Ideas, Institutions and Organized Capitalism: The German Model of Political Economy 20 Years after Unification

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Abstract

For much of the past two decades since unification, the literature on the German economy has largely focused on the erosion of the German model of organized capitalism and emphasized institutional decline and the corresponding rise of neoliberalism. The first part of the article analyzes the strains unification placed on German economic performance that caused many observers to call for modification of the model in a more neo-liberal direction. The second part takes a different focus and lays out the main rationale of the paper. It inquires why such a coordinated market economy was created in the first place and whether a renewed form of it might still be useful for Germany, the European Union, and other developed democracies in the early twenty-first century. The third section articulates the origins of the institutional and ideational components of these coordinated market economy models, during both the Bismarckian and Social Market Economy periods. The final portion inquires whether the failure of the contemporary liberal market economy approach in the wake of the worldwide financial crisis and severe recession represents a possible opening for the creation of a third coordinated market economy not only for Germany but for a redesigned European Union.

Keywords

Economic policy models, institutions, ideas, Germany, European Union, liberal market economy, coordinated market economy, organized capitalism

Introduction

At the time of German unification, Modell Deutschland was considered to be the primary reason for the health and stability of the Federal Republic’s forty-year record of strong economic performance. Many observers thought it would be an excellent foundation for incorporating the five new Länder of the former German Democratic Republic. For much of the past two decades since unification, however, the literature on the German economy has largely focused on the erosion of the German form of organized capitalism (Modell Deutschland) and emphasized institutional decline and the corresponding rise of
neoliberalism, which the first part of this essay briefly reviews. But, since mid 2008, the worldwide financial crisis has challenged the virtues of the apparent neoliberal hegemony and perhaps opened up once again a debate regarding appropriate economic policy models. In short, the crisis has suggested that a coordinated market economy (CME) might yet have some considerable virtues.

The second part of this article takes up this possible shift in focus toward a renewed CME, but it argues that in order to explain adequately the erosion of the German model in the two decades since unification, we need to pose a question that is seldom asked in the literature that chronicles its apparent demise. This purpose of this article is to investigate why such a model was created in the first place and whether a renewed form of it might still be useful not only for a Germany still struggling with unification issues, but perhaps also for the European Union (EU) and other developed democracies in the early twenty-first century. Specifically, it argues that the formation of this organized capitalist model (CME), not only in the postwar period, but also during Germany’s rapid industrialization in the late nineteenth century arose because an Anglo-American free market model was inappropriate for generating the economic growth that each epoch required. It also argues that the creation of this policy regime was comprised of dynamic, flexible institutions and a clear set of visionary ideas in the context of either state-building or state-rebuilding. In light of the recent crisis that has produced sharp challenges for liberal market economy (LME) approaches, might there be opportunities for a revived CME?

The third part of this article articulates the components of these coordinated market economy models during both the Bismarckian and Social Market Economy periods. It also suggests that the context of state formation (Imperial Germany) and state
reformation (the Federal Republic and the Social Market Economy) were fundamental processes that made the institutions and ideas greater than the sum of the parts.

The final section inquires into whether the failure of the neoliberal model in the wake of the worldwide financial crisis and severe recession represents a possible opening for the creation of a third organized capitalist model not only for Germany but for a redesigned European Union. It outlines three possible scenarios: a renewed LME, in spite of its apparent demise; a hybrid LME-CME formation in which neither dominates, but elements of both are clearly present; or a path that contains institutional and ideational elements recognizable from earlier CME models that would extend beyond Germany to other continental Western European countries and perhaps to the EU itself.

Before proceeding further, it is important to clarify terminology. Through significant portions of the postwar period, the German CME has been called Modell Deutschland. As much as this term has been used, one thing is clear: economic policy “models” are characterizations of institutional arrangements that only are recognized fully after their creation, sometimes many years thereafter. In other words, economic policy models are the institutional landscapes that we can only see through the rearview mirror. Since this paper focuses primarily on the origins of Germany’s CME experiences and only secondarily on their decline, it is more important to identify both the specific institutional and ideational components that shaped these two CMEs, as well as the processes with which they were formed. Thus, while the paper examines the origins of these two earlier periods, it will generally avoid using the term “model.” As Kathleen Thelen and Wolfgang Streeck have argued, the creation of these CME regimes was an iterative, experimental, trial-and-error process that owed much to the innovative capacities of the
economic and political actors and the institutions they were creating. They also had unintended consequences, for example, being created to serve a specific purpose at one moment, only to serve a very different purpose as circumstances changed and institutions adapted. In this context, this paper stresses that a more free-market LME was never a serious option as Germany industrialized in the late nineteenth or reindustrialized in the mid twentieth centuries. Thus, what came to be recognized as a CME “model” was not visible from the outset of either period. Yet, what all of these cooperative and institutionally dense experiments shared is that they were not embarking on a laissez faire path. There was no “system designer” for this CME, but, given the pressure to industrialize, develop, and, politically, provide access to resources, markets, and capital, these material pressures forced forms of cooperation as the only way to industrialize rapidly since the LME option was off the table. To extent that Otto von Bismarck or Konrad Adenauer/Ludwig Erhard “planned” these particular CME regimes, they were in the context of state formation and reformation, respectively.

The Demise of Modell Deutschland

By now, the litany of shortcomings of the postwar form of German organized capitalism is well known. Since the 1990s, the German economy has been beset with increasingly uncompetitive industries, persistent structural unemployment, and continued stagnation in eastern Germany. In addition, the large German banks, which for more than a century served as a guardian for dozens of German firms, began to sever their Hausbank relationships with large German firms in favor of focusing on global opportunities and
global profits. For more than a decade, within the formerly cooperative corporatist industrial relations system, German employers have been deserting their employer associations in favor of “going it alone” when negotiating with unions. In addition, the latter have fared poorly in the past twenty years with the share of German workers in trade unions dropping by almost half, now representing less than 20 percent of the German workforce. Finally, the Social Democratic Party (SPD), once the exemplar of “capitalism with a human face” after its first years as the leading party in government in the 1970s, recently has turned to serious retrenchment in the form of the Hartz IV labor market reforms that victimized many of its own supporters during the Gerhard Schröder governments of the early 2000s, only to lose control of government in the 2005 election and then suffer its worst postwar defeat in the 2009 election.

The inglorious end of the German organized capitalist “model” came to be characterized as one comprised of cumbersome, limiting, and sclerotic institutions incapable of adaptation. The conventional wisdom was that only a turn to neoliberal market approaches could pull the German economy out of the doldrums and address the continuing costs of unification that the postwar system was never able to accomplish. While the 2008 financial crisis and subsequent severe recession clearly had cut short the enthusiasm for neoliberal solutions both in Germany and elsewhere, the standard consensus by mainstream economists still remains that the current version of the organized capitalist economy does not offer much promise. This view suggests that the neoliberalism proposed by the Free Democrats, the new junior coalition partner of the Christian Democrats (CDU/CSU) following the 2009 election, is a more appropriate policy model. Specifically, this party argues that an economy dominated by older manufacturing
industries with comparatively high-priced labor may not be agile enough to remain competitive in an increasingly harsh economic climate.

**Institutional Innovation, Visionary Ideas, & State (re)building**

One can tell a great deal about the organization of a nation’s economic policy by understanding the country’s timing of industrialization and democratization. Countries that industrialized early tended to have laissez-faire, free market economies that gradually evolved into the world’s leading economies because their good fortune and path-breaking industrialization allowed them to have relatively easy access to resources, markets, and capital. The UK and the U.S. are the prime examples of this pattern. Countries that industrialized later, such as Germany and Japan, faced a different set of choices. Lacking ready and predictable access to resources, markets, and capital, they needed to construct a different set of institutions if they were to catch up to the earlier industrializers. In short, they needed to construct a model that maximized efficient access and use of resources, targeted foreign markets since their own domestic markets were so underdeveloped, and allocated capital so that each investment had a high probability of success. Unlike the “trial and error” economies of the earlier industrializers, the latecomers had much less margin for error.

Thus, with neither classical liberalism nor dirigisme (in the post World War II period) possible what other option was there? The most likely alternative was one that organized and mobilized major producer groups via the framing guidance of the state. This was not an easy task. Rather than waiting for capitalism to evolve slowly as it had in the Anglo-American world, it needed to be “force-fed” quickly to produce the most profitable
paths. Thus, in both the late nineteenth and mid twentieth centuries, the state both encouraged and allowed large firms to form with tight coordination from their financial partners. Resources had to be acquired and used efficiently, foreign markets had to be identified and targeted (since domestic demand in the early years of both models was quite underdeveloped), and capital investment had to have a high expectation of success. “Trial-and-error” capitalism was simply not sufficient or fast enough. Moreover, because production for domestic consumption was a second order priority, providing some sort of social protection for the majority of citizens who were not favored in these top-down CME systems was crucial. In essence, this was an “all eggs in one basket” economic policy model—especially during the nondemocratic Bismarckian era—that required close coordination or all major producers and the emphatic provision of social order. To be sure, in the democratic Federal Republic, the prospect for dissent and social disturbance was less regime-threatening than it was during the late nineteenth and early twentieth centuries.

In essence, to make this form of capitalism work at both the economic and political levels the founders of these two models developed a conception of institutions that were both dynamic and flexible. Such a path was only possible with visionary ideas to imbue institutions with innovative, transformative policies that could also evolve over time. Theoretically, this is captured much more effectively by institutional characteristics closer to the views of Albert O. Hirschman than those of Mancur Olson. The former believed that institutions could be more flexible and dynamic with the effective use of “voice.” The latter saw institutions as impediments to individual action and often produced suboptimal outcomes at the macro level. But in a larger sense, what enabled
these institutions and ideas to achieve and then transcend the very effective incremental adaptation at the beginning of these regimes was the specific process of state formation and reformation. This larger geopolitical perspective gave the respective sets of leaders a broader tableau upon which to make their case for these institutional and ideational innovations.

Most contemporary scholars working in the varieties of capitalism and comparative historical institutional fields focus on the decline of these coordinated market economies or models. To understand the synergy of ideas, institutions, and state (re)building, this article argues that we also need to see the origins, as well as the decline of these organized capitalist regimes. It draws heavily on the major “historical institutionalist” and path dependence literature such as that of Paul Pierson and Thelen, which examine both the decline and the origins of such regimes. But, the value-added to this project is connecting this institutional analysis to the literature on ideas and to selected literature on state formation.

Latecomers such as Germany—and other continental western European nations—were forced to create a set of institutions that could accomplish economic and political development quickly because following the gradual, evolutionary path of the UK and the US would have been disastrously insufficient, and ultimately too late. While Bismarck was able to use the state as an entrepreneur, that option was not possible in the post World War II period due to the Nazis’ colossal abuse of state power. Both epochs, however, did share the use of a universal banking system and close coordination among major producer groups as significant entrepreneurial forces. They were called cartels in the nineteenth century and the more palatable Verbände in the mid twentieth. The larger
point here is that neither the universal banks nor organized German business were
decisive individually. But, together they anchored a set of economic policies that could
industrialize—and re-industrialize quickly—and make maximum use of resources, target
markets, and use capital efficiently. Not surprisingly, rapid economic transformation
based upon industrial development and largely export-led growth did not offer much
immediate benefit to ordinary Germans. Both Bismarck and the “fathers” of the Social
Market Economy, Adenauer and Erhard, realized that such social dislocation required
protective social policies.21 These leaders did not offer such policies altruistically, rather,
they were preventive policies aimed pragmatically at minimizing social tension and
political opposition while the economy grew. Bismarck’s creation of the first social
insurance schemes (while simultaneously banning the then revolutionary SPD) was one
mechanism.22 Another was the less draconian implementation of the Social Market
Economy,23 which provided the beginnings of the postwar welfare state in Germany’s
first stable democracy.

Unlike more open free-market oriented economic policy models that had few
constraints in terms of resources, markets, and capital, an organized capitalist or
coordinated market economy requires close coordination. Making this work required
people with visionary ideas to imbue these institutions (banks, firms, Verbände, works
councils, unions, parapublic service providers, etc.) with innovative and transformative
policies, providing a total that was greater than the sum of the parts.24 Institutions may
turn into inefficient Weberian bureaucracies when allowed to atrophy. But, when imbued
with a larger public purpose such as invigorating an economy when the usual market
approaches are not available or when building or rebuilding a nation state, in the right
hands and with far-reaching vision, they can be much more dynamic than conventional wisdom holds. In fact, we have the proof of the capacity of institutional transformation in the presence of Germany’s largest banks (Deutsche, Commerz, and Dresdner which in 2008 merged with Commerzbank) and firms (Siemens, Daimler-Benz, BASF, Bayer), all of which have existed for over a century amidst periods of great turmoil.

**Bismarck and the First Organized Capitalist Model**

What specifically were the institutions, ideas and state-building context that made these two epochs possible? During the latter half of the nineteenth century, first Prussia, and then a united Germany created a universal banking system—an the idea borrowed from Louis Napoleon’s *Credit Mobilier* that focused on long-term, targeted investment in the dominant industries of the “second industrial revolution” (coal, steel, chemicals, machine tools, railroads, and industrial electronics). This required large sums of money, but the newly created firms in these sectors were unable to raise the funds themselves from the primitive stock markets of the time. By virtue of loans, ownership of company stock, holding proxies for the firms’ shareholders, and having seats on the board of directors, the banks—aided by the state—played a significant role in the industrial direction of these firms. By having deep pockets and a longer term horizon, this strategy enabled firms to establish their position in world markets. The *Verbände* (cartels) were essential since members did not see themselves as competitors of one another. Rather, they viewed their principal competition as other industries abroad, hence collaboration allowed them to maximize their respective strategies. Skilled labor was also increasingly
important for most of these industries and these firms were able to build on the legacy of
the guild system that produced workers of exceptionally high skills.\textsuperscript{29} Finally, Bismarck
used the state more as an architect, rather than in an interventionist, micro-managing way.
It supervised and facilitated—but did not direct—the evolution and growth of an
organized and coordinated set of economic experiments that later was to be called a
\textit{Modell}.

What were the visionary ideas that embodied these institutions? One was the
“marriage of iron and rye” that Bismarck forged between the feudal Prussian lords
\textit{(Junker)} who needed a way to get their grain to market and the new money industrialists
who needed cargo to transport on the new rail system.\textsuperscript{30} The second was Bismarck’s
“iron fist in a velvet glove” that saw him first ban the SPD in 1878, but then initiate one of
the party’s major demands, namely the creation of a welfare system in the 1880s.\textsuperscript{31} When
the SPD was made legal again in 1890, they were a much less revolutionary party because
Bismarck’s governments had co-opted much of the party’s platform. Significantly, both
Karl Marx (1883) and Friedrich Engels (1890) had died before the SPD became legal once
again. By that time the revolutionary socialism of the movement’s founders had been
replaced by Eduard Bernstein’s “evolutionary” socialism.\textsuperscript{32}

[Table 1 Here]

This juncture of ideas and newly created institutions took place in a context of state
building that made many of these actions possible. To be sure, Bismarck had not built the
most stable foundation when Germany unified, since he had to rely on aggressive
nationalism and considerable political repression as major tools. This autocratic version
of the organized capitalist model was successful economically and politically for a time,
but it contained the seeds of its own destruction as World War I, Weimar, the Great Depression, and the Third Reich painfully show.

This model was ultimately undermined by a series of exogenous and endogenous challenges, all of which were due to the particular timing and character of the rapid growth of the German economy in the nineteenth century and the specific form that the German state took as it unified the country in 1871. Because Germany was late to industrialize, it was also late in acquiring imperial possessions. When it attempted to do so, it used aggressive nationalism to mobilize support for challenging those countries that had acquired imperial possessions in Africa, and to acquire the material resources that a rapidly growing German industry needed. World War I was the truly unfortunate result. The combination of one other exogenous event (the Russian Revolution in 1917) and endogenous phenomena comprised the ultimately fragile foundation upon which Bismarck built the Second Reich. Grafting modern industry upon a society that had never dislodged feudal institutions, a sharp division of the German Left in the wake of the Bolshevik Revolution, the lack of deep societal commitment to democracy, and dysfunctional economic policy (i.e., hyperinflation in 1923) in the wake of the Allies’ insistence of massive war reparations produced catastrophe as the institutional structures exploded within a decade.

[Table 2 Here]

But if Germany was to industrialize and unify successfully in the nineteenth century, it is hard to see another viable path. This first iteration of an organized capitalist model suggests that imposing this framework upon one’s neighbors and one’s own citizens may produce the initial goals of industrialization and state formation. But, without adapting
these ideas and institutions to subsequent conditions (both inside and outside the country), which encompass both peaceful relations with neighbors, as well as genuine political accountability and democratic representation, it is highly unlikely that such a model would be sustainable.

The Social Market Economy: The Second Organized Capitalist Model

Many observers of contemporary Germany characterized the post World War II period as *Stunde Null* (zero hour) and the 1949 founding of the Federal Republic as a sharp departure from all that had happened in Germany over the previous century. Politically, this was true in the sense that the Federal Republic of Germany (FRG) was the country’s first stable democracy. With respect to the postwar economy, one scholar suggests that the reason for the rapid growth in the mid 1950s was a legacy of the Nazi period. Yet, for those who looked closely at the foundational elements of the political economy of the FRG, there was an unmistakable, deeper continuity with the late nineteenth century. The Allies’ original plan for Germany after the war as proposed by U.S. Secretary of the Treasury Henry Morgenthau was to deindustrialize Germany and emphasize agriculture. The Cold War and imperatives to restore a functioning German economy, however, trumped such fanciful concerns. Thus, both public and private-sector actors chose familiar patterns of industrial organization to rebuild the country since a trial-and-error free market model once again was off the table. Not only did Germans have no experience with large-scale laissez-faire economic practice, but the imperative to rebuild the German economy quickly with the onset of the Cold War took precedence. Since
speed of industrial development was paramount, German banks and large German firms adopted familiar organized patterns. Universal banking, with its deep ties to larger German firms was re-established quickly, providing a stable and profitable link between finance and manufacturing.

[Table 3 Here]

Nevertheless, since this form of organized capitalism was now implemented under democratic auspices, other institutions re-emerged to act as a check on arbitrary power by the financial and manufacturing community. German unions, for instance, expanded the concept of the earlier Betriebsräte (works councils) to establish a democratic corporatism in which labor played a much more prominent role than it did under Bismarck. The trade unions and their allies in both the SPD and the CDU/CSU agreed to Mitbestimmung (codetermination) which gave trade unions membership rights on the boards of all large German companies.35 This second organized capitalist model in Germany also saw a unique form of framework regulation (Rahmenbedingungen) that acted not like American-style regulation, which tries to belatedly address specific market failures like a fire brigade. Rather, Rahmenbedingungen regulated the general rules of the game, more like an architect.36 Significant examples of this included encouraging banks to maintain high capital adequacy reserves and vetting all of those who held responsible positions in the financial sector. These framing regulations proved crucial for the health of the economy since, once again, Germany was creating an “all eggs in one basket” set of institutions in which finance and manufacturing were deeply intertwined and were mutually dependent for their—and the country’s—economic success.
The visionary ideas that animated this second iteration of a coordinated model came from a group of economists who were collectively known as the Freiburg School.\textsuperscript{37} Acknowledging that a laissez-faire policy would not work in a country with no history of it, and that the use of the state as an entrepreneur had been compromised fatally by the Third Reich, the Freiburg School economists developed a theory that refused to frame economic policy as a stark choice between state and market—a view that was most succinctly articulated by Wilhelm Röpke during the early years of the Social Market Economy:

\textit{…(our program) consists of measures and institutions which impart to competition the framework, rules, and machinery of impartial supervision which a competitive system needs as much as any game or match if it is not to degenerate into a vulgar brawl. A genuine, equitable, and smoothly functioning competitive system can not in fact survive without a judicious moral and legal framework and without regular supervision of the conditions under which competition can take place pursuant to real efficiency principles. This presupposes mature economic discernment on the part of all responsible bodies and individuals and a strong impartial state…} \textsuperscript{38}

The second visionary idea that emerged as a guiding principle of the Social Market Economy was the conception of innovation. In liberal market economies that celebrate the role of the individual, innovation is generally characterized by lone individuals or small firms discovering new products. In coordinated market economies without this laissez-faire tradition, by contrast, innovation came to be defined in very different ways. Rather than inventing new products, the large German firms would adapt inventions developed elsewhere and then integrate them into the production process and improve existing products.\textsuperscript{39} Perhaps that most obvious manifestation of this pattern is the long-running television
commercials (shown in the U.S) of the German chemical firm BASF that conclude:
“We don’t make (product x); we make (product x) better.”

These renewed institutions and context-specific ideas took place at a time when Germany could not function as a “normal” nation state and when many questioned its ability to “behave” as a democratic polity. The country’s ability to renew these nineteenth century economic institutions, but frame them in a way that enhanced rather than retarded political democracy, enabled Germany to emerge over succeeding decades as the economic, and eventually, the political lynchpin of Europe. To put this more directly, Germany’s “economic giant, political dwarf” period in the early years of the postwar period, allowed it to rebuild a state that would be anchored solidly in a democratic Western Europe yet not project the centralized power that its neighbors feared for much of the previous half-century. By building a semi-sovereign federal state that diffused strong central power but still produced economic growth and political accountability, state reformation provided an overarching context for the specific mix of ideas and institutions that produced the second variation of a German CME.40

The erosion of this second model of Germany’s organized capitalist economy did not go the way of the first, with a “bang,” rather, it eroded more with a “whimper.” Ideas and institutions that were once congruent to specific purposes and needs do not always maintain their efficacy as Thelen has powerfully argued in several of her works. In some cases, they contained the seeds of their own destruction, and, in their failure to adapt to changing conditions, can precipitate catastrophe as was the case with the first model. In other cases, such as the time of German unification in the early 1990s, they erode slowly and almost imperceptibly. Without a conscious effort by the actors that inhabit these
institutions to find organizational and ideational renewal, a once coherent policy model can erode.

To be sure, at the beginning of the 1990s, Germany faced three exogenous shocks that contributed to the erosion of the efficacy of this second iteration of organized capitalism. The combination of accelerated globalization, the expansion of the EU with its neoliberal directives that whittled away the nationally specific German coordinated market institutions, and finally (and most importantly), the stresses of unification constituted powerful forces challenging this model. There also were endogenous forces at work. First, this particular model thrived in both epochs as one that was created to “catch up” with economic powers that were more advanced. Yet, by the 1980s, Germany was seen as rivaling Japan as the two leading candidates to displace the U.S. as the leading capitalist country. This did not come to pass, of course, but it raises the larger issue of whether this model is suitable once it “catches up.” Part of the problem here is that while non-Germans could see and articulate how this model worked, Germans themselves were remarkably reticent about touting it as an explicit model. They were also complacent about assuming that their Social Market Economy would keep working, even though the Freiburg School economists whose ideas animated the model long had expired. This ambivalence prevented them from understanding how much a threat the neoliberalism of the Anglo-Americans in the 1980s, and later the EU itself were a threat to Germany’s nationally specific economic and political institutions. In a sense, the Kohl government lost its “institutional memory” regarding the functioning of the Social Market Economy with respect to the challenges of unification. Specifically, in the policy areas of property, currency, and state-market relations—pressing issues in the late 1940s and in
the early 1990s—the Kohl government’s policy ignored the Adenauer/ Erhard
governments’ policies on these issues. In the 1990s and 2000s, much of the architecture
of the German model, while still physically present, had lost much of its original
functionality due to the above stresses (as well as unification), and, more importantly, the
ideas that once animated it.

Economic policy models can erode in different ways: dramatically and
catastrophically, such as at the end of the first model, but they also slowly and quietly
such as the end of the second model. What is similar in both forms of erosion is that the
institutions that once were their foundation and the ideas that once animated them were
no longer capable of responding to newer challenges. The larger lesson to take from the
rise and decline of these coordinated market models is that they are intrinsically neither
superior nor deficient to liberal market ones. Rather, their success or failure depends on
the capacity of actors within these coordinated market models to use well-articulated and
appropriate ideas in order to imbue the institutions with the dynamism and flexibility to
respond to ever changing challenges.

Towards a Third Organized Capitalist Model?

One of the virtues of writing an article that attempts to extrapolate from the past to the
future is that it is very difficult to know what the outcome will be, thus leaving the writer
somewhat “off the hook.” Nevertheless, if using frameworks that embrace historical
institutionalism and path dependence (two schools of thought upon which the larger
project of which this article is drawn) are to be useful, there should be some reasonable
expectation of a payoff. This conclusion offers three scenarios that assess the likelihood (or not) of Germany and the EU developing a policy model that bears some resemblance to the first two models articulated above.

1. Neoliberalism Renewed

The first scenario would hold that, for all of the financial crisis and attendant economic dislocation, the neoliberal agenda, particularly as instituted by the EU and apparently embraced by most European social democratic parties, has simply progressed too far. This scenario would argue further that the age of national models has passed and that globalization is too powerful a force to allow for the social protections that the older models embodied. Together with the hypermobility of capital and labor, the erosion of the core organized capitalist institutions, “hard” laissez-faire policies, and the European Union’s role in eroding national sovereignty through its dominance of monetary and fiscal policy, it is easy to make the case that the easy “exit” from these institutions has destroyed the capacity for use of the “voice” necessary to rebuild them.

Among the key indicators for the resilience of neoliberalism would be:

- Continued hypermobility of capital and labor
- Minimal effective re-regulation of market activity
- Increased liberalization of the EU and continued loss of national sovereignty
- Erosion of core CME labor market and social protection institutions
- Continued push for laissez faire economic policies
- Policies encouraging “exit” from organizations and lack of “voice” as institutional renewal mechanism
- Fundamental challenge to comparative historical institutionalism and adaptive institutions

Specifically, in Germany and Europe we would see the re-emergence of pre-crisis patterns in terms of corporate behavior (such as a continued emulation of Anglo-American business practices) and ineffective attempts to reintroduce government
regulation of business, especially the financial sector. Theoretically, this would represent a sharp challenge to comparative historical institutionalism and its foundational core insight of adaptive institutions. But, the great unknown in the wake of the international financial crisis and serious recession that began in 2008 is whether the power of neoliberal forces within the EU and among many of the national governments of Europe is as durable as it was before the crisis.

2. Hybrid Patterns

The second scenario would see no dominant model emerge. Even now within Germany, one can see evidence of this trend. While the large German banks have “gone global” (to the recent consternation of some of them), many of the smaller regional and local banks still maintain a Hausbank relationship with firms in their local regions. This second scenario would see a number of unfocused experiments with no coherent policy. In other words, there would be regional and sectoral examples of both organized and laissez-faire economic policy models with neither becoming hegemonic in Europe. Indicators of this scenario would include:

- No dominant hegemonic model
- Unfocused experimentation with incoherent policy
- Regional, sectoral examples of organized and laissez faire policies
- Implication that path dependence and comparative historical institutionalism not generalizable beyond a few favorable cases

The context that would indicate that this outcome was occurring would be patterns of experimentation in different CME countries and regions in Germany and Europe. These outcomes would likely be driven by such variables as the kinds of sectors and industries in particular regions, the types of governments in specific areas, and the inability of
private and public-sector policy makers to impose (or generate) either a dominant LME or CME pattern of governance of the political economy. A spirit of pragmatism rather than ideological hegemony would shape the dominant discourse.

3. Towards a Third (European) CME

Finally there could be a third scenario that would produce an organized capitalist model reminiscent in the spirit—but not the letter—of the first two models. Until the financial crisis exploded in mid 2008, this was the least likely of the three scenarios. But, looking back, the conditions under which these two earlier organized models tended to thrive in the late nineteenth and mid twentieth centuries were when markets either were not available or had failed. We are now, once again, in one of these moments. When the essential features and core assumptions of liberal market economies (unfettered access to resources, markets and capital) are no longer easily attained, then neoliberalism looks far less hegemonic, or even attractive as an economic policy model. The very act of proposing this third scenario argues that Germany—and the EU—may represent a potentially critical case of third-generation CME ideas, institutions and state reformation.

Among the indicators that might suggest such a scenario was developing would be:

- Continued uncertainty about access to resources, markets and capital
- Serious discussion about the purpose of capitalism—financial innovation or production of needed goods and services?
- Human capital formation—long-term investment and productivity growth
- Social welfare to soften harsh economic dislocation
- From single market to a democratic polity—democratic deficit overcome by empowered EU citizens
- Only successful with twenty-first-century set of ideas to transform European political institutions towards a polity

Among the questions that have not been asked during the neoliberal ascendancy of the last two decades, are existential ones about the purpose of capitalism itself. Is capitalism
concerned only with financial innovation for its own sake with little concern for the production of needed goods and services in the “real economy”? Is long-term oriented investment necessary for larger projects with slower expectations of profitability no longer important? Is human capital formation—essential for productivity growth—no longer seen as a collective good for all firms or is it proprietary only for those firms that can afford it at the moment? Is a functioning social welfare state that can soften the blow for those who are displaced by this economic transformation no longer necessary?

If these are important goals for modern twenty-first-century developed economies, then adapting the spirit of earlier organized models might be of much greater use than continuing to press for a neoliberalism that has shown some extremely serious shortcomings at the end of the first decade of the century and apparently offers no better options for the near future. But, there is one large problem that a third generation of organized capitalist “model builders” must face: the age of national models in Europe is over. Any such construction would have to confront the redoubtable architecture of the EU, i.e., state (re)building. In the late 1980s “Europhoria” days, many Europeans believed that they could embrace the advantages of Europeanization without any serious consequences. Yet, when increasingly neoliberal treaties and directives were adopted and individual nation states saw their sovereignty eroded in the form of reduced control over fiscal policy (the 3 percent mandate regarding deficit spending) and monetary policy (for those sixteen countries that have joined the Eurozone), political power had essentially been transferred to Brussels without the possibility of return.45 This transfer was not literal of course, but the decreasing domestic control over fiscal and monetary policy meant that EU policies in these areas often pre-empted domestic ones. If these policies are
to be changed and a coordinated market economy is to replace it, Europeans would need
to tackle the lack of political accountability that the EU has not yet addressed—namely a
democratic polity and not just a market. By early 2010, political tensions in Greece,
Spain and Portugal over deficit spending to maintain social benefits produced the first
serious questions concerning the long term role of the euro among countries with very
diverse fiscal policies This third scenario is clearly a long-term project, but if Europe
wishes to avoid economic catastrophe and create a stable political environment, then
there are clearly options that offer more promise than the neoliberalism that no longer
seems to be a panacea for developed democracies.

Table 1: Rise of the Bismarckian Era

<table>
<thead>
<tr>
<th>Institutional Innovation &amp; Rapid Industrialization</th>
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<tbody>
<tr>
<td>– Banks and long-term, targeted investment</td>
</tr>
<tr>
<td>– Verbände—heart of organized capitalism</td>
</tr>
<tr>
<td>– Modernized guild system—skills foundation</td>
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<tr>
<td>– State as framing architect not “model builder”</td>
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</tbody>
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<tr>
<th>Visionary Ideas</th>
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</thead>
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<tr>
<td>– Marriage of iron and rye</td>
</tr>
<tr>
<td>– “Iron fist in velvet glove” (banning SPD and creating beginnings of first welfare state)</td>
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</tbody>
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<th>State Formation via Nationalism and Political Repression</th>
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Table 2: Decline of the Bismarckian Era

<table>
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<tr>
<th>Exogenous Challenges</th>
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<tr>
<td>– Late imperialism</td>
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<td>– Russian Revolution</td>
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<table>
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<tr>
<th>Endogenous Challenges</th>
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</table>
- World War I
- Unstable industry-agriculture coalition
- Division of the Left
- Too few believed in democracy
- Dysfunctional economic ideas

**Institutional Collapse and National Socialist Ideas**

### Table 3: Rise of the Social Market Economy

#### Institutional Innovation
- Bank-firm links and long-view investing
- Rahmenbedingungen regulatory framework
- Democratic corporatism: Mitbestimmung and Betriebsräte
- Personalized proportional representation electoral system

#### Visionary Ideas
- Freiburg School Ordoliberalismus—between market and state
- Incremental adaptation via high skills

**State Re-formation with Mixed Economy and Stable Parliamentary Democracy**

### Table 4: Decline of the Social Market Economy

#### Exogenous Factors
- Globalization
- European Union
- Unification

#### Endogenous Factors
- What happens when a “late” model catches up?
- “Siren song” of deregulation
- Loss of institutional memory
Institutional Atrophy and “keine Ahnung”

Notes

1 I would like to thank Jeffrey Anderson and Carolyn Forestiere for comments on an earlier version that appeared as a working paper at Johns Hopkins American Institute for Contemporary German Studies in December 2008; available at http://www.aicgs.org/documents/advisor/callen1208.pdf. Additional versions were presented at: “The Bonn/Berlin Republic at 20: From Unification to Unity?,” a symposium organized by the editors of German Politics and Society at Georgetown University, 7-8 May 2009, for which I would like to thank Richard Deeg, Anke Hassel, Konrad Jarausch, Eric Langenbacher, and Stephen Silvia; the 35th Annual Conference of the International Association of the Study of German Politics, Aston University, Birmingham, UK, 26-27 May 2009, for which I would like to thank Dan Hough, Wade Jacoby, Philipp Klages, Stephen Padgett, and Peter Pulzer; and the 21st Annual Meeting of the Society for the Advancement of Socio-Economics (SASE), Sciences Po, Paris, France, 16-18 July 2009. Thanks also to Leah Langford, my research assistant during the Fall 2009 semester. Finally, special thanks go to Wolfgang Streeck and Martin Höpner for their support of my research in 2008 and 2009 as a Visiting Research Affiliate at the Max Planck Institute for the Study of Societies in Cologne. This paper is part of a larger book manuscript in process; for a more extensive working paper on this theme, please consult my website (http://csallen.myweb.uga.edu) or contact me at csallen@uga.edu. Comments are welcome.


8 Stephen J Silvia, “From Unification to Fragmentation: The German Economy since Unification,” in this issue.


14 Gregory Jackson, “The Origins of Nonliberal Corporate Governance in Germany and Japan in Comparison,” in Streeck and Yamamura (see note 13), 121-170.


17 Pepper D. Culpepper, Creating Cooperation: How States Develop Human Capital in Europe (Ithaca, 2003); Geoff Eley, Society, Culture, and the State in Germany, 1870-1930 (Ann Arbor, 1996); Peter B. Evans, Dietrich Rueschemeyer and Theda Skocpol, Bringing the State Back In (Cambridge, 1985); Isabela Mares, The Politics of Social Risk: Business and Welfare State Development (Cambridge, 2003); Charles Tilly, The Formation of National States in Western Europe (Princeton, 1975); Daniel Ziblatt,
Structuring the State: The Formation of Italy and Germany and the Puzzle of Federalism (Princeton, 2006).

18 Alexander Gerschenkron, Bread and Democracy in Germany (Ithaca, 1989).


22 Philip Manow, Social Insurance and the German Political Economy (Cologne, 1997).


38 Wilhelm Röpke, “The Guiding Principles of the Liberal Programme,” in Wünche (see note 23), 188.


42 German unification here is initially viewed as an exogenous shock, but it has now become endogenous. The European Union is viewed principally as an exogenous shock, even though Germany’s role as a founding member of the organization suggests and endogenous role. The point here is that the neoliberal ethos of the EU’s economic policy was very much at variance with that of Germany’s organized capitalism.
43 In a series of interviews on an earlier project in 1990-91 with economic elites from the former *Sprecher* of the Deutsche Bank (F. Wilhelm Christians) to economists with the German Greens, virtually all of them believed that the German CME would be able to withstand the new challenges of neoliberalism. To a person, a common theme emerged, namely that they expected German institutions to behave as they had for much of the previous decades. But, none of them offered specific reasons for how and why this would take place.
