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Neo-Liberalism, the Changing German Labor Market, and Income Distribution: An Institutionalist and Post Keynesian Analysis

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Abstract: This inquiry relies on an Institutionalist and Post Keynesian analysis to explore Germany's neo-liberal project, noting cumulative effects emerging as measurable economic and societal outcomes. Investments in technologies generate rising output-to-capital ratios. Increasing exports offset the Domar problem, but give rise to capital surpluses. National income redistributes in favor of capital. Novel labor market institutions emerge. Following Minsky, good times lead to bad: as seeming successes of neo-liberal policies are accompanied by financial instability, growing disparities in household incomes, and sharp declines in German exports on world markets, resulting in one of the deepest, recent contractions in the industrialized world.

Keywords: Domar problem, financial instability, Germany, Institutionalist theory, Neo-liberalism

JEL Classification Codes: B52, B59, E65

This inquiry seeks to convince the reader that neo-liberal policies introduced and implemented in Germany in recent decades generate a host of direct as well as cumulative effects, observable and measurable as economic and societal outcomes. Direct and cumulative effects of neo-liberal policies would include changes in capital and labor's shares of national income, the emergence of novel labor market institutions, growing income disparities, rising incidences of poverty, financial instability, and a recent, severe contraction in output. This inquiry employs an Institutionalist and Post Keynesian analysis in an effort to explain a nexus — a concatenation in the Veblenian sense — between and among an array of related and

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connected variables. To aid and abet this exploration of Germany's neo-liberal project, along with its attendant and measurable economic and societal outcomes, this inquiry also relies upon a comparative approach, juxtaposing the previous era characterized as Social-Market-Economy with the current era of Neo-Liberalism.[1]

On Method

Author J. E. King (2002, 227) notes fruitful syntheses derived from combining the Institutionalist method advanced by Thorstein Veblen and his disciples with the tradition of John Maynard Keynes and some of his "Fundamentalist Keynesian" followers. Veblen sought to advance economic method by introducing evolutionary thinking. Borrowing from philosopher Charles Peirce, his professor at Johns Hopkins in the early 1880s (Griffen 1998), Veblen sought to establish linkages between and among variables, what he describes as *cumulative causation* (Hall and Whybrow 2009), and what this inquiry considers as *cumulative effects*. Veblen likewise focuses on advances in the instrumental — what could be considered technology — and then the ceremonial responses that include the emergence of institutions for integrating instrumental advances into society.

Keynes devoted considerable attention toward clarifying dynamics found in the world of finance. However, his contributions noting the ascendancy of financial capital in the postwar era were cut short by his relatively early death in 1946 at the age of 63. Building on the Keynesian tradition, Hyman Minsky advances an understanding of financial instability, of what is endogenously generated and integral to business cycles. This inquiry undertakes an analysis based upon Veblen's contribution toward institutional thinking combined with Minsky's contribution toward post Keynesian theory: for deconstructing and explaining a host of machinations spinning out as direct as well as cumulative effects from Germany's neo-liberal project — as observable and measurable economic and societal outcomes.

From Social Market Economy to Neo-Liberalism

Die soziale-Marktwirtschaft emerged in West Germany as a coherent set of policies. Though, similar programs could be found in other countries, such as Denmark and Sweden, where social democratic parties also wielded high levels of influence in the early postwar era. West Germany moved toward a comprehensive reform program: promoted in an effort to correct for many of the excesses that were attendant to the National-Socialist program ending abruptly in the late Spring of 1945. Shortly before the war's end, Wilhelm Röpke ([1944] 1982, 188) advocated a reformist approach, something he thought different than the ". . . moth eaten flag of capitalism." As the postwar era progressed, West Germany's experiment with this fledging economic and social system became more clearly defined. So smitten was Alfred Müller-Armack ([1960] 1982, 49-50) that he purported a belief that ". . . problems of income and property . . . [could] in principle be resolved under social market economy." As Egon Tuchtfeldt ([1973] 1982, 68) advocates, Germany's social-market-economy could be extended further and integrated with Keynesian traditions in demand-management.

In addition, labor organized into unions played a powerful role in promoting this social-democratic experiment. Integral to a corporatist model, unions in the early postwar era bargained, not just for higher wages for their members, but for higher wages and improved working conditions for wageworkers and salaried employees, generally. Going beyond wages, benefits, and working conditions, West Germany's postwar unions organized and lobbied aggressively, promoting comprehensive social policies benefiting broad sectors of society, including the youth and elderly outside of the labor market. Several unions were organized together under one umbrella organization. Of the 9.3 million union members in Germany in 1981, almost eight million were joined (Schnabel, 1989, 135) under the *Deutscher Gerwerkschaftsbund (DGB)*, or German Federation of Unions. The *DGB* membership reached its zenith in West Germany in 1981 (see Table 1). With the start of the 1981-82 world recession, union membership entered into what Schnabel and Wagner (2006) note as a persistent decline that also coincided with the start of a long-reigning conservative government.[2] Policies of the Kohl government sought to advance capital's interests vis-à-vis labor's losses, and to undo societal gains won under social-market-economy (Fitzenberger, Kohn and Wang 2006).[3] In a systematic manner, the Kohl government replaced what had been labor and society friendly policies under the era of social-market-economy with a neo-liberal program. Policies aggressively advanced interests of owners of capital, generating cumulative effects that over time include increases in capital's share of national income, growing income inequality facing the German population, rising incidence of poverty, financial instability, and a severe economic contraction.

Because Germany's social-market-economy never achieved the status of a government program supported by legal statutes, we can trace neither its official start nor its end. Social-market-economy implies a normative relationship between society and markets. Societal outcomes are deemed important, and market forces serve as one way to achieve these.[4]

In several respects, the social-market-economy contrasts sharply with its recent challenger and system nemesis, what has been loosely termed as "market fundamentalism," or a "free-market economy," and what is publicly promoted as *neo-liberalism*. Under a neo-liberal program market forces rule and members of society adjust as best they can. In short, a neo-liberal program is characteristically supported by policies that promote interests of owners of capital, what characteristically involves weakening labor's bargaining position relative to capital.

With the competition between East Germany's system of planned economy and the West German capitalist economy ended, and with victory of the Cold War fully secured, the conservative, Kohl government pressed ahead, privatizing what had been East Germany's productive assets through the agency chartered in March of 1989 as the *Treuhandanstalt*. Wages jolted up by German Monetary Union combined with the Treuhand's rapid privatization program contributed to mass unemployment at the start, initiating relatively higher levels of unemployment for this eastern region that have persisted over two decades (Hall and Ludwig 2007; 2008). Rates of eastern unemployment have failed to fall below 15% of the civilian labor force since 1992,

Table 1. *DGB* Membership in Germany

Year	German Federation of Unions (*DGB*)
1950	5,449,990
1955	6,104,872
1960	6,378,820
1965	6,474,491
1970	6,712,547
1975	7,364,912
1980	7,882,527
1981	7,957,512
1982	7,849,003
1983	7,745,913
1984	7,660,346
1985	7,719,468
1986	7,764,697
1990	7,937,923
1991	11,800,412
1992	11,015,612
1993	10,290,152
1995	9,345,670
2000	7,772,795
2005	6,778,429
2008	6,371,475

Sources: Schnabel 1989, Table 1, 135, and www.dgb.de/Mitgleiderzahlen.

Table 2. Unemployment Rates for Germany and Its Two Main Regions (Unemployed as a Percent of Labor Forces* for Selected Years)

Year	National Averages	Western Region	Eastern Region
1989		7.9	n/a
1990**		7.2	n/a
1991	7.3	6.2	10.2
1992	8.5	6.4	14.4
1993	9.8	8.0	15.4
1994	10.6	9.0	15.7
1995	10.4	9.1	14.8
1996	11.5	9.9	16.6
1997	12.7	10.8	19.1
1998	12.3	10.3	19.2
1999	11.7	9.6	18.7
2000	10.7	8.4	18.5
2001	10.3	8.0	18.8
2002	10.8	8.5	19.2
2003	11.6	9.3	20.1
2004	11.7	9.4	20.1
2005	13.0	11.0	20.6
2006	12.0	10.2	19.2

*Rate of unemployment defined as share of registered unemployed relative to total number in civilian labor force

** In October of 1990 what was the German Democratic Republic from 1949 through 1989 was integrated into the nation of the Federal Republic of Germany.

Source: Bundesagentur für Arbeit: *Arbeitsmarkt in Zahlen*, Nürnberg, January, 2007 and have registered as high as 20% of the labor force in recent years, creating a favorable environment for keeping wages down (in a country with no legal minimum wage), and also introducing work-rules throughout Germany that serve to undermine labor's gains during the era of social-market-economy (see Table 2).

Kalina and Weinkopf (2008, 2) document the rise of *Niedriglohnbeschäftigungen*, that is, an expanding, low wage segment of Germany's labor force that should be seen as emblematic of labor's declining position relative to capital, a development also contributing toward rising income inequality and rising incidence of poverty. Their study suggests that by 2008, 22.2% of western workers earned hourly wages of €9.61 and less. They further estimate that 22.1% of eastern workers earned wages of €6.81 per hour and less. This segment earning comparatively low wages has increased in recent years, giving rise to a growing category of full-time workers in households falling below a standard poverty threshold of less than 60% of median household incomes.

At the aggregate level labor's losses are evinced as declining shares of national income compared with capital's gains, especially evident since 2003 (see Table 3). Capital's gains relative to labor could register as some kind of a neo-liberal victory for capital — at least in the shorter-run. *Pyrrhic victory* rings clearer when describing the longer-run. To wit, with its growing share of national income capital sought out financial instruments, with a portion of these instruments carrying under-assessed levels of risk, thereby contributing toward financial fragility, instability, and cumulatively toward sharp declines in output in 2009.

Drive to Raise Productivity

A sizeable portion of Germany's engineers is credentialed in the field of mechanical engineering, what is termed *Maschinenbau*. These engineers play a key role in steering massive annual investments into production technologies calculated to raise output per worker-hour in the interests of those owners striving for pecuniary gain through increasing shareholder value for their business enterprises. Investment designed to foster steady increases in productivity raises output per worker-hour in the first instance. However, two additional effects need to be considered.

From one perspective, investment in technologies designed to foster increases in productivity per worker-hour could lead toward job creation and net increases in employment. The other effect renders labor redundant, leading to job loss and possibly to net losses in employment. Of advanced capitalist economies of size, Germany also exhibits the largest percentage of its workforce in manufacturing, with a substantial portion of the workforce affected by this dynamic related to investment in technology and the striving (*das Streben*) to increase incessantly the value of output per worker-hour in manufacturing.

With this dynamic in mind — and in the Veblenian sense — advances in the instrumental related to the introduction of techniques designed to raise productivity register as the key variable driving change throughout Germany's economy. These instrumental advances generate cumulative effects also appearing as societal

Table 3. Labor and Capital Shares of National Income for the Federal Republic of Germany

Year	Total	Wages and Salaries	Profits, Interest and Rents
1991	100.0	71.0	29.0
1992	100.0	72.2	27.8
1993	100.0	72.9	27.1
1994	100.0	71.7	28.3
1995	100.0	71.4	28.6
1996	100.0	71.0	29.0
1997	100.0	70.3	29.7
1998	100.0	70.4	29.6
1999	100.0	71.2	28.8
2000	100.0	72.2	27.8
2001	100.0	71.8	28.2
2002	100.0	71.6	28.4
2003	100.0	70.8	29.2
2004	100.0	68.0	32.0
2005	100.0	66.6	33.4
2006	100.0	65.1	34.9
2007	100.0	64.8	35.2

Source: Author's calculations based on data from the Federal Statistical Office, Wiesbaden.

responses, including a tendency for declining union membership, an attendant erosion of union power, and a related failure for labor to hold on to its share of income relative to capital. We also find the emergence of novel labor market institutions: with implications for increasing percentages of the working poor, and a related skewing of income distribution.

The Domar Problem and Germany's Export Response

Shortly after World War II, Evsey Domar (1946; 1947; 1948) defined what he noted and addressed as an endogenously generated tendency emerging in the U.S. economy, contributing to unused production capacity as well as the unemployment of labor. Research by Vatter and Walker (1983; 1989; 1997), as well as Wray (2008), refer to the *Domar problem* arising as investment and the implementing of innovations prove capital-saving, observable as output-to-capital ratios increase over time. The Domar problem emerges as supply effects of net investment consistently increase faster than levels of demand necessary for purchasing said supply. As Wray (2008, 155) succinctly notes: ". . . investments leading to productivity increases result in increases in supply that cannot be purchased by future increases in investment." The Domar problem confronts the German economy and is evinced by a tendency for increasing output-to-capital ratios over time, especially observable from 1991 through 2005 (see Table 4).

During the early postwar era, commitments toward a comprehensive welfare state embodied in principles of social-market-economy effectively relied upon growth in public expenditures. Federal, state and local spending provided sufficient levels of growing demand that served to offset the Domar problem from emerging related to

Table 4. Output-to-Capital Ratios for the German Economy In Billions of Euros (Current) (Years 1991 through 2008)

					Output to Capital Ratios		
Year	Total Investment	Depreciation	Net Investment	GDP	Gross	less Real-Estate	Net
1991	356.75	214.43	142.30	1,534.60	4.30	5.85	10.78
1992	387.81	234.47	153.34	1,646.62	4.25	5.94	10.73
1993	381.19	250.09	131.10	1,694.37	4.44	6.51	12.92
1994	401.83	260.77	141.06	1,780.78	4.43	6.76	12.62
1995	404.95	270.48	134.47	1,848.45	4.56	7.03	13.75
1996	399.85	276.10	123.75	1,876.18	4.69	7.27	15.16
1997	402.37	283.16	119.21	1,915.58	4.76	7.36	16.07
1998	414.50	298.22	124.28	1,965.38	4.74	7.22	15.81
1999	428.42	297.05	131.37	2,012.00	4.70	7.08	15.32
2000	442.43	308.48	133.95	2,062.50	4.00	6.84	15.40
2001	422.88	316.41	106.47	2,113.16	5.00	7.27	19.85
2002	392.97	321.88	71.09	2,143.18	5.45	7.98	30.15
2003	386.72	323.03	63.69	2,163.80	5.60	8.21	33.97
2004	387.02	328.25	58.77	2,210.90	5.71	8.31	37.65
2005	390.89	335.86	55.03	2,243.20	5.74	8.20	40.76
2006	423.09	343.13	79.96	2,231.50	5.49	7.84	29.03
2007	453.50	358.75	94.75	2,422.90	5.34	7.62	25.57
2008	478.67	363.12	115.55	2,492.00	5.21	7.37	21.57

Sources: Author's calculations based upon data from Germany's Federal Statistical Office in Wiesbaden.

some of the cumulative effects of net investment. This early postwar era characterized by growing public sector demand gave rise to the notable levels of output growth of the 1950s and 60s, dubbed as the years of Germany's *Wirtschaftswunder*. However, as growth in public sector spending became challenged by neo-liberal thinking, and practically constrained by neo-liberal policies introduced over the 1980s and 90s, Germany's exports have and continue to be relied upon to absorb production capacity, generate employment, and find markets for supply increases created by net private investment.

Starting in 1996 and running until the downturn in the last quarter of 2008, a secular tendency for shrinking domestic spending has been offset as exports have carried GDP growth, by and large (see Table 5). When the world economy faced a financial crisis in 2007-2008, Germany's economy paid a price for having countered the Domar problem by increasing export dependence. That is, export-led growth left the German economy vulnerable to a downturn in international demand for its reputable investment goods and high-end consumer products, generating a severe contraction in GDP for 2009.

Efforts to counter the Domar problem with export-led growth in manufactures requires steady changes that raise labor productivity as well as product performance in the eyes of the investor and discerning consumer. In addition to selling exports in the *Eurozone*, Germany also competes in world markets with a strong — if not-over valued — currency, and in categories like chemicals and pharmaceuticals, as well as in steel, alloys, and related downstream products that include machinery and motor vehicles. Incremental improvement required in order to render German products competitive in world markets promotes flexibility in applying labor to work tasks. As Bellmann and Kühl (2008) establish, *contract labor* taking two distinct forms has emerged and also increased dramatically in recent years, and as a way to avert union control over production and thereby increase labor's flexibility in the workplace. However, contract labor generates effects on income distribution. Wages for contract labor tend to be lower than under traditional wage agreements, as those companies allocating-out contract labor are wont to skim off the crème from labor's product, causing wages in this segment of the labor-market to remain lower than under traditional wage arrangements.

Effects of Labor's Decline

Labor market institutions emerge and evolve as German industries invest into technologies that advance labor productivity. *Leiharbeit* and *Befristungen* have emerged as two forms of contract labor.[5] Concomitant to the rise in contract labor, a shrinking of labor's share of national income relative to capital's gains contributes toward substantial increases in profits, benefiting many German firms in recent years. Capital's gains measure successes of neo-liberal policies designed to promote losses in labor's share of productivity gains relative to gains for owners of capital. An array of forces in the labor market — also backed by labor market reforms stemming from the September 2003 legislation that established the foundation for Agenda 2010 and the

Table 5. Germany's National Economic Growth, Merchandise Export Growth, and Evidence of Export Led Growth for Selected Years (Presented as Annual Growth Rates Calculated from Constant Euros, and for Selected Years)

Year	Growth Rate of GDP	Growth Rate of Merchandise Exports	Evidence of Export Led Growth*
1992	2.2	-0.8	-0.2
1993	-0.8	-4.9	-1.2
1994	2.7	8.0	1.8
1995	1.9	6.3	1.5
1996	1.0	6.0	1.4
1997	1.8	11.7	2.9
1998	2.0	8.0	2.2
1999	2.0	5.9	1.7
2001	1.2	6.4	2.1
2002	0.0	4.3	1.5
2003	-0.2	2.5	0.9
2004	1.2	10.3	3.7
2005	0.8	7.7	3.0
2006	3.2	13.0	5.3
2007	2.5	7.5	3.4
2008	1.3	2.9	1.4
2009	-5.0	-14.7	-7.0
2010**	1.8	7.7	3.2

* Noted as "Contributions to Percentage Change in Real GDP"
**Estimates for 2010
Sources: Federal Statistical Office: *Volkswirtschaftliche Gesamtrechnungen*, FS 18, Row 11, Table No. 3.2; Author's calculations.

Harz-Kommission — serve to constrain wage growth and frustrate labor's efforts along several fronts. Consequently, labor registers as the loser: certainly from the point of view of failing to claim productivity gains and historic shares of national income characteristic of the era of social-market-economy. Owners of capital emerge as the neo-liberal winners. However, capital's good times have led to bad, as over a protracted period of prosperity, German investment firms shifted toward holding wealth in financial instruments that contributed toward increasing financial instability.

This is what Hyman Minsky (1972, 7-8) suggests as a general tendency that he articulated as the first and second theorems of his financial instability hypothesis. In short, capital's good times were evinced by growing profits, and increasing shares of national income related to massive earnings derived from offsetting the Domar problem with increased exports. However, these neo-liberal "good times" laid foundations for crisis ridden "bad times" associated with the emergence of a financial system characterized by growing segments engaged in speculative and even Ponzi finance.

Minsky (1972, 3) teaches us that Keynes viewed modern finance as characterized by a "veil of money": as owners of wealth hold claims on money but not real assets. German firms were driven to export to avoid stagnation in domestic spending. Through this export drive, combined with effects of 30 years of neo-liberal policies in the United States that contributed toward massive capital deficits, Germany's financial institutions became suppliers of capital by purchasing U.S. issued private and public debts. A portion of this debt was sold as dubious financial instruments — such as mortgage-backed securities — contributing toward the U.S. housing bubble. As the good times rolled, German financial institutions came to hold more and more dubious financial instruments increasingly characterized by levels of under-assessed risk.

In this manner, capital's neo-liberal victory proves *Pyrrhic* for German business and for capital over the longer-run, as apparent successes should also be associated with international capital imbalances and other economic distortions inextricably related to export surpluses. What is more, the selling by U.S. based financial institutions of dubious financial instruments to German financial institutions, as well as to financial institutions in some other capital surplus countries, helped to precipitate a world financial crisis, spilling over into a steep decline in global spending on new investment goods, with cumulative effects causing Germany's export markets to suddenly shrink, registering as a 5% contraction in GDP for 2009, one of the most precipitous contractions in the industrialized world.

Conclusion

German industry exhibits a drive to invest in technologies in order to raise labor productivity and produce competitively in export markets. However, this tendency accentuates the Domar problem, evinced as a shrinking in domestic demand as a component of GDP, and a forced reliance on exports to carry GDP growth. This systemic and endogenous tendency of shrinking domestic demand relative to burgeoning supply is further aggravated as Germany's neo-liberal project has successfully promoted increases in capital's share of national income relative to labor's share. Additional effects are felt by the labor market, leading to the emergence of novel institutions such as the *Leiharbeit* and *Befristungen* forms of contract labor, generating cumulative effects that include increases in the incidences of working poor, and a skewing of income distribution. Rising gini-coefficients over time offer empirical evidence of such cumulative, economic and societal effects, suggesting that neo-liberal policies promote a secular move away from equity and toward inequality (see Table 6).

Table 6. Income Distribution in Germany (For Selected Years)

	Gini-Coefficients*	
Year	Market Income**	Net Income***
1991	0.412	0.257
1992	0.420	
1993	0.430	0.267
1994	0.440	
1996	0.451	0.265
1998	0.450	
1999	0.453	0.264
2000	0.450	
2002	0.460	0.292
2004	0.480	
2005	0.504	0.316
2006	0.510	
2007	0.500	

* Measure for inequality in income distribution. 0 = equality, 1 = perfect concentration of market income.
** Market Income is Gross Household Income before taxes and contributions to social security and pension systems.
*** Net Household Incomes is minus taxes and contributions to social security and pension systems.

Sources: Frick and Grabka 2008, 559; Sachverstänigenrat 2007/8, 458.

Notes

1. Philip Arestis and Malcolm Sawyer (2004, 1) offer a succinct account of key characteristics common to neo-liberal programs, noting: 1) a growing importance of central bank and interest rate policy for influencing economic expansion relative to democratic bodies and their fiscal policies; 2) associating unemployment with market frictions as opposed to insufficient levels of effective demand; and 3) relaxing national border controls over movements of capital in and out of financial centers.

2. The zenith referred to considers union enrollment in the former West Germany. With German reunification in 1990, millions of East German workers were joined into the *DGB*, and obviously bumped up its membership numbers — at least for the early 1990s. However, members of the post-reunification *DGB* as well as unions outside of this labor federation faced high rates of persistent unemployment, as well as unfriendly policies, generating effects that caused union membership to re-continue its secular decline (see Table 1).
3. Christoph Butterwegge (2009) convincingly argues that policy responses to the threat of rising unemployment related to the 1974-1975 world recession introduced by the government under Chancellor Helmut Schmidt, initiated a movement toward market-oriented solutions: what could be interpreted as the start of the shift away from social-market-economy and toward neo-liberalism, several years prior to the ascent of the Kohl government.
4. In more recent contributions to the literature, Christoph Butterwegge (2005; 2009) relies upon the term *Sozialstaat* as a contemporary term describing this normative relationship between market and society.
5. A recent contribution by Lutz Bellmann and Alexander Kühl (2008) appears as the most thorough contribution to the rise of contract and term labor, while also offering numerous cross-country comparisons. *Leiharbeit* translates literally as "loaned-labor" and figuratively as "contract-labor." *Befristungen* translates roughly as "term labor," and could be interpreted as contract labor for specified time periods.

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