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Chapter 7

The German Model in Transition

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Over the last decade, the German model has seen a remarkable transformation and comeback. At the turn of the century, calls for a radical reform of the German market economy were heard everywhere. The change of government in 1998 was followed by the short boom and bust of the new economy, leaving the country in a most miserable situation. Unemployment reached five million in 2005 and Germany violated the deficit threshold of the European Stability and Growth Pact for several years in the early 2000s. The need for reform was ubiquitous in newspaper headlines, expert commissions and the international press. The country was constantly criticized for its failure to meet the challenges of reunification, globalization and demographic changes. 'Citizen' campaigns put newspaper adverts in German papers to call for reforms. Federal President Roman Herzog lamented in a well-received speech in 1997 the mental depression that had befallen Germany and called for a *Ruck* (a sudden jerk) to liberalize the country. Germany had become the sick man of Europe (Hassel and Williamson, 2004).

By 2014 the situation could not be more different. The 'sick man' has become the unchallenged economic powerhouse of Europe. Not only did Germany survive the great financial crisis of 2008–09 in much better shape than almost any other OECD country, it is the only one where unemployment levels today are substantially lower than before the crisis. The German economy was hit hard by the recession in 2009 when GDP contracted by more than 5 per cent. However, growth bounced back swiftly after that and its performance has been solid compared with other OECD countries but particularly within the eurozone. In the midst of the financial crisis, the economy showed a remarkable recovery of the competitive position of German firms, higher than average growth and the highest employment levels ever (Möller, 2010). The country's economic institutions and economic policy are almost unchallenged in the way they work for the economy. Today no major reform calls can be heard in the country. Within the eurozone, this is a different matter as German exports have out-competed all other trading partners, putting them into a permanent trade deficit.

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Between 2003 and 2013 Germany witnessed a decade of fundamental change. The calls for reforms in the early 2000s did not go unheard. In March 2003 the then Chancellor Schröder outlined his Reform Agenda 2010 in an address to parliament. He announced far-reaching welfare and labour market reforms. Based on reports of several expert committees, radical reforms were implemented altering the German welfare state as it had developed over the years. Unemployment insurance, pension systems and social assistance schemes were all restructured while capital market regulation was relaxed and corporate taxation lowered.

These developments beg two questions. How far did the changes of the German model go? And can we still talk about a German model? These questions are not new. Already in 1995, Wolfgang Streeck posed the question: 'German Capitalism. Does it exist? Can it survive?' (Streeck, 1995). Were the changes of the 2000s the precondition for its current success? This chapter will address both of these questions and put the policy reforms in the context of wider institutional changes. It starts by characterizing the trajectories of continuity and change in the German model during the last decade and then discusses them with regard to the two major challenges of our time: the financial crisis and the crisis of the eurozone.

Fundamental features of the German model

The German political economy has long been identified as distinct from other market economies. In German political discourse, 'social market economy' is used to denote a concept that explicitly recognizes the limits of the market and thus defines the relationship between the market and the state by emphasizing that all liberal markets are embedded in a fundamental social order. As we know, neither the term nor the concept have much to do with the social dimension of a market economy, but it was a term coined by German economists to win political legitimacy and justification for the establishment of liberal markets in the climate of post-war Germany that was critical of capitalism. The general assumption of ordoliberal thinkers was that while the economy is based on markets organized by private businesses and consumers, the state is responsible for regulating those markets and for shaping the underlying social order. Defined in this way, the term 'social market economy' receives widespread approval from both the entire spectrum of political parties and the general public, since it provides legitimacy for the welfare state.

In the academic literature, the distinct features of the German political economy have been recognized in a similar way by terms such as 'German capitalism' (Streeck, 1995), 'Rhenish capitalism' (Albert, 1993) and the 'coordinated market economy' (Hall and Soskice, 2001). These concep-

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tualizations emphasize the special features of the non-liberal relationships of German capitalism, which is characterized primarily by a strongly organized civil society, regulated corporate governance and labour markets as well as an extensive welfare state. This is in contrast to liberal Anglo-Saxon countries where the organization of civil society is decentralized and takes the form of local welfare associations: the welfare state is minimalist and organized along liberal principles. Rather, trade unions and employers and other economic and political players, such as welfare and industrial federations, are highly organized and deeply institutionalized in public policy. In the past, strong civil society has replaced market mechanisms with other forms of coordination, as evidenced, for example, by the regulation of wages via collective bargaining. The Bismarckian welfare state brings together conservative, status-oriented principles and a far-reaching responsibility of the state for its citizens in the form of a social safety net.

Among the wide range of perspectives taken to analyse and categorize the German political economy, the 'Varieties of Capitalism' literature based on Hall and Soskice (2001) is the most theoretically advanced. In contrast to other institutionalist-based perspectives, they put the firm at the centre of their comparative framework and distinguish between two different regimes based on five different spheres of firms' interactions: liberal market economies (LMEs) and coordinated market economies (CMEs). According to Hall and Soskice, these five spheres of interaction determine the institutional framework within a regime:

- In the first sphere of *industrial relations*, firms negotiate and coordinate with labour unions as well as other employers regarding applicable working conditions and wage levels. CMEs are traditionally characterized by a high level or organization, coordination and centralization of industrial relations, whereas industrial relations in LMEs are decentralized.
- In the second sphere of *vocational training and education*, capitalist regimes differ with regard to the contribution and involvement of companies within the process of developing the skills of their workers. Whereas CME firms rely heavily on the availability and formation of firm or industry-specific skills that cannot be easily transferred across firms, LMEs prefer the formation of general transferable skills.
- In the third sphere of *corporate governance*, firms choose their strategies and preferences in order to access finance and cope with shareholders.
- In the fourth sphere of *interfirm relations*, firms distinguish amongst various kinds of supplier and client relations, as well as amongst different strategies to access technologies.

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- In the fifth sphere of *relationship with employees*, the coordination and communication between firms and their workers are analysed by referring to the latter's commitments and internalization of their firm's goals and interests, as well as their motivation (ibid.: 6).

In the Varieties of Capitalism literature, LMEs are contrasted with CMEs according to their differences in coordination of the relevant economic actors. The authors classify Anglo-Saxon countries as typical examples of LMEs, whereas Nordic and Continental European countries are classified as CMEs. The latter are predominantly characterized by non-market mechanisms which are present throughout the different spheres. The relationship between different spheres is characterized by institutional complementarities; institutional configurations are complementary to each other when one supports the other and reinforces the differences between regimes (ibid.: 17). For instance, the availability of specific skills is a core characteristic of firms' product market strategies in CMEs. As a consequence, these firms support vocational-training systems ensuring professional formation in line with their interests. This in turn feeds the demand for an industrial relations system that ensures job security for employees in order to protect these investments in specific skills. In addition, complementarities are supported by public policy in the welfare state. Social insurance-based welfare maintains: status and professions, employment protection legislation, job-specific unemployment insurance and earnings-related pension systems – all of which are geared towards the initial skill investment.

Firms in these institutional surroundings will take advantage of the high investment in skills. They will pursue strategies involving so-called 'diversified quality production' (Streeck, 1991) due to the variety of specific skills in their firms. Product development based on innovation and skills-specific knowledge on the firms' side will be strengthened by the employees' side in their demand for social protection and training policies that maintain this skill level. Institutional complementarities evolve within the context of skill formation and employment protection, the latter being dismissal protection or welfare provisions for this group of (skilled) employees. The higher the level of skill specification within a firm or industry, the lower the level of transferability of these skills and the higher the need for protection and stability for workers (Estevez-Abe et al., 2001).

Concomitantly, the interest of firms to protect workers' rights increases with their skill value for the firm. In Germany the strong focus on the formation and protection of specific-skilled workers has paved the way for systems with strong employment legislation and life-long earning-related unemployment benefits while maintaining a specific set of

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skills. The need to alter one's occupation or acquire new skills in the case of unemployment or market changes, as in the Nordic countries, was not part of the evolving German institutional framework.

Continuity and change in the German model

For more than two decades now, advanced political economies have started to display rather strong evidence of institutional change, particularly in continental European non-liberal market economies. Governments have implemented reforms of labour market policies (Bonoli, 2010), unemployment insurance (Clegg, 2007) and pensions (Häusermann, 2010), as well as corporate governance and financial market regulation (Deeg, 2005). Capital markets and corporate governance regulations have been the subject of intense reform pressure. Beginning in the mid-1990s, many governments liberalized capital markets towards LMEs (Culpepper, 2011). In some cases, reform was radical and far-reaching, while in others it was more incremental. Corporate finance shifted towards equity finance and some large national champions defined themselves as value firms similar to their Anglo-American counterparts.

In the following, a brief summary of the most important changes of the German model over the last decade will be provided. I will focus particularly on the key institutions as identified in the Varieties of Capitalism literature and subsequently assess to what extent these changes have altered the underlying model.

Collective bargaining institutions

Given the high levels of unemployment, low growth rates and strong criticism of economic performance, collective bargaining institutions were under a lot of pressure in the early 2000s. However, no policy changes were initiated, even though a reform of collective bargaining reform was mentioned in the Agenda 2010 proposal and was heavily discussed. The government announced its expectation that collective bargaining was to become more flexible if legal intervention was to be avoided. Such an intervention would have meant that plant-level bargaining would have been given priority over industry-wide bargaining. This would have led to massive decentralization of pay setting.

The threat of legal intervention took place in the context of an ongoing process of decentralization of bargaining, which had already been set in motion throughout the 1990s as a response to the shock of reunification and the recession in 1992–93 (Hassel, 2012). Big manufacturing plants

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negotiated plant-level agreements with works councils in order to cut costs, increase flexibility and productivity (Hassel and Rehder, 2001). This in turn increased flexibility at the level of regional collective agreements. At the same time the institutional structure of industry-wide agreements setting standards for an entire industry and region did not change. Pressures on employers' confederations, and in particular their membership losses that were prominent during the 1990s, came to a halt during the 2000s as collective bargaining became more flexible. However, on both sides of industry membership in associations continued to decline. Employers' membership rates declined from 63 to 60 per cent between 2000 and 2010. Particularly at the beginning of the decade, these associations experimented with new forms of membership which would not bind firms to collective agreements in order to pre-empt their increasing dissatisfaction. Union density rates, which had been in free-fall ever since reunification, declined from 24.6 to 18.6 per cent during the same period (Visser 2013). Employers' associations and unions thereby tended to consolidate in core industries and not expand into new areas of the service economy. At the end of the decade, institutional and regulatory stability was combined with a far higher degree of flexibility of working practices at the firm level and an increasing weakness of employers' associations and unions.

Labour market and social policy

Changes to labour market and social policies were at the heart of the government's agenda in 2003. The Hartz reforms I–IV changed not only the institutional structure of the Federal Labour Agency and the interplay between local level poverty relief and national unemployment insurance, but also the general policy approach towards mobilizing the long-term unemployed. While in the past skilled workers were largely protected from the expectation to retrain, and instead encouraged to keep their primary skills in a particular trade during spells of unemployment, the emphasis shifted to retraining and getting back to work quickly (Hassel and Schiller, 2010). In particular, the focus was on the activation of the (long-term) unemployed through a cut in benefits and an increase of pressure to search for a job. The reform of the unemployment insurance system was comprehensive and involved a drastic cut of benefits for the long-term unemployed who moved to social assistance levels after a period of 12 to 18 months of unemployment. Previous measures to protect skills by not forcing skilled workers to take on unskilled positions were removed. At the same time, a kind of negative income tax was introduced by enabling workers with low-paying part-time jobs to draw benefits so as to make ends meet. Different schemes encouraging early

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retirement were phased out and government subsidies for making elderly workers redundant were stopped.

As there is still no minimum wage, wages at the low end of the labour market declined and unskilled workers maximized their income by combining low-paid part-time employment with benefits. The rate of the working poor shot up and moved Germany to be among those countries with the highest proportion of the low-paid within the EU. While in the old German model, the labour market position of skilled workers was highly protected and wages were comparatively egalitarian, today a process of segmentation of the labour market is occurring. An increasing share of labour market outsiders work on fixed-term contracts for temping agencies or positions in marginal employment. Dualization of the labour market has emerged as a major trend of the transformation of the German model (Eichhorst and Marx, 2009a; Palier and Thelen, 2010; Hassel, 2012).

Training

The Vocational Training System (VET) 'appears to be undergoing a period of subtle but significant change' (Busemeyer and Thelen, 2012: 89). Vocational training is still the dominant form of training after secondary education with more than 50 per cent taking up some form of apprenticeship. It is a highly structured approach towards training in which firms employ apprentices to train them on the job; they then attend school for part of the time. The licensing of training and the content and the examination of apprentices are organized and supervised by the local chambers of commerce. German-style vocational training has always been seen as a highly successful way of training young school leavers below the level of tertiary education. It has consistently produced low levels of youth unemployment and high levels of specialized training.

During the 1990s and 2000s three main developments created pressures within the vocational training system (ibid.: 76–8). First, the share of firms that engage in it declined from 35 to 25 per cent which reflected the downswing of business between the mid-1990s and the mid-2000s. Second – and related to the decline of firm participation – the demand for training by school leavers could not be met. Those at the lower end of school qualifications found it increasingly difficult to find training places. As the German government is committed to provide training until the age of 18, many of those ended up in a kind of 'transition system' (Baethge et al., 2007) of state-sponsored training. Third, the attitude of large firms towards the training needs of school leavers has changed. While in the past, firms increased training capacities beyond their business needs in order to meet demand, this form of corporate social responsibility has

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significantly declined over the last decade. Firms are more reluctant to train just to fill the demand for it. Outsourcing, restructuring and fierce competitive pressure has introduced a new emphasis on cost-cutting that did not allow for voluntary training.

With regards to policy change, some incremental adjustments were made. In particular, shorter training courses (two-year apprenticeships) were introduced and some of the content was removed. The government also introduced short courses for school leavers with low skills. As increasingly school leavers either drop out of low-quality training or cannot meet the expectations of high-quality training, a school-based training regime evolved alongside the firm-based VET. The content of apprenticeships has also become more modular and flexible. Some of these developments took place in the context of the increasing Europeanization of training standards. Even though training is not part of core EU competencies, the European Qualifications Framework has introduced a credit system which should make VET in Germany more compatible with other countries.

While on the whole we can see institutional stability, many features and the content of training is markedly different today compared to the beginning of the period. However, given the current rapid demographic changes and rapidly declining numbers of school leavers, there is an expectation among policy-makers and firms that remaining school children will increasingly be pushed towards higher levels of training (Busemeyer and Thelen, 2012).

Corporate governance

Changes to corporate taxes at the beginning of the 2000s gave incentives to firms to abandon the previous tight network of corporate cross-shareholding. Since 1998 a series of laws has liberalized Germany's capital markets and the corporate sector as a whole. Four laws for the Promotion of the German Financial Market aim to provide a more transparent framework for stock trading. They have led to the establishment of a supervisory agency for stock trading at the federal level and to the setting up of rules of conduct for the participants (Hassel and Williamson, 2004). The Eichel Tax Reform in 2000–01 changed the laws on capital gains tax, enabling companies more easily to shed stakes in other firms. German companies were also enabled to apply international accounting standards (or US Generally Accepted Accounting Principles – GAAP) rather than German accounting standards (Handelsgesetzbuch – HGB). The system of interlocking directorships was loosened up. The Corporate Governance Codex adopted in 2002 encouraged executives to hold no more than five supervisory board seats. However, while the Vodafone–

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Mannesmann takeover did shake up the German corporate sector, the move towards a liberal market of corporate control has not developed further. There is still no active market for corporate control, and corporate finance is still less stock based than in LMEs. Compared to the 1990s when the trend towards an Anglo-Saxon corporate governance structure took off, the 2000s saw a backlash. Among the 100 largest firms in Germany, the share of firms who were owned by large blockholders increased, while firms with a majority in dispersed shareholders declined. At the same time, the ownership of firms has become more international. According to a recent study by Ernst and Young, about 55 per cent of the stock of DAX companies is held by foreign investors, as against only about 37 per cent by Germans (Wirtschaftswoche, 2013). Among the 100 largest firms in 2006, 28 per cent were owned by foreign investors compared to 18 per cent in 1996 (Hassel, forthcoming).

The German model and the great recession

Despite the changes over the last decade, there is evidence that the German model was a major factor as to why the German economy survived the great recession of 2009 in reasonably good shape. When the recession hit and GDP was in free-fall, firms, unions and the government resorted to the established policy instruments that were inherent in the 'old' German model to combat the crisis (Hassel and Schelkle, 2012).

In comparison to its European neighbours, the financial crisis hit Germany relatively late. Until the autumn of 2008, economic outlooks were comparatively optimistic, with a 1.8 per cent growth forecast by the Council of Economic Advisors supporting the government's initial position that the crisis would affect the USA as well as other financial centres but would pass by Germany (SVR, 2008). The first economic consequences became visible in late 2008, leading to a collapse in what had been the country's economic main pillar: exports and manufacturing. Overall, Germany's total contribution to global demand was above the OECD average (Hassel and Lütz, 2010). By the second quarter of 2009 Germany experienced a drop of more than 6 per cent in comparison to the previous year, resulting in a worse situation than in those countries considered to be responsible for the crisis (Bodegan et al., 2009).

However, the collapse was followed by a rapid recovery in relation to other OECD countries. The economy was supported by two closely spaced stimulus packages on 5 November 2008 of €11.8 billion and on 27 January 2009 of *c.* €50 billion, combined with the welfare system's automatic stabilizer initiatives. The German equivalent of the 'Cash for Clunkers' programme which gave subsidies towards the acquisition of

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new cars of *c*. €5 billion aimed to subsidize car manufacturers on a global scale with a particular focus on the protection of skilled workers in export oriented industries.

In addition another instrument helped not only to countervail unemployment in the short run during the crisis, but also to reduce it to below pre-crisis levels. According to the European Commission, the elasticity of employment relative to Germany's GDP was the second lowest among the EU member state countries (European Commission, 2010a). The main factor for this development was the initiative to reduce working hours (Lehndorff, 2010). This helped to disconnect business slumps from layoffs by adapting measures to reduce overtime, to implement working time accounts, to reduce the general working time and to use public short-time provisions. Being used by approximately 20 per cent of all firms this package of initiatives was the most valuable tool to countervail the economic and social consequences of the crisis. With a total usage of *c*. 30 per cent of all firms, the implementation of working time accounts was the most important mechanism, followed by job rotation (14 per cent), extra holidays (13 per cent) and pay cuts (11 per cent) (Bodegan et al., 2009).

Through this strategy German firms were able to keep their skilled labour and react quicker than liberal market regimes once the world markets showed the first signs of recovery. Referring back to Hall and Soskice's concept of institutional complementarities, the enabling force for labour hoarding and the initiatives taken with regard to reductions in working time were enabled by plant level agreements between firms and their core employees during the late 1980s. From the employees' perspective, these measures helped to protect the skills of the workers. From the firms' perspective, it has had a long-term positive effect on unit labour costs. Whereas the latter increased first in 2009 as a consequence of the hoarding initiatives taken, they decreased in 2010.

Subsequently, the German economy experienced the highest employment levels ever, combined with a recovery of the positioning of its firms on a global scale (Möller, 2010). The combination of public policies such as the implementation of 'short-term working models' with adjustment tools developed in dialogue between firms and labour during the post-unification crisis fostered Germany's economic stabilization in the financial crisis.

Still, it remains to be shown how far the country's comparatively successful recovery refers to all sectors. In the absence of a national minimum wage and an increasing low-skilled service economy the continuous focus on export-oriented high-skill industry might lead to economic and social effects in the long run on bargaining institutions as well as on the sphere of vocational training and skill formation.

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The German model and the crisis of the eurozone

The German model plays an important role in the unfolding of the crisis of the eurozone but also in the attempts to overcome it. The model contributed to the crisis but is also seen as a benchmark for policy recommendations to combat it. In the following a short interpretation of the underlying mechanisms will be presented. The solution of the eurozone crisis does not only depend on changes in the German model, which has itself been transformed by the eurozone.

European Economic and Monetary Union (EMU) imposed a unitary monetary policy to an economic area which is made up of different business systems. The German model is one specific business model in which wage setting is controlled by large wage-bargaining actors in which training is extensive and social policy has been reformed with the aim of lowering labour costs and improving competitiveness. Other Northern European countries such as the Netherlands and Austria, but also the Nordic countries, have similar wage setting and training institutions. Other members of the eurozone have very different economic models. In the literature, Southern European eurozone members have been described as 'mixed market economies' which have similar elements of coordination but which are more heavily dependent on the state to sponsor coordination. In the course of the first decade of monetary union northern eurozone countries have developed very differently from southern countries.

The incomplete and asymmetric currency area in which monetary policy is centralized but fiscal policy and wage setting is regionalized has systematically produced different trajectories of inflation and labour costs. Inflation differentials in a regime of standard interest rates led to negative real interest rates in countries with higher inflation and to high real interest rates in those countries with low inflation. For the German model, which was particularly specialized in delivering long-term wage restraint, the harsh monetary environment during the first decade of the eurozone gave even further incentive to restructure and to keep labour costs low. The setup of the eurozone therefore pushed the German political economy even further towards reducing labour costs and improving competitiveness.

On the other hand, the drive towards restoring competitiveness of German business put an enormous burden on the southern countries which were institutionally not capable of using bargaining institutions to keep wages low. In addition, a whole range of structural factors increased the vulnerability of these countries significantly. First, southern countries benefited from low to negative real interest rates; second, they also benefited from the credit ratings of the eurozone as a whole; third, the emerging credit

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bubbles led to a deterioration of competitiveness; and fourth, once the crisis had struck, these countries did not have the instruments to deal with the crisis.

Undoubtedly, the overarching challenge to the eurozone today is the diverging development of competitiveness amongst different regions which has led to major imbalances (Scharpf, 2011; Hancké, 2012). The one-size-fits-all monetary policy put a strain on economies with low inflation rates, such as in Germany, and did not balance overheated economies such as the Irish. In both cases, monetary policy that was oriented towards an average target for the eurozone as a whole had a pro-cyclical effect. Governments did not use the cheap credit they accessed for economic development but rather for consumption. Over time current account deficits and surpluses accumulated and competitiveness diverged. These problems with the EMU were known from the beginning and did not come as a surprise to policy-makers or analysts.

For most of the 2000s, the standard macroeconomic indicators gave little concern for most countries of the eurozone. This is even true for those which had problems meeting the convergence criteria. Both nominal wages as well as inflation differentials diminished over the first decade of the euro. Nominal wages rose faster in Southern Europe compared to Germany but the differences declined. The same is true for inflation differentials, which during the first half of the 2000s have remained unchanged (Scharpf, 2011). Greece, Ireland, the Netherlands and Spain all had significantly higher inflation than the eurozone average. Germany, on the other hand, had the lowest inflation and highest real interest rates and therefore was held back in growth. At the same time, lower prices in Germany in the long run benefitted the competitiveness of its firms.

However, higher nominal wages and higher inflation in peripheral countries led to a loss in competitiveness in Southern Europe and eventually expressed themselves in current account deficits/surplus and diverging unit labour costs. These came into full view after the financial crisis in 2008 and forced governments to bail out banks. The subsequent recession and lack of access to capital markets revealed the reduced competitiveness of Southern Europe vis-à-vis Northern Europe.

During that time, Germany had persistently the lowest nominal wage increases in the eurozone and the OECD. The institutional basis for long-term wage restraint consists of the capacity to coordinate wage setting through pattern bargaining or centralized control over wages (Hassel, 2006: 165; Johnston, 2009). Pattern bargaining describes the process in which unions and employers in export-oriented industries set the upper limit for wage negotiations. They then serve as an orientation point for non-traded and public sectors. The fact that in Northern

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Europe wage increases in the non-traded sector are generally not higher than in the export sectors is not a standard phenomenon – rather the opposite. In Southern Europe, the non-traded sector – fuelled by cheap credit – saw the highest pay increases in the 2000s. Private sector unions and firms were not able to hold down wage developments in the sheltered sector. This is a key factor for explaining the pay differentials within the eurozone and in turn the imbalances that emerged over the last decade.

The differences in wage setting institutions go directly to the core of the German model. Here, manufacturing firms have to stand the pressure of international competition, and labour costs are not only a major concern of these firms but also for the unions. Pay increases have been exchanged with job security in leading manufacturing firms through rounds of plant-level concession bargaining.

The response of the Troika to the troubled countries of Southern Europe has been to request structural reforms in exchange for financial help. Structural reforms often attack those elements which are part of the German model: centralized wage bargaining, organized civil society, highly regulated labour markets. At the same time, the debate within the EU has also recognized that there are two sides to imbalances: the German trade surplus mirrors the deficit of the southern countries. Therefore, the German government has frequently been targeted by those seeking reforms to increase domestic demand and reduce the reliance on an export based growth model. For instance, the European Council published its country-specific recommendations at the end of May 2013 urging Germany to increase wages and lower high taxation for low paid employment:

> Policy action to reduce the high tax wedge for low-wage earners and improve the integration of the long-term unemployed into the labour market has been limited so far. Germany should do more to reduce the high taxes and social security contributions that they levy on low wages. Further efforts are needed to improve transition from certain types of contracts, like mini-jobs, into more sustainable forms of contracts, thus avoiding labour market segmentation. (European Council, 2013)

In other words: the German model as it is today poses a major threat to the internal balance of the eurozone as it has developed a model of economic restructuring in which competitiveness of industries is boosted by driving down wages and conditions for peripheral labour. It is very much in doubt how the eurozone can develop a sustainable growth model without major changes to the German model.

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Conclusion

The assessment of how far the transformation of the German model has gone is hotly debated. Some authors, in particular Wolfgang Streeck (2009a), maintain that the distinctiveness of the model compared to other political economies has become largely irrelevant as the process of liberalization and deregulation has introduced market mechanisms in all advanced political economies to an extent that the peculiarities of the training system, wage setting and corporate governance are not much more than decorative features. Others – Iversen and Soskice (2009) and Carlin and Soskice (2008) – argue that the core features of a coordinated market economy based on non-market coordination has remained intact and continues to dominate the central features of the political economy.

In-between these two main positions a third has emerged that recognizes the trends towards liberalization and deregulation but argues that these trajectories fundamentally differ in different kinds of political economies. 'Liberalization' – a vague term in itself – takes place in different forms in different institutional settings (Hall and Thelen, 2009; Palier and Thelen, 2010). The transformation of the German model towards a more liberal one therefore is undeniable, but in essence it remains 'German' in the sense that many of its institutional characteristics define the process of liberalization. For instance, the dualization of the labour market is not the same as a straightforward liberalization towards a liberal labour market as in the UK or USA. Compared to liberal countries, labour market regulation in Germany for labour market insiders are still strict. However, strong protection for some workers co-exists with very loose protection and low conditions for labour market outsiders. Dualization is a feature of liberalization of CMEs. Continued coordination at the core and increasing liberalization and dualization at the periphery are two sides of the same coin (Hassel, 2012). The transformation of the German model is therefore not primarily a process of converging on a liberal, Anglo-Saxon, model. It is a transformation in its own right.

The two main challenges to the German economic model during the 2000s – the financial crisis and the crisis of the eurozone – has shown the ongoing importance of its distinctive features. The growth stimulus in 2009 based on short-term working and stimulating the crucial car industry fed into the core institutions, as has been outlined. The crisis of the eurozone can only be understood when taking into account the role of the institutions of the German model, which cannot easily be replicated elsewhere. The competitiveness of German industries that combines strict cost control and high-quality production is a major source for economic imbalances in the eurozone. Therefore, to dismiss the German model as

just one version of universal capitalist market economies (Streeck, 2009a), means to give up a conceptual understanding of market economies which has given observers so far the most powerful theoretical understanding of different business systems.

However, there is a dynamic process of change taking place. The German model is moving into a new era which combines coordination in the core features of the manufacturing sector with new liberal elements. It is a combination of continuity and change, which is the key to understanding current reform processes: institutions are hollowed out while their formal structures remain intact. As with the modernization of a house, the walls remain standing but the wiring and plumbing is replaced. In that sense, many formal institutions of the German model are still the same as they were in the post-war period: centralized collective bargaining, legal works councils, a dual corporate board structure, insurance-based social policy and the vocational training system are all based on the same institutional structure. Very little formal change has taken place.

The second key element of change consists in the underlying expectations, attitudes and values in business, politics and society (Hassel and Williamson, 2004). While the protagonists of the liberalization literature assume that it is mainly driven by a coalition of ill-advised policy-makers and international investors who insist on high returns at the expense of the wider population, incremental change within formal institutions is often driven by a new and different understanding of the role of work. For instance, while the 'old' German model gave a high premium to job tenure and life-long employment in major manufacturing firms, this model is not compatible with a workforce that is female and in the service economy and has a substantial share of migrant workers. Both women and migrant workers are more likely to change employers more frequently and therefore have less specific skills. The lower attachment to a particular employer makes it harder for them to attain and protect specific skills. The premium of skill specificity is therefore much harder to maintain when the workforce is more mixed.

Modernization of German society, higher employment rates of women, increasing competitive pressure on firms, the rise of global investors as well as the continuing deindustrialization of the economy have all impacted on the effectiveness of the traditional institutions of the German model. The initial reform policies in the area of the welfare state at the beginning of the 2000s had an important effect on the structure of the labour market. The decline of protected jobs in contrast to precarious jobs and the increasing dualization were major changes of the model.

On the other hand, traditional policy tools were used to combat the crisis using labour hoarding and short-term working. In the context of the eurozone crisis, it is the traditional feature of highly competitive wage

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setting and micro-corporatist cooperation between unions and firms that have led to strong export performance and contributed to the imbalances.

On the whole, the picture is therefore decidedly mixed. The old model is revamped and appears in new clothes. The process of change is moreover far from complete and remains problematic as it has not even started to deal with imminent challenges. These are the commencement of rapid demographic change as the share of young school e same is true for the role of women in the labour market and in society as a whole. Compared to many other countries in Europe, Germany still has a highly traditional male breadwinner model which assigns women the role of secondary earners. Low fertility is related to this as many qualified women are not prepared to play this role. There are many challenges ahead and it is very likely that during the next decade the transformation of the German model will continue.