

## THE EUROZONE CRISIS: WHY DOES GERMANY CALL THE SHOTS?

The simple answer is that Germany is more prosperous, and its government finances are in better condition.

So how did this come about? And can anyone reach this exalted state?

Saudi Arabia is wealthy as a result of one single factor – one single word: oil. Other countries with plentiful supplies of vital minerals and other resources are in the same situation – adequate to excessive (though possibly unsustainable) wealth with little or no work involved. Germany was not so endowed. The country has no more natural wealth than any other European country; indeed its ordinary people are little different from any of its neighbours.

The story of Germany's current prosperity is the result of a 'virtuous circle'. A 'virtuous circle' is an upward spiral, as one fortunate turn of events sparks others in a growing progression, culminating ultimately in a relatively stable and secure prosperity.

And yes, any individual, community or nation can do it. It's neither magic nor rocket science. It's simply teamwork.

### Banking for Industry

Ultimately, **prosperity** is based on one single factor: **productivity**. Producing better goods for less cost. And the German tradition of quality reaches right back to the Guilds of the Middle Ages which established the German tradition of creating products known for quality and durability. A craftsman was not permitted to pursue a trade until he could demonstrate the ability to make high-quality products. Out of that same tradition came an equally strong passion for education and vocational training, for no craftsman was recognized until he had thoroughly learned a trade, passed a test, and been certified. Much of this foundation remains today.

Later, State-support also became a contributive element. The Industrial Revolution reached Germany long after it had flowered in Britain, and the governments of the German states scrambled to support local industry in order not to be left behind. Many enterprises were government initiated, government financed, government managed, or government subsidized. As industry grew and prospered in the 1800s, Prussia and other German states consciously supported all economic development and especially transportation and industry.

German banks too played central roles in financing German industry. They also shaped industry-wide producer cooperatives, known as cartels which secured major financing projects by protecting markets. Different banks formed cartels in different industries. The principle of collaboration between banks, governments and industry with the unifying aim of strengthening the regional economy was already established.

So when the Swedish government stunned Europe in 1818 by offering 160,000 Taler to the German province of Westphalia, as reparation for the damages incurred when Swedish and Dutch soldiers marched through the province during the Napoleonic Wars, this did not find its way into government or princely coffers, but was decreed the property of all Westphalia by its President, Freiherr von Vincke.

The funds were to be used to develop the region's economy and pay for public works projects. Some formal policies were needed to distribute the money, and in 1832 the Westphalian Provinzialbank-Hülfskasse was founded to accomplish this task. This was the first *Hülfskasse*, 'Assistance' or 'Development Bank' in what was then Prussia, and played a pivotal role in expanding the region's economic potential throughout the 1800s.

Frederick William IV, king of Prussia, impressed by the advantages which the *Hülfskasse* concept offered Westphalia, ordered that a similar bank be created in the Rhineland in 1847. Its government founded the Provinzial-Hülfskasse of the Rhineland in 1854.

Both banks became Landesbanken before the end of 1800s, which greatly increased their range of services, since *Hülfskasse* banks had more restricted charters. Their new names were Landesbank für Westfalen Girozentrale, and Rheinsche Girozentrale und Provinzialbank, Düsseldorf. The two banks were instrumental in making the Rhine-Westphalia region one of the most important and productive industrial areas in Europe, continuing the central role which German banks have long played in financing industry.

If the 20 years before 1870 saw the foundation of Germany's industrial might, the years immediately following Unification saw its full fruition. Within five or six years of the proclamation of the Empire under Bismarck in 1871, substantial progress was made in the infrastructural organization of the Empire. A common currency and banking system had been established, together with a Postal System for the whole Empire. New codes of commercial civil and criminal law were framed. Above all, industry and trade flourished so that Germany soon became like Britain, one of the workshops of the world.

The German banking system played an important role in the growth of German Industry after 1870 by making money available to industrial entrepreneurs. As industry became larger in scale so large amounts of capital and investment were needed to set up manufacturing plants. In their turn the industrial magnates invested money in the banks and often took their seats on the board of management. Thus arose the inter-penetration of banks and industry in Germany which came to be described as Finance Capitalism.

Government too played a powerful role in the industrialization of the new German Empire. It supported not only heavy industry but also crafts and trades in order to maintain prosperity in all parts of the empire. And where the national government did not act, the highly autonomous regional and local governments supported their own industries. Each state tried to be as self-sufficient as possible.

The German Empire also established, under Bismarck's direction, the social compact under which the German labouring classes supported the national ambitions of the newly united German state in exchange for a system of social welfare provided sickness and accident benefits as well as a guaranteed pension. Bismarck was not a socialist, but he believed that it was necessary to accept portions of the socialist platform to sustain prosperity and social cohesion, a concept actively maintained in Germany today.

With the administrative and infrastructural facilities of the unified German Empire quickly put in place, the ultimate wealth of the empire proved immense. German aristocrats, landowners, bankers, and producers created what might be termed the first German economic miracle, the turn-of-the-century surge in German industry and commerce during which bankers, industrialists, mercantilists, the military, and the monarchy joined forces.

But when a Serbian fanatic assassinated Archduke Franz Ferdinand, heir to the Austro-Hungarian throne in Sarajevo on 28th June 1914, Austria declared war on Serbia and as a result of multiple treaty obligations the rest of Europe was drawn in. And Germany was plunged into 30 years of darkness.

#### 1945: Picking up the pieces.

During the recovery years following the end of WW2, British and American bankers and economists claimed that German industry and its banks were too industry-oriented, too cautious and locally focused, suggesting the German economy needed to slim down its manufacturing sector and focus more on financial services, while industry should look more to the stock market than to local banks. Wisely, the Germans declined the advice.

As Germany's postwar economic and political leaders shaped their plans for the future German economy, they saw in the ruins the opportunity for a new beginning, an opportunity to position Germany on a new independent path, drawing on its old traditions of precision and professionalism, coupled with measures which would ensure social cohesion. Echoing the tradition of social welfare established by Bismarck after the 1871 Unification, the economy was to be an instrument for prosperity, but it was to be a widespread prosperity, so helping to maintain a stable society. The new German leaders wanted social peace as well as economic prosperity. They wanted an economic system that would give an equal opportunity to all and avoid creating underprivileged social groups.

Industrially, the regional focus of the Landesbanken again played a major role in the creation of yet another German "Economic Miracle", in particular through the provision of secure on-going finance to the German "Mittelstand" (small and medium-sized companies) in their respective regions. Nor should their power be underestimated. With 3 million mid-sized businesses the Mittelstand industries employ more than 70% of German workers and contribute roughly half the country's GDP.

Klaas Hubner, a former member of the German Parliament and himself owner of a Mittelstand company observes that mixing social democratic values with localism is a major element in Germany's sustained economic success. "What we have here is stakeholder capitalism, not shareholder capitalism," he says. And like most Mittelstand owners, he adds: "I live where my company is located. I want a good image in the town I live in." The Mittelstand remains blissfully immune to the many pressures that share-price-oriented financial markets inflict on their American counterparts. "We don't have short-term strategies, only long-term strategies," says Hubner.

Mittelstand companies are not publicly traded, and they benefit from an extensive system of vocational education and a sector of municipally owned savings banks that work solely with local businesses. Roughly two-thirds of German small and mid-size businesses get their loans from these banks. "Our banks are restricted to doing business in their regions; they have to concentrate on the real economy."

Through such radical notions has Germany thrived.

In Germany, banking serves industry, providing safe, longterm, committed investment. Contrast this with the Anglo-American approach in which banking has become largely involved in hi-tech gambling while industry struggles to keep the stock market entertained with short-term profits and only sporadic, fair-weather support from the banks.

And German industry provides a model of creative and productive cooperation at all levels from shopfloor to management. Workers, owner-managers, local communities, local or regional banks, colleges and universities, and the federal government where necessary, all work together to ensure stable industry and widespread prosperity.

#### The Mittelstand Industries – a Team Effort

The Germans like to refer to their economy as a Social Market Economy, stressing both its free market orientation, and an underlying sense of social responsibility. This can be seen throughout German industry, but particularly in the Mittelstand, the family-owned small and mid-size manufacturing firms that dominate the economy.

A typical Mittelstand company is AWS Achslagerwerk, a factory in the farmlands of Saxony-Anhalt, about two hours west of Berlin. As in many such companies, this factory turns out specialized products: axle-box housings for Chinese and German high-speed trains, machine tools requiring climate-controlled precision measurement. With annual revenue of 24 million Euros, the factory has won a significant share of the world market, though it employs only 175 production workers.

The workers at AWS Achslagerwerk are highly skilled, and most stay with the firm for decades. When the downturn hit Germany in late 2008, business for manufacturing firms declined the most, but subsidies from a government program called Kurzarbeit (short-time working) allowed firms to keep their workers part time rather than laying them off. By keeping its skilled workers, the company was able to rev up production quickly when China's stimulus boosted the market for their products in 2009.

But in addition to government assistance, managements play their part too, drawing once again on the German tradition of co-operative labour management and social responsibility.

Ms. Schoder heads a Mittelstand factory in Langen, just outside Frankfurt. Her grandfather started the Schoder firm in 1924 by engraving numbers and letters on early typewriters. As Germany's economy evolved, so did Schoder. From the 1950s to 1970s, it moved away from typewriters and started engraving serial numbers on car parts, mostly for German car makers. It also started to produce steel face plates for machines.

Under Ms. Schoder, who has run the business since her father retired in 2003, the company has gone even more high-tech. In addition to stamping logos on cigarette papers for clients in the United Arab Emirates, she uses state-of-the-art milling machines to build parts for high-strength lids on gas turbines. A potential new business: engraving on lipstick.

Her business took a big hit even before the recession, when a single client cancelled a large number of orders. Like many other Mittelstand, she got help from the government's Kurzarbeit program that cuts hours, not staff.

To get by, she also suspended a bonus program with a promise to repay workers once profits returned. She cut costs elsewhere by reducing office cleaning and using some of her idled factory workers to make deliveries, all in order to "keep these people on board as long as possible."

Tital, a firm that makes precision titanium- and aluminium-cast products for the aerospace and racing car industries, is another classic Mittelstand example. Based in the small town of Bestwig in the Ruhr Valley, Tital has about 420 workers — mostly from the local area, trained through apprenticeships by the firm — and is owned by its management team.

"The management doesn't worry about quarterly growth figures, but rather thinks long-term," said the sales director. This approach allowed it to weather the financial crisis without needing to lay off any permanent staff. "There is much more team spirit here," he adds. "We would never jeopardize our long-term growth for short-term opportunities. Nobody is going to lose their job if we don't grow for two years. It's wiser to go slow and invest."

German Mittelstand are for the most part managed by their owners; they grow long-term and they don't have to please the financial community.

Keeping community roots strong is also common to Mittelstand, and co-operative labour-management relations add to the community spirit. And this works across the generations as apprenticeship schemes ensure a continuing flow of expertise. German universities work hand in glove with researchers at local firms. Suppliers cluster round big manufacturers. Owner-managers rub shoulders with workers. And there is an underlying sense, tradition and history of teamwork and social responsibility.

Germany's large manufacturers too – VW, Siemens, BMW – surely feel market pressures, but they, unlike a growing number of their American counterparts, still invest quite profitably at home. In large part, that is due to Germany's system of *Mitbestimmung*, or co-determination, which places an equal number of union and management members on corporate boards. The German metal workers union, IG Metall, has been working with automakers to train workers, for instance, to mass-produce electric cars. “Our goal is to retain high-value-added manufacturing in Germany,” says Martin Allespach, the union's policy director.

Indeed, this concept of *Mitbestimmung* is an important element in German industrial relations. *Mit* means ‘with’, and *Bestimmung* literally means ‘giving voice’. In practice it can be translated into English as ‘co-determination’. And who are the parties involved? This question can best be answered with an Anglo-American concept often voiced but rarely practiced: co-determination among *stakeholders*.

The idea is that all those involved in the fate of a business, workers, managements, shareholders, even the community especially if it's a one-industry town, all should to some extent be involved in decision-making since their livelihoods depend on it.

This is not flower-power cooperative, nor is it bosses patronizing the unwashed masses. The motive behind *Mitbestimmung* reflects another German characteristic: *Ordnung*. Germans don't like disorder. And unresolved conflict, whether in a workplace or a community or a nation, is disorderly, not conducive to smooth and efficient operation.

And there, the Germans have in fact, hit a Great Truth right on the button: prosperity is produced by cooperation rather than conflict.

The lesson is inescapable. German industry is built on teamwork. Teamwork between banking and industry, between workers and managements, between today's workers and the young apprentices training for tomorrow's jobs. That in turn creates a sense of continuing stability, ironing out economic ups and downs, and from government's point of view, maximizing taxes and minimizing welfare outflows. One good thing builds on another.

That's the virtuous circle.

With secure finance for locally-based industry across the country, a dynamic approach to world markets, training new talent for the future, and a greater sense of boardroom-shopfloor teamwork replacing *shareholder* capitalism with *stakeholder* capitalism, any country can emulate Germany's “Economic Miracle”.

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