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Reform Pressures and Political System Dynamics

Edited by
Roland Czada and Kenji Hirashima

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Roland Czada

Introduction

Governing Germany is characterized by three distinctive features. The *first* is related to the extent of political power-sharing which has been traditionally high. Power-sharing arrangements are still predominant in party politics, in cooperative federalism, and in the field of corporatist state-society networks.[1] In consequence, German policy-making is less based on majority decisions than on negotiations in party coalitions, amongst state and federal administrations as well as in bicameral legislative processes, and between administrative departments and societal interest associations. Besides the institutions of "Negotiation Democracy", a *second* feature concerns the type of economic governance. Germany has been described as a coordinated economy with reference to its social partnership approach in industrial relations and wage bargaining. Corporatist vocational training schemes and employee codetermination rights are still outstanding features of the "German Model". Moreover, one finds peculiarities of corporate finance linked to a universal banking system subdivided into private, cooperative and communal banks. The country's *third* distinctive mark refers to the welfare state. Comprehensive and obligatory social insurance schemes have long been determined to defend the majority of the workforce against losses of income and status acquired through work.

The German political system and political economy usually restrain political reform efforts by maintaining high consensus thresholds. Policy-making proved to be slow and incremental due to coalition governments, cooperative federalism, bicameral legislative vetoes, and macro-corporatist concertation (Katzenstein 1987; Lehmbruch et al. 1988; Czada 2005). Despite these obstacles, German politics and policy changed considerably during the 1990s and thereafter. Contrary to widespread beliefs (e.g. Posen 2009), the reform agenda has been particularly strong with regard to structures and regulations of the corporate and financial sectors. The shift away from post-war patterns of credit regulation had already begun in the late 1970s. Among the first big steps to improve the legal protection of shareholders, one finds the privatization of the Frankfurt stock exchange, followed by the intensification of state supervisory powers and the introduction of new regulatory structures from the mid-1990s to the present. Equity Market Liberalizations were introduced throughout these years in a step-by-step fashion. Thus, innovations took shape in a cautious manner.

During the 1990s Germany came under severe adaptive pressures. The nation's overall welfare has been deteriorating compared to other industrialized countries. The most dramatic relegation can be seen in comparative rankings of GDP per capita. This main indicator of productive wealth determines the potentials for consumption, investment, and redistributive policies. With regard to GDP per capita, most of its European neighbouring countries as well as many OECD-countries have surpassed Germany, which had been among the three richest nations in the 1970s and early 1980s. In the face of macro-economic stagnation, the country's institutions of negotiation democracy, coordinated capitalism, and the Bismarckian welfare state were no longer considered as problem-solvers, but as major obstacles for employment and economic growth.

Whereas the overall German Model had been fairly preserved during the 1980s, the following decade not only led into deep economic crisis, but also opened up new avenues in policy-making and initiatives for institutional reform, among them a series of four financial market promotion acts. Beginning with the new millennium the Federal Government even succeeded to pass drastic welfare retrenchment programmes aimed at new incentives for work and a balanced budget.

While reform pressures increased, political decision-making became more difficult due to growing conflicts over how the government should solve the problems. This was true for the realm of party politics as well as in the federal negotiation system. Policy-making was particularly strained by the financial burdens of unification.[2] Furthermore, party politics underwent fundamental changes during the last decades. This was due to strong, post-materialist orientations mainly in West Germany, and predominantly leftist attitudes lingering in the East. The Greens *(Grüne)* and the new Left-Party *(Linkspartei)* are currently on the road to victory, whereas the old parties of the Bonn Republic, the Christian Peoples Parties (CDU and CSU), Social Democrats (SPD), and Free Democrats (FDP) ceded to determine politics and policy in Germany. Policy-making has been further complicated since redistributive issues have become the top priority in large parts of the electorate. Many blame the political reforms of the 1990s and early 2000s for losses of social status, rising inequality, and stagnant real wages. Pollsters find a growing number of voters disappointed and the majority of the electorate drifting to the left. Despite a left electoral majority, Germany is very unlikely to have a left government in the near future. This is because the declining Social Democratic Party and the Greens refuse to form such a government together with the leftist *Linkspartei*.

The growing popular disappointment with recent reform policies not only moves the electorate left, but also feeds a general mood of disenchantment with politics. According to various opinion polls, a majority of Germans are now dissatisfied with democracy, with the highest scores among welfare recipients and those in the low income brackets. In 2008 the POLIS/SINUS institute reported that 57 percent generally reject recent welfare reform policies (FES 2008). Earlier surveys conducted by the FORSA institute showed that 61 percent of the population are dissatisfied with the functioning of the political system. Growing complaints against social and economic injustice indicate that the once praised "Social Market Economy" either ceased to meet its former promises or has vanished over the last decades.

Meanwhile the question arises whether the country has left its traditional middle-of-the-road approach between free market liberalism, public welfare provisions, and socio-economic coordination. Or will reforms, as governments continue to emphasize, only help modernizing and, thus, preserve the foundations of the German Welfare State? Its most significant feature lies in the fact that in Germany, more than in most countries, welfare policies have traditionally been employed as instruments of economic governance. Since its very beginning in the late 19th century social policies helped to enhance employment and productivity. A particular variation of this approach emerged in the late 1970s, when the welfare state had been used to withdraw surplus labour from the economy. All the more after unification, the welfare state became a major instrument to wind up the East German socialist economy. Extensive training and retraining schemes, reductions of working hours, and early retirement served to constrain the supply of labour in the face of mass unemployment. This tempted critics to charge that in Germany one finds the oldest students, the youngest retirees, and the longest vacationing workers in the world.

In the following paragraphs the causes and courses of change will first be discussed. I will try to show that reform issues have been handled reactively in most cases. Looking back to the early 1990s one can see successive reform cycles beginning with issues of financial and economic governance, followed by quite fundamental changes in the labour market and the industrial relations system. Significant welfare state reforms came later. They have caused the most far-reaching distortions in political attitudes and in the fabric of political power. In analysing the antecedents of the welfare crisis, it turns out that it can be traced back to the beginning of the 1980s, when the government, in line with unions and employer associations, began to shift huge parts of the labour force into welfare programmes in order to disburden the labour market.

1. Causes and Courses of Change

In order to explain the German reform policies of the 1990s one must first refer to unification. Clearly uniting the West German Federal Republic and the former socialist East Germany involved a number of fundamental changes. The number of constitutional states increased from 11 to 16 on October 3rd 1990, the day of unification. The country's central government moved eastwards from Bonn to the new capital of Berlin. East Germany went through a time of upheaval in its transition from socialism to capitalism. Most changes in the West, however, occurred out of circumstances that had been unpredictable to relevant political and economic actors. Unification had been expected to be an opportunity, or even a necessity, for systematically elaborated reform policies. However, it soon became clear that to reform the West German political and economic institutions, together with their extension to the east, would overburden political capacities and probably end up in fiasco. Western political elites preferred to transfer a system that was familiar and predictable to them rather than to burden unification policies with experiments of overall institutional reform. Thus, contrary to what had been expected, the unification shock generally hindered systematic reform policies at first. Nevertheless a number of reform initiatives like the privatization of public monopolies were already under way before the fall of the Berlin Wall in 1989. Telecommunications and railways, however, were still owned by the state at that time. Had the government not made massive investments via its own enterprises, one can luckily say, the unification and reconstruction of these sectors in the new Eastern states would have taken much longer (Lehmbruch 1998).

By the mid-1990s a number of institutional innovations had occurred without an explicit political intent to reform. Rather, they followed from immediate pressures to act. The unexpectedly high costs of unification and its financial management gave rise to gradual adaptations at an early stage. Unification policies generally followed a pattern of flexible adjustment or even of sheer "muddling through". Looking back, one can see that the first wave of systematic reforms pertained to the financial sector. Changes of the labour market and the industrial relations system came second, and elementary welfare state reforms made up a last step, as will be shown in the following paragraphs. Political conflicts over welfare state reform policies have been much more intense than those over unification policies, financial reform packages, or the decline of corporatism. Additionally, welfare reforms were developed in a more authoritative and systematic manner. The general direction of reform policies can therefore be characterized as developing from muddling through to struggling through. Beginning with the mid-1990s intense conflicts over welfare state issues prevailed until the formation of a Grand Coalition government of the Social Democratic and Christian Democratic Parties in 2006.

In General, unification did not originate new reform ideas, but rather slowed down or accelerated previous initiatives. The latter was particularly true for the financial system. Already in 1986 the liberal-conservative Kohl-government had begun to campaign for admitting new financial products and privatizing the stock exchange. From 1990 onwards four bills to promote the financial service industry were passed. Particularly the second bill, passed in 1994, caused fundamental institutional changes. "It moved Germany away from the traditional self-regulation of securities markets and exchanges with the creation of an independent Federal Supervisory Office for Securities Trading. The new state agency, modelled after the U.S. Securities and Exchange Commission, was charged with enforcing a new legal ban on insider trading and newly stringent information reporting requirements by issuers of securities and traders. The push for greater openness and transparency in corporate accounting and reporting and in the equity markets represented a dramatic break with the past" (Lütz 2000; Deeg 2001: 26).

How did unification accelerate capital market reforms in Germany? Early in 1990 pressures for financial reform had been moderate. Politicians were confident that West Germany's large external surpluses, amounting to some DM 500 billion, with the highest annual surplus of DM 108 billion registered in 1989, would provide a safe cushion to manage the costs of unification. Within two years, however, there was a swing of DM 150 billion in Germany's balance of payments account and the surpluses turned into a deficit. Germany, as it turned out, came to have severe problems in mobilizing international investments and the *Bundesbank* was forced to pursue a policy of high interest rates in order to attract foreign money. American investors, like pension funds, were not allowed to engage in the German equity market at that time. German financial institutions were considered to be under-regulated and generally lacking in international security standards. This had never been a real problem before since Germany had an uninterrupted surplus in its balance of payments from the 1950s onwards. It was against this background that the Federal Government made additional efforts to reform the financial market systems. In early 1992, at the beginning of the so-called "unification crises" (Kocka 1995), the German Finance Ministry launched its *Finanzplatz Deutschland* campaign. In this respect unification had serious financial implications for Germany as well as for international markets. The breakdown of the European Monetary System in 1993 was among the most momentous of the international consequences (cf. Czada 2002).

Moreover, further changes occurred in the financial sector. An expanding equity market and a mild shift away from the universal banks and *"Hausbank"* system towards investment banking narrowed the gap between the Rhenish model of Managed Capitalism and that of Atlantic Market Capitalism (Lütz 2000). The big private banks’disengagement from direct industrial credit traces hack to the early 1980s when they began expanding their business to European and global markets (Esser 1990). Their reluctance to contribute to the reconstruction of East Germany, either as investors or sponsors, was already a consequence of those preceding transformations of industrial governance. At the same time, the *Treuhandanstalt* was anxious not to let bankers preside in the supervisory boards of East German firms. Thus, the banks were no longer the *prefects* of German industry, as Shonfield (1995) has called them. Their new role has to be seen as an indication of fundamental changes compared to the earlier post-war reconstruction-period.

It is important to note that the early period of unification policies was one of only minor political conflict. Party politics as well as federal relations were characterized by consensus at that time. Institutional innovations and policy changes have been driven mainly by forces of circumstance, situational constraints, and pragmatism. In 1997, however, the welfare consensus that dated back to the 1950s between the major parties diminished when the Social Democrats rejected the government's pension reform bill. Since then, intensive conflicts over welfare retrenchment policies have emerged, culminating in the so-called Agenda 2010 and

Hartz reform debates. Taking effect at the beginning of 2003, the *Hartz* labour market reforms were meant to avoid the financial collapse of the social systems and to increase employment by strengthening individual responsibility. Consequently, lowering individual social transfers for the unemployed has been one of its main instruments (cf. Czada 2005; Buhr and Schmidt 2007).

2. Crisis of Corporatism

Labour markets and wage bargaining changed considerably during the 1990s. Most innovations came about in an incremental manner and almost unnoticed. During the 1980s the German unions and employer associations still aspired to the logics of neo-corporatist exchange. By pursuing such an approach, German unions hoped to be rewarded for their moderate stance in wage settlements and their cooperation in policies of industrial modernization. The German Model came under a modicum of stress when other countries, namely the United States and Britain, switched to monetarism and economic deregulation. Austerity measures and monetarist policies pressed labour unions to dispense with high wage demands, because — in the face of a tight money supply — this approach would have caused economic recession and massive job losses. All over the world, neoconservative politicians learned how to discipline labour unions without having to let them participate in political and economic decision-making. In Germany, however, the consensus approach still militated against neoliberal reform policies.

The corporatist features of German welfare capitalism initially facilitated the policies pursued under unification, as has been shown by the so-called 'Solidarity pact' of 1993 *(cf.* Sally and Razeen 1994). Persistent efforts to preserve and renew the corporatist consensus should not be misinterpreted as conservatism in the face of global changes. On the one hand, these efforts aimed at a negotiated reform of the welfare state towards a more market-led system. On the other hand, there are a lot of changes at the meso, or sectoral, level of the economy which contradict the old corporatist system of negotiated self-regulation. The governance of infrastructure like railroads, telecommunications, postal services, the mass media, and the supply of electricity and water changed considerably. Public utilities which had once been provided by public-service corporations were transformed into private-law companies. Simultaneously, the government installed new agencies to regulate these businesses. In the long run, this will change the whole administrative system. Together with European regulatory politics, such developments will eventually move the administrative-law framework closer to the U.S. system of independent regulatory commissions.

In sum, the unification period saw a last triumph of social corporatism (cf. Lehmbruch 1998). The cooperation of national and state governments, and labour and capital was generally supportive to the transfer of the West German welfare state system to East Germany. Beyond the redistributive arena, however, corporatism was declining during the 1990s. Public service monopolies diminished as well as the traditionally dominant role of banks in industry. Sectoral self-regulation had been gradually replaced either by competitive markets or by new forms of governmental oversight in areas like stock market regulation, safety regulation, or health insurance schemes for example.

In post-war West Germany, labour unions were organised by industry in order to support their unity and avoid competition for members. However, during the process of unification, and owing to the structural dislocations in the service and telecommunications sectors, the unions began to compete for members and, thus, violated the once 'holy' principle of inter-union solidarity. Eventually this called for rearrangements in their membership domains in the way of organisational mergers. The chemical workers' and miners' unions merged after their close cooperation in the restructuring of the eastern German chemical, lignite industries. In response to rapidly growing employment in service industries and increasing overlaps of their membership domains, all service-sector unions proposed to build a new labour organization called 'Verdi'. This new mega-union plans to unite not only workers in the public and private service sectors, but also workers in the new telecommunications and internet economy. Thus, labour unions are not in any way moribund, but are reorganizing themselves in order to maintain and create new ways of participation in economic- and social-policy making.

During the 1990s, the traditional pattern of wage bargaining was in the process of disintegration. In 1998 only 20 percent of eastern German manufacturing firms were members of an employers' association that was engaged in wage bargaining. Small and medium-sized firms, as well as foreign investors, often refused to become members of employers' associations. They wanted to conclude in-house or firm-level contracts instead. Even firms in western Germany refused to proceed as usual. The system of industry-wide bargaining declined, as did the coverage of industry wide wage contracts. In many eastern German companies, works councils negotiated wage cuts in order to safeguard jobs and to restore their company's competitiveness. Whereas unions suffered from membership losses and declining wage-bargaining power, works councils won new responsibilities. One has to bear in mind here that German works councils are representative boards elected by all employees of an industrial establishment — unionized or not — and are therefore legally independent from the influence of labour unions. The balance of this dualistic industrial relations system became rather precarious as works councils took over traditional union roles of wage bargaining in the eastern parts of Germany. In the west, a growing service economy with low union-membership supported this trend.

3. East-West Cleavages

The Federal Republic of Germany became more heterogeneous in social, economic, and political terms after unification and, thus, more like its predecessor states, the German Empire of 1871 or the Weimar Republic. Historically, Germany had been a rather heterogeneous country. It was characterized by considerable territorial imbalances and a multi-ethnic population. For instance, the German Reichstag had a fraction of Polish MPs until the end of the First World War. And even the Weimar Republic was characterized by a multi-party system with regional parties represented in parliament. In this respect, one could say that West Germany, that is the 'Bonn Republic', with its homogeneous economic and social structures and its high political predictability, was something of an anomaly in German history.

Differences in economic performance and income inequality between East and West Germany are still visible. In 2007, out of a total population of 13 million East Germans, 16.8 percent (1.3 million) were unemployed, while the percentage of unemployed in West Germany, with a total population of 65 million, was equal to 8,4 percent (2.5 million)[3]. Though improvements of earned income can be registered in East Germany, differences continue to persist. In 2005, the average gross wage per worker was equal to — 33.982 in the West against — 27.662 in the East. Corresponding to 81 percent of the West in 2005, the ratio was much lower in 1991 when the average income in the East amounted to only 56 percent of the West (BMVB 2006: 151).

Opinion research so far shows that East and West Germans often have two opposite visions of the society in which they live. While West Germans still find their country a relatively equal society which attempts to provide fair and equal opportunities to all citizens, East Germans are much more sceptical on this issue. "In particular, East Germans tend to believe more strongly than West Germans that differences in income in the new society are too large, that they do not get rewarded for their efforts as they should and that the government should work harder to reduce social differences" (Cerami 2004: 10f).

Two decades after" the fall of the Berlin Wall, the regional cleavage opposing East and West Germany has not diminished at all. Besides the economic gradient, one finds significant cultural and political differences. Despite what may be, because of their experiences with a socialist political regime, East Germans rate state intervention and social equality much higher than West Germans. The new Left Party *(Linkspartei),* a successor of the socialist PDS, has grown stronger than the Social Democrats in East Germany. Political tensions between East and West have been in line with lasting distributive conflicts in the federal system. The new East German constitutional states insist that the interstate equalization schemes and special programmes supporting their budgets will be continued. This further indicates the tremendous impact unification has had on cleavages in the federal structure as well as on party politics.

4. Germany in the Global Economy

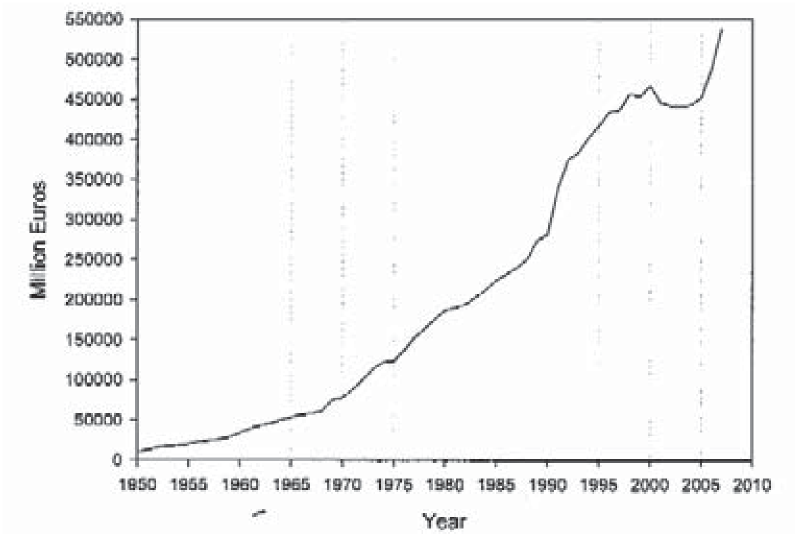
Given its high level of exports of about 40 percent of the GDP, Germany is said to be much more affected by economic globalization than, say, the United States or Japan. However, one has to keep in mind that two thirds of Germany's exports remain within the European common market. Germany's exposure to foreign markets has been countered by European integration and even more by the Euro Zone. As a consequence, the country is less sensitive to global economic turbulences and, thus, less vulnerable today than ever before in its economic history.

Adding its export share within the EU to those going to emerging markets like China, Russia, India, the Middle East and South Africa, the German economy has certainly gained some independence from the U.S. economy. It is now less bound to the U.S. market than, say, Japan or China. Of course this varies across sectors and products. Car manufacturers for instance still heavily depend on U.S. sales.

Despite the EU serving as a major buffer against the imponderabilia of global trade, Europeanization restricts national policy making in order to react adequately on economic and social challenges on the domestic level (Scharpf 2003). EU membership deprived national governments of policy instruments like tariffs, deficit spending, currency- and exchange rate manipulations, and even taxation and welfare spending. Tax cuts proved inevitable in order to attract foreign investments and also keep mobile production factors at home. Besides tax competition within the EU, low wages and welfare-state differentials in the new Eastern member states as well as reunification costs put pressures on the German welfare system. In particular, *German Tax revenues* declined sharply after several tax cuts, while public welfare spending continued to explode at the turn of the millennium (figure 1).

2000 was the first year since the founding of the Federal Republic that nominal tax revenues slumped dramatically. Many have speculated as to why the Schroder government enacted its massive welfare state reform policies in 2000. The leftist government's welfare retrenchment policies undermined its earlier intentions to preserve the welfare state and implied a major risk to loose massive votes in federal and state elections to come. To explain the Agenda 2010 by ideology, a dominant neoliberal orientation in particular, obscures the fact that the government was mainly led by situational constraint and a strong feeling of practical necessity to close the *revenue-outlay gap.*

Figure 1: Nominal Tax Revenues 1950-2007 (General Government)



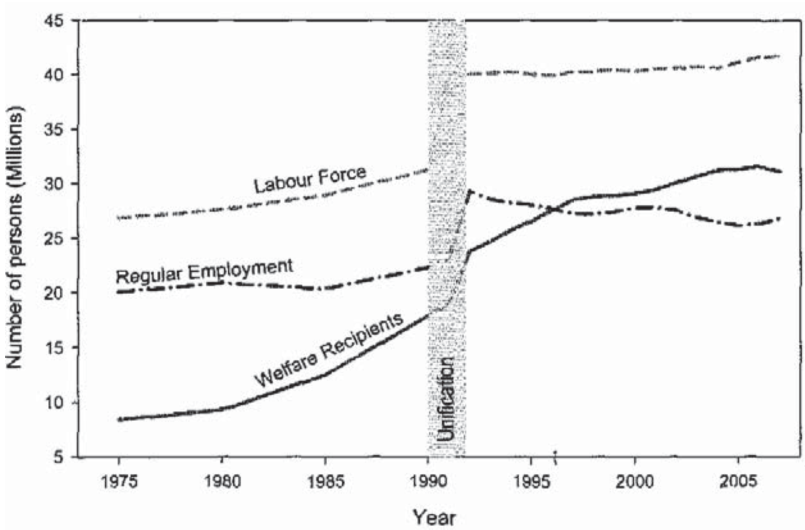
Source: Statistisches Bundesamt, Kassenmäßige Steuereinnahmen Deutschland 1950 bis 2006 http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/DE/Content/Statistiken/Zeitreihen/LangeReihen/SteuernFinanzen/Content100/Irfin02a,templateId=renderPrint.psml (July 21, 2008).

5. Antecedents of the Welfare Crisis

Two distinct factors contributed to the ever widening revenue-outlay gap and, thus, made up the context of policy challenges to the German welfare state. The first factor can be traced back to the so-called'German Model'of forced, industrial *modernization policies;* the second stems from the *unification* of the economically weak, socialist German Democratic Republic with the still prosperous Federal Republic of Germany.

From the late 1970s onwards, German governments have prioritized industrial modernization policies to preserve high wages and welfare standards on the basis of high industrial productivity. The concept culminated in the model of a "blueprint-nation", an industrial knowledge economy combining skilled labour with high-tech manufacturing. Resulting job-losses, as well as the vanishing of industrial sectors with low-productivity and low-income, were meant to be compensated by social welfare policies. A number of social scientists of the time hailed the *corporatist productivity coalition* between the national government, labour unions and employers associations. The conservative Kohl-government put the concept into action through a massive early retirements programme in 1984. Rejuvenating the workforce proved to be overall successful at first. Nominal unemployment rates dropped slightly during the 1980s and in 1999 more than a third of the new pensioners retired due to unemployability at an average age of 52.

Figure 2: Labour Force, Regular Employment and Welfare Recipients (1975-2007)



Notes: Welfare recipients include old age pensioners, recipients of unemployment benefits, recipients of accident annuities, general welfare recipients, and asylum seekers. Regular Employment: Number of wage earners paying compulsory social insurance fees.

Source: Bundesministerium fur Arbeit und Soziales, 2008: Statistisches Taschenbuch 2008.Arbeits- und Sozialstatistik. Berlin: BMAS, Statistisches Bundesamt.

The "Model Germany" approach resulted in disproportionately rising numbers of welfare recipients and, as a further consequence, rising non-wage labour costs. These, in turn, negatively affected the labour market. Low-income jobs became too expensive in particular, and were no longer sustainable in many sectors of the economy. Again, massive dismissals pushed up unemployment rates and early retirement leading to even higher social fees. In consequence, a spiral process of rising unemployment due to rising non-wage labour costs and rising non wage labour costs due to rising unemployment emerged.

As figure 2 shows, rising unemployment and welfare spending were also an effect of the so-called‘unification shock', which in 1990 saw Germany's GDP per capita drop by DM 6,000 (€ 3,077) to DM 34,990 (€ 17,943) as a result of the number of inhabitants growing more than economic output. Additionally, while the new constitutional states in eastern Germany experienced massive job losses in the aftermath of a historically unique de-industrialisation process, the western German economy, which remained strong, had to shoulder the resulting social costs. Accordingly, the social expenditure ratio (i.e. public-welfare expenditure as a share of GDP) rose sharply after unification (Figure 3). Thus, unification policies simply followed the industrial modernization track that had already been put to test previously in West Germany.

From the early 1990s onwards the disproportion between unemployment rates of all age groups and those of the elder workforce has been highest in Germany among all OECD countries. By contrast, Japanese unemployment rates scored lowest in the age group 40 - 54 and second lowest in the group 55 - 64. According to OECD Labour Force Statistics, Germany is the only country where unemployment in the age group 55 - 64 was continuously higher than overall unemployment. Moreover, the proportion of labour market exclusion of the elder in Germany would have been even higher without massive early retirement. Youth unemployment, on the other hand, has been lower in Germany than in most European countries.

6. The Cure

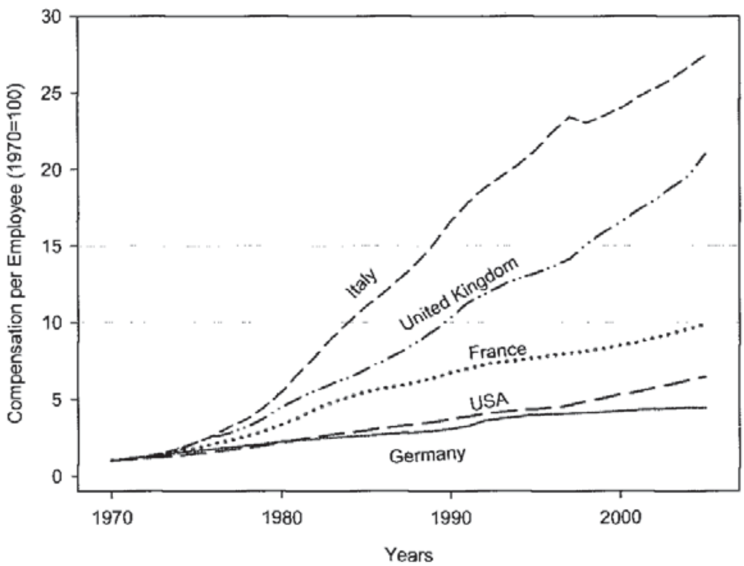
At the turn of the millennium German welfare capitalism had been declared ailing or even dead (Manow/Seils 2000). Since 2006, however, the "sick man of Europe" during the 1990s is showing new signs of vitality. Exports grew from 24 percent of GDP in 1991 to 39,8 percent in 2006. Public deficits are declining now. The number of unemployed has dropped from five to three million within three years (2005 - 2008). How can this turn be explained? Is it just globalization that drives German exports or are certain favourable conditions of the German political Economy still alive? Did the welfare reforms of the Schroder-Fischer government save the country?

To be sure, when it comes to productivity German industry is still on top. The share of high-tech and medium-high-tech in manufacturing is highest compared to all other OECD-countries (Kaloudis/Smith 2005). At the same time, overall economic growth rates have been the lowest, and early retirement as well as unemployment rates have risen from the early 1990s until 2005. In other countries, however, medium and low-tech industries have pushed growth rates and employment more than the German-style forced industrial modernization policies (Kaloudis and Smith 2005). The latter not only overstressed, but eroded the German welfare state. Exploding social security contributions, high unemployment rates, and a rising ratio of the working poor have to be seen as delayed consequences of the "blueprint-nation" concept.

Despite the fact that some low-productive sectors like coal or mass steel products diminished, the German Economy is still heavily biased towards manufacturing, e.g. cars, trucks, plant engineering and construction, chemicals, etc. The global economic conditions have been favourable for exactly that kind of specialisation. Thus, the early focus on industrial modernization instead of on sectoral restructuring may have stood the test of time. Germany's unions and leftist politicians, however, argue that economic recovery stems mainly from a long period of wage restraint. Indeed, for the majority of the population, real wages in Germany have been sinking over the recent past. In 2006 they fell to a level last seen 20 years ago. According to figures from the Labour Ministry, adjusted for inflation, a German worker received on average — 15,785 last year after taxes and social insurance contributions. This equates to net earnings of only — 1,320 a month, only five euros more than 1986. Among other causes, unification has disciplined the work force more than cooperative unionism this time.

Inequality within the lower wage categories in the 1990s increased significantly after German unification. In other words, the reunification of Germany and the low wages in the east were used to lever down wages in the west, and in particular in the lower income levels. As a result, unlike some years ago, highly qualified Polish workers no longer seek work in Germany. They can enjoy better conditions in Norway, Spain, Italy, and particularly in Britain and Ireland, than in Germany.

Figure 3: Compensation per Employee (1970=100)



Source: Compensation of Employees per Employee, Total Economy-EU-KJLEMS Database

Since the introduction of the "Agenda 2010" reforms, unemployment has declined and the range of low-wage jobs has expanded. Since 2002, coinciding with the implementation of the *Hartz* welfare reforms, the ratio of part-time employees to the overall workforce has risen from approximately 11 to 17 percent. Another consequence of the *Hartz* reforms was a massive increase in low-wage marginal part-time workers earning less than 400 per month from three to now six million people. The shift from welfare to workfare policies not only expanded the supply of low skilled labour but put additional pressure on wages in the lower and middle income brackets. Moderate pressures on wages that have been caused by unification since the mid-1990s has grown even stronger on account of recent welfare retrenchment policies.

Germany not only recovered from economic standstill. Contrary to widespread beliefs, the political system and economic governance institutions underwent quite a number of transitions from the mid-1980s onwards. Some passed off unnoticed, submerging beneath the major political agenda; others resulted from deliberate reform policies. Reforms took place despite manifold institutional obstacles resulting from the German negotiation democracy and consensus economy. To explain them, one has to refer to the extraordinary problem pressures culminating in a fiscal emergency as well as to the changing power structures in politics as well as in civil society.[4] Labour unions have been weakened in the course of the unification crisis. The same holds for employers associations. As a result, corporatism and collective bargaining lost their impact on the determination and distribution of wages. At the same time, the party system became more diversified and even the state diversified in the form of new powerful federal regulatory agencies which have been established in the aftermath of market liberalizations and privatization policies in the financial and telecommunications sector.

Apart from the multitude of single elements of change in different sectors, one should bear in mind the interplay of these elements; that is, their contribution to a newly emerging system of political-economic governance. The common features of this system refer to increases in social, political, territorial and institutional diversity, replacements of corporatist self-regulation by government supervision and state regulation, as well as shifts towards a more market-led capitalism. However, the strengthening of competitive markets and regulatory authorities does not mean that conventional features of associational interest intermediation or private interest governance vanished. Business associations as well as unions and employers' associations are still strong. They still bet on industrial productivity, though they stopped externalizing unemployment at the costs of public welfare schemes as seen during the 1980s, and to an even greater extent in the following reunification period.

The German welfare state turned away from its tradition to comprehensively protect the workforce from losses of income and status. Looking back, one has to concede a failure of the corporatist-cum-welfarist "blueprint nation" concept of the early 1980s. Shifting low skilled and elder parts of the workforce into the welfare system burdened the public budgets in an excessive manner. It also intensified the country's economic growth problems. The workfarist, post-2000 labour market and welfare state reforms of the *Red-Green Schroder-Government* went against these earlier strategies. The policy turn has been criticized as an ideological, neoliberal reorientation. In reality, however, reforms were directed largely by immediate fiscal and economic pressures to act. Of course these have been advanced by forces of circumstance caused by the challenges of unification, globalization, and Europeanization. In contrast to the German unificafion crisis, however, adaptive pressures resulting from the international political and economic sphere hit all countries in a similar manner depending on their levels of development and regional neighbourhoods. This holds true for the EU member countries in particular. Globalization and Europeanization had already exerted strong pressures for change prior to 1989. The European Union pushed market liberalization and deregulation, promoted monetary convergence and austerity, and pressed for the‘downsizing’of governments and the welfare state.

The revival of the German economy was largely due to moderate wage increases that had been much lower than elsewhere. The German economy has regained cost competitiveness through wage moderation since the mid-1990s. The post-2000 welfare retrenchment programme changed labour supply incentives and, thus, reduced unemployment just as predicted. Chancellor Schröder's Agenda 2010 succeeded in creating jobs, in particular for those in the low-income brackets. It proved to be quite a successful cure, although with serious side effects. Fiscal recovery and less unemployment stand against rising public anger and even unrest in parts of the electorate. Among its politically unpleasant consequences one finds an increased number of voters disappointed. Some of them - the unemployed and low-income earners in particular - account for a steep rise of the new socialist party, *Die Linke.* At the same time, middle-income earners press the federal government to take back parts of the welfare retrenchment programme of its predecessor, namely to reintroduce some tax privileges. Federal and state elections in Thuringia, Brandenburg, Saarland and Saxony in 2009 tempt the Christian Democrats in particular to demonstrate social conscience. Otherwise, as chancellor Merkel's party fears, the Social Democrats and *Die Linke* would take office in 2009.

Political sentiments may very well change in favour of the left as a result of the 2008 global financial crisis. The left is in a position to capitalize on the ‘bogeyman’ image of neoliberalism, which has gained ground in the German electorate. The German economy, however, seems only modestly hit by the bad loans crisis. Despite manifold changes in politics and the economy, the traditional dominance of manufacturing and mechanical engineering industries still exists. Its share in GDP has fallen by roughly 10 percent (1970 - 1995) but is still among the highest compared to other OECD countries (Germany 27 percent, Japan 26 percent). In the United States, for instance, the finance, insurance, and real estate sector swelled to 20 percent of GDP in 2000, jumping ahead of manufacturing, which slipped to 14 percent. Germany, in contrast, lacks a strong service economy and, as some economists maintain, also a modern private banking sector. Critics stress that manufacturing remains a disproportionate share of the German economy because interlocking directorates and the vested interests of entrenched owners and workers have been able to resist reallocating capital to new sectors and businesses (cf. Posen 2004). It is doubtful whether this is a sound diagnosis since industrial hardware has served as a profitable business segment up to now. Strong manufacturing capacities have proven beneficial, particularly in times of expanding global markets. Despite their tremendous growth prospects, these industries have been less bubble-prone than financial and asset businesses. In addition, when it comes to explaining the persistent surpluses in exports, the traditional labour relations and social security schemes, though modernized, still appear to be important. German reform policies and institutions have developed in a preserving, path dependent manner, although maybe less path dependent than previously expected (e.g. Yamamura and Streeck 2000; Dyson and Padgett 2006). As politics and policy-making became more complex and internationally interwoven, with more levels of government, more political parties, and more societal actors involved, processes of consensus-formation turned out to be less predictable and, thus, more open for change. This will probably stay true, at least for the near future.

Notes

1 The reform of federalism, though meant to reduce the constraints of joint decision-making, did not change Germany's character as a negotiation democracy (cf. Benz 2009).

2 The unification of the former East German socialist Democratic Peoples Republic and the West German Federal Republic in 1990 was a crucial break in the German post-war history. It resulted in an economic unification-crisis burdening the national budget with additional spending. The German Government was facing a fiscal challenge similar to the one its Japanese counterpart had to meet as a result of the Bubble crisis.

3 Labour market times series statistics are available from the Federal Labour Agency: http://www.pub.arbeitsamt.de/hst/services/statistik/detail/z.html

4 Here one finds some general similarities with the Japanese case see (Hirashima 2009).

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