Germany's socio-economic model and the Euro crisis

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Germany's socio-economic model, the "social market economy", was established in West Germany after World War II and extended to the unified Germany in 1990. During a prolonged recession after the adoption of the Euro in 1998, major reforms (Agenda 2010) were introduced which many consider as the key of Germany's recent success. The reforms had mixed results: employment increased but has consisted to a large extent of precarious low-wage jobs. Growth depended on export surpluses based on an internal real devaluation (low unit labour costs) which make Germany vulnerable to global recessions as in 2009. Overall inequality increased substantially.

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Germany's socio-economic model has changed substantially over the years. The foundations of its basic model, the "social market economy", were laid in West Germany after the World War II. After unification they were extended to East Germany. During a prolonged recession after the adoption of the Euro, major reforms were introduced which many consider as the key of Germany's recent success (at least relative to other OECD economies).

The Federal Republic of Germany (FRG; West Germany) emerged in 1949 from the three zones of Germany occupied by the three western allies USA, UK and France. The constitution of the FRG defined it as "a democratic and social federal State" (Art. 20 GG). Art. 9 guarantees the right to establish trade unions. The allied powers introduced workers' co-determination in the coal and steel industry, which had been the core of the German armaments industry and whose owners had often

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supported the Nazis. In 1950 a German law redefined and secured these achievements due to massive pressure by trade unions and against the resistance by employers and conservative politicians. In 1952 the law regulating the participation of workers in enterprises (Betriebsverfassungsgesetz) came into force, which granted the workers councils many rights ranging from information to co-determination in various areas.

Even before the foundation of the FRG the allied authorities had carried out a monetary reform in 1948 that established the Deutsche Mark as the national currency. The "Bank Deutscher Länder" (Bank of the German States) managed the monetary policy as central bank until the "Deutsche Bundesbank" was established in 1957. Within the Bretton Woods system the central bank's capacities to determine the exchange rate were severely constrained. The exchange rate of the Deutsche Mark was pegged to the US-Dollar at 4.20 DM/USD.

Until the mid-1960 the German economy grew very rapidly. The strong growth resulted from post-war reconstruction and the desire of the German population to enjoy the new consumption goods that formed the basis of the Fordist growth (cars, refrigerators, washing machines, TV etc.). The strong growth resulted also from the real undervaluation of the Deutsche Mark within the fixed-exchange-rate regime, which facilitated export surpluses. Fiscal policy during these first years showed budget surpluses. Real wages grew also fast as productivity increased strongly and the labor force remained full employed. Actually, by 1955, the labor shortage became so critical that Germany started to import labor migrants who originally were supposed to stay only temporarily in Germany. For some observers (Abelshauser) the resulting change in the German labor force with a higher share of low-skilled (and, for language and cultural reasons, arguably hard to skill) workers has been the root cause of the persistent long-term unemployment later after 1975 when the Fordist mass production regime went into decline.

The economic policy of the conservative government was informed by specific economic thought, the so-called ordo-liberalism which stresses free markets on the one hand and systemic regulation ("Ordnung") on the other hand. The resulting system was called "social market economy" with a limited role for the state in particular regarding the business cycle. One of its famous proponents[1], Ludwig Erhard, has been minister for economics from 1949-1963 and then federal chancellor (Bundeskanzler).

In 1966, the first recession occurred and led to a change in power and macroeconomic governance. Keynesianism supplanted the former ordo-liberal school as the dominant economic idea informing economic policy. The Social Democratic Party (SPD) joined the government in a grand coalition. Karl Schiller of the SPD, a leading Keynesian, became minister of economics. According to a new Law for Stability and Growth which came into force in 1967, economic policy should aim at four goals ("the magic rectangle"): price stability, full employment, external bal-

[1] His most famous book was *Prosperity for all* (*Wohlstand für alle*).

ance and growth. Deficit spending was allowed in order to fight a recession. The new Keynesian approach worked well. The German economy recovered quickly and continued to grow until the first oil price shock. Fiscal policy became an accepted tool of economic policy (besides monetary and wage policy).

The next major change occurred in 1974 as a reaction to the crisis in the wake of the oil price shock and the demise of the Bretton Woods system of fixed exchange rates. On December 5, 1974, the Bundesbank announced to switch to a monetarist approach aiming at a money-supply target. Monetary policy enjoyed additional power in an international regime of flexible exchange rates. The Deutsche Mark appreciated rapidly vis-à-vis the US-Dollar. In the German domestic context monetary policy became the leading economic policy and price stability the top priority. Unemployment increased as the Bundesbank reacted with strong interest rate hikes to trade union demands for higher wages which in turn were supposed to compensate for the oil-price-induced inflation.

This Bundesbank-led model of economic governance produced relatively (in comparison to other OECD countries) good results. The SPD-led socio-liberal government did not challenge the Bundesbank. Wage growth remained strong and secured domestic demand. Workers' co-determination (Mitbestimmung) was extended to all large enterprises in 1976 while it had been limited to the coal and steel sector before. The extension met resistance from employers but ultimately consolidated the successful model of "Rhineland Capitalism" based on high skills, innovation, internal flexibility, and diversified quality production. Although unemployment was higher than in the full employment period between 1953 and 1973 it was below 5% but this was achieved by frequent household deficits and a rising level of public debt.

By 1982, concerns about the international competitiveness and resistance against the rising government debt had become too strong for the SPD. The Bundesbank refused to tolerate further deficit spending. The then chancellor Helmut Schmidt (SDP) was replaced by the conservative Helmut Kohl (CDU) when the minor liberal coalition partner FDP switched sides. The promised change ("Wende") remained rather weak. The dominant role of the Bundesbank (price stability through a restrictive monetary policy) was reinforced. Although some social policies were reformed and wage growth restrained the basic model of Germany's Rhineland Capitalism remained unchanged. But by the end of the decade Germany ran a substantial current account surplus due to the weaker domestic demand, and the public debt burden (debt/gdp) had declined although the nominal amount of government debt has never decreased.

THE LASTING BURDEN OF UNIFICATION AND MONETARY UNION

This situation provided a favorable base to cope with the challenges of Germany's reunification in 1990. Basically East Germany adopted the West German system of law, rules, regulation and institutions. Even worse it took over the

Deutsche Mark at a highly overvalued rate of 1:1 (market rates had been between 1:3 and 1:7). This system and exchange rate were forced upon an economy that was not competitive in a globally open market economy due to very low productivity levels. West Germany did hardly try to save the jobs at stake. It preferred to substitute the former Eastern production by Western production. At the same time (or shortly afterwards) the German trade unions began to drive the still relatively low, albeit overvalued East German wages up to West German levels thus further endangering the often underproductive jobs in the East.

The resulting gap between production and (politically desired and necessary) absorption in East Germany had to be closed by transfers from West Germany. West Germany provided 50% of the East German GDP. A large part of these transfers were financed through the social insurance system. Unemployed and (often early) retired East Germans received benefits without having paid in the system and without a strong base of contributions from East Germany. Therefore, contribution rates had to increase substantially from 17.7% to 20.3% for old age insurance and from 4.3% to 6.8% for unemployment insurance. In total, non-wage labor costs went up by more than 5 percentage points. When unemployment in Germany increased during the 1990 many economists blamed it on the high non-wage labor costs that were said to make labor too expensive.

Besides the social insurance system new government debt has been a major source for financing unification. It increased from roughly 40% in 1991 to 60% of GDP in 1999. The Bundesbank tolerated this to some extent but killed the "unification boom" of 1992 when inflation threatened to rise. It increased the discount rate from under 3% in 1988 to 8.2% in 1992 thereby destroying the European Monetary System. At the same time, the member states of the European Union signed the Maastricht Treaty, which stipulated the European Monetary Union and the introduction of the Euro as a common currency. Germany accepted the end of its macroeconomic hegemony in Europe as the political price for the unification.

When the Euro was introduced in 1999 there was some debate if Germany had entered the monetary union at an overvalued exchange rate. Actually and in spite of widespread fears Germany has remained competitive. At least it never ran a trade deficit and the current account deficits after unification remained manageable. The core problem in the 1990s has been high unemployment and, partly resulting from this, weak public finances. Both issues dominated the public debate and led eventually to the reforms of the so-called Agenda 2010 proposed in 2003 by the red-green (SPD/Green party) coalition government led by Gerhard Schröder.

The thinking behind the Agenda 2010 was influenced not only by conservative economists (such as Hans-Werner Sinn) who (wrongly) assumed that Germany lacked international competitiveness but also by progressive ones (such as Fritz W. Scharpf and Wolfgang Streeck) who blamed the persistent high level of, in particular long-term, unemployment on the slow growth of the service sector. One important explanation for that slow growth was the difference between high labor costs (high tax wedge) and low productivity in the service sector resulting in a, by international comparison, small low-wage sector. An alternative explanation (by

Abelshauser) saw the causes of mass unemployment in the mismatch between the structure of the German labor supply and the demand by an increasingly high-skill economy. The German workforce consisted, thanks to years of massive immigration, of many low-skilled workers of foreign origin. These workers and often their children, too, had language problems and little chances to acquire the skills and educational achievements (diploma etc.) to succeed in the labor market.

THE REFORMS OF THE AGENDA 2010

The years between 1998 and 2005 were characterized by slow growth — with the exception of the short dotcom boom in 2000 — leading to high and persistent unemployment of approximately 10% and budget deficits of about 3%. Inflation was low and, due to the weak growth and wage restraint, lower than in the countries of the Eurozone. Net exports were the most important driver of growth, while domestic demand — in particular investment, but also private consumption — stagnated. The government wanted to reduce its deficit not at least in order to comply with the so-called Maastricht criteria of the European Stability and Growth Pact which requires public deficits lower than 3% of GDP and public debt lower than 60% of GDP. The austerity policy adopted during the recession possibly prolonged the weak growth and high unemployment.

During this phase (until 2005), Germany was widely considered the sick man of Europe, an economic laggard. It received little foreign direct investment (with the exception of Vodafone's huge takeover of Mannesmann). These perceptions were even more dominant within Germany than abroad. The mainstream of German economists, the media and most think tanks, in particular those close to business, advocated a major reform of the German labor market and welfare state or else Germany would turn into a uncompetitive basket case. Although many of the arguments presented were dubious — Germany showed export surpluses despite the assumed weak international competitiveness — politics eventually followed the dominant rhetoric.

In 2002-2004, the government (SPD/Greens) introduced several reforms, including a number of labor market reforms (Hartz IV), followed up later (2007) by an increase in the retirement age from 65 to 67. The reforms paved the way to a strong expansion of the low-wage sector from about 13% in the 1990s to 22% in 2005, a rise by about 50%. The wage dispersion exacerbated: not only did low wages no longer increase, but the share of high wage-earners grew from 21.8% to 26.3% while the middle class shrank from 63.2% in 1995 to 51.6% in 2006.

The reforms were not limited to the labor market. Capital markets were also liberalized by deregulating financial markets and alleviating the sale of stockholdings. Before 2000, the profits had been taxable. The liberalization led to a massive break-up of the cross-holding structure within the German economy. Major banks and insurance companies used to own large parts of industrial companies.

Supervisory boards overlapped with members holding seats in several boards thus creating the interlinked structure of a huge Germany, Inc.

Graph 1: Cross shareholdings in Germany 1996

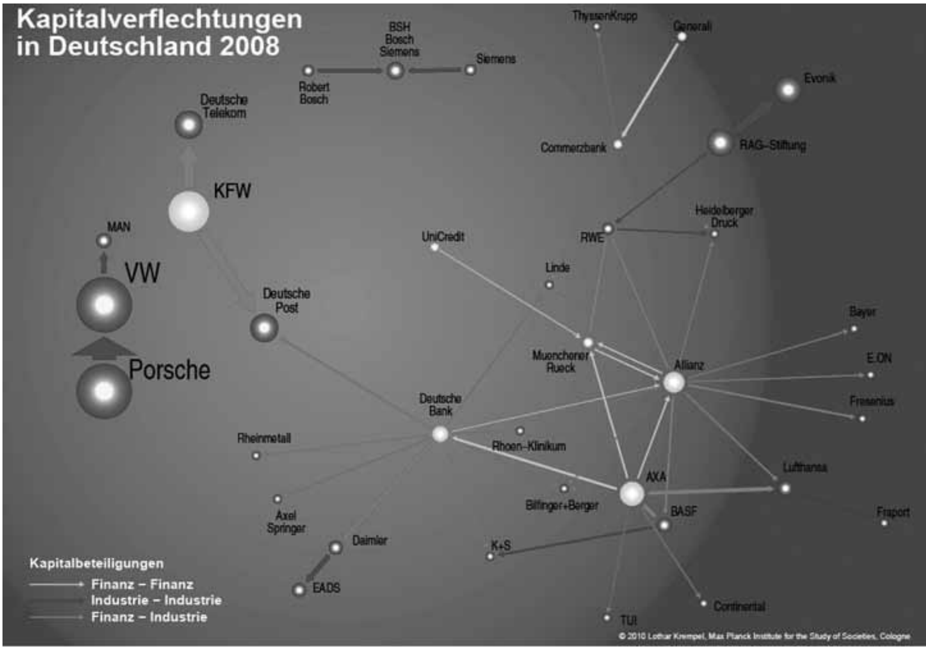
Source: http://www.mpifg.de/aktuelles/themen/doks/Deutschland_AG_1996bis2008.pdf. Yellow arrows: finance--finance; red arrows: manufacturing-manufacturing; orange arrows: finance-manufacturing.

Within a dozen years, the shareholding landscape of Germany had changed dramatically (compare Graphs 1 and 2). German companies became more often targets of take-overs by hedge funds and other companies. The influence of the supervisory board members from the trade unions decreased somewhat as share-holder-value became a more important goal and the role of "patient capital" receded. Arguably, with these reforms, the famous "Rhineland Capitalism" came to an end and was replaced by a more market-liberal model.

The reforms encountered substantial opposition, in particular from trade unions, but went through nonetheless. However, the voters punished the SPD, which lost its majority in 2005, receiving only 23% of the vote in 2009 (down from 40.5% in 1998). The labor market reforms contributed to substantial change in Germany. The low wage sector and wage dispersion increased massively. The share of wages in GDP, already in decline, decreased further. However, the intended effects of lower unemployment and higher growth did not materialize in the short term. The following Table 1 compares the eight years before the reforms with the eight years afterwards.

The main positive effect has been a substantial rise in German price competi-

Graph 2: Cross shareholdings in Germany 2008



Source: http://www.mpifg.de/aktuelles/themen/doks/Deutschland_AG_1996bis2008.pdf. Yellow arrows: finance--finance; red arrows: manufacturing-manufacturing; orange arrows: Finance-manufacturing

tiveness. Germany's export surplus increased to about 5% of GDP although export growth had actually been stronger before than after the reforms. One can interpret Germany's economic policy as internal real devaluation with wages and prices growing substantially slower than in most other countries of the European currency union. After the long period of meager investment, private enterprises again started to invest in 2005, albeit modestly. Together with the rise of export demand this led to higher growth and a slow decline in unemployment. In the end, by 2007--2008, Germany was — from a macroeconomic standpoint — in quite good shape: growth was recovering, unemployment declining, inflation was below 2% and the budget was approaching balance.

The major drawbacks were the rising inequality, combined with a high savings rate. As these savings were only partly invested at home a large part flowed abroad. The capital outflow mirrored the export surpluses. Both resulted basically from the same cause: unequal distribution of value added between labor and capital. While workers and those dependent on social benefits (pensions and so on) faced stagnating or declining real incomes, enterprises and the rich enjoyed incomes that rose faster than their intentions to invest or consume. Lower wages and increasing productivity resulted in lower unit labor costs. The resulting capital outflows and export surpluses built up Germany's net foreign investment position.

On balance, the negative effects outweighed the positive ones. In Table 1, the

Table 1: Germany's economic performance before and after the reforms

Indicators	Dimension	Before Reform 1995-2003	After Reform 2003-2011
Growth	Average annual rate of growth	1.95%	2.34%
Investment	Average ratio (in % of GDP)	21%	18%
Productivity	Average annual rate of growth	0.97%	0.72%
Real wage growth	Average annual rate of growth	> 0[a]	-0.8%[b]
Unit labor costs	Average annual rate of growth	0.29%	0.45%
Unemployment	Average ratio	10.3%	9.1%
Wage share	Average ratio	54%	51%[c]
Labor market flexibility	Average ratio of entries into and exits from employment	36.4[d]	40.6[e]
Income distribution	Gini coefficient	0.27 (1998)	0.31 (2005)
Labor Force	Additional new labor supply	1,754,000	831,000
Employment	Additional new jobs	1,064,000	2.323.00
Hours worked (billions)	Average annual amount	57,068	56,581
Export growth	Average annual rate of growth	9%	7%
Export surplus (current account in % of GDP)	Average ratio	-1%	5%[c]
Budget deficit (in % of GDP)	Average ratio	2.1%	1.9%
Government debt (in % of GDP)	Average ratio	59%	69%[c]

Source: SVR; [a] Source DIW 1991-2000 : +0.9%; 2000-2008 : 0.0%; [b] 2004-2008; [c] 2003-2010. [d] Source: BA (2000--2003); [e] Source: BA (2004-2009). Gray shading indicates a better development in the corresponding period

improvements that are positive in comparison to the other period are indicated by gray fields. In the pre-reform period there are ten indicators with a better performance compared to only five afterwards. It is worth to note that investment, productivity, employment and export growth performed all better before than after although the myth remains strong that the reforms were positive in this regard.

GERMANY DURING THE RECENT CRISIS

The German growth model contributed through its inequality and beggar-thy-neighbor policies to the global financial crisis and the subsequent Euro-Crisis. Germany (together with other surplus countries) created the imbalances that fuelled capital markets with savings in search of higher returns. While its own asset markets (notably the housing market) remained fairly stagnant, its savers and banks wanted to benefit from rising asset prices abroad. When the crisis hit in September 2008, Germany first considered itself only marginally affected. Reality turned out to be different.

In due course and somewhat reluctantly Germany joined the other governments by adopting anti-crisis policies to rescue banks and stimulate demand. Two programmes were particularly successful: a working-time reduction with wage compensation in industries/enterprises affected by the crisis, and a "cash for clunkers" (scrappage) subsidy of several billion Euros to replace old cars with new ones. In the end, Germany probably benefitted most from the efforts of other countries to stimulate demand through loose monetary and fiscal policies.

Germany's GDP declined severely — by more than 5% — in 2009. This decline was deeper than in many other countries that had had bigger asset bubbles because the German economy was (and still is) dependent on exports. With world trade declining so did the German export machine. Indirectly, the German economy suffered from a credit crunch when major banks became basically insolvent and remained operative thanks only to government bailouts.

Although its GDP had declined so deeply, the recovery in 2010-2011 was equally strong, resulting in a V-shaped recession. By the end of 2011, Germany was more or less back on the growth path it had followed since 2005. Germany was the only major economy where unemployment decreased rather than increased during the crisis. This success was caused by an ingenious corporatist working time management involving government, trade unions, works councils and employers. On the one hand, the state paid short-time worker allowances to workers who had to reduce their working time. On the other hand, workers could withdraw hours from working-time accounts that had been established during the last decade facilitating more flexibility and steadier incomes. Like with savings accounts workers could (and still can) accumulate a stock of hours worked (usually over-time) during boom times which are not paid at the time, and withdraw them at times of recession thus getting paid for those hours without actually working. Of course, if the crisis had lasted longer, both ways would have run into financing problems. Enterprises would have had to fire workers and the government would have had problems to continue paying generous short-time work benefits.

By 2011, Germany was considered an economic miracle once again. It seemed to have overcome the crisis relatively unscathed. GDP had recovered, employment was buoyant. The public debt was significantly higher than before the crisis (about 83% of GDP in 2010 in comparison to 64% in 2007), but remains well below levels in other Euro countries or the United States and under control thanks to rising tax revenues. But this positive development is caused less by German ingenuity and efforts than by the huge spending programs abroad, which fuelled Germany's export growth.

Problems are thus arising less from within the German economy than from abroad. The major challenge is the crisis of the Eurozone. Most Eurozone countries increased their government debt massively during the financial crisis, partly by bailing out banks (Ireland), partly by stimulating the economy and compensating for private deleveraging, and partly due to the automatic stabilizers (shrinking tax revenues, increasing expenditures on unemployment benefits and so on). In the end, the average ratio of public debt to GDP in the Eurozone increased by about 20 percentage points. When Greece had to admit in 2010 that it had fiddled its accounts and that its debt and deficits were actually higher than previously stated creditors panicked. First Greece and then Ireland and Portugal needed public support via loans from EU governments, the EU, the IMF and/or the newly established EFSF (European Financial Stability Fund).

Since 2010, the crisis has broadened and deepened. It has spread to more countries, such as Spain and Italy, and now threatens even the credit rating of French and, possibly, German government debt. Debt levels have increased further despite massive austerity measures adopted by debtor governments. Germany has been the main culprit with regard to this disastrous development. It has refused to authorize the ECB to intervene more in the government bond market and to share mutual responsibility for all Eurozone government debt (for example, via "Eurobonds"). The crisis of confidence in the financial markets has affected the banks and the real economy, too. Banks no longer trust other banks — like after the Lehmann collapse — because they have large exposures to Eurozone government bonds. Some debtor countries live in fear of bank runs. The ECB and the national central banks are financing current account deficits and capital flight from debtor countries via Target2accounts (the clearing system of the EMU).

With the Eurozone rapidly approaching recession or even an all-out crisis if a government — possibly Greece — goes bankrupt and/or leaves the Eurozone, Germany's unchanged growth model is in danger. Germany continues to preserve its competitive edge through wage and fiscal restraint at the expense of the deficit countries. But competitiveness cannot guarantee demand when the buyers are forced to deleverage. German stock markets reacted accordingly to each turn of the political process between Brussels, Berlin, Paris and Athens. With each concession of the reluctant German government, the DAX leaped upward. With each proof that minor concessions and half measures cannot pacify markets the DAX collapsed.

Germany's exports make up almost 40% of its GDP. A large share (about 70%) goes to Europe and in particular to the Eurozone (about 40%). China absorbs less than 5% of German exports, albeit with high growth rates. A recession in Europe, possibly spreading to the United States and eventually to emerging markets would bring about a recession in Germany, too. The crisis of 2008 has shown how much Germany depends on world trade. Germany must take a responsibility for the financial stability of Europe (and the world) commensurate with its role in trade.

The development of the German economy largely depends on the outcome of the Euro crisis. If Europe and Germany can overcome the crisis the German economy might continue with its export-led growth model. But this scenario implies a readiness to finance the deficits of the debtor countries in a sustainable way, transforming the EU into a fiscal and transfer union. Up to now, the German government under Angela Merkel has opposed such a solution, which in any case would not enjoy much support among German voters.

On the other hand, a collapse of the Eurozone, possibly accompanied by a global financial crisis, would push Germany into another recession which would probably be more severe than the one of 2009, as three of the relevant cushioning processes are much more difficult to achieve: first, Keynesian government deficit spending would have to start from an already high level of public debt; second, interest rates cannot fall much further; and third, short-time working cannot again rely on the reduction of accumulated overtime accounts but would need much more public income support. A new financial crisis triggered by sovereign default will also harm the value of German savings. Germany has confused prosperity with financial wealth. Accumulated savings in the form of foreign investment represent real wealth only to the extent that foreign debtors are able and willing to honor their liabilities.

The long-term stability and growth of the European and global economy (on which Germany's prosperity relies) would be better served if Germany adopted a new growth model based on domestic demand rather than on export surpluses. Such an expansion of domestic consumption would require higher wage growth, more equitable distribution of income and more government spending, in particular on social services, such as education and care. A better education system would correct the class bias of the present system and increase productivity and employability.

IS GERMANY A MODEL?

In order to answer the question if and to what extent Germany could be a model for other countries it seems appropriate to evaluate two dimensions: 1. the cost and benefits of the German model for Germany itself; 2. the conditions which other countries would have to fulfill in order to adopt the German model or, more probably, elements of it. The answer to the first question might provide a clue at what price an adopting country might have to pay.

The most obvious result of the German model characterized by the Agenda 2010 reforms is a strong rise of inequality in Germany. West Germany used to be (in 1985) one of the more equal capitalist societies, with a Gini coefficient of 0.25. By 2007, this value had increased to 0.3. To illustrate this change, the current income distribution in Germany resembles that of Italy in 1985, while in 1985 it was similar to that of Norway today. Behind this overall picture one should look at developments in Western and Eastern Germany. Thanks to its socialist past Eastern Germany's income inequality was relatively low in 1991 but increased rapidly thereafter. By 1995 the primary distribution — that is, market income before redistribution by taxes and transfer payments — had become more unequal than in Western Germany. While the average per capita income in Eastern Germany slowly approached the Western German level, inequality increased in both parts of the country.

Functional distribution between capital and labor has changed dramatically: the share of wages declined from 73% in 1993 to 64% of GDP in 2006. It recovered slightly and temporarily during the deep recession when profits collapsed faster than wages declined. But in 2010 the old trend reappeared. Income differentials among wage earners increased strongly from 0.41 to 0.46 (Gini coefficient) reflecting the rise of the low wage sector and above average increases of earnings among the already rich (for example, CEOs). The low wage sector expanded from 15% in 1995 to 22.2% in 2006, with low wages defined as less than two-thirds of the median wage. Women are still discriminated against in the labor market earning 22% less on average than men. Since workers are in general poorer than self-employed people or employers, the changing functional distribution has led to a less equal personal distribution.

On balance, over the past decade Germany has exhibited one of the strongest increases in inequality among the OECD countries. The causes are both political and economic. The political causes are the labor market reforms and the general pressure on wages under the aegis of competitiveness. But these political trends, attitudes and decisions reflect other, more fundamental trends. To name but three:

(i) Globalization which exposed the German tradable sector to competition from low wage locations. This trend made itself felt in the form of competition for investment locations rather than in terms of imports. German employers shifted or threatened to shift certain production stages to low-cost locations. A typical example was the closure of a Nokia factory in Bochum which was relocated to Romania (which has also now been closed there).

(ii) Technology which substituted unqualified labor to some extent (or again served as a threat to quell employees' wage demands).

(iii) Decline of union density which has been particularly rapid and broad in Eastern Germany due to its deindustrialization and high unemployment.

Poverty has also increased. In Germany, poverty is measured by the poverty risk ratio, which gives the share of households on 60% or less of the median net equivalent income (a fictional income adjusted for household size). These values have increased (indicating a higher risk of poverty) from about 10% during the 1990s to almost 15% in the late 2000s. The rise was particularly strong in Eastern Germany where it grew from 13% in 1998 (the lowest value between 1992 and 2009) to a peak of 23% in 2006 (declining to about 20% thereafter).

CAN AND SHOULD THE "GERMAN MODEL" BE COPIED?

The German model has, as can be seen above, two dimensions:

1. As a system, it is still a "social market economy" of the more coordinated type (following the classification by Hall and Soskice "Varieties of Capitalism") which has also been called "Rhineland Capitalism" albeit, after several reforms, less pure than in the last century. This system is based on a specific relationship between state and market, and between capital and labor.

2. As a growth model in its more recent shape it relies upon low wages and low unit labor costs which lead to an unequal distribution of income and high export surpluses.

The systemic model is hard to copy. It is a result of historic development going back centuries. Some elements such as the dual system of vocational training, the co-determination of labor, or the (Bismarckian) welfare state might arguably be easier to copy but it is doubtful if they would work within a completely different societal and political context. The fact that some of those features are criticized by important German experts and interest groups as no longer functional and appropriate indicates how difficult and possibly counterproductive such a transfer might be.

The recent growth model is currently very fashionable. The conservative/liberal German government loves to peddle it to the highly indebted crisis countries in the Eurozone and beyond. If copied successfully such a strategy would indeed lead to a real internal devaluation and reduce or even eliminate the current account deficits these countries suffer from. It is very similar to the advice the IMF and the World Bank used to give to deficit countries in the context of Structural Adjustment Programs based on the so-called Washington Consensus. Actually, China follows this part of the German model already for a long time. Inequality and household savings have increased substantially in China fuelling (in spite of large investments) a big export surplus, which is in turn reflected in the build-up of huge US-Dollar reserves.

The snag of such a strategy is the necessary global economic imbalances. China, for instance, relies on the U.S.A and its willingness to run deficits and go into deeper and deeper debt. In a similar way, Germany (and to a minor extent some other smaller surplus economies of the Eurozone such as Austria, Finland and the Netherlands) depends on the readiness of the deficit countries to indebt themselves. If now other former deficit countries are supposed to adopt the German model and turn into surplus countries then there have to be new debtors and deficit countries. In the end, it is the former and current surplus countries that would have to change their strategy. Germany is rather unwilling to run deficits. In the case of China, there seems to be more flexibility and a certain propensity to rely more on domestic demand.

Actually, for the sake of global stability, it would be much better if Germany adopted the growth model of, say, Spain during the years 1998-2008. Germany should more invest domestically and consume more. Greater domestic absorption would provide more tax revenue and help to deleverage public debt and, at the same time, create a larger market for imports. Germany could transform the dubious financial wealth of foreign monetary assets into real wealth at home (not primarily buildings as in Spain, although there is some need for better housing and infrastructure, too, but renewable energy production, education, health and care).

What about Brazil? Brazil shares with Germany the strong export performance albeit based on manufactured goods and raw materials. Actually a boom in raw material exports might endanger the competitiveness of Brazilian manufactured exports (possible Dutch disease). Brazil has also a much more unequal distribution of income than Germany. But, contrary to Germany, it has improved its income distribution being one of the few countries in the world which have avoided the general trend to more inequality. Certainly, economic development in Brazil needs more investment in education and health in order to improve the productivity and employability of the population.

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