INTRODUCTION

Writing about the German economy, the social arrangements that underpin it and the political management of its structures and processes invariably involves a paradox. On the one hand, this core political economy of greater Europe has maintained its leading status as a highly productive trading nation, exporting more goods in 2007 ($1.36 trillion) than either China ($1.22 trillion) or the United States ($1.12 trillion), which have, respectively, populations sixteen times and three-and-a-half times that of Germany. Without Germany's massive balance of trade surplus, the European Union's and the eurozone's external balances would look much less favourable. Secondly, its engineering products, most notably its investment goods and its motor vehicles, carry a badge of quality which makes them less price-sensitive than those of their rivals, both because of their established reliability and because of the quality of after-sales service provided to their customers. Thirdly, it produces more industrial patents per head of population than practically any other European country, except Sweden. It continues to attract relatively high levels of foreign direct investment (2006 stock levels, approximately $763.9 billion) despite the comparatively high marginal wage costs (social insurance etc.) paid by enterprises in Germany.

As a catalogue of virtues, this kind of record would satisfy most superficial judges of economic fitness and successful political management. The paradox, the other side of the coin of success, is – inevitably – the set of indicators that question the sustainability of that success. Germany's rate of economic growth – its average annual increase of real gross domestic product (GDP) – has been comparatively disappointing in recent decades. Since 1993 there have been two business cycles; the first from the recession year in 1993 to the pre-recession year of 2002 showed an annual average rate of growth of just 1.24 per cent; in the, as yet unfinished, cycle from the recession year of 2003 to 2007, it is probable that it will result in a similarly low average. Growth in 2006 (3.1 per cent) and 2007 (2.6 per cent) indicated a cyclical recovery, but such recoveries have historically always occurred; in Germany's case they have been fewer and farther between in recent years. Notwithstanding the huge shock of German–German unification in 1990, growth in this core industrial economy has been weaker than any other EU-15 country since 1993; the GDP growth weakness has translated into weaker employment growth and more particularly into less favourable unemployment. In 1993 the standard rate of unemployment in

Germany – at 7.6 per cent – was lower than the Organisation for Economic Co-operation and Development (OECD) average of 7.8 per cent (OECD 2007: Statistical Annex Table 14) but by 2005 had risen to 10.6 per cent while the OECD average had fallen to 6.7 per cent; the 2006–07 recovery has helped to reduce unemployment, but in all likelihood Germany will end this current cycle, as in all others since 1975, with higher unemployment than at the end of the previous cycle. A rule of thumb among economists contends that economies currently require an average rate of GDP growth of around 2 per cent to prevent unemployment rising inexorably from cycle to cycle. The medium-term signs for the German labour market are not favourable, therefore. Structural unemployment was well embedded even before unification and, reinforced by the tribulations of East Germany's transition to market economics, is set to remain firmly entrenched in the united country's political economy. This is in part a result of a relative decline in the proportion of GDP that is reinvested in the national economy, the investment ratio, which has fallen from a typically high average of over 20 per cent before 2000 to 18.4 per cent in 2007 (after two years of strong growth in investments); the average investment ratio for the new cycle since 2001 is thus set to decline further, compared to previous cycles. Without a significant reversal of investment activity in the domestic economy, Germany's overall trend of GDP and employment growth is therefore likely to be disappointing.

The paradox of evident strengths side-by-side with evident weaknesses should not be so surprising, even if one sets aside the problems associated with unification. The political economy of the Federal Republic had identifiable structural problems in the 1970s and 1980s (Leaman 1988) which have in part only been reinforced by unification; part of the purpose of this book is to examine the threads of continuity and the longer-term determinants of the country's paradoxical status and to assess whether Europe's industrial Colossus has more obvious 'feet of clay' today than in the 1980s (ibid. 263ff).

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A fundamental point of departure for this analysis is the assumption that Germany's 'economic order', like that of all other social formations, has changed markedly over the last century and will continue to change – probably more rapidly – in the twenty-first century. This truism needs to be stated for one simple reason: it challenges the theoretical and practical political assumptions based on the notion of an ideal-typical market order that underpins neoclassical economics and the political orthodoxy of neoliberalism, which is currently *en vogue* in Germany and elsewhere. Market fundamentalism, for which 'neoliberalism' is the most commonly used label, has theological characteristics in its postulation of a purity of

market mechanisms which have supposedly been distorted or disabled by state interference but which could be restored through a programme of reversal ('roll-back') towards the pure *status quo ante*. Polanyi describes this school of thought as 'liberal utopianism'. The 'roll-back' is akin to Jeremiah's plea to the corrupted citizens of Jerusalem to 'return to the Lord' and was reinforced by the apparent triumph of market capitalism over state socialism after 1989 and by the (admittedly absurd) notion of the 'end of history' (Fukuyama) and the seeming convergence of a purified West with a fundamentally restructured 'East'.

The details of the paradigm shift from Keynesianism / Marxism 'back to' market fundamentalism will be dealt with in subsequent chapters. It is sufficient to say, in the introduction, that this study of Germany's political economy rejects entirely the notion of the ideal-typical model of economic and social organisation which can be restored to health and permanently fixed. Every teleological state of perfection, be it the sanctified Prussian state in Hegelian conservatism, communism as 'final stage' of social development in Marxian thought or the paradise of market freedoms for neoliberals, defies the overwhelming evidence of flux, of change, of irreversible history and the uncertainty of future human development. The *desirability* of distributional fairness, social justice and sustainable human welfare will never make these *inevitable*. The constitutional, legislative and normative anchors which societies develop individually as nation states or even collectively as international bodies are also not bound to prevent change, favourable or unfavourable. In the history of economic and social 'orders', the discontinuities arguably far outweigh the continuities. This is more than evident in the case of the development of the German political economy in the last 150 years. Periods of relative stability (e.g., 1949 to 1989) were preceded and followed by periods of extreme change. There were dramatic discontinuities at the level of the state-form presiding over economic development, from the autocratic particularism of the mid-nineteenth century, through the federal autocracy of the 'Second Empire' 1870–1918, the federal democracy of the Weimar Republic 1918–1933, the centralised autocracy of German fascism 1933–1945 and – after the interregnum of Allied occupation – the extreme federalism of the Federal Republic of Germany (FRG) and the state socialist autocracy of the German Democratic Republic (GDR). While this extreme discontinuity of state-form concealed significant continuities in the structures of ownership and their respective economic and political elites – the 'cartel of rye and iron' (Kitchen 1978) – it also reflected significant shifts in the contextual conditions of economic and political activity. The sectoral shifts in production and employment – firstly from agriculture to industry and then, after the Second World War, from industry to the service sector, produced major demographic changes, above all in the process of urbanisation, which in their turn presented major challenges to the political management of change in a political economy

dominated by the land-owning aristocracy until at least 1916. The subsequent evolution of Germany's particular forms of political management has been variously described by economic and social historians in terms of a 'special path' (*Sonderweg*) (Blackbourn and Ely 1984), a 'German path' (Abelshauser 2005: 127) etc. This was in large part to explain the world historical catastrophe of Germany's genocidal imperialism, but also to account for the particular features of what Abelshauser describes as 'the German production regime' (ibid. 77ff). Such accounts are invaluable for tracing the origins of the traditions which have evolved in Germany over the last century, in particular when contrasting this development with that of other political economies.

The military-aristocratic mercantilism of Bismarckian and Wilhelmine Germany can be seen to predefine the particular pathway towards industrial modernisation pursued by subsequent generations of economic and political leaders. The toleration/promotion of universal banks and cartels by the Prussian–German state was informed by and in turn nurtured the 'aversion to risk' generally accepted to characterise the investment, production and distribution regimes in Germany in the critical first half of the twentieth century. The strong preference for bipartite corporatist regimes (state plus trade associations) up to 1945 and for tripartite corporatism (state, trade associations and trade unions) in the Federal Republic after 1949 equally reflects a culture which more readily sought to prevent or avoid the unnecessary costs of conflict and/or competition.

This much would justify the student of comparative economics in using the concept 'organised capitalism' to characterise (in admittedly very general terms) the way in which Germany's political economy was managed and regulated, and in placing it in the 'conservative' (Esping-Andersen 1990) or 'Rhenish' (Albert 1992) segment of the spectrum of governance in the family of capitalist states. It is far less convincing to describe Germany's variant form of capitalism as 'non-liberal' (Streeck and Yamamura 2001) in contrast to the 'liberal' capitalism represented by the United States and Britain (ibid. 5). Firstly, as Streeck himself concedes, 'liberal' or 'standard' capitalism 'is no more than an ideal type' (ibid.), i.e., a heuristic abstraction, never actually realised, even in Anglo-Saxon economies. It is in fact a pretty crude abstraction which, with the polarity to nonliberal, implicitly applies the theological yardsticks of Hayek, Mises and the Chicago School to the measurement of 'liberality'. This adds confusion rather than clarity to the analysis of both liberalism and the German political economy. It thus arguably plays into the hands of the high priests of market fundamentalism, by implying that German (and Japanese) elites have constructed an organisational framework for the operation of capitalism which excludes 'liberty'. However, the most basic analysis of the concept 'liberalism' reveals a veritable bran-tub of confusing choice and the unhelpful knowledge that, as a semantic blanket, it covers

a political spectrum from Beveridge to Pinochet. The rhetorical malleability of 'liberty' reflects both the political potential of its use/abuse (Harvey 2005: 39ff) and the frequent intellectual 'poverty' of liberalism (Wolff 1969).

It does not require a great deal of reflection to ask of the proponents of 'liberalism' what particular liberties are primary and how they are constituted and protected. Whose freedom is involved, from what bondage and to what end? This kind of enquiry would reveal that 'liberalism' is deployed to justify a host of 'liberties', some of which can clearly be seen to be antithetical: e.g., the freedom to exploit other human beings (as owner of land, commercial property, means of production, scarce resources) clearly collides with the freedom from exploitation. The list of such potential contradictions is endless. They can at the very least be deployed to suggest that certain provisions of 'organised' or 'embedded' capitalism, e.g., in health and safety legislation, consumer rights, contract law, licensing laws etc., are designed to maximise the potential of certain (market) freedoms by curbing harmful, negative 'liberties'. 'Nonliberal' as a category of analysis and as a vehicle for understanding the evolution of Germany's political economy is at best a provocative heuristic fiction, at worst a misleading and crude simplification.

If we therefore examine the main constituent elements of Germany's variant of organised capitalism, it is possible to identify a considerable number of features which limit, regulate or constrain the operations of 'the' market or particular markets, but also other features which favour and promote those operations in ways which market fundamentalists would generally applaud. Conversely, an examination of the recent practice of 'liberal' states, e.g., the United States and the United Kingdom, reveals features of statist intervention, mercantilism and rule setting which the Chicago School would eschew – 'Reagonomics' in the 1980s is a perfect example of this (see Palley 2005: 24).

The economic order established in the Federal Republic after 1945 was very much the product of historically embedded structures and beliefs as well as the experience of defeat and political failure. The extreme federalism imposed on the architects of the temporary constitution, the Basic Law, by the Western occupying powers created a relatively weak central government and extensive devolution of powers to regional and local government. Central (federal) government was further weakened by the establishment of a central bank – the Bank deutscher Länder, later the Bundesbank – which was independent of government control. This fragmentation of executive power meant that there was effectively 'no place for Keynesianism' (Abelshauser 1983). Furthermore, the architects of West Germany's 'social market economy' – within the governing Christian Democratic parties after 1949 – were strongly influenced by the 'ordoliberal' school of economists based in Freiburg under the leadership

of the German economist Walter Eucken (Leaman 1988: 50ff); the Christian Democratic Union's (CDU's) Düsseldorf Principles from 1949 reflect this influence quite fundamentally with an explicit disavowal of the need for state interventionism. Through the establishment of a competitive market order with the help of monopoly control, 'the state is … freed from the worry of central direction. There remains the task of making and protecting the law, of encouraging competition and organising monetary affairs' (cited in Leaman 1988: 54). While the reality of CDU government policy during the period of postwar reconstruction clearly did contain elements of intervention and shrewd mercantilism, there was never anything remotely resembling the programmatic application of state intervention as evident in most other European economies in the 1950s and 1960s. The brief experiment with Keynesian 'global steering' under Karl Schiller from 1967 to 1972 was ill-starred and ultimately self-defeating, as it coincided with the upheavals of Bretton Woods and the building boom prior to the Munich Olympics and, in any case, involved delays to fiscal stimuli – compounded by a fragmented policy architecture – which produced a massive pro-cyclical surge and high inflation on the eve of the first oil crisis. From the early 1970s onward, German economic management was increasingly dominated by monetary policy and the preferences of the independent Bundesbank (Marsh 1993; Leaman 2001). As David Harvey has rightly observed, the insulation of 'key institutions, such as the central bank, from democratic pressures', is a strong preference of neoliberals (Harvey 2005: 66). German (and more recently EU) monetary policy has thus arguably been more compatible with neoliberal fundamentalism than in the case of the United States where the Federal Reserve Board is statutorily obliged to consider the effects of its policies on the growth cycle. The Bundesbank and the European Central Bank are required to focus primarily on price stability and the money supply.

The statism reflected in Germany's 'organised capitalism' is thus not to be found in the pursuit of the orthodox antithesis of neoliberalism – Keynesianism – but in the modes of state regulation and private sector self-regulation which emerged in the exceptional context of defeat and occupation. These features include the system of mandatory social insurance, which had four pillars (health, unemployment, old age and accident) until 1995 when a fifth (long-term care) was added. With the exception of accident insurance, which is the exclusive responsibility of employers, the funding of the other four schemes is shared by employees and employers; the federal state has subsidised the pensions system from the very beginning, averaging almost a quarter of total pensions payments in the early 1960s, but after unification has been obliged to raise its contribution to more than a third (some €80 billion per annum), in part to reduce pressure on employers' 'non-wage' costs. Nevertheless, employers' contributions to the social insurance funds can be regarded as employee

income (qua wage mass) set aside for the insuree's benefit, payable – in the case of pensions and unemployment benefit – as a proportion of final or latest salaries. Germany's individualised social insurance system, established by the shrewd tactician Bismarck in the 1880s, differs markedly from the more obviously statist systems of social security funded by general government revenue, as in the United Kingdom or Denmark.

A second feature of state 'organisation' of market forces can be found in the body of legislation governing employment relations. While wage-setting is rooted in the principle of free collective bargaining (*Tarifautonomie*) by centralised trade associations and trade unions, industrial disputes deriving from the comparatively rare failure of such bargaining are subject to very strict statutory procedures, involving state sponsored arbitration, cooling-off periods, mandatory secret ballots and an independent branch of labour jurisdiction (*Arbeitsgerichtsbarkeit*). Germany has extended employment law to include a highly developed system of workers' participation, generally dubbed 'codetermination' (*Mitbestimmung*), which in its most extensive form (in heavy industrial companies with more than 1,000 employees and other industrial and commercial enterprises with more than 2,000) confers on the company workforce the right to representation on the supervisory boards of joint stock companies. This elaborate and (superficially at least) expensive statutory system of codetermination, developed between 1951 and 1976, has been in the firing line of neoliberal critics of German 'statism' as a hindrance to market-driven decision-making processes (Institut der deutschen Wirtschaft 2008; Münchau 2008); supporters of German codetermination (Friedrich Ebert Stiftung 2005: 19) assert the institution's contribution to the promotion of economic competition and the prevention of damaging disputes. Interestingly, a 'Codetermination Commission', co-sponsored by the Bertelsmann Foundation and the union-funded Hans-Böckler Foundation in the 1990s, attested to the institution's positive achievements, while criticising only aspects of its practice in individual cases (discussed by Abelshauser 2005: 138). Codetermination is nevertheless a clear example of a conscious regulating corporatism and of a juridification of social relations designed to manage the vicissitudes of market forces. The institutionalised 'social partnership' of employers and employees is evident in their joint oversight of social insurance schemes, in their parity status in Labour Court panels, in the deeply embedded system of apprenticeship training and in sectoral schemes of participation, e.g., in the health service and in higher education.

One of the strongest structural contrasts between the political economy of Germany and that of Anglo-Saxon countries has been the emphasis on long-term stakeholder relationships within the corporate sector and between industrial and commercial corporations on the one hand and Germany's universal banks (both private and state-owned) on the other.

The security and predictability afforded by Germany's bank industry relations has historically underpinned the operations of both the large corporations and, through local state banks, the renowned *Mittelstand* of innovative small and medium-sized enterprises. The banks' privileged knowledge of corporate activities may raise all sorts of worries about insider advantages and distortions of competition, but there is strong evidence that the 'patience of the banks' has enhanced the long-term international competitiveness of German companies (Hutton 1995: 263f). Bank parcel holdings in Germany's 'nonbanks' are a vivid illustration of a general 'enmeshing' of private businesses and of the strongly cooperative behaviour within the corporate sector in general. In terms of maintaining Germany's technological and trading competitiveness, it functions very effectively alongside the horizontal and vertical concentration that German companies share with their counterparts in other major OECD countries.

The original conception of the politically ordered 'social market' gave absolute centrality to 'monopoly control' (Christlich Demokratische Union 1949: 440) and preventing the abuse of market power. However, while the Federal Cartel Office in Berlin, together with the EU's Competition Directorate (DG IV), has been relatively effective in prosecuting cartels, it has been powerless to prevent the inexorable process of concentration in the major branches of German industry and commerce. Statism or market ordering has been imperceptible in the process of national and international agglomeration of capital. On a scale of 'liberality' one would have to describe the political context for mergers in Germany – and elsewhere in the world – as benign.

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The above thumbnail sketch of Germany's political economy is intended to provide a point of departure for the study of the progress that political economy has undergone over the last quarter of a century and the changes that have affected that progress through the so-called paradigm shift in the 1980s and the turmoil of German unification. When describing the 'German model' and the threats to its survival, this study certainly does not proceed from any strong advocacy or defence of its merits as a blueprint for other societies to copy. The high levels of capital concentration, the oligarchic features of corporate cooperation and the weak democratic credentials of the state's economic policy architecture (independent central bank, fragmented fiscal authorities) do not recommend themselves for any new democracy based on openness and social justice. That said, there are other features of Germany's economic and political culture which are not simply worth defending, but which offer the promise of a civilised escape from the current global trajectory of increasing disparity and the conflictual resolution of the problems of resource distribution that threaten to engulf

human society: Germany's tradition of skill, of consensual politics, of social solidarity and reflective long-termism could, if allowed, be deployed to navigate its citizens away from the calamities which an obsessive adoption of neoliberalism has arguably hastened.

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