.
5. Works councils share in choice of directors. Works councils are (as in Germany) elected by all employees and only employees.

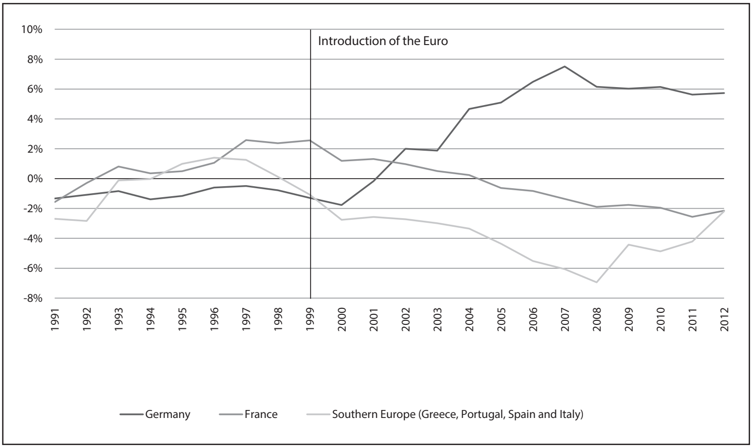
Source: Tylecote and Visintin, 2007, Table 3.

Figure 1: Unit labour costs, selected Eurozone economies, 1999-2012.



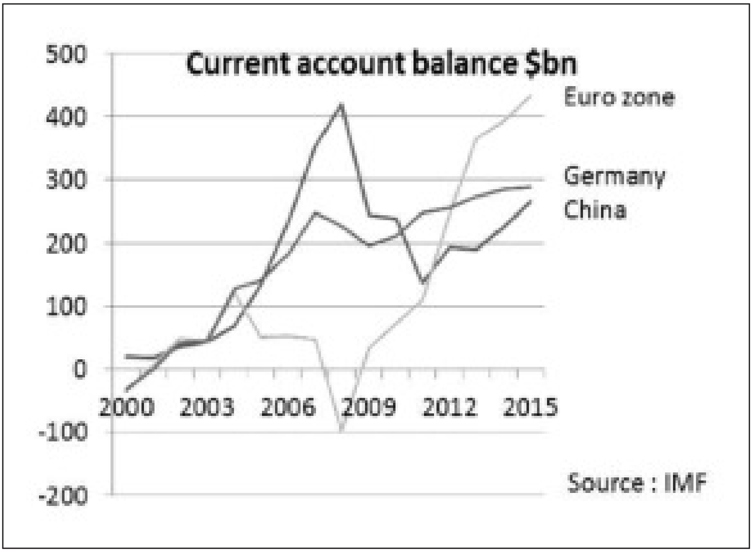
Source: Costas Lapavitsas, *Eurozone Crisis: True Causes and Effective Therapies*, SOAS/RMF Dec.2013.

Figure 2: Current Account Balances, % of GDP: Germany, France, Southern Europe.



Source: Costas Lapavitsas, *Eurozone Crisis: True Causes and Effective Therapies*, SOAS/RMF Dec.2013.

Figure 3: Current Account Balances, Eurozone, Germany and China, 2000-14.



Source: 'Europe's current account surplus: Europe's rebalancing is not borne by Europe', *The Economist*, Sept 26th 2014.

Germany and Italy as "Models" of Political Economy

Philippe Schmitter with Arpad Todor

The political economy of Europe – both West and East – has generated many "models" of enviable performance since its recovery from World War II in 1945 and, once again, since the end of the Cold War in 1989. A large number, perhaps a majority of its member states, have been declared superior, admirable or even miraculous at some point during that period and, hence, worth emulating (which is presumably what a "model" of political-economic institutions is supposed to do). The fact that, in virtually every case, the country involved subsequently fell into disgrace and even became a "model" of unenviable performance has been less well-noted.

As this moment, Germany seems to many in Europe (and specifically in Italy) to enjoy such an exalted status. How long this will be the case is unforeseeable, but that it will not do so permanently seems very likely from past experience. Seen from the Italian perspective, the key question is not how long will it last, but what will be its impact while it exists. Not only is it the largest political economy (in both size of GNP and population) in Europe, but also it is the dominant member of the European Union. *Ergo,* Germany has a unique capability for affecting the performance and reputation of its neighbours. Small country "models" are much less appealing or threatening to a country like Italy.

In practice and for public consumption, "models" of politico-economic performance are based on reputation. It is enough that they are admired and envied by significant others. In theory and for analytical purposes, "models" are based on two distinct suppositions: (1) That it is the complementary nature of formal institutions and informal practices – political as well as economic – of the country that is responsible for this outcome; and (2) That these conditions are sufficiently generic that they can potentially be imitated.[1] The literature, perhaps because it is dominated by economists who only regard politics as a potentially obstructive factor, tends to stress the usual economic outcome variables: high GNP growth, less inflation, full employment, export competitiveness and, occasionally, more equitable distribution of benefits. This ignores the fact that at least in contemporary Europe these favorable outcomes are contingent on the democratic performance of their respective political institutions and policies. Hence, a successful "Model" – especially one with some chance of enduring – also depends on the presence of such things as competitive elections between credible political parties, the legitimacy accorded by citizens to those who win them, the stability and effectiveness of the government produced by these winners, the existence of stable and non-violent relations between representatives of capital and labour and, finally, an honest public administration and legal system that impartially implements policies and protects rights regardless of the party in power.

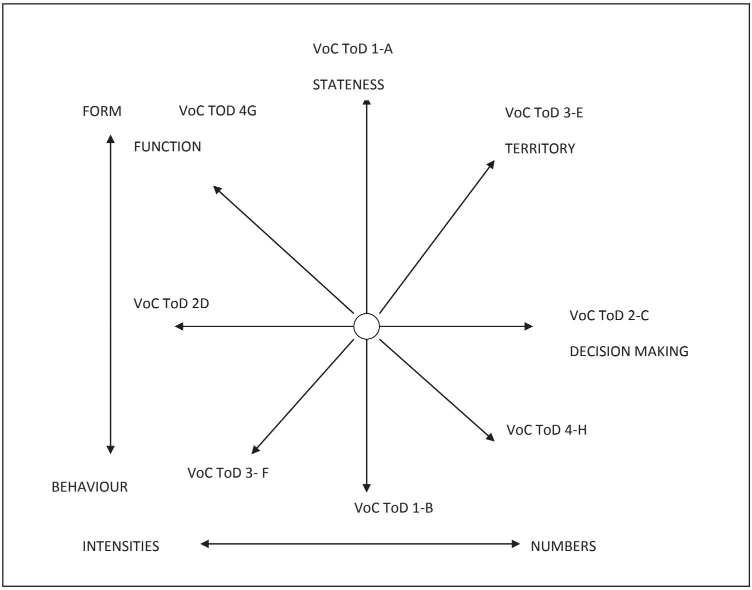
Needless to say, this theoretical convergence and subsequent complementarity between favorable economic outcomes and political conditions that make them more likely is not easy to produce – and to sustain. In actual practice, many national political economies have attained "model" status without having has all of them. Most recently, for example, some of the most admired economies have a very poor record with regard to the distribution of benefits. Some of the more successful polities have exhibited alarming tendencies toward a reduction in the credibility of traditional centrist parties and emergence of new extremist populist ones, more contentious relations between capital and labour and more instability in forming and sustaining government – not to mention growing ineffectiveness of public policies.

As far as elite and public opinion in Italy is concerned, the Federal Republic of Germany is indisputably the best current "model" of political economy in Europe. While it is widely admired, it is also widely feared. What makes this status so controversial is not simply that there is considerable ambiguity about whether it should or could be imitated without generating quite different effects for the Italian population, but also that it comes with some serious historical memories and contemporary worries. Italians retain very negative memories of the period of Nazi occupation from their surrender in 1943 to the end of the war in 1945 – and these are constantly being reinforced by the repetition of events celebrating the exploits of the *partigiani (the Italian partisans)* who opposed it. The novel element, however, in the equation is the perceived role of Germany in dominating the economic and monetary policies of the European Union.[2] It is one thing to admire a country's performance and to be prepared to adjust or emulate one's institutions and policies accordingly; quite another to suffer not only the direct effect of superior competitiveness, lower rate of inflation, and lesser disruption of production, but also the imposition of its "model" on a supra-national institution that has an authoritative impact on the polices of its member-states. In this case, it is not a matter of learning from a "model" and voluntarily imitating it, but of being compelled to adopt it. Given the peculiarly transitional period in which the Italian political regime presently finds itself since the demise of Berlusconi – somewhere between its Third and Fourth Republic – the receptiveness is even more problematic.

Varieties of Capitalism and Types of Democracy

One of the basic contentions upon which this article rests is that the status of "model" of superior performance depends not exclusively on the nature or complementarity of economic institutions – as the existing literature on varieties of capitalism assumes – but upon the interrelationship between economic and political institutions. In other words, a national political economy will perform better when it has something approaching a double complementarity – first, among its economic institutions and among its political institutions and, then, between the two subsets.

Figure 1: Generic Properties of VoC and ToD



Recent research conducted by myself and Arpad Todor[3] has attempted to measure and test for this relationship. It begins with a conceptual plot of four radial variables at the national level, each of which is divided into two spokes. Our pretense is that this captures the key sources of variation in both capitalism and democracy: (1) the role of public authority (Stateness); (2) the type of decision-making; (3) the distribution of territorial representation; and (4) the nature of Functional representation and then, divides each of them into two "spokes," one measuring institutions and the other measuring performance. The extremes of variation are labeled "social capitalism/liberal capitalism," and "social democracy/liberal democracy." When the data are plotted, the best performing units should be those that have two macro-configurations: (1) the spider web of indicators for capitalism and democracy should come closest to forming a circle, presumably indicating the extent to which they coherently approach the social or liberal extremes; and (2) the extent to which their respective spider webs match when they are superimposed on each other.

In Figures Two and Three, I have plotted the two cases. When applying the "Inter-Ocular Impact" test, i.e. eye-balling the data, they would appear to have a surprising number of similarities.[4]

1. In both countries, the economic institutions and performances are more "social" than are the more "liberal" political ones, although Italy comes closest to having a "circular" fit between the two suggesting greater complementarity. According to Hall and Soskice, the best performing economies/polities are the ones that come closest to resembling one of another of the "ideal" types.[5]

2. Neither country's economic or political variables form the sort of round circle that is supposed by Variety of Capitalism theorists to be the key to good performance. If anything, Italy's spider web looks slightly more circular in both regards.

3. The stateness of the economy in both countries is about equally high when measured by the role of publicly-owned banks, but much less liberal in the case of Italy when measured by a composite index of "economic freedom" developed by the Heritage Foundation. This measures the extent to which the behavior of capitalists in product and labour markets are regulated by public authorities.

4. The stateness of the political regime shows Germany as

more liberal both in terms of a lower level of total expenditures at all levels of government as a percentage of GNP and of a lower proportion of government employees in the total labour force.

5. The differences in economic decision-making are asymmetric. Both Germany and Italy are high on the composite indicator of corporate governance (indicating that their firms are more protected from hostile takeovers or shareholder pressure – a presumed social trait), but when it comes to concentration of ownership (presumably, the higher it is the more social is the variety of capitalism), Italy comes out ahead – largely because its extensive number of small enterprises are proportionately less productive than is the German *Mittelstand*.

6. When it comes to political decision-making, the two are far apart and this just might be the best clue to the differences in their political economy. Italy's polity is much more centralized as measured by the lower number of formal veto points its institutions. Both have experienced long periods of hegemony by the leading party in executive power from 1950 to 1998 – although this obviously ignores the much greater rapidity with which specificgovernments came and went in Italy during this period.

7. It has not proven easy to conceptualize and measure the territorial element to the respective economies for the simple fact that economists and those who gather data for them are calculatedly indifferent to this aspect of capitalism. However, using two proxies, "market capitalization as a % of GNP" and a "Composite Indicator of Shareholder Rights," one finds Germany and Italy virtually identical and closer to the "social" model in the former regard, but quite far apart

in the latter. Italy is one of the most "social" in its illiberal opposition to the rights of shareholder and Germany is one of the most "liberal."

8. Territory has always been a central dimension in discussions of type of democracy. Parties tend to vary in their presence and success across component units, especially in federal systems such as the German none, and the relation between voting strength and allocation of seats in the legislature is also a highly differential matter depending on the design of constituencies and electoral laws. In Figures Two and Three, we find that both Germany and Italy have a very similar and low number of effective political parties (as of 1990) which tends to correspond with the "social" profile, but this is greatly distorted in the German case by a high disproportionality in the distribution of seat across its sub-national units. This is usual in federal regimes and it might just be another of the political advantages enjoyed by the German political economy.

9. Finally, we come to the radial that has figured especially prominently in the debates about both capitalism and democracy, namely, the manner in which capital and labour bargain with each other to affect wages, working conditions and, sometimes, general economic and political policies. This "functional" dimension varies greatly across contemporary capitalist democracies from a social or corporatist extreme at which such bargaining is comprehensive and binding to a pluralist liberal one which is highly fragmented and voluntary. Thanks to its prominence, we have many potential indicators to choose from. In terms of its economic model, Germany comes out as more "social" on both spokes: (1) a labour coordination index that measures the extent to which

bargaining between capital and labour is coordinated across sectors and territories; and (2) an indicator of employment protection. However, Italy is far from being located at the other "liberal" extreme on either indicator.

When we switch to the political equivalent of functional representation, we again find Germany closer to (but not that near to) the model of "social democracy." Its place on an indicator of corporatism from the 1970s to the 1990s is higher than that of Italy, but far inferior to the positions of Austria or the Scandinavian countries. When it comes to membership in trade unions as a proportion of the active labour force ca. 1990, Germany is only slightly more "social" than Italy – and membership in both countries has declined since.

Figure 2

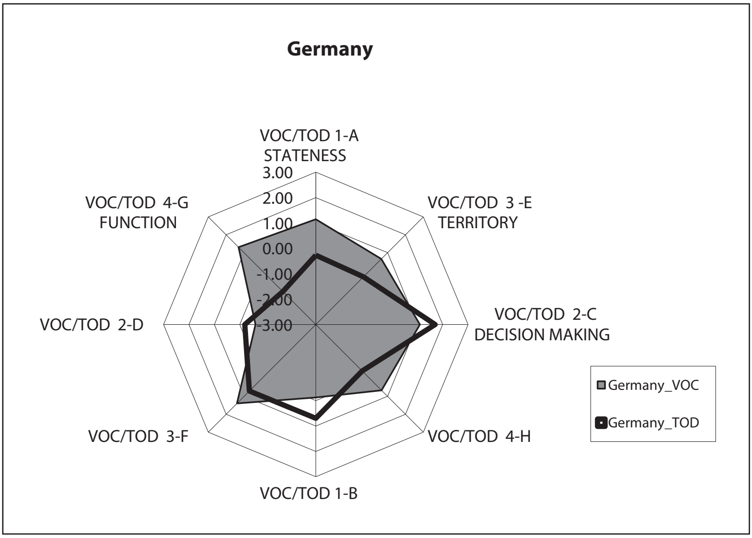
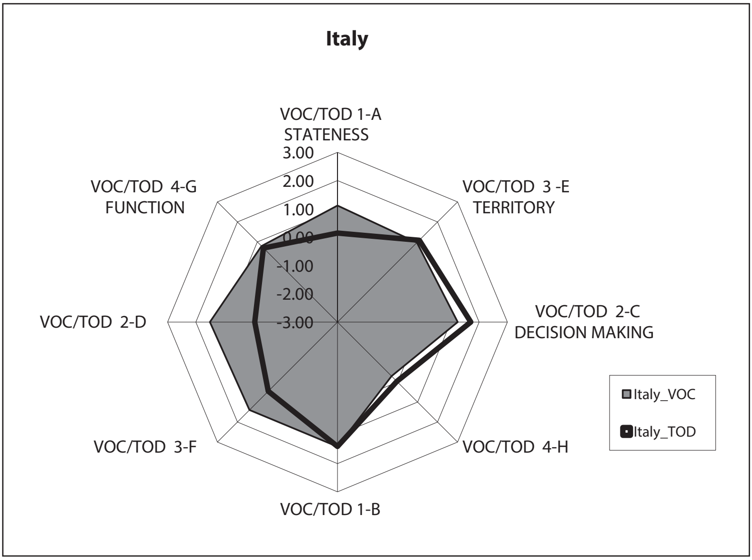


Figure 3



Conclusion

What have learned from this brief exercise in comparative political economy? Germany may have a solid reputation as a model today, but the objective charateristics of its institutions and practices do not conform to the theoretical expectations of those who study comparative political economy – especially those applying the ideal-typical approach of "varieties of capitalism.. In other words, "the German model seems to work in practice (for now, but not always in the past), but not in theory (forever). Yes, the country has piled up remarkable export surpluses – while supressing domestic wages and purchasing power, helped no doubt by the artificial low exhange rate produced by its membership in the Eurozone. And, yes, certainly compared to Italy, it has enjoyed much fuller employment, less public endebtedness and at least stable but not declining prosperity. It would, however, be hard to describe its institutions as "circular" reflecting some natural complementarity among them. Germany's spider web seems more the product of improvisation and experimentation than the abstract locic of a "coordinated market economy" or of "social capitalsm/democracy." My assunption is that its decided heterogeneous profile represents a country that has adjusted its political economy to conform to the diversity of its distinctive historical and cultural circumstances, not to conform to some abstract model of how capitalism or democracy works best.

A second hypothesis is that this process of adjustment has been driven by prior changes in political institutions and practices rather than economic ones. Unfortunately, due to limitations in data, we have not been able to trace this process– only to observe its (eventual) successful convergence. My hunch is that three political factors that most distinguish Germany from Italy (and from many of the other European democratic polities) are responsible for this outcome: (1) a system of limited number of parties that compete centripetally for the support of moderate voters, but which nevertheless alternate in power over time, thereby, reducing the tendency for entrenched partisan oligarchy and corruption; (2) a regular and predictable arrangement of functional representation and interest bargaining among social classes and economic sectors that encorages mutual responsiveness, while tolerating differentiation in outcomes at the meso- and micro-level; and (3) a territorial distribution of authority that is decentralized in critical but limited aspects such that some competition between regions/*Länder* encourages competition between their respective authorities and, hence, innovation in political-economic policy.

Our shallow timeframe also prevents us from tracing the accelerated sequence of adaptation to changes in the global political economy since the mid-1970s. No one can deny that Germany during this period has adapted more successfully to globalization than, say, Italy and, for that matter, most European political economies – but why this was so can not be discerned from our static plots. After all, it was not that long ago that the Federal Republic was regarded as "the sickman of Europe" and Italy was basking in its "miraculous" status! That global political economy – not mention the regional one of Europe – has continued to evolve at an accerated pace and nothing ensures that in the not distant future German institutions will prove capable of sustaining their superiority.

Notes

1. Interestingly, the two European countries that have enjoyed, not the best, but the most consistently good politico-economic performance during this period: Switzerland and Norway, are almost never cited as "models" for the simple reason that the conditions responsible for their success – reliable financial institutions and bank secrecy in the one case and oil and gas production in the other – cannot easily be emulated elsewhere in the region.

2. As one recent headline in La Repubblica put it, "The Clock of the EU is observing only German Time" (13 October 2014). As yet, to our knowledge, no one has accused Germany of converting the EU into its "Fourth Reich," as happened in Greece. The populist (and anti-Euro) politician, Beppe Grillo, however, has repeated accused Matteo Renzi, the present Prime Minister, of being the "puddle of Angela Merkel" and worse.
3. Schmitter, Philippe and Todor Arpad, 2012, "*Varieties Of Capitalism And Types Of Democracy"* in Varieties of Capitalism, Types of Democracy and Globalization, Routledge London.
4. For various reasons – mainly scarcity of resources – the data were gathered at a single point in time: ca. 1990. Germany during the Cancellorship of Gerhard Schroeder later in the 1990s introduced a number of changes in labour market policies making them more liberal than they are depicted in Figure Two. In Italy, Prime Minister Silvio Berlusconi was more preoccupied with advancing his many investments or keeping himself from criminal punishment to have introduced any such reforms. It has fallen to the present Prime Minister Matteo Renzi to begin to make such changes – against strong resistance from within his own party.
5. Refeeence to Hall and sockice (can you find it form e???)

To be Respected, but Not Imitated: The German Model from the Polish Perspective

Sebastian Płóciennik & Agnieszka Łada

Germany, one of Poland's largest neighbours – and undeniably its wealthiest, has always enjoyed a great reputation among Poles concerning its economy. During communist times, "going West" often meant going to Germany, and was associated with prosperity and a much better life. The closer ties made possible after Poland's entry into the European Union helped Poles get a better look at the German economy and validate their stereotypical ways of thinking. There is much to admire in the economic model of its western neighbour, but not all of Germany's solutions seem to be applicable to the Polish institutional system. And despite its current heyday, Germany faces many challenges, and how the country approaches them will be decisive for its future prosperity.

The German success story and Polish perceptions

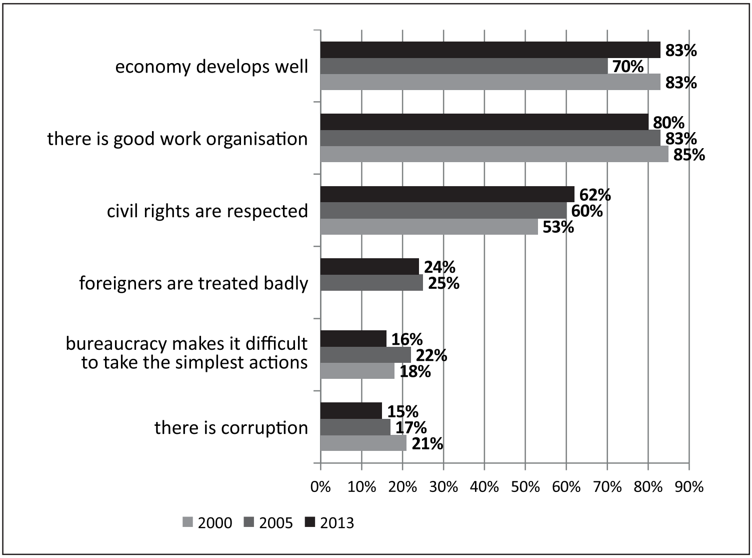
In recent years Germany has become a symbol of economic prowess and a point of reference in debates about economic reforms in Europe. The country has enjoyed moderate, but stable growth, low unemployment and an impressive re-balance of its public finances. Another distinct feature of Germany's success is the stunning dynamism of its exports, which totaled about 1,094 billion euros in 2013 with a 198 billion euro trade surplus.[1]

This message is even more impressive if two factors are taken into consideration. First, this heyday has come after a long period of poor performance. Just a little more than a decade ago, Germany was struggling with unemployment figures of 5 million, one of the lowest GDP-growth rates among the OECD countries, and a rising public deficit. Its economic failings even led some to call Germany the "sick man of Europe", and Paul Krugman condemned Germany as a loser, saying "Germany Kant compete" because of its rigid approach to the economy. It is stunning how far today Germany is from this low point and it says much about its ability to change. Second, German prowess peaked at a time when the rest of the eurozone fell into the deepest crisis in its history. In nearly all areas of economic policy Germany has performed better than most of its neighbours. In other words, there must be something special in the German story.

For Poland this development has been of great importance. Germany – a large neighbouring country with traditionally strong ties to Poland – is the buyer of one quarter of Poland's exports (close to 40 billion euros, a factor in Poland's trade surplus – a rare case in Europe) and its good shape contributed towards helping Poland successfully recover during the global financial crisis. The economic performance of its neighbour is also important for the several hundred thousand Polish migrants working in the country.[2] On the other hand, German exports to Poland have also been rising tremendously in recent years and have made the Polish market more important for German firms than the Russian one. But apart from sheer economic data, the recent heyday has changed the slightly dusty image of the German economy stemming from previous years. Certainly, the well-being of Germans has always been noticed and admired among the wider public, but in the early 2000s, the Polish elite also associated their neighbour with rising protectionism, overregulation and stagnation. Berlin's decision to keep the German labour market closed to the new EU entrants until 2011 seemed to confirm this and pushed many Poles to seek their fortunes in the more open, liberal economies of Ireland and the UK. Just before the crisis these countries and their economies became for many Poles better known and more worthy of observation than that of their closest neighbour.

The recovery in Germany helped to refresh its positive image and strengthen the historically rooted respect Poles hold towards Rhenish capitalism. This is clearly visible in the surveys carried out by the Institute of Public Affairs in Warsaw (IPA),[3] in which respondents stressed Germany's good work organization, low level of corruption and high standard of living. In response to the open question of what they associate Germany with, Poles mentioned attributes which could be a summary of "a country of prosperity": high standards of living, high salaries, well-developed economy, world economic power and the social welfare state. German firms also enjoy an excellent reputation in Poland and are considered to be well-managed, caring towards their employees and the environment, as well as law-abiding. Furthermore, this is a stock perception, irrespective of experience or contact with German businesses or their employees. Another poll carried out by IPA shows that Polish experts working in international surroundings[4] claim that German companies in Poland stand out positively among companies operating in Poland – both Polish and other foreign companies (52% of them express this opinion).

Table 1. Polish opinions of the German state in the years 2000, 2005 and 2013



Source: Institute of Public Affairs 2000, 2005 and 2013

Is there a "German model"?

The opinions quoted above provide ample evidence that not only does "the German model" exist in the perception of Polish people, but that it also has certain positive associations. The existence of a specific model of economy in Germany has always been quite obvious to Poles. In this context, the time of Poland's partition plays a part. From the end of the 19th century up until the end of the First World War, Poland was divided up amongst Russia, Prussia (later the Reich) and the Austro-Hungarian Empire. Living under three dramatically different legal and social regimes during the turbulent early "formative" years of capitalism left Poland with different approaches to the economy, visible even today. There is a widespread conviction that the Wielkopolska region with its capital of Poznań, which had belonged to Prussia and used to be economically the most successful region, still ticks in a different way than the regions of south-east Poland with their small, conservative communities.

Another source of experience was the Polish *Gastarbeiters (guest workers)*, who migrated to Germany throughout the 20th century. Many of them returned to Poland after the collapse of communism and founded successful businesses, such as Solaris, one of the largest bus manufacturers in Europe. They brought with them the experience of an economy with a high culture of compromise, strong business organization and trade unions, as well as dense networks of small- and medium-sized companies and public banks. Germany was also associated with a restrictive and stability-oriented monetary policy. In the last decaying stage of communism, buying the Deutsche Mark was for Poles one of the few methods available to protect their savings from rampant inflation.

These perceptions are not dramatically different from what theory says about the German model. The Varieties of Capitalism (VoC) approach, one of the leading methods in comparative political economy, has made Germany a defining analytical anchor, calling it a coordinated market economy (CME). This model is in clear opposition to the liberal market economies (LMEs), exemplified by the USA. Crucial for this distinction is that German firms (the essential actors in economies) have access to "patient," long-term capital via relational banking. Germany's labour market is characterized by a high protection of workers and influenced by formalized wage negotiations between branch trade unions and business organizations and skills are generated with the participation of companies under the regime of dual vocational training. In addition, macroeconomic policy is oriented to monetary stabilization which enables social partners to make credible, long-term commitments. Last but not least, the social insurance system is based on contributions paid from wages, which increases incentives for workers to invest in skills.

From a bird's eye view, this form of capitalism has been very efficient in creating a pool of specific skills and narrow specializations based on so-called incremental innovations. Germany fits well into this picture, being very competitive in the production of, for example, cars and other means of transportation, investment goods and advanced machinery. Yet there is not much room in this competitiveness profile for the spontaneous discovery of new products, for example in media, bio-technology and information technology. Even when they are developed – with aid from the state – the industry has little idea what to do with such "radical" devices as, for example, the MP3 player. To put it simply: Germany is devilishly strong in its traditional branches, and has been not just since the 1970s, but in fact since the end of the 19th century.

This model picture of a CME must be, however, treated with some reservations. Germany has indeed changed much in the last decade, particularly under the reforms of Gerhard Schroeder. The biggest shifts have been observed on the labour market and in social policy. There is definitely more flexibility today (atypical employment, the diminishing role of branch trade unions, higher adjustment capabilities on the level of individual firms, an activating labour market policy). All this has convinced many to identify a shift of Germany towards LME-solutions. Yet the story is more complicated. The Rhenish-CME is not dead, but has rather been restricted to core industries and high-skills areas generating export, where traditional features are still visible and necessary. Around this core there are buffers of services employing people with lower skills under quite flexible conditions, often with government subventions. This is a very efficient hybrid system. It has helped to keep wages frozen for a fairly long time, making Germany more competitive. This happened at a time of booming wages in other European countries and the formation of the eurozone, which halted eventual currency appreciation (there was no longer the Deutsche Mark). When one adds to this a massive increase in demand for traditional industrial goods from countries like China, India and Russia, we have an explanation as to why German export exploded and why the country was able to achieve its undeniable success. It was thanks to both clever institutional arrangements at home and extraordinarily favorable conditions abroad.

Could and should Poland become like Germany?

At the first glance, Poles would be happy with becoming more German. After all, Poland has added to its constitution the "social market economy" – banner (Art. 20), referring clearly to the German experience. But this reference is related more to the goal of a high standard of living, and not necessarily to the way Germany has achieved it. Copying the sophisticated social environment of Rhenish capitalism is probably neither advantageous nor possible.

German capitalism in its current form did not sprout from nothing. It has roots in the pre-capitalist organization of society and established patterns of the specialization of its companies. It is based to a large extent on non-contractual relations which are extremely hard to emulate or copy. It was much easier for transition economies in central Europe to emulate LME-patterns, because they are based on clear contractual relations enforced by formal institutions.

In fact, Poland chose a more liberal pattern, which was on a par with the Washington consensus standards. The effect, after 25 years of change, is a system with weak trade unions and business organizations, flexible forms of employment, and an education system that generally produces transferable, rather than specific skills. The economic success of Poland in recent years is based on openness, low costs and foreign direct investment of transnational companies, but also on the myriads of small, locally oriented, not too innovative enterprises. This is still a system in *statu nascendi* and the literature on Poland and comparative economics reflects this. Some have called the country a dependent market economy (DME), others a mix of the liberal model and the south-European model.

The biggest problem for Poland now is how to encourage this relatively open and undefined system towards the development of specific skills and innovations. The success of the last decades has brought the country to the point where it finds itself in a so-called "middle income trap," which means that it is becoming too expensive for simple manufacturing and needs a new driver of growth: innovation. However, since its companies are relatively weak and not eager to invest in research and development, the main activity in this area will probably have to be taken up by the government and its agencies. This means Poland will have to seek more of a DARPA-like solution resembling liberal patterns to boost innovation, rather than a dense network of business associations. Anyone who hopes that Poland could become "more German" by encouraging the cooperation of trade unions and companies in order to increase productivity should take note of the slow-moving attempts to implement the EU-idea of works councils in firms employing more than 50 workers.

Is Germany's "success" sustainable?

Complaining about the difficulties of copying Germany's endemic and sophisticated model, reportedly a dead-sure recipe for success, is going too far. There are other roads to follow to improve the country's welfare – which the VoC literature also suggests. But even more convincing is the fact that the German economy has – surprisingly – many weak points hidden behind the satisfying short-term data on the labour market, fiscal policy and growth, as well as many growing challenges.

First of all, one should look at Germany's level of investment. In recent years Germany's GDP has been driven by consumption and net export, but surprisingly little has been spent on investment. In comparison to other eurozone countries, the German data is worrying: only about 18% of GDP has been allotted for future capacities of the domestic economy. The *DIW* (German Institute of Economy) warned in early autumn 2014 that the economy is on the skids and is living from its own substance. A good example is Germany's transport infrastructure which, according to many experts, is in a disastrous state. Also, companies' capital endowment is in decline, which may be to some extent the effect of "frozen" labour costs in the last decade. It was more cost effective to employ workers, than to invest in new equipment.

Second, there are some doubts as to whether the tendencies on the German labour market are really supportive for education and social coherence. For those who are working in the framework of atypical and flexible employment, exclusion from the acquisition of high skills and high income can become a durable phenomenon. Add to this the still high number of long-term unemployed, whom the recent reforms have not helped, and, gradually, the German social structure may start to change and lose its famous coherence. The introduction of a minimum wage could be an important measure to reduce this threat, but nobody knows if it will be sufficient.

Third, Germany is facing a rising demographic challenge. In the upcoming years thousands of workers will be lacking on the job market. This may force German companies to invest abroad – in economies with younger societies.

Fourth, Germany is, despite its progress in recent years, still a country in debt; the public debt amounts to 78.4% of GDP. Only in the face of the crisis did the government decide to act more decisively and add the so-called "debt-brake" to its constitution. In this sense Poland has been more prudent, as this measure has existed in the Polish Constitution since 1997, when Germany was only theorizing about it. However, even the debt brake itself will not solve the problem. Faster growth is needed to reduce the debt, and this growth will be very difficult to achieve if the state cuts spending.

However, this is not everything: Germany could face further challenges related to technological progress and new tendencies in employment. The so-called "Second machine age" with the expansion of robots and 3D-printers into industrial manufacturing could massively damage the basis of Rhenish capitalism – the small and medium-sized enterprises (*Mittelstand*). Experts foresee a massive reduction of employment, both in industry and in services. An effect of this could be a society where such courageous ideas as guaranteed minimum income and free access to public goods may be necessary to guarantee social peace. Decision makers in Germany should take this perspective into consideration very carefully.

What should Germany do?

The most important and relatively clear goal of Germany for the coming years is to increase the level of investment – both private and public. There is a need to pump billions into its crumbling transport infrastructure. Many roads, railways and bridges built in the serene era of 1970s and 1980s are in need of an overhaul. The country also needs a boost to its digital infrastructure.

It will not be easy, however. After recent decisions made by the ECB, access to money is easier than ever before, but business still refrains from investing. Public spending should be easier, but the government is trapped in its own assumptions regarding financial austerity. Since 2008, the mainstream of Berlin politicians as well as the country's economists have persuaded the European audience that the only way out of the financial and economic crisis is to bring fiscal budgets into balance and to start reducing excessive public debts. Abandoning this narrative and accepting a persistently higher public debt could be politically costly, but there is probably no feasible alternative.

The second area on which the country should focus is human capital. Germany has to experiment further with incentives for women to do two things: have children and go to work, which means, for example, spending more money on pre-school education and day care and institutions protecting the employment of mothers. Something must be done about the long-term unemployed (one million), whose situation is still difficult despite labour market and social reforms. Human capital improvement will also require changes within the educational system. Germany needs more flexibility and life-long learning, e.g., for graduates of vocational education who decide to start tertiary education. Also a clever system of attracting more qualified migrants should be developed.

The third area worthy of attention is the *Energiewende* – the switch from carbon and nuclear energy to renewable energy. This is a very ambitious idea with the potential to induce growth and create jobs, but it will require hundreds of billions of euros to be invested in new technologies, new devices and transmission. It will also need a good institutional environment in order to efficiently combine market forces with public regulation. So far, many decisions have seemed to be controversial (the sophisticated system of subsidies) and have left business and households confused.

So, indeed, Germany has its work cut out. Just the same as its admiring neighbour.

Notes

1. According to Destatis, the German Office for Statistics.
2. For more about Polish-German economic relations and Polish migration to Germany in the past 10 years see: A.Łada (ed.), *Ein gemeinsames Jahrzehnt. Polen und Deutschland 10 Jahre gemeinsam in der Europäischen Union*, Institut für Oeffentliche Angelegenheiten, Warschau 2014
3. The quoted data come from perception studies conducted by the Warsaw-based think tank, Institute of Public Affairs, described in the reports: A.Łada, "Deutsch-Polnisches Barometer 2013", Institute of Public Affairs, Warsaw 2013; and *Poland, Czech Republic, Germany. Mutual relations / cooperation development, Future fuelled by knowledge*, volume 6, PKN Orlen, Warszawa 2013
4. "Experts working in international surroundings" refers to research conducted among employees of major Polish companies in July 2013.

Germany's Success: a Finnish Perspective

Pekka Sauramo

Introduction

Finland has traditionally had close political, economic and cultural ties with Germany. During the past twenty years growing European integration has strengthened these ties and, in particular, the birth of the Economic and Monetary Union (EMU) has played a special role in deepening integration between these countries. The Finnish membership in the EMU has made the economic relationship between Finland and Germany closer than ever before.

In this article I pay special attention to one channel which has been of special importance: within a monetary union the absence of a sovereign currency has the consequence that wage policy directly affects price competitiveness. Wage policy can play a role which exchange rate policy or exchange rates have in the presence of sovereign currencies.

The economic crisis in the euro area has shown how important a role wage policies, and German wage policy in particular, can play in a monetary union. Its effects can be similar to a beggar-thy-neighbour exchange rate policy. It has not been surprising that German wage policy has been characterized in this fashion (Flassbeck and Spiecker 2005, 2009; Lapavitsas *et al*. 2010; Stockhammer 2011). During the euro era, German wage policy has been based on very moderate wage increases which have not been in line with the two percent inflation target set by the European Central Bank. There are good reasons for the claim that German wage policy was a major cause of the economic crisis in the eurozone. It bolstered diverging economic developments among the EMU countries.

Finland is not one of the crisis countries but, as a member of the EMU and as a neighbour of Germany, it has been influenced by German wage policy. Rather than only emphasizing the importance of German wage developments on the Finnish economy and competitiveness, I underscore the role of the collective bargaining system on which German wage moderation has been based. Within a monetary union not only wage policies but also bargaining institutions are likely to be interdependent. In the case of a small country like Finland it is highly likely that the German collective bargaining system will create pressure on the Finnish collective bargaining system – at least when outcomes of wage negotiations i.e. wage developments differ.

I will show that although collectively agreed wage increases have not differed very much, average wage developments in general have given good reason to discuss German wage policy and the German collective bargaining system in Finland. From a Finnish perspective Germany's success and the "German model" are important and topical subjects.

Germany's success and the "German model"

If employment figures are used as a benchmark for success, Germany has been economically successful during the euro era. The total number of unemployed has fallen, and even during the economic crisis Germany did not experience a big increase in unemployment. A major factor contributing to good employment performance has been excellent price competitiveness which has fostered exports. During the euro era, economic growth in Germany has been export-led, and Germany has reached all-time records in the volume of exports (see, for example, Dustmann *et al*. 2014). Germany's gains in competitiveness with regard to, for example, France, Italy and Spain have mainly been due to wage moderation. In comparison to these countries wage increases in Germany have been very small.

In the explanation of the causes of wage moderation, the role of the German collective bargaining system, or rather its change, has been emphasized (Dustmann *et al*. 2014; Schulten and Bispinck 2014; Streeck 2009). Depending on the writer, the change has been characterized in different ways. From a Finnish perspective it seems justified to talk about a partial erosion of the system (Haipeter 2013; Schulten and Bispinck 2014). The institutional change has led, for example, to a shift in the power relations between capital and labour, in favor of capital.

For neighbouring countries the cause of this kind of success; wage moderation in combination with the erosion of the bargaining system, is certainly problematic. If gains in competitiveness are due to wage moderation, they have been attained by policy which can be regarded as beggar-thy-neighbour wage policy. Good employment performance has been attained at the cost of the neighbouring countries. Gains would not have been achieved if every neighbouring country had followed the same policy.

But has wage moderation anything to do with the "German model"? If we think that the "German model" is a description of a stable institutional structure, like non-liberal capitalism, the above characterization of the causes of wage moderation is not consistent with it. Erosion is an indication of change in institutional structure. An interesting analysis about the change, or disorganization, of the "German model"is provided by Streeck (2009:116). His conclusion that: "if there was anything permanent, it was that all elements of the system were continually in motion individually and with respect to their mutual functions and dysfunctions", seems persuasive.

However, looking at German economic policy and economic policy targets, one is likely to find more continuity. After the Second World War the German authorities chose the promotion of export-led growth as the basic economic policy strategy. This strategy was carried out with a combination of the liberalization of domestic and foreign trade and the maintenance of price stability. Within the regime of fixed exchange rates, guaranteeing price stability was the main responsibility of an independent central bank, the Bundesbank. The general aim of price stability was to foster exports by pursuing lower inflation than competing countries.

This kind of economic policy strategy has been described as "monetary mercantilism" (Holtferich 1999; see also Casaratto and Stirati 2011). Even though speaking about a stable "German Model" may be misleading, speaking about a relatively stable "German Economic Policy Model" may be appropriate. At the center of the model is monetary mercantilism which the German authorities have been pursuing for decades within various variants of fixed exchange rate regimes.

In 1950 Ludwig Erhard put the idea of monetary mercantilism as follows:

"A great opportunity for the future of German exports has arisen out of the current situation. If, namely, through internal discipline we are able to maintain the price level to a greater extent than other countries, our exports strength will increase in the long run and our currency will become stronger and healthier, both internally and with respect to the dollar" (Holtfrerich 1999: 345; see also Cesaratto and Stirati 2011: 17).

Erhard emphasizes here the importance of internal discipline as a guarantee of price stability. Obviously, its essential element is wage moderation, or wage discipline. Before the EMU, cooperation between the Bundesbank and the trade union movement was essential in the pursuit of wage moderation. The pursuit was largely successful, however with some exceptions.

It is not obvious why German trade unions accepted wage moderation. In the early 1990s Giersch *et al.* (1992) gave a number of reasons, for example, the fact that productivity growth exceeded trade union expectations, taking a responsible standpoint during the reconstruction years as a part of establishing co-determination, but also organizational weakness. Organizational weakness may have been a relevant factor only in the initial years 1948-50 (see also Cesaratto and Stirato 2011:22).

German monetary mercantilism was not without harmful influences for the other neighbouring countries in the era of sovereign European currencies. From time to time it created confidence crises in countries whose currencies were more or less pegged to the D-Mark. However, by adjusting the pegs the crises could be resolved. In the euro era this is impossible. The euro crisis has shown that it may lead to a very painful adjustment period in crisis countries, if German wage policy remains unchanged.

The euro era supports the continuity thesis of German monetary mercantilism. Even though the German economic policy model has been relatively stable, the importance of the factors which have maintained it has changed. During the euro era the main explanatory factor of wage moderation has been the partial erosion of collective bargaining.

With the erosion of the German system of collective bargaining wage moderation has been institutionalized. Currently this is most harmful for the crisis countries but the other EMU countries do not remain unaffected by the erosion: and Finland is an example. The erosion of collective bargaining in Germany creates pressure which may also weaken the collective bargaining system in Finland.

Germany and Finland

As regards collective bargaining there are big differences between Germany and Finland. The basic difference is that even though trade unions have lost some of their power and influence in Finland they are still strong actors in the Finnish labour market and in Finnish society in general. This fact is also reflected in the Finnish collective bargaining system.

During the past forty-five years an essential part of collective agreements has been based on centrally negotiated incomes-policy agreements which have been outcomes of tripartite cooperation between employees' and employers' central confederations and the government. Unlike in many European countries this kind of incomes policy is still alive in Finland. It is one indication of the strength of the Finnish trade union movement. During the past fifteen years union density may have declined but it still stands at 70 per cent.

The importance of local bargaining has increased, but this has not taken place at the cost of centrally negotiated comprehensive incomes policy agreements. Decentralization has been organized and complementary to the higher-level bargaining. It has taken place in a manner in which higher-order collective agreements constitute benchmarks for local bargaining. The role of higher-order agreements have therefore been crucial and, consequently, the use of opening clauses has been exceptional. In addition, the high bargaining coverage, 90 percent of employees, has heightened the importance of collective agreements in wage formation. It has been one factor behind the high level of bargaining coordination.

Because of vast differences in the collective bargaining systems, one would expect that wage developments in Germany and Finland have differed a lot. This has been the case but the manner in which they have differed is not necessarily obvious.

During the past few years, which have been overshadowed by the European economic crisis, Finnish competitiveness has been one of the major topics in Finnish economic policy discussion. Wage developments in Germany have been monitored very closely, and in the debate the German collective bargaining system has been an important topic. The most important actor behind these interchanges has been the Confederation of Finnish Industries, EK.

EK's representatives have maintained that, because of too costly collective agreements, the Finnish exports industry has lost its price competitiveness. In its statements, EK have emphasized that, in particular, a drastic deterioration of price competitiveness *vis-à-vis* Germany has taken place.

Figure 1 summarizes some similarities and differences in wage developments in Finnish and German manufacturing during the years 2001 to 2013. The most important similarity is between developments in collectively agreed wages. Annual changes may have differed a little but, on the whole, in both countries collectively agreed wages increased by 30 percent during the period from 2000 to 2011. During the past two years collectively agreed wage increases have been a little higher in Germany. There is, however, a noticeable difference between changes in average actual wages during the period from 2000 to 2013. In Finland average wages increased faster than collectively agreed wages but in Germany they typically increased less than collectively agreed wages. This means that in Germany wage drift, the difference between the increase of actually and collectively agreed pay, has normally been negative while in Finland it has been positive.

Even though the difference between increases in actual wages in Finnish and German manufacturing is obvious, it has not been due to collective agreements. It is therefore misleading to say, as employers' representatives often say in Finland, that collectively agreed wage increases have been too costly in Finland.

The discrepancy is due to differences between the collective bargaining systems. In Finland, collectively agreed pay increases normally set a minimum for actual pay increases, but in Germany this is not the case. An important cause of negative wage drift has been the use of opening clauses (see, for example, Bispinck and Schulten 2011). As employers may benefit from the use of them, it has not come as a big surprise that EK has been interested in increasing the possibilities of also extending the use of opening clauses in Finland.

The most important conclusion to be drawn from the above comparison is as follows. Within a monetary union, differences in collective bargaining systems may give rise to notable differences in actual wage increases even if increases in collectively agreed pay have been similar, and consequently, to corresponding differences in unit labour costs. Even when trade unions act responsibly and accept collective agreements which are consistent with maintaining price competitiveness, actual wage developments may differ because bargaining systems differ. For example, possibilities to use derogation clauses may differ.

It is not surprising that currently one of EK's main objectives is to increase "German" elements within the Finnish collective bargaining system. But why would convergence of the Finnish bargaining system towards the German system be inevitable even though pressures created by the common currency are strong?

The question of convergence can be elaborated by examining the literature on the relationship between convergence and divergence of national capitalist systems. Streeck (2009:18) criticizes Hall and Soskice (2001:64) about overemphasizing the role of the financial sector as a *master sector* driving the systemic change of capitalism. It can be asked whether, within the EMU, the German collective bargaining system does act as a *master system* which drives changes in collective bargaining in countries like Finland, at least over a longer period of time.

So far the Finnish bargaining system has been surprisingly immune to factors which may be regarded exogenous to Finland. Finnish wage policy represents more continuity than change and, accordingly, path dependencies seem to have dominated over external factors. The persistency of the system has been due to the willingness of the parties of the tripartite co-operation to maintain it. Even though path dependencies may also be the most important factors in the future, the relatively short history of the EMU has already shown that the evolution of the Finnish bargaining system will also depend on developments in the neighbouring countries, and, in particular, developments in Germany. The German bargaining system need not be a *master system* in order to have an influence in Finland.

Therefore the sustainability of Germany's success, and the German economic policy model is also important for

Finland. On the other hand, Germany's success is likely to depend on the other EMU countries.

Is Germany's success sustainable? What should Germany do?

Germany's success has been based on the promotion of export-led growth by means of monetary mercantilism. The problem with monetary mercantilism is that it tends to be beggar-thy-neighbour policy, and therefore its potentially positive consequences cannot be exported to every neighbouring country. Furthermore, during the past twenty years the pursuit of monetary mercantilism has been accompanied by the erosion of the German collective bargaining system. This has had the consequence that, considering bargaining systems, discrepancies between Germany and some EMU countries may have increased.

German monetary mercantilism can be a successful economic policy strategy for Germany as long as the other members of the EMU accept beggar-thy-neighbour wage policy. It is, however, highly likely that the day will come when they will no longer accept it. The EMU cannot survive if the core country pursues mercantilist economic policy strategy.

Therefore one policy option suggests itself: wage policy in Germany should be reversed and, more generally, monetary mercantilism should be abandoned. That said, it is highly unlikely that this option will be realized in the near future. In this chapter I have emphasized the continuity of the German economic policy model. I have also argued that the deflationary bias of German wage policy has been institutionalized. The erosion of the bargaining system maintains it. A necessary condition for the reversal of German wage policy would be a re-strengthening of the bargaining system.

The eurozone crisis has shown that the EMU may have been too ambitious a project. A common currency may magnify the consequences of differing economic policy strategies and differing institutions, wage bargaining institutions included. From the Finnish perspective the erosion of German wage bargaining and its main consequence, institutionalized deflationary bias in wage policy, has been problematic as it also threatens to weaken the wage bargaining system in Finland.

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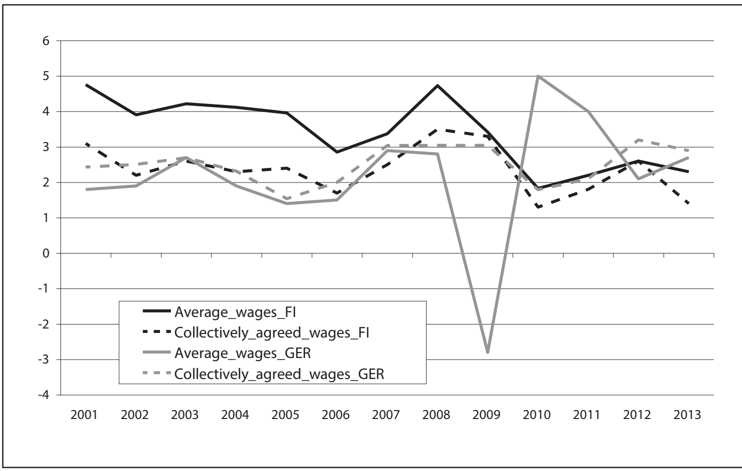
Figure 1. Developments of average wages and collectively agreed wages in Finland and in Germany 2001-2013: manufacturing (%).



Source: TURI database on collectively agreed wages, Destatis, Statistics Finland

Since the Financial Crisis in 2008 Germany has performed economically far better than most of its neighbouring countries. What makes Germany so special that nobel prize winner Krugman called it a German miracle and is this sustainable? Is it its strong economic and political institutions, in particular trade unions, which by international comparison are a solid rock in turbulent waters, its vocational training which guarantees high skilled labour and low youth unemployment, its social partnership agreements which showed large flexibility of working time arrangements during the crisis and turned the rock into a bamboo flexibly bending once the rough wind of globalization was blowing? Or was it simply luck, booming exports to China and the East, a shrinking population, or worse so, a demolition of the German welfare state? All along from miracle to fate to shame of the German model: Is there such a thing like a core of Germany? The debate on the German model is controversial within Germany.

But what do neighbours think about Germany? The Nordic countries want to copy German labour market institutions. The Western countries admire it for its high flexibility within stable institutions, the Austrians have a similar model but question Germany's welfare arrangements and growth capacities. Many Eastern European countries are relatively silent about the German model. There is admiration for the German economic success, but at the same time not so much for its institutions and certainly not for its restrictive migration policy. The Southern countries see it as a preposterous pain to Europe by shaping EU policy a la Germany and forcing austerity policy at the costs of its neighbours. Can the German model be copied? And what do neighbours recommend Germany to do?

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