

Capitalist Economies

- A. The Japanese Economy
- B. European Capitalism
 - 1. The Republic of France
 - 2. Sweden
 - 3. The Federal Republic of Germany

Japan (*Nippon*) Land of the Rising Sun



- ❖ Constitutional monarchy (Emperor Akihito), Heisei period started 1989.
- ❖ Parliamentary system dominated by LDP in bicameral Diet (*Kokkai*).
- ❖ Prime Minister is Taro Aso, 13th PM in Heisei period. Yasuo Fukuda last PM. With exception to Junichiro Koizumi, average term has been one year.
- ❖ 127 million people on five main islands and 3000 smaller ones – an area smaller than California and more mountainous.
- ❖ World's 2nd largest economy, GDP~\$4 trillion depending on exchange rates.
- ❖ World's 4th largest exporter. World share declined from 9.9% in 1993 to 5.5% in 2006.

Some comparative data:

- PPP per-capita roughly 75% of U.S. level (was 85% in 1991), but income sometimes higher at official exchange rates.
- Life expectancy m/f = 78/85 years (~Sweden).
- Education: 3.6% of GDP (was 5.8 in 1980), 14 yrs average.
- Inequality: GINI=37.9, 10/10=21.7/4.8.
- Economic freedom index = 7.9 (U.S.=8.7).
- Perceived corruption index = 7.1 (U.S. = 7.6).
- Exports+Imports ~ 20% of GDP.
- Central Government budget ~ 38% of GDP.
- Very large budget deficits, high debt ratio.
- Maximum tax rate ~ 50% (was 93% before 1984).
- Unemployment rate 2005 ~ 4.4% (having fallen since 2003)
- Inflation rates 1997-2002 ~ -1.4%

Early History

- By legend, Japan was founded in 600 BC by the Emperor Jimmu, a direct descendant of the sun goddess and the ancestor of the present ruling imperial family. Native religion is Shintoism.
- Heavily influenced by China – Influences like Chan Buddhism, Confucianism, and Chinese characters became *Zen*, *bushido*, and *kanji*.
- Yamato dynasty the nominal rulers, but real power was usually held by *shoguns* (military governors)
- Tokugawa shogunate (1603-1868):
 - Portuguese traders and Jesuit missionaries in 1500s initially threatened to dominate Japan, but were expelled by the Tokugawa shoguns; afterwards, foreign trade was limited to a small island outside the harbor at Nagasaki. Other foreign contact was forbidden (*sakoku*).
 - Tokugawa Japan was stable, isolated, agricultural (rice-based), reasonably prosperous, traditional, militaristic, and feudal.
- Commodore Perry and his "black ships" arrived in 1854:
 - Convention of Kanagawa led to opening of Japan.

Restoration of the Meiji Emperor

- Fears of foreign domination led to a *ronin* rebellion against the Shogun.
- Massive social change: elimination of guilds and legal classes, freedom of occupational choice, adoption of western educational systems and technology.
- Redistribution of land: half the government's budget went to paying off the former *Daimyo* lords and *samurai* warriors → a new capitalist class.
- Development of the structure of a capitalist economy through government intervention: banks, state-owned enterprises, subsidies and government loans, and the Bank of Japan.
- Growth of *Zaibatsu* financial cliques:
 - Interdependent suppliers, banks, and trading companies.
 - Interlinked family ownership.
 - Four major Zaibatsu controlled 40% of equity in 1945.
- Japan became an exporter to the west in many labor-intensive manufactures, such as textiles.

Japan at War

- Japan's military also became more modern:
 - 1895 naval defeat of China – Treaty of Shimonoseki granting control of Taiwan and Ryuku islands.
 - 1905 defeat of Russia over control of Korea, Chinese Manchuria.
 - Annexation of Korea in 1910 with secret U.S. approval.
- In the first world war, Japan sided with Allies;
 - Treaty of Versailles (1919) gave German concessions in China to Japan.
- Japan became increasingly democratic in 1920s, but military took control by the 1930s:
 - Assassinations of politicians by officers intimidated the Diet.
 - Japan invaded Manchuria in 1931 → created Manchukuo.
 - Japan's signed "anti-Comintern pact" with Germany in 1936.
 - Japan invaded China in 1937 → Rape of Nanjing, "kill all, burn all" in countryside.
 - Japan invaded British colonies and concessions in 1939.
 - Promotion of "East Asia Co-prosperity Sphere." Some sympathized.
 - U.S. Blockade of Japan → Oil in Indonesia, military/industrial threat.
- Attack on the U.S. at Pearl Harbor on Dec. 7, 1941.

Occupation

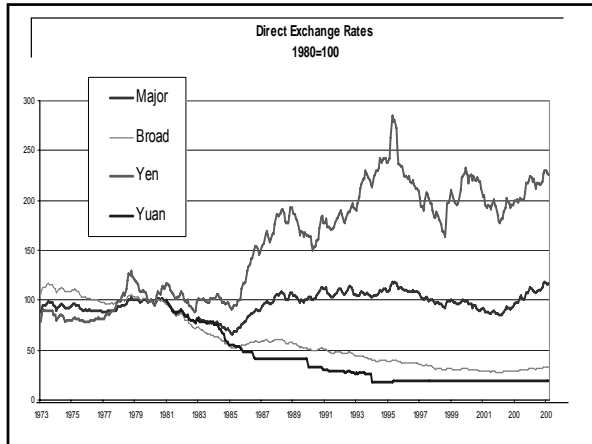
- U.S. forces occupied Japan through 1952, most of the time under the command of General Douglas MacArthur.
- Conflicting policies between Truman Administration and MacArthur.
 - Democratization, decentralization, and demilitarization:
 - labor unions were legalized
 - land was again redistributed
 - military officials were purged from the government and some were tried for war crimes
 - minor parties were legalized (even socialist and communist parties)
 - *Zaibatsu* were broken up
 - The Emperor Hirohito remained in power, but forced to renounce his divinity.
 - Traditional elites continued to dominate in both business and in politics: *Zaibatsu* recreated as *Keiretsu*.
 - Punishing vs. rebuilding conflict.
- Korean War 1950-1953:
 - Big demand boost + change in U.S. priorities.

After Occupation:

- By 1954, Japanese GDP to recover its prewar levels.
- In 1955, the leading conservative parties merged to form the Liberal Democratic Party.
- Iron Triangle: LDP politicians, big business leaders (*Zaikai*), and government agency technocrats (esp. in MoF and MITI). Practice of *amakudari*.
- Unions large and contentious in 1950s, but now mild and relatively small. *Shunto* (Spring offensive) becoming less relevant.
- Interventionist approach to finance and trade.
- U.S. initially very condescending, but tolerated policies promoting exports and restricting imports (subsidies, low exchange rate) during Cold War.
- Relatively minimal welfare state.

Keiretsu – looser groupings of firms formed from the old *Zaibatsu* – based around a trading company and a main bank. Competitive oligopolies. Sony as an exception.

- Main bank system:
 - Convoy of risk sharing and mutual support
 - Intertwined ownership
 - Reliance on short-term debt
 - Implicit deposit guarantees under Ministry of Finance
 - Bank of Japan monetary policy also under MoF
 - Low interest rates, rationing to keiretsu.
- Three treasures: lifetime employment system, seniority pay, enterprise unions. Also bonuses, long hours, and two-class system with subcontractors.
- Industrial policy under Ministry of International Trade and Industry, subsidies, tax breaks, choosing winners, import substitution, export promotion. Some indicative planning under Economic Planning Agency.
- High savings rates, in part due to minimal consumer credit and weak social security system.
- Little reliance on foreign savings (equity, DFI, or lending).
- After 1971, continued appreciation of the Yen.



Japan's Real per-Capita Growth

1820-1870 – 0.1% average in the late Tokugawa.

1870-1910 – 1.3% average during the Meiji Restoration -- among the fastest growing economies during the period.

1910-1950 – 1.0% average (in spite of 10% decline in 1930-31 and 53% decline from 1940-1945).

1950-1970 – 8.4%, recovery and beyond. Largely fueled by rapid capital investment combined with high technology.

1970-1990 – 3.4%, slowing but still rapid growth after OPEC oil embargo and world recessions. By 1991, Japanese per-capita income was seven times greater than the 1940 peak – an average growth rate of 4%.

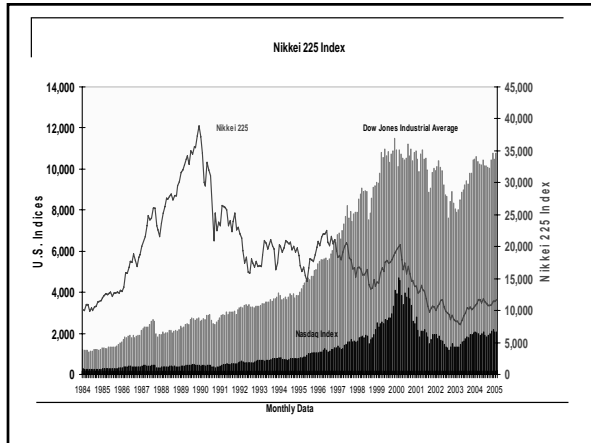
1990-2000 – 1.0%; 2000-2005 – 1.2%, several recessions.
2005-2007 – 2.3%. Perhaps a recovery???

The Bubble Economy

- Unbalanced financial liberalization in late 1970s and 1980s gave banks more portfolio options, but regulatory framework was based on the past regime.
- Optimism of "Japan as Number One." Japan came to dominate many high-tech sectors, and ran up large reserves of foreign exchange.
- Large trade surpluses offset by (or caused by) by large foreign savings outflow.
- Appreciation of Dollar due to high real interest rates led to the Plaza Accord in 1985, and a sell-off of dollars.
- After Louvre Accord and complaints by exporters, accommodative monetary policy in the second half of the 1980s.
- Low interest rates, rising asset prices:
 - Housing/income ratio in 1983 equals 670% of 1950 level (7.9 in Tokyo). From 1985-1989 it tripled again.
 - Nikkei index rose to 38,000 in 1989 (14,000 in 1992).
 - Interdependence between land prices, equity prices, and lending demand and supply.

Burst of the Bubble

- The Bank of Japan raised the discount rate in May 1989, and continued with tight monetary policy through 1994:
 - Interest rates rose.
 - asset prices collapsed.
- Banking crisis:
 - The unwillingness of regulatory authorities to allow bankruptcy to remove inefficient capital from the market.
 - Insolvent banks kept lending to insolvent firms and hoped for the best.
- When the Bank of Japan finally changed policy, it did not provide sufficiently stimulative policy.
- Political crisis – LDP lost power in 1993, Hosokawa stepped down in 1994, rapid turnover in weak coalition governments.
- Continued support for LDP due to local spending on construction and other pork, but rising government debt ratio (150% of GDP by 2002).
- Price deflation – rising money demand and slow growth in money supply, expectation of currency appreciation, zero interest rate policy (real rate = nominal rate – deflation rate).

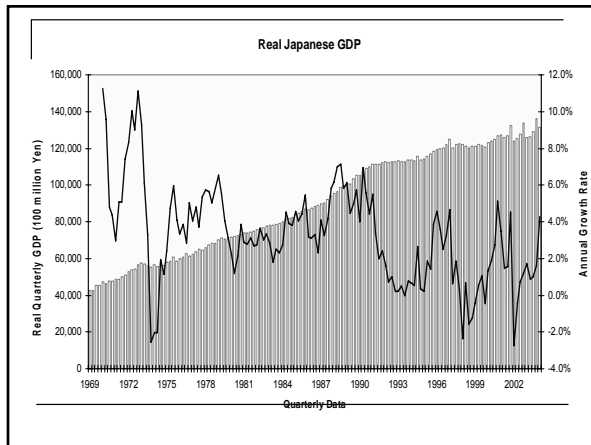


Many Changes in the Japanese Economy

- Gradual acceptance of the need for closing down insolvent firms and banks.
- Gradual erosion of the Keiretsu system, the lifetime employment system, and other features of the Japanese system.
- Lifting of restrictions on foreign investment and ownership.

An End to Japanese Growth?

- Most Japanese do not see this as a crisis.
- Still a wealthy, high-tech society.
- Large exporting firms able to "opt out" by going to international markets.
- Worries include an aging population, with women increasingly opting out of both parenthood and the workforce.
- Reform since 1997 is significant but still lagging behind and insufficient.
- A recent upturn leads to hopes of recovery (finally), and the past year's growth is very strong, but many economists are not yet confident of this continuing.



Republique Francaise

- ◆ Monarchy until 1789 Revolution:
 - World leader in science, philosophy, literature, and culture.
 - Centralized state power, especially after Louis XIV. Mercantilism and Dirigisme under J.B. Colbert, his finance minister (i.e., Colbertisme).
 - Wide divide between rich and poor.
- ◆ After Robespierre's Reign of Terror, alternating republics and autocracy (e.g., Napoleon, King Louis XVIII, Louis Philippe).
- ◆ Weak Third Republic (1870-1940).
- ◆ Western battleground of two world wars.
- ◆ 1958 Constitution for Fifth Republic, with Strong Presidency (esp. DeGaulle), elected Assembly under Prime Minister, and Senate.
- ◆ New President is Nicolas Sarkozy, New Premier is François Fillon.



Some Relevant Facts:

- ❖ GDP ~ \$2.0 Trillion, currently replacing U.K. in 4th place (but it depends on the year, since exchange rates vary).
- ❖ Roughly 60 million people (same as U.K., with less than half the density).
- ❖ Cropland ratio ten times greater than either U.S. or U.K., and more workers in agriculture (3% vs. 2%). Higher labor productivity in agriculture, with a strong Farmer's Lobby.
- ❖ GDP per-capita (PPP) \$29,900 (2005 est.), roughly 72% of U.S. level of \$41,800.
- ❖ Life expectancy (m/f=76/83 years) higher than U.S. (m/f=75/81).
- Education: 5.2% of GDP, 15-16 yrs average (=US)
- Inequality: GINI=33, 10/10=24.9/2.5
- Economic freedom index =7.5
- Perceived corruption index = 6.7
- Exports+Imports ~ 55% of GDP
- Central Government budget ~ 45% of GDP, overall spending highest in G-7 countries.
- Maximum tax rate ~ 57%
- High unemployment rate ~ 9%
- Low Inflation ~ 2%
- Unions relatively small & weak (except public sector)
- Firms relatively small compared to U.S., U.K.

Per-Capita Growth in France

(Maddison estimates)

- Prior to 1820, little data available. French average income comparable to U.S., but distribution of income more unequal.
- 1820 – 1870, per-capita growth of 1.0% per year, falling from 70% to 60% of U.K.
- 1870-1913: per-capita growth of 1.3%, back to 70% of U.K.; but investment slowing, vintage of technology and capital rising.
- 1913-1945: average growth of -1.0% due to Great Depression and world wars, down to 33% of U.K. level in 1944 (and 19% of U.S. level).
 - Great concern that slow growth in interwar years would continue.
 - 1940-45 artificially low due to German occupation.
- 1945-1952: Recovery: GDP doubled, back to 80% of U.K. level, 53% of U.S. level (1913-1952 growth average 1.2%)

Growth since 1952:

- 1952-1980: Planning era: continued growth of 3.6%, reaching 117% of U.K. level and 82% of U.S. level.
 - Maddison calls 1950-1973 the "Golden Era" for all western capitalist economies. Per-capita GDP grew by 4.1% (same for France).
 - World economy (with France's) slowed in late 1970s.
- 1980-1990: Socialist Reforms and the Ni-Ni Policy under Mitterrand, growth falling to 1.6%.
- 1990-2000: Cohabitation under Mitterrand and Chirac Presidencies, growth about 1.5%.
- 2000-2005: Growth slowed to 1.0%,
but rose back to 1.6% in 2006-2007.

Indicative Planning

- Influenced by U.S. Aid (Marshall Plan), power of the Communist Party, and Gaullist nationalism.
- Jean Monnet's Planning Commissariat created in 1946:
 - Small bureaucracy – General Planning Commissariat for Equipment and Productivity (CGP) of 50 staff
 - Indicative vs. directive planning
 - Horizontal and vertical “modernization commissions” of business, government, and labor (but dominated by Grandes Ecoles).
- Information, *concertation* and consensus-building, commitment, and consistency.
 - “The process is as important as the plan.”
- Cheerleading vs. credibility.
- Can government really do this better than private firms?

Implementation

- Monnet Plan, 1947-1951, 1952-53, focused on recovery, modernization, 6 strategic sectors.
- Harmonizing Plans, 1952-65, expanded plans to other sectors, “relatively accurate” in spite of some conflict with macroeconomic objectives.
- Selection of and investment in one or two “National Champions” in each sector.
- By 1970s, National Plans began to seem more like wishful thinking as they became more complex and began to include social objectives. Loss of credibility.
- Under Giscard d’Estaing, French planning was scaled back to more of a forecasting process.
- Evaluation: Did planning lead to faster growth?

Welfare and Redistribution

- Prior to 1970s, the French had one of the most unequal distributions of income in developed capitalist world.
- New “cradle-to-grave” social benefits:
 - Includes prenatal and maternity benefits, birth grants, monthly family allowances, sickness benefits, medical insurance, pensions, unemployment, disability, and survivor benefits.
 - Railroad workers, for example, retire at age 50.
- Higher government spending and tax rates (highest rate up from 60% in 1970s to 70% in 1984).
- Regulated labor market, high minimum wage, large employer contributions, layoffs difficult.
- Rising unemployment rates (4.4% in 1976, 10.5% by 1987).
- French macro policy characterized by higher inflation from loose monetary and fiscal policy.

European Union and Exchange Rates

- Monnet a leading Federalist, Gaullists wanted to offset U.S. power.
- Marshall Plan required cooperation with other countries.
- France, Germany, Italy, and Benelux the founding "inner six" of the ECSC and then the EEC.
 - EEC policies included the Common Agricultural Policy (CAP), to keep prices high and provide government subsidies.
- However, chronic balance of payments deficits plus an unwillingness to keep holding inflated dollars helped to set off 1971 collapse of the Bretton Woods system.
- Afterwards, France tried to stabilize exchange rates within Europe, but had limited success until 1980s.
- Currently, the French trade mostly within Europe, and run a trade surplus – we will get to why later.

Mitterrand's Socialist Reforms

- Socialist Party won Presidency in 1979, and then won majority of Assembly.
 - Re-implementation and expansion of plan, expanding concertation and contracts.
 - Rapid Increase in nationalization.
 - Labor codetermination (*autogestion*), much from German *mitbestimmung*.
 - Active labor market policies, from Sweden.
 - Expansion of welfare policies.

Nationalization

- State ownership has history back to Colbert, Napoleon.
- Alongside postwar growth of planning system, government began to nationalize and invest in many firms, including those in utilities, insurance, railways, postal service, transport and finance.
 - Nationalized firms prior to 1980s included Air France, Aerospatiale, Credit Lyonnais, Elf-Aquitaine, Renault, and others.
- Largest nationalization program ever in a western democracy began in 1982 under President Mitterrand.
 - State bought 39 banks, two financial holding companies, nine major industrial groups.
 - State paid more than market price to avoid charges of confiscation.
 - State now controlled 52% of investment, 29% of sales, 22% of employment, and 90% of deposits.

The Ni-Ni Policy

- Government expenditures and concern over future helped to create another Balance of Payments crisis, and falling Franc, after 1982.
- "Franc Fort" policy of 1983 focused on tight monetary policy.
 - State control of banking allowed "selective monetary policy"
 - Afterwards, French monetary policy focused on providing stable exchange rate. After creation of unified Euro, monetary policy is controlled by ECB in Frankfurt. Low inflation resulted.
- Mitterrand scaled back nationalization and other socialist reforms to halt crisis.
- Conservatives took the Assembly in 1986:
 - Chirac new prime minister.
 - Privatization announced for 65 firms. Initial revenue was \$50 billion, but 1987 stock market crash halted plan.
- Mitterrand re-elected in 1988:
 - Ni-Ni policy – no more nationalization, no more privatization.
- Fiscal policy also dominated by Euro requirements, including reduction of government deficits and interest rates.

Cohabitation

- Mitterrand vs. Chirac 1986-1995.
- Chirac elected as President in 1995, with Juppé as Prime Minister.
 - More efforts at privatization (e.g., Renault).
 - Failed effort to scale back welfare benefits.
- Socialists re-elected to Assembly under Jospin.
 - Workweek dropped to 35 hours (with no decrease in pay). French currently work less than any other major economy.
 - Unemployment remained high (8-11%).
- Jospin stepped down after 2002 election, replaced by Raffarin, who then stepped down in 2005 after demonstrations on government policy to reduce unemployment by making it easier to fire new hires.

Kingdom of Sweden

Konungariket Sverige

- Constitutional monarchy, under King Carl XVI Gustaf
- Parliamentary democracy, unicameral *Riksdag*, under P.M. Fredrik Reinfeldt.
- Politics dominated by SDP since 1932, but lost majority again in 2006.
- 8.9 million people
- Area = Size of California
- GDP ~ \$300 billion



Some comparative data:

- GDP per-capita roughly 71% of U.S. level
 - PPP never reached more than 90% of U.S. levels, but at official exchange rates Sweden had a higher per-capita income in 1970s
- Life expectancy high: m/f = 77/82 years
- Education: 8.3% of GDP, 14-15 yrs average
- Inequality very low: GINI=25.0, 10/10=20.1/3.7
- Economic freedom index =7.9 (near Germany)
- Perceived corruption index = 9.0 (U.S. = 7.6)
- Very Trade-Dependent: Exports + Imports ~ 87% of GDP
- Central Government budget ~ 43% of GDP
- Maximum income tax rate ~ 31% (was 85% before 1980s)
- Unemployment rate ~ 5.4%

Background

- No invasions, no major migrations.
- After Vikings, never really feudal.
- Early participant in reformation, population mostly Lutheran.
- Great military power in spite of small size from Thirty Years War through 1718.
- Neutral since 1813 (Napoleonic wars).
- Homogeneous population until 1970s; now about 20% are immigrants or have at least one foreign-born parent.
- Relatively homogeneous culture, stronger sense of egalitarianism, less divisive politics, less ideology, more emphasis on cooperation and consensus.

Conflict during Industrialization

- Agricultural economy, slow transition from village to private farming.
- Large emigration to U.S.A. from 1850-1890
- Latecomer to industrialization:
 - Conditions for growth began after 1850 (e.g., abolition of guilds)
 - Growth really began after 1870
(Swedish growth 1870-1913 fastest after Japan)
- Highly contentious labor relations:
 - 1898 – LO, Swedish Confederation of Trade Unions
 - 1902 – SAF, Swedish Employers Association
- Split in SDP in 1921 between communists (Left Party) and moderates.

Real Per-capita growth in Sweden

- 1820-1850: 0.2% per year – 55% of U.K. level
- 1820-1870: Growth begins – 1.3%
- 1870-1913: Export reliance – 1.5%
- 1913-1950: Weathering storms – 2.1% (catching up to U.K.)
- 1950-1973: Growth keeps rising – 3.1% (now 120% of U.K., catching up to U.S.)
- 1973-1990: Slowdown – 1.6% (U.K. catching back up)
- 1990-2000: Average growth still 1.7%
- After 2000: Return of growth?
2.2% from 2000-2005, 2.6% in 2006-2007.

Government intervention

- During Great Depression:
 - Early interventionist fiscal policy.
 - Early departure from gold standard – along with U.K. and Norway – prevented Sweden from following U.S. into monetary collapse. Price level targeting replaced fixed exchange rate for awhile.
 - Unemployment never exceeded 8%.
- Basic Agreement (Saltsjöbaden, 1938)
 - Initial focus on rules, negotiations to bring peace to labor relations
 - After WWII, centralized collective bargaining
 - Framework agreement over wage share, working conditions
 - Less leapfrogging, reduction of conflict
- After WWII, establishment of the Swedish Welfare State – arguably, the most generous in the world

Stockholm School (Rehn-Meidner Policies)

- EFO Model – focus on international competition
- Wage share bargaining:
 - Unions supported productivity gains, and move away from low-wage technologies.
 - Disincentive for higher education.
- Active Labor Market:
 - National Labor Market Board – centralized job information
 - Recruitment subsidies
 - Retraining and relocation
 - Public works during recessions, transition periods
 - Micro fiscal policy – not aggregate demand stimulation

Savings policies

- Public pension funds – codetermined management
- Public equity capital – employee funds for private investment
- Reserve fund system for stabilization:
 - Tax incentives for deposits with Riksbank
 - Spending approved by NLMB
- High savings rate fueled capital investment.

Welfare Policies

- Generous subsidies to families
 - maternity, children, childcare, education, health insurance, disability, retirement, et cetera. Workers also receive five weeks of vacation.
- Progressive taxation
 - in 1970s, 62% average tax rate for single earners, 71% top marginal rate.
- Unemployment replacement ratio high – 60% in 1970, above 90% after 1985
- Incentive problems, including brain drain, underground economy, high sick days
- Unemployment remained relatively low through 1980s
 - From 1990 to 1994 it rose from less than 2% to 10%
 - Since then it declined back to less than 4% (now 5%)
- Labor force participation rates are also very high

"In Sweden, a large fraction of women work in the public sector to take care of the children of other women who work in the public sector to care for the parents of the women who look after their children." – Sherwin Rosen

The Swedish Paradox

- Consensus vs. competition: "... human relations not based on the laws of the jungle."
- A "middle way" attacked during the Cold War by both the left and the right.
- Impressive economic performance through 1975, largely driven by high-tech, high quality exports.
- High productivity and high employment in spite of all the theoretical incentive problems.

Slowdown in Sweden

- After 1971, Sweden continued to maintain stable exchange rate against major trading partners – leading to importing inflation.
- 1975 World Recession followed by effort to insulate economy with monetary and fiscal policy. Exports fell.
- Rising inflation, unemployment, and government deficits. SDP out of power 1976-1982. Conservative government nationalized steel, shipbuilding.
- SDP returned in 1982, devalued Kroner → export-led rebound, deficits turned to surpluses.
- Wage-price spirals, continued inflation and devaluations.

Sweden/U.S. Foreign Exchange Rate
(Swedish Kronor to One U.S. Dollar)

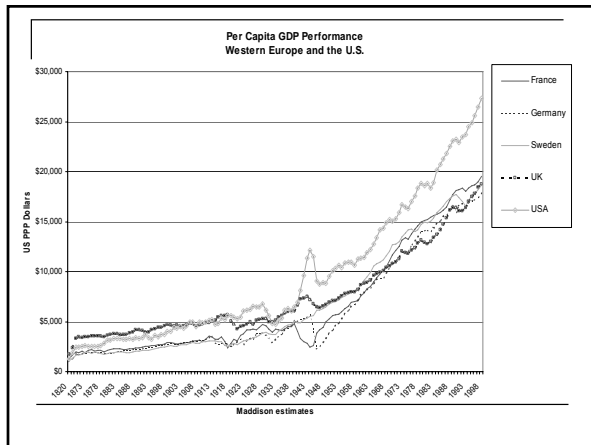


The 1990s

- 1991 Moderate Party coalition (Bildt) – more laissez faire, social welfare cutbacks, tax cuts.
- 1992 European monetary crisis:
 - Government defended Kroner (overnight rates rose to 500% annual rate in Sep.)
 - Unemployment rose to record highs
- SDP returned to power in 1994 (Carlson)
 - Sweden joined EU in 1995 and pegged to the DM
 - Still not part of the Euro currency area
- Growth slowly recovered to moderate 1-2%, with low inflation and unemployment.

Where from here?

- Some aspects of the Swedish model are dying:
 - EFO model broke down due to rising public sector unions.
 - Effects of high taxes and wage solidarity on incentives has led to some scaling back.
- Continuing debate between “traditionalists” and “renewers” over future policies, now linked to EU/ Euro debates.
- While even SDP has backed away from extreme Swedish model, there is still wide public support for welfare policies, government intervention, and equality.



Bundesrepublik Deutschland

- ❖ Federal Republic since 1949:
 - Ceremonial Presidency, currently Horst Köhler of CDU.
 - Parliamentary system: leader of Bundestag is the Chancellor (Kanzler), currently Angela Merkel of CDU.
 - Federal system: much power retained by 16 Länder and Freistäten.
- ❖ World's 3rd largest economy. GDP ~ \$3 trillion (PPP).



Some comparative data:

- ❖ World's largest exporter (currently slightly ahead of U.S.), surplus.
- ❖ 82 million people – more than France or U.K., though West Germany (the original BRD) was the same size.
- ❖ Density = 235 people per sq. km. (same as the U.K.).
- GDP per-capita roughly 73% of U.S. level.
- Life expectancy m/f = 76/82 years (>U.S. level).
- Education: 4.8% of GDP, 15 yrs average.
- Inequality: GINI=38.2, 10/10=23.7/3.3.
- Economic freedom index =8.0 (U.S.=8.7).
- Perceived corruption index = 7.4 (U.S. = 7.6).
- Exports+Imports ~ 68% of GDP.
- Central Government budget ~ 32% of GDP.
-- but remember it is a federal system. Total government spending is 50% of GDP.
- Maximum tax rate ~ 53%.
- Unemployment rate ~ 10%.

Early History

- They call themselves the Deutsch – Germanii was the Roman term for the northern tribes.
- Unlike France and England, never fully part of the Roman Empire (though in late western empire, Trier served as a northern capital).
- After Charlemagne, Germany was not ever really unified. Holy Roman Empire of the German Nation, 843-1806 (First Reich), was more of a loose Catholic confederation.
 - Voltaire: "neither holy, nor Roman, nor an empire."
- In Thirty Years War, Germany was the battleground between Protestants and Catholics.
- Prior to 1870, Germany was largely a collection of independent regions and feudal principalities.
- In 1848 Prussia was offered the empire, but refused.
- *Zollverein*: an early trade union arranged by Prussia.
- Prussia very militaristic, paternalistic, aristocratic, and agricultural.
- Franco-Prussian wars followed by unification of Germany by Prussia in 1871, German Empire (Second Reich) under Kaiser Wilhelm I.

History after Unification

- Chancellor Bismarck's "Iron & Rye" alliance:
 - Protectionism in both industry and agriculture
 - Social security & welfare
- Rapid industrialization and militarization – "blood and iron"
- The Great War, 1914-1918:
 - An assassination in Bosnia, and the Austro-Hungarian Empire vs. Serbia
 - German concerns about Russia
 - France's alliance with Russia and the entry of the British
 - Trench warfare in the West
 - War and revolution in the East – the Treaty of Brest-Litovsk
 - Exhaustion and starvation on the Home Front
 - Entry of the U.S. in 1917
 - Ludendorff and von Hindenburg's spring 1918 offensive – stopped on the Marne
 - abdication of Kaiser Wilhelm II
 - Suspicions of being "stabbed in the back" by domestic enemies.

Weimar Republic: 1918-1933

- Democratic, but too many parties, weak chancellor
- Reparations and the Treaty of Versailles
- Hyperinflation in the early 1920s
 - From 1920-1923, money supply rose 7.5 million times
 - Prices rose 88 billion times
 - Value of Mark fell to 0.00000000023¢
- Fixed exchange rates helped the U.S. pull Germany into the Great Depression
- After 1929, rising power of communists, and the election of National Socialists in 1932 to second largest party
- Appointment of Hitler to Chancellor post in 1933
- Chancellor Hitler's "Enabling Act" after burning of the Reichstag – Weimar Republic dissolved, Hitler becomes "Der Führer" and Germany becomes a totalitarian dictatorship.

The Third Reich: 1933-1945

- Fascism – a militaristic, nationalistic philosophy of Mussolini and others.
- Capitalism with private ownership and markets, central state control and cartelization, direct and indirect intervention, coercive and material incentives.
- Dismantling of labor unions.
- Social face: employment and housing.
- Racism and Eugenics – the "master race" and extermination of Jews, Slavs, Roma, etc.
- Military expansion for "Lebensraum" – Rhineland, Austria, Czechoslovakia, Poland, and War.

Postwar Period

- Division of Germany and Berlin into four zones: British, French, American, and Soviet.
- High inflation, shortages during Occupation.
- New Deutschmark and creation of Deutsches Bundesbank in 1948, plus price liberalization led to a "big bang."
- Marshall Plan – development, not reparations.
- Four "D"s: Demilitarization, Denazification, Decartelization, and Democratization – including the encouragement of unions, political parties, and civil institutions.
- Founding of BRD in 1949 (Basic Law):
 - Konrad Adenauer's mild authoritarianism + Ludwig Erhard's economic leadership
 - Federal system to reduce central power
- Freiburg School of Neoliberalism, under Alfred Müller-Armack:
 - Sozialer Rechtstät (individual rights, civil law, classical liberal economy)
 - Sozialstät (justice between groups, interventionism)
 - Neoliberalism – A "Middle Way"

Soziale Marktwirtschaft

Social (*not* Socialist) Market Economy

- Bismarck's welfare state (decentralized)
- Strong, nonradical unions along industry lines
- Labor policies:
 - Labor Regulation
 - Mitbestimmung – codetermination in work councils, supervisory boards
 - Apprenticeships
- Regulated product markets
- Subsidized savings programs
- European Union
- Undervalued currency and support for the Dollar through 1971
- Little state planning
- Little state ownership
- Monetary policy focused on stable currency
- Noninterventionist fiscal policy
- *Gastarbeiter* (guest workers)
- No capital gains taxes or double taxation of dividends – until 2001
- 1957 Law against limitations of competition
- Small military, decentralized police force
- Strong export orientation

Real Per-capita Growth in Germany

- 1820-1870: 1.1% growth (slower than U.S. or U.K.).
- 1870-1913: 1.8% growth, catching up from 59% to 76% of U.K. level.
- 1913-1950: Net growth of 0.3% per year, but big swings:
 - First a 28% net decline during WWI
 - Big drops in 1919, 1923
 - Then 57% net recovery by 1929
 - Then 25% net decline in Great Depression
 - Followed by recovery/militarization – 91% net increase through 1944
 - End of WWII: 60% net decline through 1946
 - During Occupation, a 71% net recovery
- 1950-1973: The *Wirtschaftswunder* – per-capita growth averaged 5% growth per year, and Germany overtook the U.K. by 1961.
- 1973-1990: Slowing growth, but still high – 2.1% average.
- 1990-2005: Reunification -- slow growth of 1.3% average.
- 2006-2007 growth rate about 2.8%

Reunification

- Soviet Occupation and the German Democratic Republic (DDR)
- End of the Brezhnev Doctrine
- Collapse of Berlin Wall
- State of the DDR's economy
- Exchange rate conversion problem – savings, prices, wages
- BRD labor market regulations
- Privatization under Treuhandanstalt
- European recession, 1992-94:
 - German fiscal deficits, DBB tight money, high real interest rates
 - Fixed exchange rates led to a balance of payments crisis for U.K.
- Unemployment:
 - In West, unemployment rose from <1% before 1964 to 7-9% in 1980s
 - In East, "full" employment before 1989, then 1/3 of workers laid off, 16.5% unemployment in 1992
- Conflict: Ossies vs. Wessies, neo-nazis vs. *gastarbeiter*