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SPECIAL REPORT

Effective but difficult.

Can the German model be an example for Europe?

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#0 [contents]

#1 [introduction]

Europe would be in a much better economic condition today if all its member states had fared as well as Germany. Does that mean that the FRG's economic model should be seen as the example to follow? There is some evidence that the markets for capital, jobs, skills, and also the reformed social policy could be interesting points of reference, even if many of them are deeply rooted in German culture. Much less convincing is the German growth model, which is too dependent on exports and generates dangerous external imbalances.

Germany today is considered the country with the most effective economic model in the European Union. It should therefore be no surprise that in such hard times there are attempts to give it a special role to play. Some would like to see Germany as a "locomotive" that could use its enormous potential demand to pull the continent out of the stagnation it has been in since 2008. Others, such as the bestselling American author Jeremy Rifkin, feel a 'fresh wind of economic change' (Handeslblatt, 2011) blowing between the Rhine and the Elbe, a wind that sooner or later will reach other countries. To put it simply: Germany is a role model and a rich source of institutional innovations for other countries. The verse that goes 'the German character may save the world once again' [1] sounds much less pretentious today than it did a couple of years ago.

But one question arises: What exactly should be emulated? In order to determine whether and how Germany can be a 'model for Europe', we must first imagine what an efficient economic system is and then see whether Germany fulfills the criteria. Given the recent crisis, it would seem that sustainable development is the most important issue. It is not only about environment and ecology, which are usually connected with the issue; it is about the entire economic system. It is important to stress that sustainable development is not the same as equilibrium. The effective market economy is not an economy that falls rarely or never into disequilibrium. Such an economy is able to change the course if disequilibrium becomes dangerous.

Features of sustainability should be looked for in three areas. The first of these is the nature of growth: its composition, role of consumption, future oriented investment and risky but profitable exchange with other countries. What matters is also the way in which the state can impact on this spheres using monetary, fiscal and exchange rate policy. Sometimes this can restore balance, sometimes it can contribute to a disastrous disequilibrium, as the last crisis proved. This area is usually called the macroeconomic sphere. The second concerns functioning of markets, where particular attention should be paid to factor markets for capital, labour, skills, and knowledge. Monopolies, debt bubbles, unemployment—all of these are symptoms of inefficient, unsustainable markets. However, if they have mechanisms of restoring balance, economies can develop in a more sustainable way. Thirdly, a healthy market system is also characterized by social equilibrium. The main criteria are income differences, which have an original sense: they translate into access to public goods and shape social mobility. An economy that creates huge income differentials, an economy that doesn't allow economic losers the chance to get back into the game, certainly fails in this regard.

These three spheres are closely interrelated. Disequilibrium in one sphere 'infects' others, and eventually spreads throughout the system, resulting in a crisis. This may in turn lead to infection of the political system. It is not an exaggeration to say that sustainable development translates to democracy, and that unsustainable development requires dictatorship, which most frequently uses chaos as its justification. Germany seems to be quite far from this scenario, because it has been able to face up the crisis. Does this mean that the country has all the features of a sustainable system? If yes, are its solutions universal and should other countries take them as examples?

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[1] Author's translation. E. Geibel, Deutschland Beruf, 1861. Published in „Projekt Guttenberg – DE ", http://gutenberg.spiegel.de/buch/3396/202

#2 [sustainable growth]

Barely ten years ago Germany was referred to as 'the sick man of Europe'. Indeed, at that time its economy was bogged down in a stagnation it would not escape until 2005. The recovery process stalled in 2009, but only temporarily. Since 2010 the FRG has clearly outpaced the other large economies of the EU (with the exception of Poland) and—according to Eurostat projections – will continue to do so at least until 2014 (see figure 1 in the statistical appendix).

What was the source of Germany's recovery? To a modest extent, consumption. In each year from 1999 to 2008 the annual real growth in private consumption was lower than in other Euro-zone countries; it rarely was more than 1 percent, and in some years it was negative. This situation has only begun to change in recent years (figure 2). Investments contributed to growth only modestly. Since 2003 their level has been lower in relation to GDP in Germany than the average for the Euro-zone; it has never exceeded 19 percent (figure 3). The main motor of the German economy have been exports. In 2008 the trade surplus was 177.5 billion Euros, and after a brief decline to 138.9 billion in the following year it reached a new record of 186.5 billion Euros (figure 4). Thanks to this Germany has been getting excellent results in its current account balance, which in the last two years has neared 8 percent of GDP. At the same time other large European economies have recorded significant deficits. It's therefore clear that German growth has depended to a large degree on what happens abroad.

How has this development been affected by tools of the monetary, fiscal and exchange rate policy? Did they help in recovering from stagnation?

At first glance, the impact of the monetary policy was rather moderate. Since 1998 Germany is in the Euro-zone, which means that it cannot make its own monetary decisions – that is the realm of the European Central Bank. Its official goal is monetary stability and not primarily boosting growth. Even if Germany had such monetary autonomy, expectations for a very expansive policy should have remained limited. Post-war Germany feared inflation and this why control over money was transferred to the independent Bundesbank – the last thing that could be said about this institution is that it was an advocate of a soft money policy. The anti-inflationary model of Bundesbank has been transferred to the ECB, so the orientation of monetary policy has not changed much, also because the Bundesbank officials still have a big say in Frankfurt. So even if after 2000 there were some arguments for a very expansive policy, advantageous for lagging Germany, the ECB remained cool: cuts in interests rates ended in 2003. (Europan Central Bank, 2011, pp. 122-129) (figure 5)

Figure 1. Real GDP growth rate – volume, in %.

Source: *EUROSTAT*

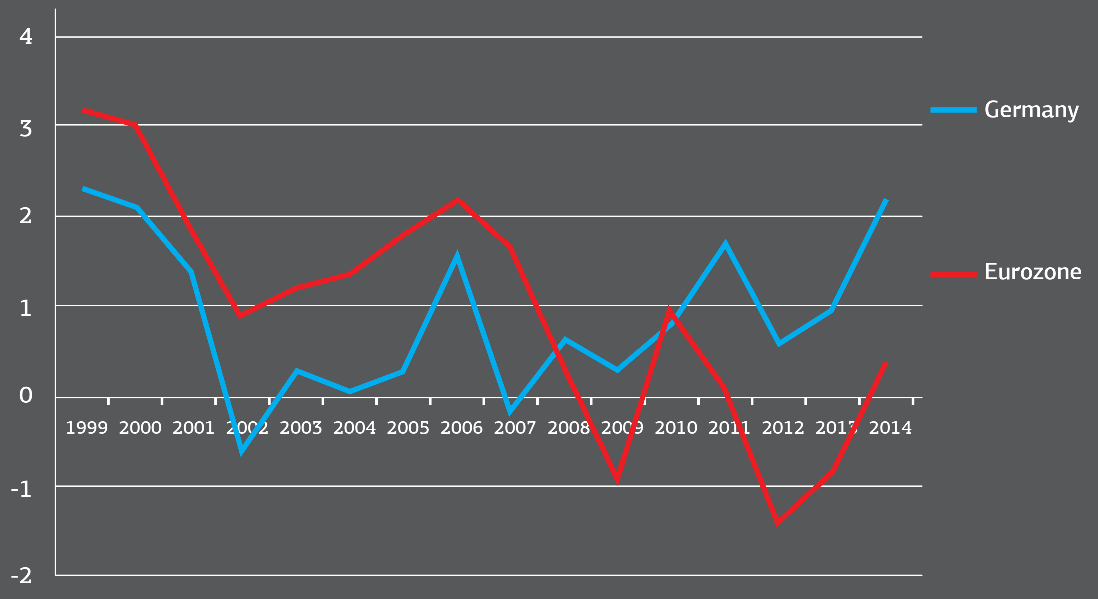

Figure 2. Rise in real private consumption, percentage change on previous year.

Source: *OECD*

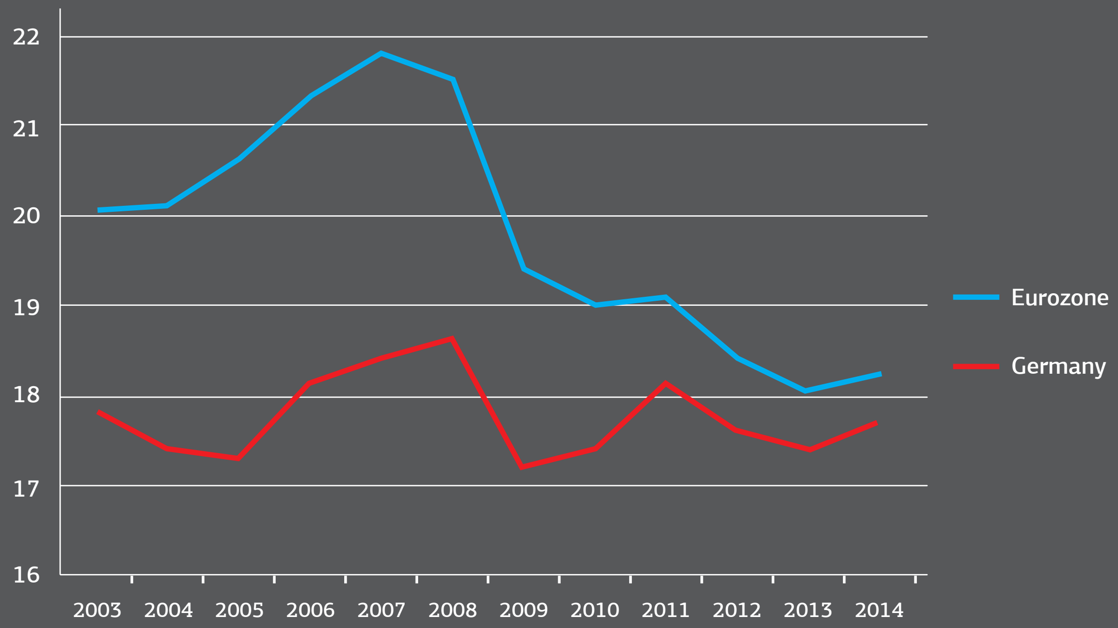

Figure 3. Current account, percentage of GDP.

Source: *EUROSTAT*

A much more important change happened in the exchange rate policy. This might sound a bit surprising: since there is no German mark anymore and no exchange rate volatility in the EMU, why should this area be important? To understand this issue we need to come back to the restrictive monetary policy of the Bundesbank from the pre--euro times. Its side effect was a huge appreciation of the mark, which hit the German exporters. Facing a steady rising currency they had to develop methods of reducing costs and prices (it is called real depreciation). An

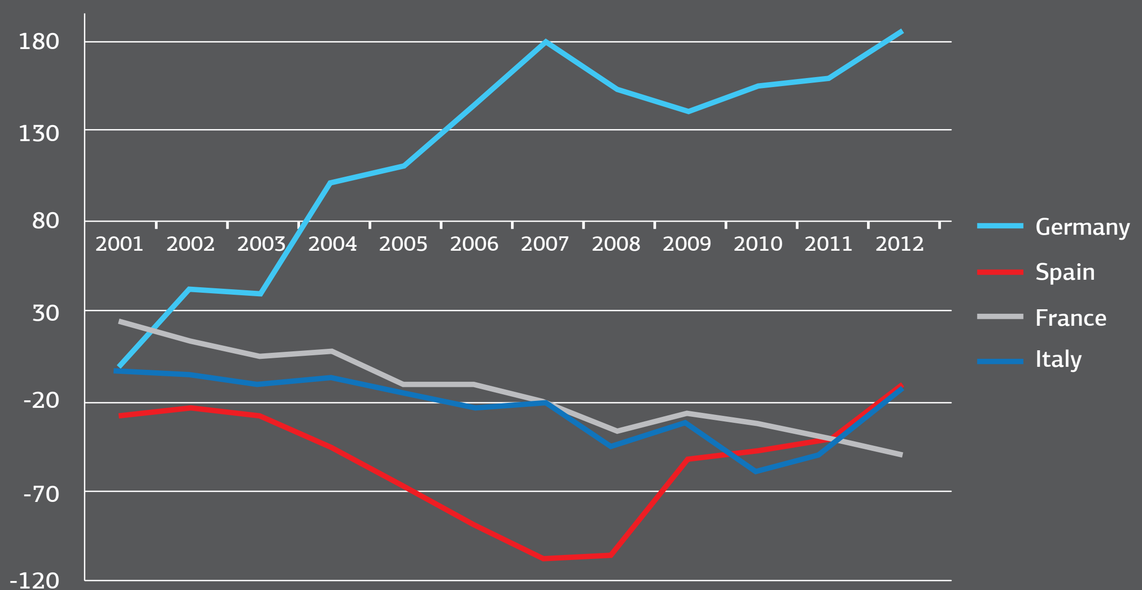

Figure 4. Current account transactions (exports, imports). Net balance in 1000 million Eur.

Source: *EUROSTAT*

Figure 5. Inflation rate (HICP) in %.

Source: *EUROSTAT*

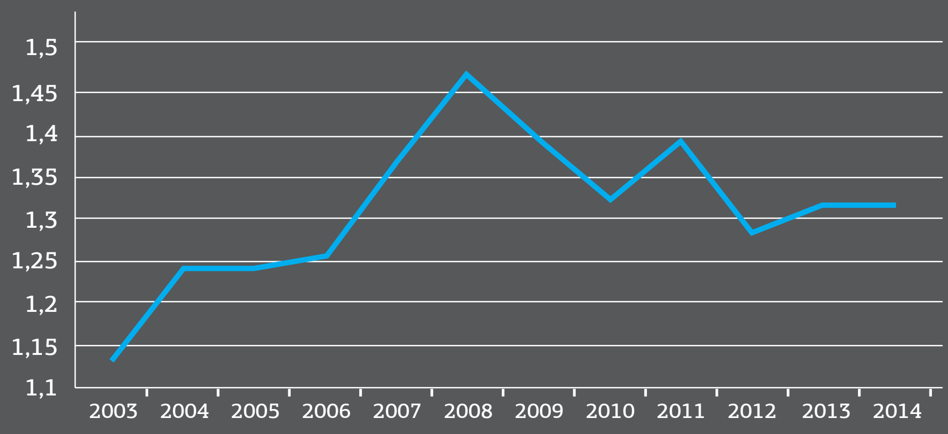

Figure 6. Euro exchange rate against the Dollar. Source: *EUROSTAT*

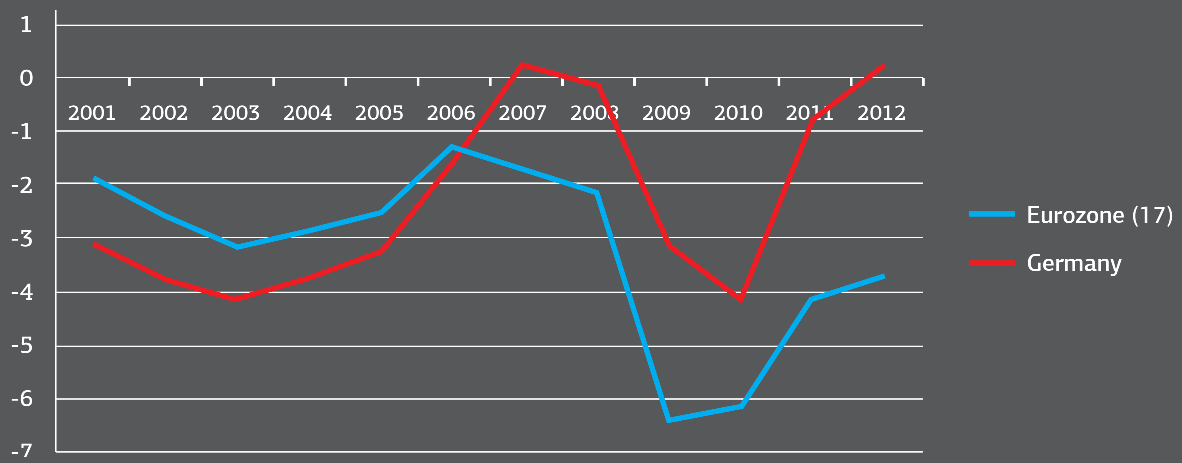

Figure 7. Public sector balance, percentage of GDP. Source: *EUROSTAT*

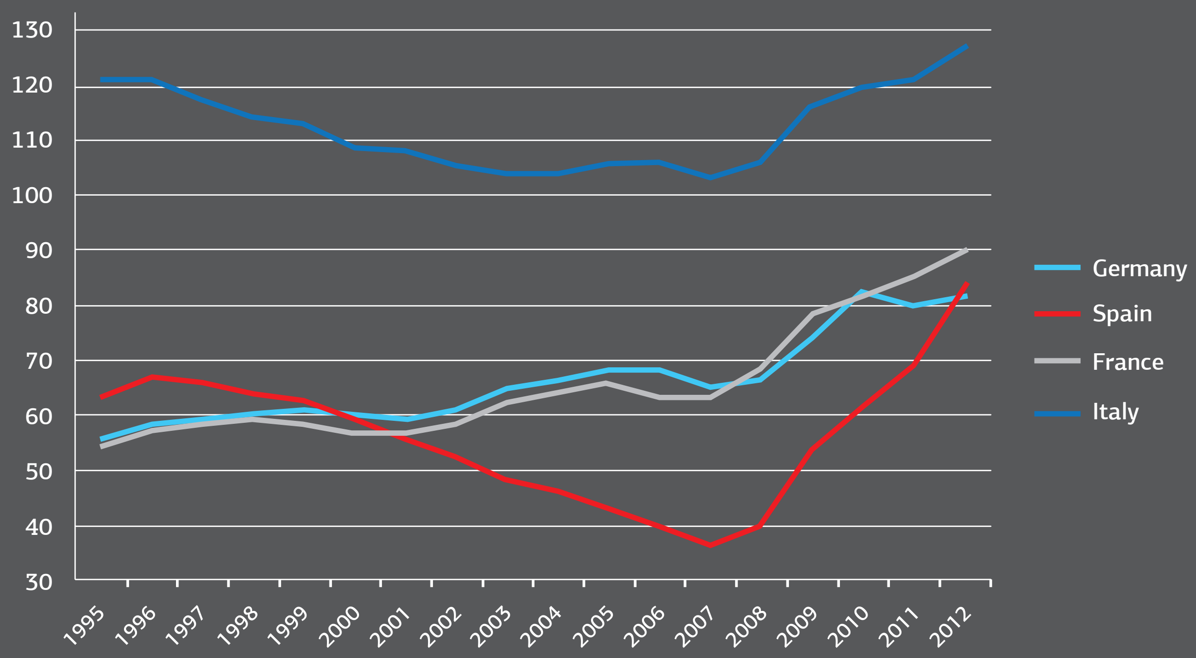

Figure 8. Government debt, percentage of GDP. Source: *EUROSTAT*

export industry used to this kind of adjustment found itself in an ideal situation after 1998: no appreciation risk of the home currency towards the most important trade partners. This allowed room for flexibility, which became even bigger when the euro started to weaken against the US dollar after 2008. (figure 6). The export of German companies in the world economy was set to expand.

A controversial issue is the last area: the impact of the budget policy. Until the mid-2000s Germany displayed high public deficits and in cooperation with France it dismantled the European Stability Pact aimed at punishing excessive imbalances. One could suppose the chancellor Gerhard Schroeder wanted to avoid a situation in which the harsh supply reforms of Agenda 2010 overlapped with cuts on spending, thus lowering consumption and investments. The policy changed after 2006, when Germany decided to stabilize its public finances and introduced reductions in public subventions and investments (the exception was the anti-crisis spending program). The 'debt break' inserted in the Basic Law in 2009 is a powerful reflection of this; it prohibits the federal budget from requiring net debt greater than 0.35 percent of GDP (from 2016 on). As of 2020 the German Lands will not be able to be net borrowers. There are rather limited alternatives to this policy because of huge public debt, currently 81.2 percent of GDP. This is only slightly less than the notorious 85.3 percent average of the EU27, and decidedly more than the Maastricht criteria allow. Luckily, debt servicing costs in the last years have been extraordinary low. According to Eurostat, in July 2013, the yield on ten-year German bonds was 1.56 percent, two times lower than the Euro-zone average, which resulted in additional billions in the budget. Germany could still count on this effect. According to the German Institute for Economic Research, in 2014-2015 the federal budget saved 50 billion euros as a result of low interest rates (Grieve, 2013). The effect of a more restrictive budget policy and cheap re-financing can be observed in current data. In 2012 there was even a small surplus of 0.2% of GDP in the public budget. In this regard Germany remains unique in the Euro-zone, where national deficits continue to exceed the limit set by the Maastricht Treaty. The outlook for Germany is still good. In the first half of 2013 Germany recorded a surplus of 8.5 billion euros – 0.6 percent of its GDP (Federal Statistical Office, 2013).

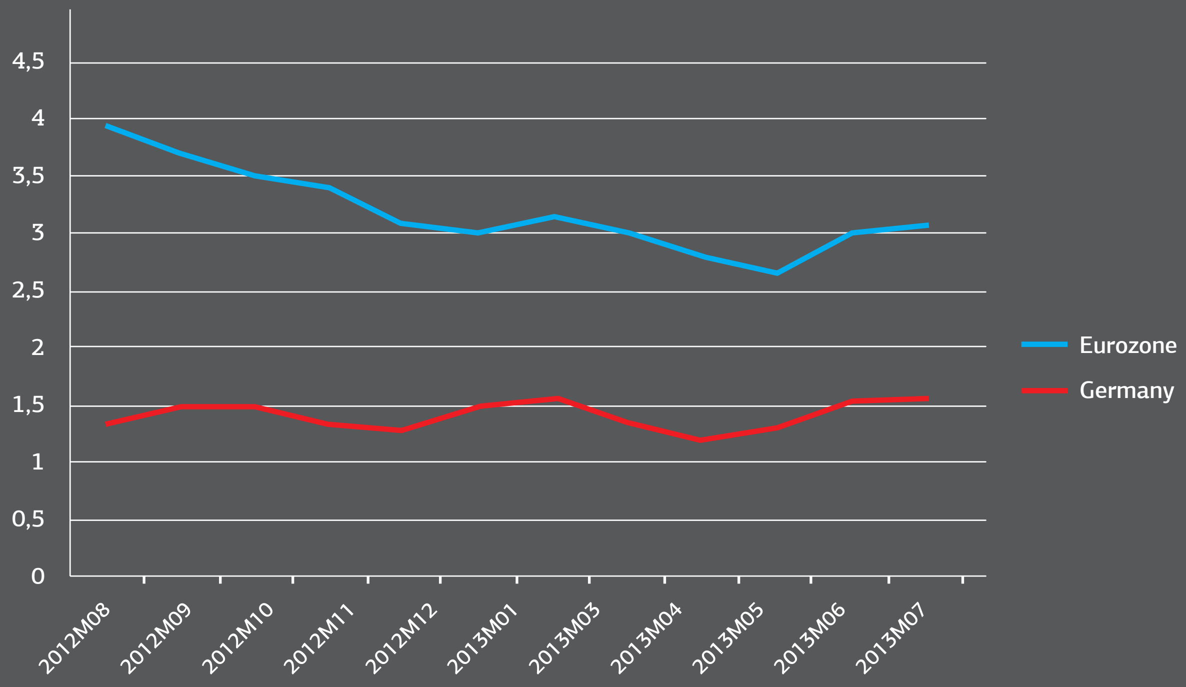

Figure 9. Long-term government bond yields. Source: *EUROSTAT*

#3 [sustainable markets]

One strength of the German economy today is its factor markets – for capital, labour and skills. None of them have experienced drastic bubbles or crashes in recent years, something that can be attributed to the hard-won flexibility achieved in the past few decades.

3.1 ACCESS TO CAPITAL

This can be clearly seen in the sphere of capital, which is governed by tradition, conservatism, and reluctance to take risks. It is no accident that the stock exchange, which is so popular in Anglo-Saxon countries, has relatively low capitalisation in Germany. According to Eurostat, this was 1223.7 billion euros in July 2013, much lower than Great Britain (2929.89 billion euros), and Japan (3177.69 billion euros) – not to mention the US (16549.37 billion euros)[1]. Germany is also more cautious when it comes to new forms of investment. For example, venture capital types of investments are much less popular than in most EU countries. In the FRG they amount to the equivalent of 0.021percent of GDP, while in France the percentage is 0.032, in Ireland 0.044, and in Sweden 0.053[2]. All of this data, which suggests German caution in the world of finance, is further confirmed by the study published by the McKinsey Global Institute in the summer of 2013, which shows debt in the corporate sector in Germany falling slightly since 2000, while in the rest of Europe and the US it has grown very significantly. The combined debt of German firms amounts to 50 percent of GDP, compared to 70 percent for American firms, 110 percent for French and British firms, and 150 percent for Spanish firms (Mueller, 2012).

In the past this data would have been regarded as evidence of the weakness of the German economy, as proof of its 'backwardness'. It results, however, in large part from the German culture of the Mittelstand – that is, small and medium-sized firms with a specific business model (Berghoff, 2006) (figure 10). The owners are usually families, which prefer financial autonomy and freedom to make their own management choices. They favour conservative, long-term loans over issuing sha-

[1] Eurostat. Tables, Graphs and Maps Interface (TGM)

[2] Eurostat. Tables, Graphs and Maps Interface (TGM)

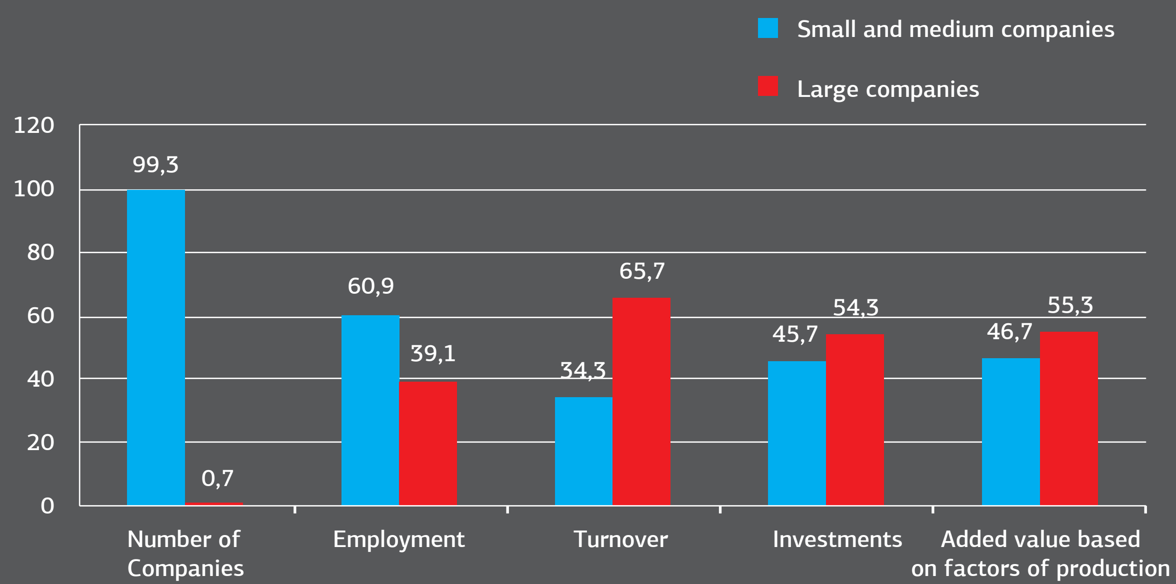

Figure 10. Companies in Germany, percentage share according to size, 2011 data. Small and medium companies – up to 250 employees; turnover up to and including 50 million Euros (or total assets up to and including 43 million Euros).

Source: *DESTATIS, https://www.destatis.de/de/zahlenfakten/gesamtwirtschaftumwelt/unternehmenhandwerk/kleinemittlereunternehmenmittelstand/tabellen/insgesamt.html#fussnote1* res. This is facilitated by the nature of the German banking sector. Its total assets amount to 8.634 billion euros (2012), but these assets are distributed among 1869 institutions – private commercial banks (including several very large banks such as Deutsche Bank), public banks, and cooperative banks (Bundesbank, 2013, p.6). Those last two categories of banks are crucial for the Mittelstand since they have local roots, offer the full range of banking services and build relations with firms based on trust as well as on contracts. This makes long-term, affordable financing possible and helps to avoid risks connected with venture capital markets.

In recent years there have been attempts to 'marketise' this banking sector in the name of increasing profits, with little mention of the fact that this would also increase risk. But the Germans have not gone as far as the Spanish with their 'cajas' (Garicano 2012), and perhaps because of this have avoided a serious crisis. Large 'Land' banks and a few private institutions (e.g., HRE, IKB, WestLB, BayernLB) have had problems, but a systemic crisis was averted. Disillusioned with 'top-down' liberalisation, Germans are skeptical about plans for a European banking union, since they view it as another threat to their 'backward' model (Welt Online 2012). The City of London and Wall Street may not understand, but Germany views its financial sector in a very straightforward manner—not as completely autonomous, but rather as a subordinate branch, tasked with providing stable financing for firms and assuring economic flexibility.

It should be noted, however, that this approach applies to small firms and small banks, but not necessarily to the world beyond them. Among the big players—the big firms and the big banks – Germans speak a language that is perfectly understood in London and New York. Over the past two decades Germany has done an excellent job of learning to take advantage of the benefits of the liberalisation of capital markets and a completely different type of flexibility. Two or three decades ago the standard practice was creating stable relationships between banks and firms – the so-called Deutschland AG. In essence this was the Mittelstand culture on the corporate level, a powerful 'insider' and informal capital market. By the end of the 1980s these ties had begun to weaken (Vitols, 2004): the big banks were starting to operate globally, following the American example, while the big firms sought capital on the stock exchange. Daimler's acquisition of Chrysler symbolises this process, as does the unprecedented growth of the market position of the Deutsche Bank, which 'The Economist' has called 'the greatest risk fund in the world' (Economist, 2004).

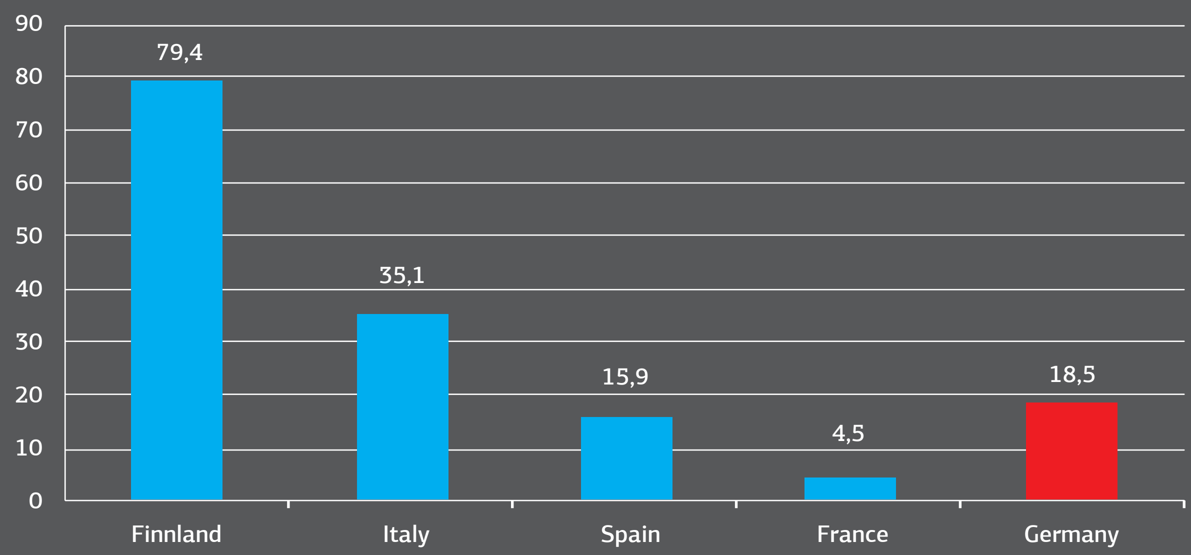

Figure 11. Trade union membership, percentage of employees, 2011. Source: *OECD*

3.2 EMPLOYMENT

Currently the improvement in the labour market is making the biggest impression on observers of the German economy. While the German labour situation was described as 'dramatic' only a decade ago, today unemployment is no higher than 6 percent, considered to be close to 'full employment' (OECD, 2013). It's hard to find a greater contrast than that with Spain or Greece, where unemployment has reached 25 percent. The better situation of Germany is even more striking in youth unemployment, which, at 8.5 percent, is twice as low as in other OECD countries. Good news can also be found in the rate of the population that is economically productive (72.6 percent in Germany versus 64.6 percent in the overall OECD, 2011), and in employment among older people (59.9 percent versus 54.4 percent in the OECD, 2011).

What explains such good results? It appears that they are due to the creation of a system that is able to combine various types of flexibility – in terms of forms of employment as well as in setting wages.

The core of the German labour market is still formed by traditional institutions created after World War II: stable employment based on stringent protections against dismissal and the rule of the 'full' employment contract. With 'hiring and firing' not possible, firms attained flexibility primarily through Mitbestimmung, co-determination with works councils, with which they could work out changes in work structure, overtime, etc. As a result, the average German spent his or her career in a single firm, developing specialised skills on a single, continually improved product. This worker was well-paid, although the pay was a result not of individual negotiations with the employer, but rather of collective agreements worked out by branch trade unions and employer associations. Thanks to these agreements, the firm would invest in the employee, since there was no fear that a competitor would steal him or her away with a better-paid position. This system was by no means cheap, but it allowed industrial firms to adapt to changes in economic conditions in such a way as to protect knowledge and skills.

This has become somewhat more flexible in recent years – but not in every way. Strict protection against dismissal has been retained, so the widely used EPL-indicator (Employment Protection Legislation) rose for full employment from 2,7 to 3,0 (European Commission, 2013). Many changes have taken place in the sphere of wages. The system of branch collective bargaining has been weakened, as trade unions and employer associations come to play a smaller role. In the last decade unionisation in the FRG has fallen by 6.1 percent, more than the OECD average of 2.4 percent; in 2011 unionisation was 18.5 percent, only slightly higher than the OECD average of 17.5 percent (OECD, 2013) (figure 11). Collective agreements continue to define working conditions for over 60 percent of those employed (European Commission, 2012), but negotiations have been de facto decentralised to the level of individual plants. This has meant a significant increase in the flexibility of individual firms in managing their labour force, while preserving structures of conciliation.

The real innovation in the German system has turned out to be the expansion of irregular employment as a result of the Agenda 2010 reforms. Alongside this, mini- and mid-jobs, fixed-term contract work, part-time work, and the practice of 'delegating' workers all appeared on a large scale, creating a market for employment agencies. These changes can be seen in the statistics. The EPL indicator clearly declined in the sphere of irregular employment from 2,0 to 1,3 (European Commission, 2012). Many Germans began working part-time, without any clear stability or job security.

This new sector has been strengthened by the reform of unemployment insurance (Hartz IV). Since 2005 those who have been without work for over a year are in the care of a system that guarantees them a flat-rate allowance of 382 euros while compelling them to mobilise themselves or face cuts in this allowance. An unemployed person must therefore accept almost any job offered by the employment agency, although if it pays less than the allowance the remainder will be made up. This suggests that the statistics must be interpreted somewhat differently. According to the Federal Employment Agency, in July 2013 5.22 million people were registered to receive unemployment insurance. This is much more than the official number of unemployed, which stands at 2.91 million (Bundesagentur fuer Arbeit, 2013).

This data confirms that the current unemployment insurance system is very much oriented towards activation of the unemployed. The previous system protected mainly income, but was it less effective in the fight against unemployment? In the summer of 2013 the labour ministry made a statement on the effectiveness of the Hartz IV reforms, in response to an interpellation from the Left Party (Bundesagentur für Arbeit, 2013). According to the ministry's data, the new system has lengthened rather than shortened the time spent receiving allowances by the long-term unemployed. In 2004 the average length of time receiving this allowance, then called the ALG (Arbeitslosenhilfe), was 48 weeks, but currently the average length of time on the allowance, now called the ALG II (Arbeitslosengeld II), is 130 weeks, although this takes into account people working within activation incentives. When we examine the numbers of people who have been in the system for more than four years, it looks worse: in the ALH era such cases were the exception, but since the Hartz IV reforms they constitute over one-fifth of beneficiaries. This may indicate that sanctions and supervision are ineffective as instruments for increasing employment, and that it may be necessary to apply another logic: basic, unconditional job security, combined with shortening work hours and intentionally creating low-skilled jobs. Similar opinions have been expressed by the DIW, with expert Karl Brenke asserting that the Hartz reforms, based on the Fordern ('Demand') logic, have essentially had no effect. (Neuerer, 2013)

There is more to the new labour market than just more flexible forms of employment. As one might guess, salary and wage principles are rather liberal, especially since there is still no universal minimum wage. As a result, pay differentials have increased, as shown by the Institut fuer Arbeitsmarkt- und Berufsforschung (IAB) report comparing Germany with 17 selected EU countries (Rhein, 2013). According to this report, almost one fourth of German employees (24.2 percent) receive the so-called 'low hourly rate', less than two-thirds of the median hourly pay, which in the FRG is 9.54 euros per hour. Only in Lithuania is a higher percentage (27.5 percent) paid at this rate.

3.3 SKILLS FORMATION

In the third domain, skills formation, Germany has also managed to create a system characterised by flexibility. In the postwar era this was based not only on a well-developed system of general and higher education, but also on a particular method of acquiring professional qualifications. Under this system education took place simultaneously in schools and in firms, which offered paid apprenticeships that usually turned into regular employment. The number of apprenticeships was worked out with the trade unions and the state, as were professional profiles and their certification. As a result, this tightly regulated system was flexible enough to facilitate the acquisition of specialised skills needed at any point by industrial enterprises.

What changes have occurred in the past decade? The system has certainly not been dismantled, but it has been somewhat loosened, increasing the number of professional profiles and creating apprenticeships in special centers created by the state. It continues to be a key element of German education (Fazekas & Field, 2013). Germany has the highest share of workers with at least secondary education: 86 percent compared to the OECD average of 75 percent (2011). The majority of these workers have skills designed for a specific profession (OECD 2013).

What is new is a boom in higher education led by the idea of 'full academisation' of employment. This was supposed to increase the mobility of the workforce, with university studies creating a pool of the 'soft', transferrable skills necessary in the rapidly growing services sector. Germany has not, however, experienced an educational bubble, such as those bursting currently in Spain and the US, where university graduates cannot find work. In this context the fact that only 28 percent of Germans aged 25-34 have master's degrees, compared to the OECD average of 39 percent, is not at all a weakness of the German system; instead it shows the wisdom of its policymakers. The situation with undergraduate degrees reflects a similar approach. Yes, in 2011, 46 percent of Germans aged 25-34 held such degrees, an increase of over 36 percent on 2005, but this was still significantly less than the OECD average of 60 percent. Certainly these proportions will change, with greater spending from the Higher Education Pact (der Hochschulpakt), the agreement between the Lands and the Federal government on increasing funding for additional university places (Vitzthum, 2013). But much of this money is intended to increase quality rather than quantity. Proof? The number of students studying the so-called MINT disciplines (mathematics, information science, natural science and technology) is growing very quickly. Germany is definitely beating the OECD average in the proportion of graduates from programs of advanced research studies: 2.7 percent versus 1.6 percent, behind only Switzerland and Sweden (OECD, 2013).

To sum up, Germany has managed to create and maintain its own specific educational system, characterised by equilibrium between professional skills and academic, transferrable skills. Unlike some other countries it has avoided the mistake of depreciating vocational training and dangerously overemphasising expensive and not always necessary academic education.

#4 [social sustainability]

In the postwar era Germany was considered a typical European welfare state, in which income differences were ameliorated with tax and subsidy transfers, and a strong sector of free public services fostered social inclusion. Thanks to this there was a lot of mobility between social spheres (the so-called milieus); there was a chance of upward social mobility. But as time passed this construction of solidarity began to cost the state too much. In the 90s Germany encountered the dilemma known as the Krugman hypothesis: the old model could not be sustained, so it had become necessary to settle either for high income differentials, as in the US, or high unemployment, as in many European countries (Krugman, 1994) (Puhani, 2003). With its long-lasting high unemployment Germany could serve as a textbook illustration of the 'European' version of the Krugman hypothesis. After 2000, however, it adopted a new policy, called 'Foerdern und Fordern', or 'support and demand'. The essence of this policy was limiting purely compensatory transfers and replacing them with transfers supporting professional activation through a flexible and low salary. The assumption was that this would not lead to a drastic increase in inequality. Did it work?

In German society's eyes, no. 'Over the course of the last ten to twelve years inequality has become much more severe', claims one of the leading FRG historians, Hans-Ulrich Wehler (Spiegel Online, 2013). It is not difficult to find commentary in a similar vein, as well as data to back this up. For example, according to a Federal government report, in 1998 the richest 10 percent of households owned 45 of net assets. In 2008 that 10 percent's share of assets had grown to 54 percent, while the share of the poorer half of society had fallen from 3 percent to 1 percent (Bundesministerium fuer Arbeit und Soziales, 2013, p. XIII). The Gini index of the distribution of income (0 to 1, with 0 signifying that everyone receives the same income and 1 signifying that one person receives all the income) suggests greater stratification over the last two decades. At the end of the 2000s the Gini index for Germany was 0.30, somewhat less than the OECD average of 0.31. But from the mid-1980s to the end of 2000 in Germany this index rose 0.7 percent annually, while in the OECD it increased only 0.3 percent per year (OECD, 2011).

More in-depth analysis, however, would steer us away from the claim that Germany is starting to resemble the US in social terms. The newest OECD data (OECD, 2013) for 2007-2010, and thus for at least part of the crisis, brings some surprises.

First, the vast majority of OECD countries experienced a fall in income from labour or capital (market income) of about 2 percent. Growth in market income occurred only in Poland and Chile (2-3 percent) and in Germany, Austria, and Slovakia (about 1 percent). In the FRG this increase came primarily from growth in pay, which does not fully fit the hypothesis that German wages have fallen.

Secondly, market income inequality measured by the Gini index grew on average 1.4 percent in this period in the OECD. This is a huge jump, greater than in the preceding 12 years taken together. The exceptions to this trend are Poland, the Netherlands, and to a lesser degree Germany. But it should be noted that in Europe this drastic stratification of market incomes was balanced by tax and social policies, as well as by emergency government spending. Germany took this route, increasing taxes as well as transfers. As a result the Gini index for disposable income remained unchanged, while the situation of the poorest 10 percent of households improved more than the situation of the richest 10 percent.

Thirdly, it is interesting to analyse 'relative impoverishment', which shows the percentage of people with incomes lower than half the median income. In the OECD as a whole, this amounted in 2010 to 11 percent, with Denmark and the Czech Republic having the lowest numbers at 6 percent and Chile, Turkey, and Israel having the highest, 21 percent. Generally in the two decades preceding 2007 this percentage has risen in all countries, especially in Sweden. In Germany in 2010 it was 8 percent, having grown about 1 percent since 1995. Interestingly, during the crisis it remained stable, but this may result from the fact that median incomes fell during the recession, thereby lowering the statistical point of reference. Because of this the OECD based its analysis of 'relative impoverishment' on the median of real income from 2005. This analysis shows much greater increase in poverty within the OECD, especially in Iceland, Mexico, Southern Europe, and Estonia. Only in Israel, Poland, Belgium, and Germany did the situation improve.

Fourth and finally, the general tendency in the OECD has been for children and youth to become relatively poorer while only the oldest are doing better. In this regard Germany again looks very good. It is the only country in which the indicator of relative poverty among youth fell by 2 percent in the research period. Children and the oldest experienced a small increase in poverty, which may be in part a result of the difficult but necessary reform of old age pensions.

All this data suggests some caution in listening to arguments about the growth of social inequality in Germany. But those arguments should still be considered. The OECD itself emphasises that data from the recessionary year of 2012 will be necessary for a full picture. We cannot ignore the opinion that the stratification process, driven by the sphere of irregular employment and by the tax system (Biewen & Juhasz, 2010), is only beginning. Certainly Germany is at a turning point, in which there is still no clear positive or negative evaluation of the social situation resulting from the Agenda 2010 reforms. This dilemma is well illustrated by the research carried out by the Institut der Deutschen Wirtschaft (IW) in Cologne as well as the Initiative Neue Soziale Marktwirtschaft (Institut der Deutschen Wirtschaft, 2013). Although the authors' conclusions are optimistic enough, it is impossible to ignore the fact that over 18 percent of Germans from the second income quintile and as many as 26 percent from the third quintile have experienced social decline (table 1). Most frequently this has come about as a result of unemployment and family breakdowns, with – note this – consequences for starting families. This bodes badly for the demographic future of Germany.

The IW experts see education as the best opportunity for overcoming stratification. This fits with the view that income differentiation is not a negative phenomenon per se, as long as the economic system permits upward mobility as much as it does social decline. While it is possible to be a moderate optimist on this question – since the educational system is generally good – we must recognise the huge risks resulting from, for example, the educational level of immigrants. An additional burden for the system is the middle class's reaction to the menace of growing income disparities. The phenomenon of middle-class 'helicopter parents', who invest huge amounts of their own resources in the education of their children, is one such response. At the same time those who earn less are having to limit their expenditures on ever more expensive supplemental education. This accelerates stratification and makes it lasting. Lisa Herzog, a German sociologist, notes that 'the junctures that are set up in childhood and youth define societies for decades. Currently in many places they are set to cause greater and greater divisions between social groups. Thus more and more brutal competition for advancement arises in one group, while the second group experiences a desperate feeling of exclusion. There may be even deeper social effects, with nothing good about them' (Herzog, 2013).

INCOME QUINTILE, REFERENCE YEAR	INCOME QUINTILE, SUBSEQUENT YEARS					
	1	2	3	4	5	TOTAL
1	74,0	17,5	5,4	2	1,1	100,0
2	18,4	55,3	19,4	5,4	1,5	100,0
3	5,5	20,4	53,2	18,1	2,9	100,0
4	2,1	5,0	18,7	58,2	16,0	100,0
5	1,2	1,5	3,9	15,6	77,9	100,0

Table 1. Reading the chart: between 2005 and 2011 approximately 17.5% of those in the lowest quintile was able to increase income enough to move to the second quintile.

Source: *Institut der Deutschen Wirtschaft, 2013, p. 14.*

#5 [german sustainability, german flexibility]

Looking over the points above we may observe a certain paradox. Germany is usually associated with caution, conservatism and over-regulation. It was none other than Nobel prize-winner Paul Krugman who commented ironically that 'Germany Kant compete', referring to the burdensome legacy of the Kantian imperative (Krugman 1999). At the same time Germany's current economic success and equilibrium result from an unprecedented flexibility and pragmatism worthy of William James.

The key to understanding this is the microeconomic level, in other words the company level. In the past this was based above all on stable access to capital, to labour, and to specialised skills, which were created and protected to a large extent thanks to cooperation between trade unions and employers' associations. This "social peace" was the foundation for the competitiveness of German industry, which occupied a dominant position in the world not only in the automotive industry but also in many niches that the patient "pocket multinationals" from the Mittelstand found for themselves. It created specialised and high-quality products, which competed by means other than price and thus enjoyed more stable demand.

This 'Rhenish capitalism' (Albert, 1993) had its 'golden era' in the 1970s and 1980s. Everything about it was neatly tied together and coordinated: even the Bundesbank's anti-inflation obsession allowed unions and employers to make long-term plans for pay and investment. However, escaping from the low-cost competition from Asia to higher productivity it started to lose workers, who were not able to raise their skills. The unemployment level and burdens of the welfare state rose. This creeping crisis, which culminated in 2000, was confronted with reforms. This was not a matter of dismantling the previous system but adding new, more flexible and market-oriented elements, above all in the sphere of employment and in the fast-growing services sector. This transformation was supported by a transformation of the welfare state, now geared not so much to protect incomes as to mobilise the unemployed.

This has created an unusually effective hybrid model, which has great potential for flexibility and real depreciation (figure 13). Its success would not have been so spectacular, however, were it not for the additional flexibility created for Germany by entry into the Euro-zone. The old pressure from the appreciation of the national currency, which ate away at the effects of microeconomic flexibility, was now transformed into exchange rate stability vis-a-vis Germany's largest European partners and actual depreciation vis-à-vis the US dollar. Thus German growth began to be driven by exports. According to OECD data, exports went from 38.5 percent of GDP in 2004 to 50.1 percent in 2011 (OECD,

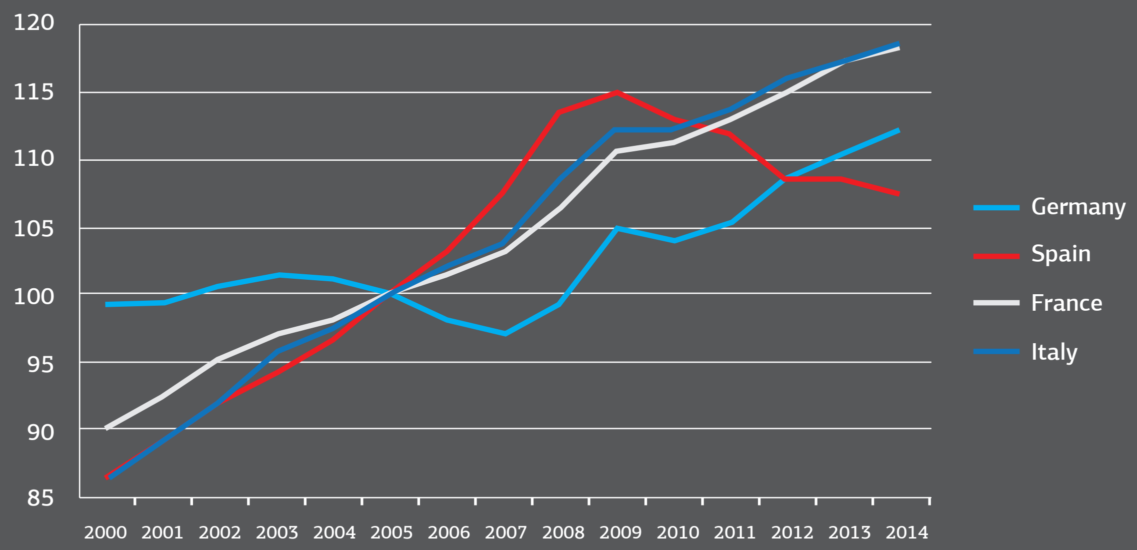

Figure 12. Nominal unit costs, 2005=100, annual data. Source: *EUROSTAT*

2013). The result was a huge current account surplus, which in the form of loans to foreign entities continued to fuel demand for German products. The stability achieved by Germany was then put to use to fight its greatest weakness: its public finances. Lowering public debt is a requisite for regaining fiscal flexibility, which will definitely be needed by the next business cycle, not to mention the demographic challenges. This policy is propped up by a relatively stable social situation. Despite the supply oriented reforms, Germany has – at least so far – boasted a relatively egalitarian society.

#6 [a role model for europe?]

This – in a nutshell – is how the German sustainability model looks. Most European governments would be happy to accept an economic situation close to Germany's. The question is, however, whether the FRG model is at all suitable as a template for other countries. There are doubts about this.

The biggest concern is the current account surplus, which is treated as a permanent phenomenon, as indeed a desired effect of the system – as suggested in statements made by some German politicians and businessmen. First of all, every trade surplus must be someone else's deficit, and therefore all the countries of the Euro-zone cannot simultaneously run surpluses. As economist and journalist Wolfgang Muenchau writes, such a scenario would be equal to everyone simultaneously occupying first place in the European football championship (Münchau, 2013). Such a situation would only be possible if all Euro-zone countries had surpluses vis-a-vis trade partners outside the Euro-zone, such as China, Russia, and the US, which seems an unlikely scenario. The reality is different: it is a map of structural surpluses and deficits in Europe, permanent debtors and creditors, which translates into gigantic political and economic imbalances.

Secondly, a current account surplus means that capital is leaving the country. Rather than remaining in the country to fuel domestic demand, it is most often lent, which increases the chances of profit and thus carries a degree of risk. The experiences of recent years show that this is not purely a hypothetical matter: some large German banks, especially public banks (e.g., WestLB), which did not have experience in complicated financial operations, suffered huge losses investing overseas (Financial Times Deutschland, 2007). Furthermore, many of them have in their treasuries debt obligations of structural debtors of the Eurozone, facing a danger of further losses. This is another manifestation of European imbalances to which the German current account contributed in a significant way..

These points give rise to vocal criticism of Germany. Before becoming head of the IMF, Christine Lagarde stated that 'it takes two to tango', meaning that the German predominance in exports cannot be permanent (Steltzner, 2010). American economist Adam S. Posen stated explicitly that 'the German obsession with exports threatens to destroy the Euro-zone'. There is no lack of critical opinions in Germany itself about the 'export addiction' (Fricke, 2009), although there have also been opposing voices, arguing that expecting the FRG to undertake policies limiting exports is absurd. It should be noted, however, that it is not really a matter of Germany exporting less but rather spending more on its own market, which would automatically reduce the trade surplus.

Fiscal policy is also a matter of great controversy. No-one in their right mind would deny the value of a balanced budget or low debt, which are goals for Germany. The problem is that the application of the FRG model in countries with weak domestic demand and futile hopes for growth in foreign demand, combined with a fixed exchange rate, would threaten to bring about a severe economic collapse.

There is no lack of German experts – among them Lüder Gerken, head of the ordoliberal Centrum für europäische Politik (CEP) – who predict a possible deepening of the crisis that would result from further cuts to be the necessary price to be paid for the undeserved prosperity of preceding years (Bentzien, 2012). This price, in their view, is worth paying, since it will be followed by rapid growth. These opinions were backed up in the famous article by Kenneth Rogoff and Carmen Reinhard (Rogoff & Reinhart, 2010), which showed that countries with less public debt had faster growth. When it turned out that this research contained errors, defending the position became more difficult. The last hope of German austerity advocates are the Spanish, who have bravely combined financial consolidation and supply-side reforms. But we will have to wait a little while yet for the results of that experiment.

It's certainly not the case that 'today Europe is speaking German' in matters of public finance, as Volker Kauder, parliamentary chair of the CDU/CSU, argued in 2011 (Lohrenz, 2011). Rather Germans are saddled with the label of 'madmen or sadists', ready to risk a multi-year depression all for the sake of sticking to their principles or – as some say – in order to further their own financial interests (guarantee that the debt will be paid, not reduced). In Germany itself, however, the public debate is now dominated by economists who assert that austerity is no longer feasible. These include, for example, Heiner Flassbeck, chief economist of UNCTAD, and Peter Bofinger, who believes that neither Germany nor Europe can afford an economic depression and therefore it is necessary to loosen fiscal restrictions. Bofinger considers increasing competitiveness through saving a 'typical German idea'. 'Saving is viewed as a kind of Lent: we save a little and come out of it stronger', observes Bofinger ironically (Bentzien, 2012). Criticism towards German austerity points out also the domestic dimension, or the composition of growth. In recent years FRG performance in investment was rather weak. In such a situation the government should boost public investment, all the more as the infrastructure and education need it urgently. Saving on these areas can lower growth in the coming years and reduce budget revenues, a bad option if one was to lower the public debt.

Similar doubts can be expressed in regards to the German preference for low inflation. No one denies the value of monetary stability, but at a time of fundamental crisis – this is the Eurozone reality – the only real method of staying afloat is cheap money. And that is just what the European Central Bank led by Mario Draghi is doing, to the dismay of Germany and the Bundesbank. There is also another problem with the anti-inflationary course. Let's assume that Germany's stabilisation orientation results in large part from the conviction that the state should guarantee trade unions and employers' associations the stable macroecononomic framework they need so that they can responsibly negotiate pay. Here the German approach ceases to be universal. In economies without such mesoeconomic organisation, where wages are determined by the market on an individual basis, more flexibility in macroececonomic policy is needed. Its prices can be a temporarily higher inflation, but it is still a better deal than a long recession.

To sum up, the German idea of making the economy sustainable through export-fuelled growth, enabling fiscal austerity by a stable exchange rate (the euro) and low inflation, cannot be copied. Its biggest obstacle is an external issue. In a monetary union this approach works only as long as the German surplus 'ying' has – somewhere abroad – its deficit 'yang', for which someone has to pay. The problem is that Germany is not willing to accept that.

The first possible way of countering the German 'surplus'" could be a current account deficit, moderate budgetary savings, and access to easy money printed by the ECB. In this scenario Germany pays an inflationary tax on its own savings. This "monetary social policy', as Herbert Walter, former chair of the Dresdner Bank, has named it, is already functioning and will cost savings of 14 billion euros in 2013, and 21 billion in the following year (Manager Magazin Online, 2013). A second possible "European" equilibrium model would involve maintaining the German surplus and the corresponding deficits of other countries, maintaining monetary stability, but loosening fiscal policy in the Euro-zone. But this is nothing other than a vision of a transfer union, which creates panic in Berlin.

The ideal model, the first best choice, would be balancing Germany's current account as a result of greater internal demand, which would gradually improve the balances of other Euro-zone countries. That is what the IMF, among others, has recommended to Germany in its reports (International Monetary Fund, 2013). This would make it possible to maintain restrictive fiscal and monetary policies, although it would liquidate the huge current account surpluses. This would be a different German model. It's worth adding that there is still another possibility, which few dare to raise in public debate. It involves giving up the euro and correcting national disequilibria through devaluation or appreciation, an approach suggested among others by Wolfgang Streeck (Streeck, 2013) and Kai A. Konrad (Greive, 2013). This would constitute a different European model based on integration, and would certainly carry with it huge political risk.

The question of 'copying' German experiences in the microeconomic sphere is completely different. German capital markets, labour markets, and skills markets offer very attractive templates. It is not by chance that representatives of foreign governments visit Germany more frequently than in the past, in order to explore the sources of its economic success. For example, the number of British officials visiting their German counterparts has quadrupled since 2010 (Nixon, 2013). But are the German solutions not too specific to be transplanted onto foreign soil?

Let's have a look at the Mittelstand model, which is undoubtedly a very attractive one. Eric Schweitzer, head of the DIHK, claims that no other country has anything like it: 'Some have a lot of small firms, we have those too. They also have a few large firms with anonymous structures of ownership traded on the stock exchange – we have those as well. What others do not have are a lot of medium-sized and larger family firms, this vast Mittelstand' (Heller, 2013). Everyone who wants to transplant the German model quickly realises that its microcosm with medium-sized banks and business organizations is the product of a long evolution and owes a lot to German culture – endemic, complex and not very universal. What remains is the principle of the unconditional support of medium-sized firms, which must be adapted to local conditions. It sounds comforting that the development of new communication technologies and transnational financial instruments are conducive to this. This includes such methods as crowdfunding – financing by social networks, which can be a flywheel for new, smaller businesses (Elsner, 2013).

The second interesting institution of German capitalism is the labour market. Very impressive is the way in which two different methods of flexibility have been fitted under one roof: the traditional one, based on cooperation, and the new one, which is market oriented. Theoretically, it is easier to imitate the last one. It is enough to deregulate the sector of low pay and low skills—that is exactly what Germany did in the last decade. But not everyone likes this. For example, Belgians with their minimum wage of 12 to 13 euros are not in a position to compete with German firms, which hire on the basis of mini-jobs paying 3 to 4 euros an hour. This is why the Belgian economics minister, Johan Vande Lanotte, has openly accused Germany of 'social dumping' and has made a complaint to the European Commission of violation of EU directives (Deutsche Wirtschaftsnachrichten, 2013).

The real challenge, however, is achieving the flexibility that Germany enjoys thanks to cooperation between trade unions and employers' associations, and on the level of the individual plant between the works councils and management. This is not a matter of firing and hiring workers but rather adjustments in pay and work organisation, thanks to which highly skilled workers are protected. Americans recognised the advantages of this model not long ago and have tried to implement it in Volkswagen factories (The Economist, 2013). But there are serious limitations to transferring the 'Rhine' experience. First of all, the German system has functioned well above all in industry, and has turned out much worse in services, which require more dynamic organisation. Thus economies dominated by services do not have a model to copy. Secondly, it is hard to copy the German culture of conciliation and corporatism. In many countries confrontational industrial relations and trade union pluralism are traditions. It is hard to imagine that such actors would want to follow the German model.

The third institution worth imitating is the system of skill acquisition. Above all, Germany's skepticism regarding the ideology of the complete academisation of employment should be appreciated. It should be taken to heart especially by such countries as Spain, which has a high proportion of formally well-educated youth for whom there are few job offers. German conservatism in this regard was probably dictated by the existence of its own excellent dual system of education. This model is beginning to be copied by the Spanish, who have named it Los Azubis (from Auszubildende) or education 'a la Merkel' (Böcking, 2012). There are some doubts however – the German system of vocational education is organised around specialised industrial skills that are not applicable in many countries. Those based on services to a greater degree than Germany will likely skip this experiment.

The last element of the German model, social sustainability, is probably the most interesting reference point in the reform of other economies. In essence, the FRG today is a laboratory, in which the risks and costs of transitioning from a traditional welfare state to a society in which there are chances not just for prosperity but also for social decline are being tested. The Agenda 2010 reforms were based on mobilising human activity not just through the promise of a better future but also through fear of a worse tomorrow. Flexible and low-paid work is a crucial part of this logic, but so is a mechanism for bringing the losers back into the game. The stakes of this experiment are high. If it turns out to be an inequality-creating machine, nothing good is in store for Germany. More and more research shows that societies with relatively low income differentials create better economies with stable demand, not to mention more stable political systems (Stiglitz, 2012; Wilkinson & Pickett, 2009). The most recent data coming out of Germany suggests, however, that perhaps more states, such as France, will begin to prepare their own reforms on the basis of German experiences. Who knows, perhaps Schroeder's social 'third way', between Scandinavian maximalism and American minimalism, will be the most universal component of the German model?

As a whole, the German economic model does not serve as a pattern to copy. The current growth model looks sustainable from the perspective of the export sector. At the same time it is not able to create higher investment and contributes to imbalances in the Eurozone. On the microeconomic level Germany has several 'model' features, but these are natural outgrowths of German culture and the result of a long, symbiotic evolution together with other institutions of local capitalism. It should also be mentioned that they are dependent on the deep, endemic industrial profile. Everyone who considers copying it must weigh up the risks connected with such a "return" to the industrial past, particularly in the face of new production methods like 3D printers, which will enforce other organizational models.

The only elements of the German model that are suitable for imitation are the new, market oriented ones. The problem is that they are components of the German model and not its essence. Taken separately, they do not create knowledge and skills but mainly income gaps. Perhaps it was this feature of German capitalism – a genial hybridity – that Alan Blinder, the American economist, was referring to when he said "blame Teutonic efficiency for what ails Europe. The other countries just can't compete" (Blinder, 2011).

So there is no chance for a simple 'copy and paste' (Casertano, 2012) and the conclusion of this analysis is therefore not very exciting. The Euro-zone countries enviously observing the German economy should instead work out their own models of sustainable development. If they are successful in this, perhaps in ten years we will be writing about the Greek, Portuguese, or Spanish models as examples for Europe.

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