

GERMANY LEADS EUROPE'S ECONOMIC RECOVERY

Memo to Donald Rumsfeld: "Old Europe" is still very much alive

By Nick Gier

The German heart beats only weakly, buying very little from its neighbors. A scrimping Germany will be a greater burden for the Eurozone than spendthrift Greece.

--Edward Hugh at Economic Resources

With the Euro reaching a 3-week high against the dollar and most of Europe's banks passing their "stress" tests, the continent appears to be on the road to recovery. The exception, of course, is Greece, where citizens are losing patience with a government austerity program that has cut the budget deficit by 46 percent. Spain, Portugal, and Ireland, while growing only slightly, have been saved by budget cuts and tax increases.

The main problem for Ireland is its banks, which went on a binge of lending under the government's libertarian policies. The main culprit is the Anglo-Irish Bank, which has now cost Irish taxpayers \$32 billion—11 percent of the small country's Gross Domestic Product. On the other hand, the U.S. may make money on its bank and car company bailouts, and it is predicted that Britain will make \$30 billion from saving its banks. Without this government intervention the world would be now be in a deep depression.

The latest figures published in *The Economist* shows that the 16 countries in the Eurozone grew at an annualized rate of 3.9 percent, while the U.S. dropped to 1.6 percent. Just as is the case with the individual American states, the performance these countries ran the gamut from good to poor. Germany led with a dramatic 9 percent increase, while Sweden followed with 4.7 percent, Britain (still under Labor rule) at 4.5 percent, Denmark with 3.9 percent, and Austria increasing 3.8 percent.

While the U.S. is struggling with a 9.5 percent unemployment rate, Norway, Switzerland, Austria, and Denmark are at 3.5, 3.8, 3.9, and 4.1 percent respectively. Excluding Norway's budget surplus because of its oil wealth, the three remaining countries have an average budget deficit of 3.8 percent. The U.S. budget deficit has fallen 2.2 percent since April 7, but it is still at 8.9 percent. Greece's deficit is 9.5 percent, but Europe's highest is Ireland at 14 percent.

It is significant to note that all these countries, except for Ireland, were developed by Social Democrats, whose generous health and social services (financed by high income taxes) have been trimmed only slightly under recent center-right governments. According to free marketeers, these countries should be economic basket cases, but obviously they are not that at all. Indeed, it is primarily countries such as Iceland, Ireland, and the Baltic States that have failed under libertarian, free market policies.

In the 1990s the Danish Social Democrats invested in a jobs training program (expending 20 times more per capita than the U.S. does), which has kept unemployment at a 3-4 percent rate

ever since. During their last term in office (1995-2005) the German Social Democrats instituted a jobs program and relaxed tight labor laws, and the number of unemployed dropped from 5 million in 2005 to 3 million in 2008. Although the rate is still relatively high at 7.6 percent, Germany is in its 13th straight month of falling unemployment--right through the throes of the Great Recession.

Germany is the world's fourth largest economy after the U.S., China, and Japan, and it just lost its place to China, now the second largest exporter after the U.S. Nevertheless, demand for Germany's high quality cars and machine tools is giving the country a dramatic boost, with exports up by 28.5 percent in June. While sales of Mercedes have fallen at home, they have tripled in China and doubled in India. BMW and Volkswagen, the world's largest car maker, are also doing well.

Germany's Social Democrats have traded places with the conservative Christian Democrats since 1949, with the latter ruling 29 years and the former 24 years. The two parties formed a "grand coalition" twice—first from 1966-69 and recently from 2005-09 under the leadership of Christian Democrat Angela Merkel. Merkel describes Germany as a "social market economy," one that combines, as one source phrases it, "a capitalist mode of production with the belief that society should protect all its members from economic and social need." A German Banking Federation survey showed strong support this view: 61 percent Germans polled wanted more "social protection," while only 23 percent desired more "market."

Beginning with the rule of Otto von Bismarck—under pressure from the fledgling Social Democrats—Germany was the first nation to institute social welfare programs. The Workers Health Insurance Law came in 1883; Old Age and Invalidity Insurance in 1889; the Youth Welfare Act of 1922; and national unemployment insurance came in 1927. The unique aspect of the German welfare state is that many programs were developed at the local level by labor unions and churches, and they are now administered by the states not the federal government.

Today the German state's contribution to social and health programs amounts to one third of the Gross Domestic Product. Katha Pollitt, columnist for *The Nation*, just returned from a year in Berlin and she found that Germans were "utterly bewildered" by the negative response to Obama's health care plan. Very much like ObamaCare, the German system relies primarily on private insurers (who may not take a profit) and offers subsidies for the poor. In 2008 each German spent on average \$3,673 for health care, while each American had to pay out \$6,402, the highest in the world.

Ironically, the poor and women in general are less likely to get the full benefit of Germany's social programs. In 2006 Germany ranked 49th out of 58 industrialized countries for gender equity, while the U.S. was in 17th place and the Scandinavian countries were on top. *The Economist* reports that "only 17 percent of German mothers with two or more children work anything like full time, whereas in France more than half do." (Although German women are having fewer children, the old adage for German female roles *Kinder, Küche, und Kirche* still applies.) The social benefits of those women who do not work are tied to their husbands' jobs. One area where East Germany excelled was government day care for children, something that the old West Germany lacked.

The secret to Germany's success lies primarily in its hard-working, thrifty people. Critics say that German pride and the tendency to think of the Greeks as lazy delayed the European Union plan to save them, and, as a result, added hundreds of billions of Euros to the cost of the bailout. The irony is that the Greeks work on average more hours per week (42) than the rest of the countries on the Euro (40). Even more ironic is the fact that in 2006 German workers worked the third lowest number of hours in the industrialized world.

A poll of Spaniards showed that only 20 percent were spending less on food and drink during the recession, while 50 percent of Germans reported that they were scrimping. Even though German banks got into trouble by buying collateralized mortgage debt from the U.S., they were not allowed to issue subprime loans. This of course would be unnecessary for the eminently credit worthy Germans.

There were no subprime loans in Spain either, but personal and public debt has skyrocketed nonetheless. Spanish banks fueled a huge housing bubble, causing house prices to rise, along with Ireland's, at the highest rate in the world. Three million new homes stand empty, and lay-offs in Spain's construction industry have led to a 20 percent unemployment rate.

Economist John Maynard Keynes is given credit for articulating the Paradox of Thrift, but the principle may go back as far as 1714. During the Great Recession even spendthrift Americans increased their savings from 1 percent of disposable income to 7 percent last year. That should be good, right? No, not quite, because, paradoxically, what is needed for economic recovery, according to Keynes is for people to spend more—especially the Germans and the Chinese.

As Edward Hugh of Economic Resources states: "The German heart beats only weakly, buying very little from its neighbors. A scrimping Germany will be a greater burden for the Eurozone than spendthrift Greece."

Donald Rumsfeld once declared that "Old Europe" was dead, but the Third Way between Communism and Cowboy Capitalism appears to be very much alive.

Nick Gier taught philosophy at the University of Idaho for 31 years, but, since his retirement in 2003, he has been reading *The Economist* faithfully every week.