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German Capitalism: Does It Exist? Can It Survive?

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ABSTRACT

In the roughly four decades between the end of the Second World War and German unification, West German society gave rise to a distinctive kind of capitalist economy, governed by nationally specific social institutions that made for high international competitiveness at high wages and, at the same time, low inequality of incomes and living standards. Already by the late 1980s, when the differences in performance and social organization between the West German economy and its main competitors came to be widely noticed, the continued economic viability of the 'German model' began to appear doubtful to many. Shortly thereafter, the survival of the German version of advanced capitalism became tied to its successful extension to the former East Germany. With the 1992 completion of the European Internal Market, it became in addition dependent on the compatibility of German economic institutions with the emerging regime of the integrated European economy.

RESUMEN

En las aproximadamente cuatro décadas transcurridas entre el fin de la Segunda Guerra Mundial y la unificación alemana, la sociedad germano-occidental dio origen a un tipo distintivo de economía capitalista, gobernado por instituciones sociales nacionalmente específicas que produjeron alta competitividad internacional con salarios altos y, al mismo tiempo, baja desigualdad de ingresos y niveles de vida. Ya alrededor de fines de los '80, cuando las diferencias en performance y organización social entre la economía germano-occidental y sus principales competidores comenzaron a ser ampliamente percibidas, la sostenida viabilidad económica del 'Modelo Alemán' empezo a aparecer dudosa a los ojos de muchos. Poco tiempo después, la supervivencia de la versión alemana de capitalismo avanzado quedaba sujeta a su exitosa extensión a la ex Alemania del Este. Con el completo establecimiento del Mercado Común Europeo esta supervivencia devino, además, dependiente de la compatibilidad de las instituciones económicas alemanas con el emergente régimen de la economía europea integrada.

Does It Exist?

In the roughly four decades between the end of the Second World War and German unification, West German society gave rise to a distinctive kind of capitalist economy, governed by nationally specific social institutions that made for high international competitiveness at high wages and, at the same time, low inequality of incomes and living standards. Already by the late 1980s, when the differences in performance and social organization between the West German economy and its main competitors came to be widely noticed, the continued economic viability of the 'German model' began to appear doubtful to many. Shortly thereafter, the survival of the German version of advanced capitalism became tied to its successful extension to the former East Germany. With the 1992 completion of the European Internal Market, it became in addition dependent on the compatibility of German economic institutions with the emerging regime of the integrated European economy.

At the time of unification, West Germany was the internationally most successful of the major economies (Table 1). More exposed to the world market than both Japan and the US, the country accounted for a significantly larger share in world visible exports than Japan, with roughly half its population, and for about the same share as the United States, which has a population twice the Japanese. West German trade and current account balances, expressed in percentages of GDP, exceeded those of Japan and presented a stark contrast to the chronically deficitarian Anglo-American economies. This was in spite of the fact that German wages had long been considerably higher than Japanese and American wages.

Characteristically, the international success of the West German high-wage economy was accompanied by comparatively little internal inequality. The difference between high and average wages, as measured by the ratio of the ninth over the fifth decile of the wage spread, was much lower in Germany than in its major competitor countries. Similarly, German low wages, as represented by the first decile of the distribution, were significantly higher in relation to the median (Table 2). Moreover, during the 1980s, at a time when in all other industrialized countries the wage spread increased, the relation of the high German wage to the median remained essentially unchanged, whereas the low wage increased substantially, from 61 to 65 percent of the median wage. Furthermore, intersectoral wage dispersion was dramatically low in West Germany compared to both Japan and the US, and so were the earnings differentials between workers in small and large firms (Table 3). In the latter respect, it is important to note that the employment share of small and medium-sized firms in West Germany was far higher than in Britain and the US and close to Japan, in spite of a comparatively low wage differential. Finally, the ratio of German chief executive salaries over skilled wages, while higher than in Japan, was lower than in Britain and, in particular, the US.

Table 1

The Performance of the West German Economy at the End of the 1980s

	Trade in Goods and Services, as Percentage of GDP, 1988[a]	Visible Exports as Percentage of World Total Exports, 1988[a]	Trade (Current Account) Balance Percentage of GDP, 1988[a]	Hourly Wage of Workers, 1992 US = 100[b]
Germany	29.6	11.9	6.5 (4.0)	160 (119)
United Kingdom	30.2	5.4	-4.5 (-3.1)	91 (82)
Japan	17.7	9.8	3.3 (2.8)	100 (66)
United States	11.7	11.8	-2.6 (-2.6)	100

[a] *The Economist Book of Vital World Statistics*, 1990, pp. 154, 156, 168.

[b] In parentheses: In purchasing power equivalents. Source: Freeman (1994, 31), based on data from US Bureau of Labor Statistics, *Hourly Compensation Costs for Production Workers in Manufacturing*, 1992.

Table 2

Wage Spread

	D9:D5[a] Early 1980s	Early 1990s	D1:D5[b] Early 1980s	Early 1990s
Germany	1.63	1.64	0.61	0.65
United Kingdom*	1.72	1.99	0.68	0.59
Japan*	1.63	1.73	0.63	0.61
United States	2.16	2.22	0.45	0.40

* Males only

[a] Ninth over fifth decile. Source: *OECD Employment Outlook*, July 1993

[b] First over fifth decile. Source: *OECD Employment Outlook*, July 1993

Table 3

Other Indicators of Inequality

	Intersectoral Wage Dispersion		Average Earnings of Workers in Small Enterprises, in Percent of Earnings of Workers in Large Enterprises[a]	Ratio of CEO Earnings to Average Earnings of Manual Workers in Manufacturing[b]
	Freeman[c]	ILO Data[d]		
Germany	17.7	14.9 (29)	90 (58)	10.2
United Kingdom	21.0	20.0 (20)	80 (40)	15.5
Japan	26.7	24.1 (20)	77 (68)	7.8
United States	27.3	24.8 (24)	57 (35)	25.8

[a] Source: Loveman and Sengenberger (1990, 34). In parentheses: Employment in small manufacturing enterprises, as percentage of total employment in manufacturing 1986/87. Small manufacturing enterprises are those with less than 500 workers. Sources: Acs and Audretsch (1993, 228); Statistics Bureau of Japan, Management and Coordination Agency, *Annual report on the Labour Force Survey.*

[b] Source on CEO earnings: The Wyatt Company. German and British data relate to large companies in all industries; Japanese data, to companies of all sizes in all industries; US data, to manufacturing firms of all sizes. To increase comparability, earnings are calculated as average earnings in the upper quartile of CEO earnings. Average earnings of workers: various national sources.

[c] Freeman (1988) uses several indicators of interindustry wage dispersion, calculated on different data as the variance of the *logarithm of earnings by industry, multiplied by 100*. The figures in the table represent the average of the three most recent indicators that include all four countries. The indicators are based on UN data from 1983, ILO data from 1984, and US Bureau of Labor Statistics data from 1986.

[d] Coefficient of variation of average wages and salaries of full-time workers at adult rates of pay between ISIC categories (industries). Source: ILO Yearbook, own calculations. In parentheses the number of sectors over which the coefficient was calculated. Fewer categories are likely to underestimate the coefficient.

The Economic Institutions of Postwar German Capitalism

The West German combination of external competitiveness and normalized high-wage employment reflects the operation of a distinctive set of socioeconomic institutions. These, in turn, reflect a complex historical compromise between liberal capitalism, as introduced after the Second World War, and two different countervailing forces, Social Democracy and Christian Democracy—as well as between traditionalism and two alternative versions of modernism, liberalism and socialism, and of course between capital and labor. This compromise was struck, and became firmly institutionalized, at a time when both the Communist wing of the labor movement and the authoritarian faction of the German business class were, for different reasons, excluded from political participation.

In the circumstances, those who wanted to turn the new Germany into a liberal market economy had to accept the revival of a variety of traditionalist status protections—for farmers, civil servants, *Mittelstand* and the like—as well as an extensive welfare state and established labor unions. At the same time, the old middle classes, represented especially by the Christian Democratic Party, while successfully defending some of their protective institutions—like the special status of artisanal firms—had to learn to use these under the competition regime of a market economy *and* in the presence of a safely entrenched union movement. Labor, finally, was never strong enough, as it was in Sweden, to rid society in the name of progress of, for example, small firms, apprenticeship, or works councils. Indeed German unions were rebuilt after the war as *Einheitsgewerkschaften*, uniting previously divided socialist and Catholic movements, which contributed to the recognition by labor of the need to seek productive coexistence with nonsocialist, traditional forms of social organization, as well as class compromise at the workplace and beyond.

While the result of all this was certainly a capitalist market economy, it was one that was and remains richly organized and densely regulated by a vast variety of institutions that have sprung from sometimes incompatible sources, from *Mittelstand* traditionalism to various ideological stripes of organized labor. While this makes Germany different from the United States, it also distinguishes it from Sweden, in that Germany never became a Social-Democratic society (see Pontusson in Crouch and Streeck forthcoming). Although workers and unions were able gradually to build a strong position for themselves in German capitalism, stronger than in all the other large capitalist countries, the German political economy continued to allow for decentralized compromise and local commitments supplementing, underpinning, and sometimes superseding the high politics of class accommodation at the national level. On the other hand, although its political economy is highly institutionally coordinated and regardless of many other, often striking parallels, Germany also differs from Japan in that the institutions that embed its economy and shape its performance are politically negotiated and typically legally constitutionalized, rather than commanding compliance as a matter of informal obligation or as a result of successful conservative social engineering in a closed national or 'enterprise community.'

Compared to the other major capitalist economies, the institutional framework of the German economy can be summarily described as follows:[1]

[1] The following stylized account draws on the typology developed in Hollingsworth *et al.* (1994).

1. *Markets* are politically instituted and socially regulated and are regarded as creations of public policy deployed to serve public purposes. The postwar competition regime is strict, resulting in comparatively low industrial concentration in most sectors. At the same time, wide areas of social life, like health care, education, and social insurance, are not governed by market principles at all, and some markets, like those for labor and capital, are less so than others. Competitive markets coexist with an extensive social welfare state, and political intervention and social regulation often interfere with the distributive outcome of markets, for example by building a floor under them. Also, small firms are in various ways shielded from the competition of large industry or are publicly assisted in competing with it. Reflecting a history of fragmented markets offering little space for mass production, price competition is often mitigated by product specialization.

2. *Firms* are social institutions, not just networks of private contracts or the property of their shareholders. Their internal order is a matter of public interest and is subject to extensive social regulation, by law and industrial agreement. Also, managers of large German firms face capital and labor markets that are highly organized, enabling both capital and labor to participate directly in the everyday operation of the firm and requiring decisions to be continuously negotiated. Decisions thus take longer but are also easier to implement once taken.

German capital markets are not 'markets for control.' Many companies continue to be privately held; only a small part of the productive capital is traded at the stock exchange; banks may hold equity; shareholding is highly concentrated; and shares and companies do not often change hands. Firms finance themselves less through equity than through long-term bank credit. Since banks can cast proxy votes on behalf of shares they hold in deposit, they can effectively monitor management performance, which allows them to give firms long-term loans and creates an incentive for them not to speculate with stock. Labor is similarly present within firms, with workforces exercising legal rights to codetermination through works councils and, where applicable, supervisory board representation. Together with collective bargaining and legal regulation, codetermination supports an employment regime that makes it difficult for employers to dismiss workers, resulting in employment spells almost as long as in Japan and much longer than in the US (Table 4). Turning labor into a more fixed production factor and making it more similar to capital than in market-driven employment encourages high employer investment in skills.

3. The postwar German *state* is neither *laissez-faire* nor *étatiste*, and is best described as an *enabling state*. Its capacity for direct intervention in the economy is curtailed by vertically and horizontally fragmented sovereignty, and by robust constitutional limitations on discretionary government action. Vertical fragmentation between the federal government and the *Länder* closely limits what political majorities at national level can do, making political change slow and policies less than immediately responsive to electoral majorities. The electoral system, which

favors coalition governments, further adds to the centrist drift and the long response time of German politics.

Table 4

Employment Stability

	Median Tenure in Present Job, in Years	Average Tenure in Present Job, in Years
Germany (1990)[a]	7.5	10.4
United Kingdom (1991)	4.4	7.9
Japan (1990)[b]	8.2	10.9
United States (1991)	3.0	6.7

[a] 1990. Excluding apprentices.
[b] Regular employees (persons hired for an indefinite period); temporary workers hired for more than one month; daily workers hired for over 17 days, in private establishments with over 9 employees.
Source: OECD *Employment Outlook*, July 1993.

Horizontally, sovereignty is divided between the federal government and a number of independent authorities insulated from electoral pressure, like the Bundesbank or the Federal Cartel Office. Policy objectives like monetary stability and competitive markets are in this way removed from government discretion and depoliticized. A similar effect is caused by strong constitutional protections, like the right of unions and employers associations to regulate wages and working conditions without government interference. The result is both immobility and predictability of government policies, precluding rapid political innovation and allowing economic agents to develop stable expectations, pursue long-term objectives, and build lasting relations with one another.

Constitutionally dedicated to competitive markets and a hard currency, the postwar German state lacks capacity for a selective industrial policy. In compensation, it offers firms and industries a wide range of general infrastructural supports, like high public spending on research and development. Moreover, to safeguard social cohesion, the federal government spends a considerable share of the Gross Domestic Product on social protection. It also accepts a constitutional obligation to provide for ‘equal living conditions’ in all *Länder*, which has given rise to an extensive, redistributive system of revenue sharing. To expand its capacities in line with its responsibilities, the German state has developed an extraordinary ability to assist groups in civil society in organizing themselves, devolving on them governance functions that would otherwise have to be either performed by the state or left to the market. It is through state-enabled collective action and quasi-public, ‘corporatist’ group self-government that the German political economy generates most of the regulations and collective goods that circumscribe, correct and underpin the instituted markets of *soziale Marktwirtschaft*.

4. Widespread organized cooperation among competitors and bargaining among organized groups, conducted through publicly enabled *associations*, is probably the most distinctive feature of the German political economy. Governance is delegated either to individual associations or to collective negotiations among them, with the state often awarding its outcome legally binding status. Associations performing quasi-public functions are typically granted some form of obligatory and quasi-obligatory membership, helping them overcome the free-rider problems associated with collective goods production and giving Germany the most densely organized civil society among the larger countries.

Publicly enabled associations regulate instituted markets in a variety of ways. German business associations, prevented by law from operating as cartels, turn price into quality competition by promoting product specialization and setting and enforcing high quality standards. To the same effect, employers’ associations prevent low-wage competition by negotiating uniformly high labor standards with national industrial unions. To make the outcome economically viable, ‘dual’ training, with associatively organized cooperation among competing firms, between government and industry, and between business and labor, procures the skill-base firms need to be competitive in quality markets. For the same purpose, associations also organize cooperative research and technology transfer. Legally enabled associational support is especially vital for small and medium-sized firms.

Above all, associative regulation constitutes the single most important source of egalitarianism in the German economy. Joint governance of labor markets by employers’ associations and centralized industrial unions is so firmly established that by the 1980s Germany had become the only major economy in which the ‘postwar settlement’ between capital and labor had remained intact (Table 5). Although unionism has been comparatively stable, associative labor market governance in Germany is above all accomplished through near-universal collective bargaining coverage, due to strongly institutionalized, industry-wide negotiations and legal extension of agreements. More than anything else, it is the German system of centralized and interconnected collective bargaining that is responsible for the low dispersion of wages in Germany among individuals, industrial sectors, and small and large firms.

5. German economic *culture* is often traditionalist. Savings rates are high, and consumer credit, although increasing, remains low by comparison. Price competition is mitigated by socially established preferences for quality. Markets do not *per se* confer merit: social status and solidarity interfere, and security is regarded as important. Speculation is not valued. Continuous monitoring of one’s short-term balance of economic advantage is not a social norm, encouraging

long-term orientations and commitments and supporting, among other things, a redistributive tax system. Professional competence is highly regarded for its own sake; German managers tend to be engineers, and authority at the workplace is based on superior technical knowledge. Collectivism and discipline have given way as core cultural values to privacy and autonomy from organizational control and market pressure, as evidenced by strong cultural support for short working hours, low participation in paid employment, and a qualification-based organization of work. Work-related knowledge is vested in an occupational qualification structure, where the distinction between knowledge and skills is conceived as gradual rather than categoric. Institutionally, this is reflected in the unique vocational training system, with its long socialization periods leading to portable certificates under national regulations negotiated between unions and employers' associations.[2]

Table 5

Unions and Collective Bargaining

	Union Density[a]				Collective Bargaining Coverage[b]	
	1980	1985	1988	1990	1980	1990
Germany	37.0	37.4	33.8	32.9[c]	82	82[d]
United Kingdom	50.7	45.5	41.5	39.1	70[e]	39
Japan	31.1	28.9	26.8	25.4	28	21[f]
United States	23.0	18.0	16.4	15.6	26	18

[a] Employed members only. Sources: 1980, 1985, 1988: Visser (1991); 1990: *OECD Employment Outlook*, 1994.

[b] Adjusted for employees excluded from bargaining rights. Source: Golden (1994), based on *OECD Employment Outlook*, 1994

[c] West Germany.

[d] West Germany.

[e] 1978.

[2] Nothing in the above is to suggest that the institutional configuration that made up the 'German system' in the 1970s and 1980s was created in one piece or created for the economic purposes that it came to serve. Some of its elements were pre-Wilhelminian; others were introduced by the Allies after 1945; and still others originated in the politics of the Federal Republics, sometimes drawing on and modifying older arrangements and sometimes not. Moreover, each element, for example the banking system, was subject to its own historical dynamic. All were and continue to be changing, for their own reasons as well as in reaction to each other, and certainly there can be no presumption of a preestablished fit among them, even though one might want to allow for some reinforcement effects of the 'model's' historically contingent, social and economic success. That its parts happened to perform together so well during the period in question must be attributed at least as much to *fortuna* as to *virtu*.

f 1989.

Institutional Structure and Economic Performance

In the 1970s and 1980s, the institutional structure of the West German economy conditioned and sustained a distinctive pattern of performance that happened to be highly competitive in world markets. High costs originating in socially circumscribed labor markets ruled out price-competitive production throughout the economy and forced firms to seek survival in quality-competitive international markets. *Here, the same set of German institutions that constituted a prohibitive liability in price-competitive markets served as a competitive asset*—with what would be *debilitating rigidities* for firms trying to compete on price, offering *enabling flexibilities* to firms pursuing quality-competitiveness through upgrading and customization of products.[3]

While imposing *constraints* that make low-cost production prohibitively costly, German economic institutions offer firms rich *opportunities* for strategic upgrading. An extended social welfare state, negotiated management under codetermination, and encompassing collective bargaining place the economy under social pressures that prevent more than moderate differentiation of wages and working conditions. Unions and business associations, then, find it in their common interest to deploy their quasi-public powers to help the economy move into quality-competitive markets, through cooperative upgrading of skills, work organization, technology and products. Just as the universality of the pressure accounts for the fact that only very few German products have remained price-competitive, the general availability of cooperative supports, also generated by encompassing labor-inclusive associative governance under state facilitation, explains the high general competitiveness and low sectoral specialization of the German manufacturing sector. How successful this system was is indicated by the fact that before unification, that sector was proportionately larger than in any comparable country, in spite of it having to pay much higher wages. It also was and still is internationally competitive across a uniquely wide range of products, making Germany the world's by far most diversified export economy.

German industrial upgrading is typically slow and gradual but also continuous, reflecting an institutional infrastructure that makes for long decision times while fostering long-term orientations. The resulting pattern of innovation is one that is more likely to generate improvements of existing products of existing firms and sectors than to give rise to new sectors.

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[3] For more detail see my essay on "diversified quality production" (Streeck 1992). Quality competition can be described as pursuit of monopoly rents through product diversification. The latter can, within limits, expand quality-competitive markets by breaking up existing mass markets. Within quality markets, price competition is suspended as long as the price differential to less customized, substitute products is not excessive.

Generally, sticky decisions, steady commitments, and delayed responses in German institutions make for slow fluctuations, up or down, in economic activity and performance; for flat cyclical movements, especially compared to the United States; and for low dispersion of outcomes; all of which are conducive to stable cooperation and steady improvement across the board. Averages are typically high, coefficients of variation low, and extreme cases are rare at both ends.

The broad movement of the German economy in the 1970s and 1980s into quality-competitive markets was helped by the traditional preference of German consumers for quality. Traditionalism contributed also to a high savings rate, which helped generate the patient capital needed for continuous upgrading of products and production factors. Within firms, sticky capital and committed labor, having access to voice as an alternative to exit, enabled managements to take the long view, based on stable bargains with and between both. In politics, divided and immobile economic government enshrined a currency regime that foreclosed devaluation to restore price-competitiveness and offered investors insurance against electoral volatility.

Above all, the success of the 'German model,' as long as it lasted, derived from the way in which it utilized social pressures for an egalitarian distribution of economic outcomes to generate an egalitarian distribution of productive capabilities, *with the latter in turn enabling the economy to underwrite the former*. Complementing social constraints on some economic strategies with productive opportunities for others, and thereby creating a pattern of production capable of sustaining a socially desirable but economically improbable pattern of distribution, the system managed to combine competitive efficiency with high economic equality and social cohesion.

Three Conditions of Success: A Socio-Economic Tightrope Walk

Competitive success of an institutionalized high-wage economy like the German one is inevitably precarious and fragile, as it must simultaneously accommodate international markets and domestic pressures for equality and social cohesion. Three highly elusive conditions must be met for this to be possible:

1. Worldwide *product markets* for quality-competitive goods must be large enough to sustain full employment in an economy that has barred itself from serving price-competitive markets. The volume of demand that a quality-competitive economy can attract depends on the historical evolution of global demand generally, the competitive capabilities of other economies, successful domestic product innovation expanding quality-competitive at the expense of price-competitive markets, and domestic production costs not exceeding the point where the price differential between quality-competitive and price-competitive goods becomes too large for too many customers.

2. *Product innovation* must proceed fast enough to give the economy a sustained edge in the quality-competitive markets in which it competes. This requires continuous high investment in research and development. Product leadership also depends on a country's culturally rooted pattern of knowledge production and diffusion, as well as management, technology use, work organization, and skill formation, continuing to match changing markets and technologies.

3. The economy's *labor supply* must fit the volume and character of demand in quality markets, providing the skills needed to serve such markets and allowing for a satisfactory level of employment in high-skill and high-wage jobs. The latter requires that no more than a few among a country's workforce must be unable to function in high-skill jobs. Only if these are not too many can they be taken out of the labor market and sustained by a welfare state funded from the rich proceeds of high quality competitiveness. Employment for the others must be made possible by a labor market policy, public, private, or both, that upgrades their skills to a level where they can earn the high wages mandated for them by collective bargaining and social citizenship. Moreover, to the extent that markets for high-quality products cannot be indefinitely expanded by accelerated product innovation, demand-side employment constraints must be accommodated by cutting the labor supply, through reducing working time or retiring part of the workforce, to allow for an equitable distribution of the available high-wage employment among the vast majority.

Socially acceptable redistribution of employment is possible only as long as quality-competitive product markets are large enough for institutionally mandated underemployment to be small enough to be welcomed as leisure. If underemployment incurred in defense of normalized high-wage employment exceeds the very low level that alone can be socially acceptable, thereby turning into unemployment—be it because international quality markets have become crowded; the rate of innovation in the domestic economy has slowed down in comparison to relevant competitors; labor market policy has failed, for whatever reason, to upgrade skills or retire capacity efficiently and equitably; or wage moderation, containment of social spending, and process innovation fail to compensate for limited product advantage or the failures of labor market policy—the costs of social support for those outside the labor market must soar, further depressing the economy's international competitiveness, and high equality among the employed is bound to be increasingly overshadowed by deep inequality between the employed and a large number of long-term unemployed.

At this point, social institutions that rule out low-wage employment in order to generate high-wage employment become increasingly likely to be overridden by market forces. As the labor constraint that drives industrial strategy in an instituted high-wage economy is weakened, with low-wage employment becoming an option for profit-seeking employers and work-seeking workers, its virtuous supply-side effect wanes, eventually resulting in even less high-wage and high-skill employment than there might have been without deregulation. In the ensuing spiral of institutional erosion and structural downgrading, the difference in governance and performance between an instituted high-wage and a liberal market economy disappears.

Can It Survive?

In 1993 the German economy moved into its worst recession in postwar history, raising the possibility that the German economic *Sonderweg* might finally have ended. In the following I will distinguish three sources of the present *malaise* of German capitalism: (1) a possible *secular exhaustion* of its capacity to perform the complicated balancing acts required for its success; (2) the strains caused by the *shock of unification*; and (3) the changing conditions in the *global economy* of which Germany is part. My argument will be that while in normal circumstances the ‘German model’ may or may not once again have found a way out of its difficulties, unification may have so much exacerbated these as to make them insurmountable. Moreover, even if East Germany could against the odds be incorporated in United Germany on West German terms, the simultaneous incorporation of Germany as a whole in a globalized world economy exposes German economic institutions to new kinds of pressure which they may be unable to withstand.

The Model Exhausted?

If there was one blemish on West German economic performance in the 1980s, this was persistent *high unemployment*. To be sure, unemployment in the much more market-driven economy of the United Kingdom was even higher throughout the period (Table 6). But in Germany, with its institutionalized commitment to social cohesion and its deployment of labor constraint as a supply-side stimulus, it posed more fundamental problems. This explains why German unions in the 1980s used their political and industrial clout to redistribute employment by reducing working time (Table 7)—foregoing economic growth by cutting labor input (Table 8), and trading potential increases in money income for leisure, in an effort to defend high equality. They also tried to win employers and government for a nation-wide ‘training offensive,’ aimed at raising worker skills to a level where ideally everybody could be employed at high wages in a flat wage structure, *so as to avoid the need to restore full employment by wage cuts, broader wage dispersion, and a proliferation of low-wage and low-skill jobs*.

This strategy was not entirely ineffective. By the end of the 1980s, unemployment was beginning to decline, and overall employment and workforce participation had slightly increased. Still, a sizable number of unemployed, almost half of them long term, remained. Depending on the perspective, this could be blamed on the *institutional rigidities* of German labor markets or alternatively on *lack of effort* in labor market policy and working time reduction. It could also be attributed to *costs*, of labor or the welfare state, having crossed the threshold beyond which they

Table 6

Employment and Unemployment

	Average Unemployment Rate 1981–1990[a]	Long-Term Unemployment 1990[b]
Germany	7.1	46.3
United Kingdom	9.5	36.0
Japan	2.5	19.1
United States	7.0	5.6

[a] Source: Kenworthy

[b] From survey-based data. Long-term unemployment is defined as the percentage of the unemployed who have been out of employment for 12 months or more. Source: *OECD Employment Outlook,* July 1992

Table 7

Working Time

	Average Hours Worked Per Person per Year[a]	
	1973	1991
Germany	1,804	1,557
Japan	2,185	2,023[b]
United States	1,831	1,737

[a] Source: OECD *Employment Outlook*, July 1993. Germany and US: dependent employment only; Japan: total employment.

[b] 1990

begin to count again even in quality markets. But it could as well have been due to *deficient product innovation* failing to keep the economy quality-competitive in spite of and together with its institutional rigidities and high social costs. As high unemployment became increasingly entrenched, the question for those trying to save the system became whether there were possibilities for speeding up innovation and improving labor market, training, and working time policies that could, if inevitable together with some negotiated cost-cutting, restore high-wage full employment, thereby preempting pressures for more markets, more managerial prerogative, and a liberal *Ordnungspolitik* of deregulation. Conversely, arguments *for* such changes came to be based on claims that improved product innovation alone would not win back a sufficiently large market share; that labor market, training, and working time policies had reached their financial, social, or other limits; and that effective cost reduction was achievable only by deregulation and returning allocational decisions to ‘market forces.’

Table 8

Labor Input

	Labor Force Participation Total (Females)[a]		Average Yearly Rate of Change in Employment, 1983–1990[b]		Percent Change in Resident Population, 1970–1988[b]
	1979	1992	Males	Females	
Germany	68.3 (52.2)	69.8 (59.0)	0.9	1.7	0.8
United Kingdom	74.3 (58.0)	75.1 (64.5)	1.2	2.9	2.6
Japan	71.8 (54.7)	75.5 (61.7)	1.0	1.6	18.6
United States	72.1 (58.8)	76.9 (68.9)	1.7	2.8	20.1

[a] Total labor force, divided by the population of working age (15–64) at mid-year. Source: OECD *Employment Outlook*, July 1993

[b] Source: OECD *Employment Outlook*, July 1993

[c] *The Economist Book of Vital Statistics*, 1990, p. 18

To many, the collapse of employment in the 1993 recession confirmed earlier diagnoses of endemic weaknesses. Japanese advances in traditionally German quality markets suggested that the era of undisputed German product leadership had ended and with it the capacity of German industry to evade price competition. Also, growing pressures on German firms to cut costs confirmed suspicions that in times of assured product advantage, German managements had neglected process innovation, especially the introduction of ‘lean’ production methods, not least in response to powerful works councils defending jobs under endemic high unemployment. Mounting mass dismissals and rapidly rising unemployment rates, not just in East but also in West Germany, seemed to show that the possibilities for working time reduction and early retirement had been exhausted. And the limitations of skill upgrading as a means of full employment policy seemed to be indicated, among other things, by a higher than ever number of young people dropping out of the apprenticeship system, due apparently to its significantly raised intellectual demands.

Perhaps most disturbing were concerns, also older than the crisis but dramatized by it, that the German system of knowledge production and diffusion might have structurally and, barring major institutional adjustments, irreversibly lost touch with changing markets. With the

Japanese successes of the late 1980s, competitive advantage in quality markets appeared increasingly to derive not from slow product refinement but from fast product turnover. The German system of innovation, management, and 'organizational culture,' with applied research conducted by research institutes and associations close to industrial users, linking up with widely available shopfloor-generated worker skills vested in long-term commitments to quasi-professional occupational identities and governed by consensus-building institutions like codetermination, seemed far better suited to the former than to the latter and unlikely to be able to move from the one to the other on short notice.

Already before unification, German capitalism may thus have hit its limits, with respect to the size of its possible product markets, its capacity to maintain product leadership, its ability to manage its labor market, or more than one of these at the same time. Indications were that in response, it had begun slowly to deteriorate into a pattern where socially instituted markets, negotiated management, structurally conservative politics, quasi-public associational governance, and cultural traditionalism resulted, no longer in industrial upgrading, but in an ever-expanding number of people being relegated to an ever more expensive and, ultimately, unsustainable social safety net in the widest sense, being kept out of employment at public or in employment at private expense.

Whether or not these tendencies could have been corrected in normal conditions is a moot question. Experience suggests that prospects for consensual cost-cutting were not entirely bleak. German collective bargaining, together with the institutionalized monetarism of the Bundesbank, has always been remarkably good at keeping unit labor costs under control, without deregulation and indeed in order to prevent it (Streeck 1994). Unification, however, and the boom and bust that followed it, did nothing to resolve whatever structural problems may have existed at the time. Instead it imparted a historical shock to the 'German model' that may well have been powerful enough to throw it off its course once and for all.

The Shock of Unification

The crisis of the early 1990s might have come even without unification, because of a secular exhaustion of the 'German model.' But it could also have been caused by unification alone, as rebuilding a country as large as East Germany would have been demanding even on the strongest economy. Sorting out the two explanations is further complicated by the possibility that the inherent institutional logic of the (West) German political economy may have forced it to define the problems of unification in a way *that made them even more difficult to resolve than they would otherwise have been*.

The West German response to unification was above all designed to protect the West German social order from being modified by the event. Unification was conceived and executed as a giant exercise in *Institutionentransfer*: a wholesale transplantation of the entire array of West German institutions to the former East Germany. This approach was supported by all major West German players, including business, labor, the conservative government, and the Social-Democratic opposition. With respect to the economy, unification involved the immediate extension to the East of socially circumscribed markets, negotiated firms, enabling state intervention, and market-regulating associations. Immediately thereafter, national unions and employers' associations formally committed themselves to raising East German wages to West German levels within the next half decade, explicitly ruling out the establishment of a low-wage area in the East. In part this reflected a shared belief that however low East German wages might be, German industry could never be price-competitive. But there was clearly also a fear that a low-wage regime in the East might erode the high-wage and high-skill regime in the West by opening up opportunities for low-wage production that might lure German firms away from the upgrading path of industrial virtue.

Together with its wages being raised far beyond its productivity, East German industry was included in the rigorous competition regime that West German firms had had four decades to learn to live with. Nobody can have been in doubt that this was bound to place the East German economy under potentially destructive adjustment pressures, with the likely outcome of prolonged mass unemployment. This, in turn, could not but trigger massive financial transfers from West to East, given that among the institutions that had been transplanted wholesale with unification was the West German welfare state. While it has been argued that these risks were difficult to gauge at the time of unification, it is questionable whether more realistic forecasts would have made much of a difference. Bent on protecting West German institutions, all relevant parties more or less consciously opted for a policy of trying to *buy the East German economy into the West German high-wage system*, at whatever cost to East German workers or West German taxpayers, in the hope that somehow the cost would be less than catastrophic.

That hope may well be disappointed. By the mid-1990s United Germany was engaged in the largest wealth transfer in economic history, having committed itself for at least a decade to subsidize the *neue Länder* at a level of about $100 billion a year and to cover all manner of expenses, from public infrastructural investment to pension supplements and, not least, unemployment benefit. Still, there is no guarantee that this extraordinary redistributive effort will not in the end be self-defeating. Public debt has exploded since 1989 and may not be reigned in for a long time—or only by cuts in the welfare state or in research and development effort that would in more than one way be obstructive of a quality-competitive 'social market economy.' Also, world markets for German products, hardly large enough to provide full employment for West

Germany and perhaps shrinking anyway for reasons of their own, may prove too small for Germany as a whole; the training costs of continued industrial upgrading, even if they might have been manageable for the West, may be too high for West and East together, especially as the latter has to be subsidized by the former; and the capacity of the West German economy for industrial innovation, perhaps already in decline, may not suffice to restore competitiveness to West and East Germany at the same time.

Eastern unemployment and, compared to the Western part of the country, regional impoverishment may thus become a lasting condition, owing in a paradoxical sense to the excessively ambitious targets imposed on the *neue Länder* as part and parcel of *Institutionen-transfer*. At the same time, abiding efforts to subsidize internal inequality down to a level compatible with institutional continuity may cause constant financial bleeding. Protracted economic stagnation and declining competitiveness may then set free market forces strong enough to erode, gradually and under growing risk of divisive political conflict, the very same institutions and make impossible the kind of economic performance that unification by *Institutionentransfer* was intended to preserve.

The Challenge of Globalization

On the surface, it would seem hard to understand why a set of economic institutions as successful in world markets as the German one should be threatened by further economic internationalization. But while the free trade regime of the postwar period left national boundaries intact—although allowing them to be crossed—globalization abolishes them. Competitive performance of German high-wage capitalism requires continuous supportive as well as directive public or quasi-public intervention, inevitably organized at a national level and dependent on a capacity, vested in the nation-state, to police the boundaries between the national economy and its environment. While versions of capitalism that require less state capacity for their governance may hope that the attrition of national boundaries under globalization will leave them intact, this is quite different for a nationally organized economy like Germany.

The postwar German compromise between labor and capital, or between German society and its capitalist economy, was conditional on limited mobility of production factors across national borders. At its core was an institutionalized mutual accommodation of capital and labor markets—both themselves highly organized by government intervention and associative self-regulation—that turned less-than-perfectly mobile capital into a societal resource and the financial sector into an economic infrastructure, for a pattern of production compatible with social objectives like low inequality, in exchange for provision of a labor supply willing and able to satisfy economic requirements of high competitiveness in international quality markets. Globalization, by increasing the mobility of capital and labor across national borders, both extricates the labor supply from national control and enables the financial sector to refuse to do service as a national utility. By internationalizing, and thereby disorganizing, capital and labor markets, globalization dissolves whatever negotiated coordination may have been nationally accomplished between them and replaces it with global hierarchical dominance of the former over the latter.

The West German *labor market* has long attracted foreign workers, so much so that by the late 1980s the number of foreigners living in West Germany had become far higher than in any other Western European country. Still, the German mixture of immigration controls, effective enforcement of labor standards, full extension to immigrants of union representation and social rights—if not political rights—and partial integration of foreign workers in training and retraining kept the supply of unskilled labor to domestic employers low enough to sustain labor market pressures for upward restructuring. The breakdown of Communism in Eastern Europe, however, has unleashed an inflow of immigrants of a dimension that in the long term seems in compatible with high labor standards, an extended welfare state, and a normalized pattern of high-wage and high-skill employment.

Unemployment in Eastern Europe will change German labor markets even without direct immigration, much more so than the completion of the European Community's 'Internal Market' in 1992. It has always been part of the German model that low-skill jobs were to be allowed to move to low-wage countries, with job outflow ideally balanced by growth of, and training for, high-skill and high-wage employment. High long-term unemployment in the 1980s showed that achieving this balance was becoming difficult even when the Iron Curtain was still in place. Today the Czech Republic in particular has become a vast low-wage labor pool for German firms—and, unlike classical low-wage countries such as Portugal, one with a skilled workforce geographically close enough to Germany even to be included in just-in-time production.

Accession of Eastern Europe to the European Union, which Germany cannot resist because it must be vitally interested in political stability behind its Eastern borders, will remove the last remaining uncertainties for Western investors, most of whom will be German. It will also make construction of a 'Social Dimension' of the European Internal Market, one that might protect German labor markets from the deregulating effects of internationalization, even more difficult than it already is. The consequence will be a further increase in the availability to German employers of cheap, and sometimes not even unskilled, labor, undermining the German high-wage system by encouraging outflow of jobs at a time of a growing inflow of workers.

As the German labor market is dissolving into its international environment, so is the German *capital market.* Financial capital was always more internationally mobile than labor, and West Germany was one of the first countries after the war to formally dispense with capital controls. But for a long time there were a number of effective impediments to capital mobility, sufficient to allow for a meaningful distinction between German and non-German capital and for the former to be governed by national institutions. For reasons related to national history and international politics, German finance capital was historically less cosmopolitan in outlook and enjoyed less international market access than British capital. Also, German banks' *Hausbank* mode of operation was and is hard to apply outside Germany; different national regulatory regimes made international operations costly to enter; and communication technology before the micro-electronic revolution slowed international capital flows, thereby limiting the size of the international capital market. As for German industrial capital, general logistical, organizational, and political uncertainties combined with cultural idiosyncrasies of management and work organization—as well as with the specific incentives offered by *Standort Deutschland*, such as high-skilled labor and social peace—to keep the outflow of investment and jobs limited.

Globalization has removed most of these constraints and turned formal into *de facto* liberalization of capital markets (see Cerny in Crouch and Streeck forthcoming). Financial internationalization weakens the hold German banks have over the credit supply to German firms, which in turn weakens the banks' capacity and motivation to monitor company performance and promote prudent long-termism in company strategy. Large German firms seem for some time to have been making efforts to extricate themselves from the tutelage of their *Hausbanken*, in part because with globalization their credit needs are beginning to outgrow the German market. Simultaneously, attracted by burgeoning international opportunities, the German financial sector is becoming more internationally minded, with even *Sparkassen* and *Genossenschaftsbanken* taking a keen interest in the global casino. As national boundaries wither away and the German financial sector dissolves into a globally integrated financial services industry, the special relationship between German banks and German firms may increasingly become less 'relational' and more market-like.

The Parochialism of Nationally Organized Capitalism

If national boundaries are doomed to fall in the course of globalization, making it impossible for nationally characterized versions of capitalism to remain distinct from their environment, could the German model not survive by being extended to the emerging global economy? Indeed as the capitalist economy internationalizes, some of the institutions that govern its German version are being adopted by other countries and international organizations. Unlike the *Institutionentransfer* of German unification, however, this process is highly selective, being strictly limited to institutions that make or accommodate markets with the exclusion of others, equally central to German capitalism, that socially embed and correct such markets.

1. International *markets* are constructed through diplomacy, not through the complex domestic class politics that gave rise to *soziale Marktwirtschaft.* They are therefore not likely ever to become embedded in protective-redistributive arrangements similar to German markets. *Nota bene* that Germany, in coalition with the British and against the French, succeeded in extending its competition regime to the European Community, whereas its efforts to endow the Internal Market with a 'social dimension,' in alliance with the French and against the British, came to naught.

2. The German *firm* cannot serve as a model for corporate reorganization in other countries. Codetermination is based, not in the individual firm and its competitive interests, but in the broader German political and institutional context. It cannot therefore be internationally extended. This holds even within the European Community, where efforts to export German company law, and with it the characteristic balance between capital and labor in the governance of large firms, were defeated by resistance, not just from European capital, but also from most non-German trade unions. Moreover, German management practices, unlike Japanese ones, have never been successfully reproduced outside Germany, reflecting the dependence of German firms for crucial governance functions on a—national—exoskeleton of rule-setting institutions that an individual firm cannot and will not build on its own.

3. Even more than in Germany, what *state* capacity there is in the international economy is weak and fragmented. International efforts to mobilize state-like forms of public power for purposes of economic governance never got very far, not even in the European Community, which historically represents the most ambitious attempt at state-building above the nation-state. If monetary union were ever to be realized, the European Central Bank will be as insulated from political pressure as the German Bundesbank and will operate under the same monetarist principles. Unlike the German state, however, the European quasi-state has no capacity to provide for equalization of living conditions in its territorial subunits. Even more importantly, the German state's quintessential ability to replace direct state intervention and provision with assistance to organized social groups regulating themselves in the pursuit of collective goods—not least, of the infrastructural conditions of international competitiveness under high labor standards and a hard currency regime—cannot be replicated at the international level. Just as German *Marktwirtschaft* is being internationalized without its social correctives, German institutionalized monetarism is about to be transferred to the European Community without the associative self-governance that makes it *sozialverträglich* in Germany.

4. German *associations* prosper because of their close relationship to a facilitating state. No such state exists, or can exist, in the international economy. To the extent that the latter is a negotiated economy, it is negotiated among states, not among associations. Beyond the nation-state there are no organized social groups with the capacity to build and maintain a floor under

international markets or correct international market outcomes by negotiated redistribution. Other than states, the only major actors in the international arena are large firms, increasingly institutional in character, with ample resources to pursue their interests individually, unconstrained by union or government pressure that would force them into international class solidarity, and indeed with a growing capacity to extricate themselves from associative governance at the national level, very likely increasingly also in Germany.

5. German traditionalist *culture* would seem to be even less suitable for internationalization. As Michel Albert (1993) has pointed out, Germans are as susceptible as anybody else to the attractions of nontraditional, 'American' economic culture. Compared to these, the slow-moving, conservative, collectivistic, and all-too-prudent German system must inevitably seem boring and utterly devoid of 'fun.' In fact there are many ways in which cultural internationalization may disrupt the standard operating procedures of a densely organized society, like Germany, that thrives on long-term incremental improvement and requires stable commitments and suppression of opportunism. Just as German savers and investors may grow more *rechenhaft,* German managers, increasingly trained at American business schools, may want to be allowed to 'make decisions' like their American role models. And there are indications that the German vocational training system is about to be dramatically transformed by internationalization, among other things by European Community 'harmonization' of skill profiles in the unified European labor market.

Market-modifying and market-correcting political intervention in the economy, including publicly enabled associational self-regulation, can take place only within nation-states, because it is only here that the public power necessary for the purpose can be mobilized. Economic globalization therefore erodes the conditions for such intervention and, by default but also by design, leaves only depoliticized, privatized, and market-driven forms of economic order. It is above all for this reason that the German version of capitalism cannot be exported. Globalization discriminates against modes of economic governance that require public intervention associated with a sort of state capacity that is unavailable in the anarchic world of international politics. It favors national systems, like those of the United States and Britain, that have historically relied less on public-political and more on private-contractual economic governance, making them more structurally compatible with the emerging global system and in fact enabling them to regard the latter as an extension of themselves. It is this *deregulatory bias* of globalization that seems to be at the bottom of Albert's (1993) pessimistic prediction that global competition will result in the perverse outcome of the less well-performing Anglo-American model of capitalism outcompeting the better performing 'Rhine model.'

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