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Germany in (the) crisis

A toxic economic miracle

For many commentators at home and abroad the socioeconomic situation in Germany is a miracle. Despite the economic and financial crisis since 2007 the strongest economic power in Europe seems to have done all things right. After the sharp decline of the gross domestic product in 2009 (-5%), the German economy has caught up relatively quick and since 2010 it has swung back to a moderate growth rate. Before we all sing the praises of the German model let's take a closer look at the causes, effects and consequences.

Exceptional situation...

The *internal causes* for the positive development are easy to spot: During the first climax of the crisis the automatic stabilizers (e.g. the social systems, particularly the unemployment benefits) kicked in as planned and worked very well. Due to this the direct cost of the crisis (unemployment, decrease in income etc.) was moderate. Despite all justified critics the impact on the population has not been as hard as in the rest of Europe. In extension on the basis of the strong social partnership of the trade unions/workers councils the politic could act fast and effective: Hence mass layoffs where avoided by reducing the working time (working hours, reduction of working time accounts, overtime etc.) and compensations were paid via the social transfer system. Finally, after much and strong public hesitation, the policy no longer refused economic recovery and investment programs (infrastructure projects, roads, renovation and construction of public facilities etc.) to stabilize and support the internal effective demand. Worth mentioning in this context is the strong support for the automotive industry (*cash for clunckers/Car Allowance Rebate System)* – still one off the key industrial sectors in Germany.

Against this background it was quite easy to ramp up the production very quick during the small economic recovery and so the newly rising international demand for German products and services could be easily satisfied after 2009. In the first months of 2011 the situation has further improved: For example the official unemployment rate was still falling (currently 2.8 million/total 3.8 million) and the export stabilized at a high level. While in Germany the public debt - as elsewhere - has risen due to the interventions to prop up the financial system, financing the economic recovery programs and the rising social transfers, this problem is far less acute. Why? Because in Germany the tax revenues are still relatively high due to the good economic situation and contrary to other countries the interest charges for the public debt have declined. For example the re-financing cost of the German debt on the financial market sank to a historic low - recent government bonds with a two year term were all sold at 0 percent interest rates.

In light of this situation the main political goal in Germany is still fiscal consolidation and so the empirical and theoretical rationality of the austerity measures are never been questioned by most political parties, in the media and by scientists. But neither is the international context of the economic miracle properly understood. Instead the very specific internal situation is for most politicians and the public a clear evidence of the effectiveness of the favored austerity measures and the necessity to increase the competitiveness by all means. This interpretation is not only wrong, but even the key aspects of the so called good German crisis management contradict this view: For example working time reduction and economic stimulus programs were never accepted as efficient instruments in decades in Germany. Consequently before the crisis of 2007/08 most experts and politicians opposed strongly all this instruments for ideological reasons and so the tools were dimensioned hesitantly, to small and were incorrectly used (mostly tax subsidies with no or lesser positive economic effects than direct interventions). And yet they have shown their positive effects again - just like in most simplistic Keynesian textbook argument always stated. At the same time the function of the welfare state as an automatic stabilizer since 2007/08 has been demonstrated. However, the political demand for further dismantling the welfare state and its performance is still the dominant mantra of the official German policy before and after the beginning of the current crisis. Finally, the massive and sustained transmission of debt and risk of the private financial sector to the detriment of the public and the rising debt was never an accepted component of the official economic policy. On the contrary there is no rational justification in the economic mainstream for the width socialization of costs and privatization of gains in their pure form. Exactly this irrational outcome of the policy could be observed nationwide all over Europe and the OECD since 2007/08.

Across the board all the instruments used after the crisis started where either (i) pure evil and irrational (the Keynesian devil) and/or (ii) diametrically contradicted in every sense the dominant view of a solid economic, financial and social policy. Otherwise the German economy benefited (iii) from the effects of the same instruments that were used in all other countries, mostly far stronger and more targeted. As a result the effective demand was stabilized on a global scale and the so induced growth is and was the *sine qua non* for the recent success of the German economy. Without this the crash of the global economy would have resulted in a severe crisis, foremost in Germany with the strong export driven growth model. Missing now a real crisis analysis in the German policy and by the main experts is more than obvious. Above all the lack of knowledge and ignorance combined with German thoroughness (let's say dogmatic approach) leads now to false prescriptions how other countries or the EU in general should solve the severe economic and social problems. It should be evident with a little logic and mathematical knowledge, that in an international trade circle (with commodities, goods and services *and* various forms of money) with different units (households, government, international, business, financial services) not all nations and aggregates can get absolute surpluses. Also not all balance sheets could be ever in stable equilibrium. Rather deficits, surpluses and disequilibrium are the nature of every dynamic economic system in the modern world.

In addition to this in the European Union countries and regions at a very different developmental stage are united. For that reason alone other conditions prevail for a country like Germany with a very broad industrial base (roughly a share of 40 percent of the national value added) and countries in the euro zone or Europe, where the share of industrial production is much lower (e.g. GB about 6 percent). Countries with a different structure, mode of production and living conditions had been tied together for political reasons with one single currency – the EURO. But with the introduction of the EURO the same differences in development have not been minimized, on the contrary they widened. And also this problem has been addressed since the beginning by critical economists across Europe. It was also predicted an implosion of the Euro system in a major crisis. Now we have exactly such a crisis on a systemic level where the absolute false crisis management added more problems on top. Yet official German politicians and there economic experts are not too tired to stress every day austerity measures. Compulsory saving and to improve the competiveness are the only medicine for the "homemade" crisis in Europe - wrongly called by the pundits as a sovereign debt crisis.

To stress these ideas in a systemic crisis is more than ignorant. But the stubborn statements will be given even when then Euro zone has long imploded and even than an intellectual change will not come easy. Until now criticism of the neoliberal agenda has always been repelled by the same pattern: the medicine was not administered in high enough doses, e.g. there has not been any real austerity and structural reforms – so the coming future legends.

...and the other side of the coin

Before the end of the EURO we should put aside this ignorance and take a realistic look behind the scenes of the German miracle to eliminate blatant misunderstandings. The relatively good situation obscured the deep social changes in the last decade in Germany. First of all there are internal changes in the labor market and in the wealth distribution. In the first area the situation changed substantially due to many social reforms (institutional as in the benefit programs) in combination with instruments to propose more flexibility of the labor market. Until the late 1990s the norm was still a strong collective bonded labor market with a high standard of social rights. Through the system of the collective bargaining with the unions we saw an overall increase of the real wage. All these reforms and other structural changes (globalization etc.) reduced little by little the collective bargaining power of the union and so the coverage and effectiveness of the unions declined. The legal conditions have been altered to the detriment of employees and with the labor market instruments the atypical, precarious employment (e.g. temporary work, sub-standard wages, mini-jobs) continues to grow until now.

Still the majority of jobs in Germany have normal conditions (permanent and with social insurance) and good wages. However Germany has made a similar extent in the low-wage sector as in the U.S. And so now approximately 25% of all employees in Germany fall into this category. Even in the expansionary phases of the "German miracle" well-paid and permanent jobs have been lost and were replaced by rapid growing temporary, precarious jobs below average wage. In addition the self-employment rose, but most was "solo" self-employment with low earning and/or unsteady income without adequate social protection. In addition to the expansion of the working poor in one of the richest industrialized countries, where many people are poor and/or constantly on the verge of unemployment, the pressure on the normal working conditions increased dramatically: If after a short period of unemployment (after 12 months of benefits a steep fall in the system of social assistance occurs) threatens, this creates an atmosphere of anxiety. Consequently the uncertainty has increased well into the upper middle class and many of them fear a bleak future (*German Angst).* Under these circumstances the effective performance of the trade unions are further limited and weakened.

So it is not surprising that in the last 10 years the wage increase in Germany were always at the lower end compared to the rest of Europe. The majority of the workers had even real wage decline to endure in times of economic recovery, a unique event in Germany since

1945. In this respect, the distribution of GDP between income from wages and profits explains two mayor developments: *On the one hand* the very unequal distribution of total income and wealth. Also in Germany only a few percent or parts per thousand of the population have the largest share of financial and tangible assets/fixed capital. And only this small group benefited most of the economic miracle. The rest (90 per cent) had to accept stagnating incomes, falling wages and social decline. *On the other hand* the decreases of the mass income diminished the effective demand for goods and services in Germany. In conjunction with the relative low effective demand of the German state in recent decades (due to public savings and debt reduction programs) and the cautious business investment the overall stagnation of the internal market is only logical.

The social costs of the German model

In this situation the absolute increase in sales of German products and thus the achievement of current account surpluses is the main goal and important for the German companies to compensate for this weakness and stabilize or better increase their profits. So the well known export model since the industrialization in the 19th century (first copy, then build own innovation and industrial production for the export) has been prolonged, remodeled and intensified. The technological base of this model was and is the mechanical engineering, chemical industry, vehicle construction and automotive industries and the overall productive companies: They produce high-quality industrial consumption and investment goods and the large surpluses in the export of these goods occur, because they exactly fit into the import structure of every developing and emerging country to foster there industrialization and/or the goods "Made in Germany" satisfy exactly the growing global demand for high quality consumption products and services.

Mirroring the good situation of the German export sector is a recycling of the so gained financial surpluses through the banking sector to the trading partner. In this financial cycle the gains from the rising exports appear on the balance sheets outside Germany as credits for the households, businesses and governments abroad to re-finance the high and rising imports of the goods. But such a structure centered on the attainment of absolute and rising current account surpluses on the one side and rising deficits and credit contracts on the other side is inherent instable. Such a situation produces endogenously the possibilities of very harsh structural economic inequalities causing painful adjustments – that is, severe financial and economic crises and deflationary pressure.

Finally with the weakness of the German domestic market the dynamics of a cutthroat competition among European neighbors is also exported. Because at the same time every decreasing real purchasing power of German consumers increases the pressure on all other exporting countries to reduce their "costs" abroad steadily. Otherwise they can't compete successful in the German market or lose against the Asian producers (China, India etc.). Until now these companies can expand their market share in the EU at far lower costs using the latest technology and production patterns. This complex competitive pressure of the German socioeconomic, financial and budgetary policy is now a burden for the Europe and the rest of the world. The internal problems of the German society got transferred abroad (beggar thy neighbor policy) and causes a race to the bottom. Under the prevailing order a relatively high standard of living in Germany could be stabilized in a situation with steadily falling real incomes and weak domestic demand. Germany is doomed to export goods, services and internal problems; the rest has to bear the burden of this stupid and destructive policy until crises forces a breakup of this unstable structure.

The policy of shifting the burden to other nations (specifically the German trade partners and borrowers) and the constant pursuit to be the dominant economic power with strict balance of payments surpluses is a testimony of the widespread failure of the political and economic "elites" in Germany to understand properly economic dynamics. In this respect the slow and often incorrect prioritization of the crisis policy is not surprising. Although the official ideology corresponds to the microeconomic logic of a single company or a household and is in this setting partially rational, to preserve the minimal achievements of the European unification process this perspective is hazardous (the well known problem of the fallacy of composition).

The "miraculous" development in Germany since 2007 based on the fast internationally coordinated and concerted support of the international financial sector (nationalization, subsidies and guarantees) as well as historically unique stimulus programs (*economic recovery programs*) in all developed and developing countries (estimated in total up to 5 trillion US$). And only through this massive injection of liquidity a sharp decline or better say crash of the global economy in 2009 could be avoided. The situation was stabilized and Germany as a leading export nation has benefited particularly from this swift and strong reaction. But unlike most industrial and emerging countries Germany has shouldered only a small portion (compared to the GDP) and it favored ineffective and not quite useful elements (tax subsidy) rather than intervening directly in the economic cycle. In contrast all other nations have mobilized far more liquidity and acted more precisely. Similarly the interventions of the central banks were crucial to prevent the crash of major parts of the money and capital markets. Also in this case the German government and leading pundits in politics, science and the public are too stubborn and prefer ideological dogmas to criticize exactly these interventions. But without these actions of the central banks most of all German private banks and leading companies would have been threatened by massive depreciations and in the end by bankruptcy. And finally, Germany benefited disproportionately from the introduction of the EURO and the single market. Otherwise the steady increase of the trade surplus would have caused a strong currency revaluation and reduced the exports by losing the so wanted competiveness.

Logically the measures to support private companies and financial institutions increased the public debt. Similarly the German "export model" is not an option for all nations in Europe. They simply can't do it by will and it is also on theoretic terms impossible. The cost of these model persuaded by the strongest economy in Europe before the crisis hit in 2007/08 could be seen for example in de-industrialization, bankruptcy, rising debt, high unemployment rates in Europe. Today all these problems are even worse. And to stress the point that every nation in Europe or in the world should only follow the good German example is more than cynical – who says otherwise either has no idea of economic dynamics, is ignorant or lying.

The inherent conflict-ridden situation in Europe has been exacerbated now by the severe financial and economic crisis and so Europe is currently at a crossroads: The previously unsolved problems of uneven development will worsen once the mentioned stimulus packages will expire. The solutions to all the mentioned problems in an ongoing systemic financial crisis are never to be found in tight fiscal discipline and austerity measures. With this “medicine” the possibility of the implosion of the euro zone will only rise day by day. But also when in the coming months the EURO still exist the overall economic conditions will stay quite bleak. Looming just around the corner is only a long stagnation and deflationary situation, which was prevented pragmatically since 2007 for some time and good reasons.

To what extent this situation can be averted in the future is partially due to a general revision of German politics at the national and the European level. A reversal of the current dominant economic paradigm in Germany is for every rational individual a “no brainer” and with no alternative. Otherwise we face very hard and troubled times or at least we will enter a long period of social stagnation and high vulnerability of our economies. Furthermore on the way we have to mobilize more and more financial resources to inefficiently stabilize constantly an inherent unstable situation.