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The German economic model emerges reinforced from the crisis

by Stefan Beck and Christoph Scherrer

For years, the business press has portrayed the German economic model as hopelessly atavistic in the face of dynamic Anglo-Saxon financial innovation and comparatively high growth rates. Recently, however, the economic historian Werner Abelshauser argued that the financial crisis would vindicate the German model of capitalism. In his view, the fading lustre of Anglo-Saxon capitalism, in particular its model of corporate governance and dominance of shareholder value, should again lead to the German or "Rhenish" model of diversified quality production and its institutions becoming more attractive. We argue here that Germany's response to the crisis has reinforced the central strategies and core institutions of the German economy. At the same time, the model has become more and more exclusive and has begun to foster European and international economic imbalances.

One of the German model's most salient lines of continuity is the maintenance of a trade surplus. After the period of stagflation in the 1970s, the Bundesbank reacted with policies focusing on rigid monetary and currency stability, in which priority was given to price stability. As a result, domestic consumption was stifled while exports remained the main source of growth. The focus on exports was shared by the trade unions, including the most powerful among them, IG Metall which supported the drive for productivity through the institutions of co-determination, and ensured that unit labour costs would not be driven up by wage demands exceeding productivity gains. The success of this strategy led to the coinage of the term "Modell Deutschland" in the mid-1970s.

Socially and economically, the model became less inclusive long before the financial crisis hit. In particular, the reforms of the social democratic and green coalition government of Chancellor Schröder shifted the German model towards institutional deregulation and a price-competitive strategy that included moderate wage increases, tax cuts and fiscal consolidation. Its core objective, however, remained the same: fostering growth through exports. During the present crisis, the focus on companies' core workforces has been reinforced.

The impact of the Financial Crisis

Unlike the US and many European countries, Germany did not enjoy a debt-driven real estate boom before the crisis. The resulting slower growth in comparison to its neighbours made Germany the object of much ridicule in the business press. In the absence of a real estate bubble, however, one would have expected that Germany might have survived the crisis unscathed. In fact, the German government believed that because of a lack of exuberance, its economy would be rather immune; which explains why the government acted rather belatedly to the crisis that eventually hit Germany at the end of 2008. It reached the German economy via two channels, the first being finance. Many of its banks were overexposed to "toxic" speculative papers originating mainly in the US and Ireland. Some of the big private banks, especially Commerzbank and Hypo Real Estate, and top public banks (the Landesbanken) had to be rescued by public guarantees of gargantuan proportions, totalling €400 billion. The more important channel, however, was trade. The export industry, the heart of the German model suffered immensely through the collapse of international demand. The automobile industry, in particular, suffered because of the overlap of the financial crisis with the energy crisis. The capital goods industry lost sales because consumer industries postponed capital investments when faced with a drop in demand.

The most visible outcome of the German model, its export success, proved to be the Achilles heel of its economy. However, the German model of close cooperation proved its worth. Despite the significant decline in GDP of 5%, job losses were miniscule (about 80.000 or 0.3 %). Some elements of the German model contributed to this "miracle". General stabilizers of the welfare state made intentional deficit spending less necessary. Whereas discretionary measures to re-inflate the economy (Konjunkturpakete I & II) accounted only for €78 billion for the years 2009 and 2010, i.e. around 3.3 % of government expenditure per year, overall government expenditure increased in 2009 by 5%. These stabilizers were enhanced by the willingness of the government to fund part-time support for workers. In 2009 the duration of part-time support was extended up to 24 months and its use reached a maximum of 1.5 million workers in May 2009 (compared to 70.000 in 2007) and then dropped again to around 900.000 workers in the first quarter of 2010. Expenditures of the Federal Employment Agency for short-term work totalled more than €5 billion in 2009.

Industry-wide collective bargaining brought about noticeable real wage losses. According to the ILO Global Wage Report, in 2008 and 2009, German workers had to accept a decline in monthly real wages of more than 0.5% (ILO 2009). Decentralisation and co-management bore fruit: In about 30% of all firms, overtime accounts have been reduced – some even going negative ("Zeitschulden"), one out of four firms reduced the use of subcontracted work, and nearly every third used other measures to increase internal flexibility. In sum, about 1.2 million jobs were preserved by reductions of working time. Lay-offs predominantly hit workers with temporary contracts.

Co-determination was also defended in another arena. The attempt to rid VW, Europe's largest car manufacturer, of state and trade union influence, failed. Under Chancellor Merkel, the federal government successfully retained the stake of the German State of Niedersachsen in VW, despite attacks from the European Commission. Because of this state's stake in VW, the Porsche's strategy to finance a takeover of VW, with cash from VW, was muted. Instead, VW took over Porsche, allowing the work council of VW to retain a strong voice. At the end of 2009, exports had picked up again and seemed to justify the current strategy.

The core of the German model, close cooperation of capital, labour and the state in pursuit of export surpluses, has actually been strengthened in the crisis. Success of the corporatist crisis management, however, may bring about the German model's own demise, with export success perhaps squeezing out neighbours who cannot shield themselves via currency depreciations - e.g. southern EU members.

International consequences of Germany's trade surplus and macroeconomic restraint strategy of growth

The Greek and Euro crises in 2009 and 2010 were portrayed by the German government and by most of the media as the result of a weak, spent-thrift government. In contrast, the German objective of budgetary parsimony was praised as virtuous and, accordingly, strict loan conditions for Greece were seen as wholly justified.

Surely, in the case of Greece it is easy to identify homemade causes of the crisis. However, there are also systemic reasons for the Greek crisis, which are related to Germany's export success. Since 1999 German unit labour costs remained nearly constant, whereas the average of the European Currency Union rose about 15% and those of Greece, Portugal or Spain between 20 and 30%. Additionally, trade and current account deficits of these latter countries have increased in parallel to comparative unit labour costs, and disproportionally since the introduction of the Euro.

From a Post-Keynesian perspective this mercantilist strategy of perpetual trade or current account surpluses is a kind of beggar-thy-neighbour-policy. It aims at fostering the growth of one's own economy and rate of employment at the expense of other countries. And given the fact that countries cannot sustain permanent deficits without rising indebtedness vis-à-vis foreign countries, such mercantilist strategies can force countries into insolvency. Moreover, such developments have internationally contractive effects on growth and can provoke economic and political instabilities. In the end, deflationary tendencies stemming from Germany and balance of payment and/or budgetary problems of deficit countries are two sides of the same coin.

The German model after the financial crisis

In sum, the German economic model was hit hard by the crisis but proved surprisingly resilient. Actually, its core, the willingness of all major stakeholders to work together in securing the export prowess of German industry, emerged from the test of the crisis stronger than ever. With the help of state subsidies, employers kept their long-term commitments to core workers, and in return, organisations representing skilled workers, i.e. work councils and trade unions, were willing to make concessions in terms of pay and working conditions. But whereas now some of those core workers (e.g. BMW) are receiving extra or 'compensatory' payments in return for their loyalty, temp workers and workers outside the export industry are bearing the brunt of the crisis as new levels of public indebtedness are leading to budgetary constraints whose first victims are again those on welfare.

While voices within and outside of Germany call for strengthening domestic consumption, the recent resurgence of exports seems to vindicate the export coalition. Therefore, it does not look very likely that the German economic model will be restructured in favour of less dependence on trade surpluses and further tensions within the euro zone are therefore highly likely.

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