Chapter 5. The Domestic Economy

The Frankfurt am Main skyline. In the foreground is the Paulskirche, meeting place of the 1848–49 National Assembly.

THE GERMAN ECONOMY is replete with contradictions. It is modern but old-fashioned. It is immensely powerful but suffers from serious structural weaknesses. It is subject to national laws and rules but is so closely tied into the European Union (EU—see Glossary) that it is no longer truly independent. It has a central bank that controls European monetary policy and has a deepening impact on the global economy but that also insists on making its decisions mainly on the basis of domestic considerations. Finally, although Germany must compete against highly efficient economies outside its own continent, it continues to carry the expense and burden of traditional industries that drain resources that could be better used elsewhere.

The German economy as it is known today is an outgrowth of the 1990 merger between the dominant economy of the Federal Republic of Germany (FRG, or West Germany) and that of the German Democratic Republic (GDR, or East Germany). This merger will one day produce a massive economic entity that will constitute the fulcrum of Europe as a production center, as well as a transportation and communications center. But each partner brings different elements to the mix, and the merger has proved difficult and costly. The merger will dominate Germany's economic policy and reality until well into the next century.

The record of the West German economy during the four decades before unification shows a signal achievement. The first decade, that of the 1950s, had been that of the "economic miracle." The second decade, that of the 1960s, had seen consolidation and the first signs of trouble. The 1970s had brought the oil shocks, the generous social programs, the rising deficits, and finally a loss of control. In the 1980s, new policies at home and a more stable environment abroad had combined to put West Germany back on the path of growth.

The East German economy had been a powerhouse in Eastern Europe, where Moscow had relied on it to produce machine tools, chemicals, and electronics. But it had grown increasingly inefficient, and its currency had become worthless outside its own borders. East Germans had felt frustrated at their lack of true material well-being, as well as their lack of freedom. They joined their economy enthusiastically with that of West Germany in 1990. The merger gave them a rude shock, however, in part because of the simultaneous collapse of East Germany's markets in the Soviet empire and in part because of the inefficiencies that the communist system had left behind.

The united German economy is a dominant force in world markets because of the strong export orientation that has been part of the German tradition for centuries. Although the burdens of unification have cut into West Germany's traditional export surplus, German industry continues to produce some of the best machine tools, automobiles, trucks, chemicals, and engineering products in the world. Its management culture, which mingles competition and cooperation, stresses quality and durability above all other virtues. Because many German companies are small or medium-sized, they are able to concentrate on a few production lines that compete effectively even if they are expensive.

The German culture of cooperation also extends to the relations between the private sector and the government. The social market economy, in which all elements of the system cooperate, stresses the importance of having all parties to the social contract work together. Workers play a role in management. Managers mingle with workers. The bureaucracy attempts to create an environment in which all parties serve a common purpose. Although the rules intended to prevent the recurrence of the German cartel system of the last century are strictly enforced by the Bundeskartellamt (Federal Cartel Office), certain practices that would be forbidden under United States antitrust laws are widely tolerated in Germany.

The dominant force in the German economy is the banking system. The central bank, the Bundesbank, is deeply committed to maintaining the value of the nation's currency, the deutsche mark, even at some potential cost to economic growth. It fears inflation above all other ills and is determined to prevent the recurrence of Germany's ruinous Great Inflation of the early 1920s. Private banks also play an important role. German industrial and service companies rely much more on bank finance than on equity capital. The banks provide the money and in turn sit on the supervisory boards of most of Germany's corporations. From that vantage point, they stress the traditional banking virtues of slow but steady and nonrisky growth. Their influence and thinking permeate the economy.

German agriculture is not as strong as German industry. It is a relatively small part of the gross domestic product (GDP—see Glossary) and is heavily subsidized by the EU's Common Agricultural Policy (CAP—see Glossary) and by the German government itself. The accession of East Germany to a united Germany expanded the relative size of the agricultural sector and somewhat improved its efficiency, but Germany is not an agricultural producer like Spain or Italy.

West Germany developed a system of high wages and high social benefits that has been carried over into united Germany. The extent and the generosity of its social programs now leave Germany at a competitive disadvantage with respect to the states of Eastern Europe and Asia. German labor costs are above those of most other states, not because of the wages themselves—which are high by global standards but not out of line with German labor productivity—but because of social costs, which impose burdens equal to the wages themselves. Thus, German companies and German workers must decide either to abandon some of the social programs that are at the core of the revered social market economy or to risk losing out in the increasingly intense global competition of the 1990s and beyond. The Germans have not solved this problem, but they are beginning to address it more seriously than before.

Patterns of Development

History

Medieval Germany, lying on the open Central European Plain, was divided into hundreds of contending kingdoms, principalities, dukedoms, bishoprics, and free cities. Economic survival in that environment, like political or even physical survival, did not mean expanding across unlimited terrain, as in the United States. It meant a constant struggle that required collaboration with some, competition with others, and an intimate understanding among government, commerce, and production. A desire to save was also born in the German experience of political, military, and economic uncertainty.

Even under these difficult conditions, Germany had already developed a strong economy during the Middle Ages. It was based on guild and craft production, but with elements of merchant capitalism and mercantilism. The trade conducted by its cities ranged far and wide throughout Europe in all directions, and Germany as a whole often had trade surpluses with neighboring states. One reason for these exports was the sheer necessity for the small states to sell abroad in order to buy the many things they could not produce at home.

The German guilds of the Middle Ages established the German tradition of creating products known for quality and durability. A craftsman was not permitted to pursue a trade until he could demonstrate the ability to make high-quality products. Out of that same tradition came an equally strong passion for education and vocational training, for no craftsman was recognized until he had thoroughly learned a trade, passed a test, and been certified.

The Industrial Revolution reached Germany long after it had flowered in Britain, and the governments of the German states supported local industry because they did not want to be left behind. Many enterprises were government initiated, government financed, government managed, or government subsidized. As industry grew and prospered in the nineteenth century, Prussia and other German states consciously supported all economic development and especially transportation and industry.

The north German states were for the most part richer in natural resources than the southern states. They had vast agricultural tracts from Schleswig-Holstein in the west through Prussia in the east. They also had coal and iron in the Ruhr Valley. Through the practice of primogeniture, widely followed in northern Germany, large estates and fortunes grew. So did close relations between their owners and local as well as national governments.

The south German states were relatively poor in natural resources except for their people, and those Germans therefore engaged more often in small economic enterprises. They also had no primogeniture rule but subdivided the land among several offspring, leading those offspring to remain in their native towns but not fully able to support themselves from their small parcels of land. The south German states, therefore, fostered cottage industries, crafts, and a more independent and self-reliant spirit less closely linked to the government.

German banks played central roles in financing German industry. They also shaped industrywide producer cooperatives, known as cartels. Different banks formed cartels in different industries. Cartel contracts were accepted as legal and binding by German courts although they were held to be illegal in Britain and the United States.

The first German cartel was a salt cartel, the Neckar Salt Union of 1828, formed in Württemberg and Baden. The process of cartelization began slowly, but the cartel movement took hold after 1873 in the economic depression that followed the postunification speculative bubble. It began in heavy industry and spread throughout other industries. By 1900 there were 275 cartels in operation; by 1908, over 500. By some estimates, different cartel arrangements may have numbered in the thousands at different times, but many German companies stayed outside the cartels because they did not welcome the restrictions that membership imposed.

The government played a powerful role in the industrialization of the German Empire founded by Otto von Bismarck in 1871 (see Bismarck and Unification, ch. 1). It supported not only heavy industry but also crafts and trades because it wanted to maintain prosperity in all parts of the empire. Even where the national government did not act, the highly autonomous regional and local governments supported their own industries. Each state tried to be as self-sufficient as possible.

Despite the several ups and downs of prosperity and depression that marked the first decades of the German Empire, the ultimate wealth of the empire proved immense. German aristocrats, landowners, bankers, and producers created what might be termed the first German economic miracle, the turn-of-the-century surge in German industry and commerce during which bankers, industrialists, mercantilists, the military, and the monarchy joined forces.

The German Empire also established, under Bismarck's direction, the social compact under which the German laboring classes supported the national ambitions of the newly united German state in exchange for a system of social welfare that would make them, if not full participants in the system, at least its beneficiaries and pensioners. Bismarck was not a socialist, but he believed that it was necessary to accept portions of the socialist platform to sustain prosperity and social cohesion.

From the prosperity of the empire during the Wilhelmine era (1890–1914), Germany plunged into World War I, a war it was to lose and one that spawned many of the economic crises that would destroy the successor Weimar Republic (see The Weimar Republic, 1918–33, ch. 1). Even the British economist John Maynard Keynes denounced the 1919 Treaty of Versailles as ruinous to German and global prosperity. The war and the treaty were followed by the Great Inflation of the early 1920s that wreaked havoc on Germany's social structure and political stability. During that inflation, the value of the nation's currency, the Reichsmark, collapsed from 8.9 per US$1 in 1918 to

4.2 trillion per US$1 by November 1923. Then, after a brief period of prosperity during the mid-1920s, came the Great Depression, which destroyed what remained of the German middle class and paved the way for the dictatorship of Adolf Hitler. During the Hitler era (1933–45), the economy developed a hothouse prosperity, supported with high government subsidies to those sectors that Hitler favored because they gave Germany military power and economic autarchy, that is, economic independence from the global economy. Finally, the entire enterprise collapsed in the *Stunde Null* (Zero Hour), when Germany lay in ruins at the end of World War II in May 1945 and when every German knew that he or she had to begin life all over again.

The first several years after World War II were years of bitter penury for the Germans. Their land, their homes, and their property lay in ruin. Millions were forced to flee with nothing but the clothes on their backs. Tens of millions did not have enough to eat or to wear. Inflation raged. Parker pens, nylon stockings, and Camel cigarettes represented the accepted, if not the legal, tender of the time. Occupation projections showed that the average German would be able to purchase a plate every five years, a pair of shoes every twelve years, and a suit every fifty years.

As Germany's postwar economic and political leaders shaped their plans for the future German economy, they saw in ruin a new beginning, an opportunity to position Germany on a new and totally different path. The economy was to be an instrument for prosperity, but it was also to safeguard democracy and to help maintain a stable society. The new German leaders wanted social peace as well as economic prosperity. They wanted an economic system that would give all an equal opportunity in order to avoid creating underprivileged social groups whose bitter frustration would erupt into revolution and—in turn—repression.

The man who took full advantage of Germany's postwar opportunity was Ludwig Erhard, who was determined to shape a new and different kind of German economy. He was given his chance by United States officials, who found him working in Nuremberg and who saw that many of his ideas coincided with their own.

Erhard's first step was currency reform: the abolition of the Reichsmark and the creation of a new currency, the deutsche mark. He carried out that reform on June 20, 1948, installing the new currency with the concurrence of the Western Allies but also taking advantage of the opportunity to abolish most Nazi and occupation rules and regulations in order to establish the genesis of a free economy. The currency reform, whose purpose was to provide a respected store of value and a widely accepted legal tender, succeeded brilliantly. It established the foundations of the West German economy and of the West German state.

The Social Market Economy

The Germans proudly label their economy a "*soziale Marktwirtschaft*," or "social market economy," to show that the system as it has developed after World War II has both a material and a social—or human—dimension. They stress the importance of the term "market" because after the Nazi experience they wanted an economy free of state intervention and domination. The only state role in the new West German economy was to protect the competitive environment from monopolistic or oligopolistic tendencies—including its own. The term "social" is stressed because West Germans wanted an economy that would not only help the wealthy but also care for the workers and others who might not prove able to cope with the strenuous competitive demands of a market economy. The term "social" was chosen rather than "socialist" to distinguish their system from those in which the state claimed the right to direct the economy or to intervene in it.

Beyond these principles of the social market economy, but linked to it, comes a more traditional German concept, that of *Ordnung*, which can be directly translated to mean order but which really means an economy, society, and polity that are structured but not dictatorial. The founders of the social market economy insisted that *Denken in Ordnungen*—to think in terms of systems of order—was essential. They also spoke of *Ordo-Liberalismus* because the essence of the concept is that this must be a freely chosen order, not a command order.

Over time, the term "social" in the social market economy began to take on a life of its own. It moved the West German economy toward an extensive social welfare system that has become one of the most expensive in the world. Moreover, the West German federal government and the states (*Länder*; sing., *Land*) began to compensate for irregularities in economic cycles and for shifts in world production by beginning to shelter and support some sectors and industries. In an even greater departure from the Erhard tradition, the government became an instrument for the preservation of existing industries rather than a force for renewal. In the 1970s, the state assumed an ever more important role in the economy. During the 1980s, Chancellor Helmut Kohl tried to reduce that state role, and he succeeded in part, but German unification again compelled the German government to assume a stronger role in the economy. Thus, the contradiction between the terms "social" and "market" has remained an element for debate in Germany.

Given the internal contradiction in its philosophy, the German economy is both conservative and dynamic. It is conservative in the sense that it draws on the part of the German tradition that envisages some state role in the economy and a cautious attitude toward investment and risk-taking. It is dynamic in the sense that it is directed toward growth—even if that growth may be slow and steady rather than spectacular. It tries to combine the virtues of a market system with the virtues of a social welfare system.

The Economic Miracle and Beyond

The economic reforms and the new West German system received powerful support from a number of sources: investment funds under the European Recovery Program, more commonly known as the Marshall Plan; the stimulus to German industry provided by the diversion of other Western resources for Korean War production; and the German readiness to work hard for low wages until productivity had risen. But the essential component of success was the revival of confidence brought on by Erhard's reforms and by the new currency.

The West German boom that began in 1950 was truly memorable. The growth rate of industrial production was 25.0 percent in 1950 and 18.1 percent in 1951. Growth continued at a high rate for most of the 1950s, despite occasional slowdowns. By 1960 industrial production had risen to two-and-one-half times the level of 1950 and far beyond any that the Nazis had reached during the 1930s in all of Germany. GDP rose by two-thirds during the same decade. The number of persons employed rose from 13.8 million in 1950 to 19.8 million in 1960, and the unemployment rate fell from 10.3 percent to 1.2 percent.

Labor also benefited in due course from the boom. Although wage demands and pay increases had been modest at first, wages and salaries rose over 80 percent between 1949 and

1955, catching up with growth. West German social programs were given a considerable boost in 1957, just before a national election, when the government decided to initiate a number of social programs and to expand others.

In 1957 West Germany gained a new central bank, the Deutsche Bundesbank, generally called simply the Bundesbank, which succeeded the Bank Deutscher Länder and was given much more authority over monetary policy. That year also saw the establishment of the Bundeskartellamt (Federal Cartel Office), designed to prevent the return of German monopolies and cartels. Six years later, in 1963, the Bundestag, the lower house of Germany's parliament, at Erhard's urging established the Council of Economic Experts to provide objective evaluations on which to base German economic policy.

The West German economy did not grow as fast or as consistently in the 1960s as it had during the 1950s, in part because such a torrid pace could not be sustained, in part because the supply of fresh labor from East Germany was cut off by the Berlin Wall, built in 1961, and in part because the Bundesbank became disturbed about potential overheating and moved several times to slow the pace of growth. Erhard, who had succeeded Konrad Adenauer as chancellor, was voted out of office in December 1966, largely—although not entirely—because of the economic problems of the Federal Republic. He was replaced by the Grand Coalition consisting of the Christian Democratic Union (Christlich Demokratische Union—CDU), its sister party the Christian Social Union (Christlich-Soziale Union—CSU), and the Social Democratic Party of Germany (Sozialdemokratische Partei Deutschlands—SPD) under Chancellor Kurt Georg Kiesinger of the CDU.

Under the pressure of the slowdown, the new West German Grand Coalition government abandoned Erhard's broad laissez-faire orientation. The new minister for economics, Karl Schiller, argued strongly for legislation that would give the federal government and his ministry greater authority to guide economic policy. In 1967 the Bundestag passed the Law for Promoting Stability and Growth, known as the Magna Carta of medium-term economic management. That law, which remains in effect although never again applied as energetically as in Schiller's time, provided for coordination of federal, *Land*, and local budget plans in order to give fiscal policy a stronger impact. The law also set a number of optimistic targets for the four basic standards by which West German economic success was henceforth to be measured: currency stability, economic growth, employment levels, and trade balance. Those standards became popularly known as the *magisches Viereck*, the "magic rectangle" or the "magic polygon."

Schiller followed a different concept from Erhard's. He was one of the rare German Keynesians, and he brought to his new tasks the unshakable conviction that government had both the obligation and the capacity to shape economic trends and to smooth out and even eliminate the business cycle. Schiller's chosen formula was *Globalsteuerung*, or global guidance, a process by which government would not intervene in the details of the economy but would establish broad guidelines that would foster uninterrupted noninflationary growth.

Schiller's success in the Grand Coalition helped to give the SPD an electoral victory in 1969 and a chance to form a new coalition government with the Free Democratic Party (Freie Demokratische Partei—FDP) under Willy Brandt. The SPD-FDP coalition expanded the West German social security system, substantially increasing the size and cost of the social budget. Social program costs grew by over 10 percent a year during much of the 1970s, introducing into the budget an unalterable obligation that reduced fiscal flexibility (although Schiller and other Keynesians believed that it would have an anticyclical effect). This came back to haunt Schiller as well as every German government since then. Schiller himself had to resign in 1972 when the West German and global economies were in a downturn and when all his ideas did not seem able to revive West German prosperity. Willy Brandt himself resigned two years later.

Helmut Schmidt, Brandt's successor, was intensely interested in economics but also faced great problems, including the dramatic upsurge in oil prices of 1973–74. West Germany's GDP in 1975 fell by 1.4 percent (in constant prices), the first time since the founding of the FRG that it had fallen so sharply. The West German trade balance also fell as global demand declined and as the terms of trade deteriorated because of the rise in petroleum prices.

By 1976 the worst was over. West German growth resumed, and the inflation rate began to decline (see table 12, Appendix). Although neither reached the favorable levels that had come to be taken for granted during the 1950s and early 1960s, they were accepted as tolerable after the turbulence of the previous years. Schmidt began to be known as a *Macher* (achiever), and the government won reelection in 1976. Schmidt's success led him and his party to claim that they had built *Modell Deutschland* (the German model).

But the economy again turned down and, despite efforts to stimulate growth by government deficits, failed to revive quickly. It was only by mid-1978 that Schmidt and the Bundesbank were able to bring the economy into balance. After that, the economy continued expanding through 1979 and much of 1980, helping Schmidt win reelection in 1980. But the upturn proved to be uneven and unrewarding, as the problems of the mid-1970s rapidly returned. By early 1981, Schmidt faced the worst possible situation: growth fell and unemployment rose, but inflation did not abate.

By the fall of 1982, Schmidt's coalition government collapsed as the FDP withdrew to join a coalition led by Helmut Kohl, the leader of the CDU/CSU. He began to direct what was termed *die Wende* (the turning or the reversal). The government proceeded to implement new policies to reduce the government role in the economy and within a year won a popular vote in support of the new course.

Within its broad policy, the new government had several main objectives: to reduce the federal deficit by cutting expenditures as well as taxes, to reduce government restrictions and regulations, and to improve the flexibility and performance of the labor market. The government also carried through a series of privatization measures, selling almost DM10 billion (for value of the deutsche mark—see Glossary) in shares of such diverse state-owned institutions as VEBA, VIAG, Volkswagen, Lufthansa, and Salzgitter. Through all these steps, the state role in the West German economy declined from 52 percent to 46 percent of GDP between 1982 and 1990, according to Bundesbank statistics.

Although the policies of *die Wende* changed the mood of the West German economy and reinstalled a measure of confidence, progress came unevenly and haltingly. During most of the 1980s, the figures on growth and inflation improved but slowly, and the figures on unemployment barely moved at all. There was little job growth until the end of the decade. When the statistics did change, however, even modestly, it was at least in the right direction.

Nonetheless, it also remained true that West German growth did not again reach the levels that it had attained in the early years of the Federal Republic. There had been a decline in the growth rate since the 1950s, an upturn in unemployment since the 1960s, and a gradual increase in inflation except during or after a severe downturn.

Global economic statistics also showed a decline in West German output and vitality. They showed that the West German share of total world production had grown from 6.6 percent in 1965 to 7.9 percent by 1975. Twelve years later, in 1987, however, it had fallen to 7.4 percent, largely because of the more rapid growth of Japan and other Asian states. Even adding the estimated GDP of the former East Germany at its peak before unification would not have brought the all-German share above 8.2 percent by 1989 and would leave all of Germany with barely a greater share of world production than West Germany alone had reached fifteen years earlier.

It was only in the late 1980s that West Germany's economy finally began to grow more rapidly. The growth rate for West German GDP rose to 3.7 percent in 1988 and 3.6 percent in 1989, the highest levels of the decade. The unemployment rate also fell to 7.6 percent in 1989, despite an influx of workers from abroad. Thus, the results of the late 1980s appeared to vindicate the West German supply-side revolution. Tax rate reductions had led to greater vitality and revenues. Although the cumulative public-sector deficit had gone above the DM1 trillion level, the public sector was growing more slowly than before.

The year 1989 was the last year of the West German economy as a separate and separable institution. From 1990 the positive and negative distortions generated by German unification set in, and the West German economy began to reorient itself toward economic and political union with what had been East Germany. The economy turned gradually and massively from its primarily West European and global orientation toward an increasingly intense concentration on the requirements and the opportunities of unification.

Unification and Its Aftermath

The East German and West German economies at the time of unification looked very similar. They both concentrated on industrial production, especially machine tools, chemicals, automobiles, and precision manufactures. Both had a well-trained labor force and an important export component, although their exports went largely in opposite directions. But the East German economy was highly centralized and guided by a detailed and purportedly precise planning system, with virtually no private property and with no room for decision or initiative.

On July 1, 1990, the economies of the two Germanys became one. It was the first time in history that a capitalist and a socialist economy had suddenly become one, and there were no precise guidelines on how it could be done. Instead, there were a number of problems, of which the most severe were the comparatively poor productivity of the former East German economy and its links to the collapsing socialist economies of the Soviet Union and Eastern Europe.

Even before economic unification, the West German government had decided that one of its first tasks was to privatize the East German economy. For this reason, it had taken over in June the Treuhandanstalt (Trust Agency, commonly known as Treuhand), which had been established by the GDR to take over East German firms and to turn them over to new management through privatization. The agency assumed the assets and liabilities of about 8,000 East German enterprises in order to sell them to German and other bidders. By the time the Treuhand was disbanded at the end of 1994, it had privatized some 14,000 enterprises.

As economic unification proceeded, issues that had been recognized but inadequately understood in advance began to surface. There was massive confusion about property rights. As wave after wave of Nazi, Soviet, and later GDR expropriations had taken place between 1933 and 1989, there was often little knowledge of the actual ownership of property. More than 2 million claims on properties in the territory of the former GDR were filed by the December 31, 1992, deadline. As more claimants emerged, with many winning cases in the courts, potential investors were often scared off.

Another problem was that East German production costs had been very high. The conversion rates of East German marks to deutsche marks often kept those costs high, as did the early wage negotiations, which resulted in wages far above the productivity level. Western German firms found it easier and cheaper to serve their new eastern German markets by expanding production in western facilities.

A third problem was that the inadequate infrastructure also became a problem for many potential investors. Telephone service was improved only very slowly. Many investors also complained about energy shortages, as many East German power stations were shut down for safety and other reasons. Roads and railroads had to be virtually rebuilt because they had been so badly maintained.

In addition to these practical problems, there was also a deep policy dilemma that underlay the entire process of unification. From the beginning, there had been a pernicious link between the earlier and later phases of the East German transition to a free-market economy. Policies calculated to make the initial adjustment as painless as possible hampered long-run growth and prosperity. Real economic efficiency could only be achieved by permitting and even forcing considerable immediate dislocations, whereas temporary compromises might lead to permanent structural burdens. However, excessive disruptions could jeopardize the economic and political stability required for a smooth unification process and might also cause streams of East Germans to move west. The government was never able to solve this dilemma. When it was forced to choose, it usually selected the more expensive and slower course to encourage persons to stay in the east.

Despite these problems, the process of unification moved ahead, albeit slowly. The Treuhand, staffed almost entirely by Germans from the west, became the virtual government of eastern Germany. In the course of privatization, the agency decided which companies would live and which would die, which communities would thrive and which would shrivel, and which eastern *Länder* would be prosperous and which would not. It also decided who might or might not buy eastern firms or services.

Whether correct or not, reports persisted throughout the first years of unification that foreign enterprises were being screened more carefully and more skeptically than German firms even as they were being invited to invest. Less than 5 percent of all investment in eastern Germany was non-German, and most of that was from companies with subsidiaries in western Germany who were expanding them to the east. The Japanese did not invest, although they had earlier expressed some interest, and the offices Treuhand established in New York and Tokyo found few investors.

As might have been expected, the economy of eastern Germany went into a deep and precipitous slump immediately after unification. Within a year after unification, the number of unemployed rose above 3 million. Industrial production in eastern Germany fell to less than half the previous rate, and the total regional product fell precipitously through 1991. One estimate was that in 1991 the entire production of eastern Germany amounted to less than 8 percent of that of western Germany.

Because the process of unification was managed by persons from western Germany, new eastern firms were usually subsidiaries of western firms, and they followed the western ownership and management patterns. Bank participation became customary, especially because the large Frankfurt banks assumed the assets of the former East German State Bank, and most eastern firms thus owed money to those Frankfurt banks. The banks installed their representatives on the boards of the new firms and assumed some supervisory functions—either directly or through control by western firms with bank representation. The Treuhand had close contacts with western German banks. Many of its employees came from those banks and planned to return to their jobs at the banks.

Because of these circumstances, private investment and economic growth came to eastern Germany at a relatively slow rate. Little new equity capital flowed in. Investment during the early years of unification was only 1 percent of the all-German GDP, when much more was needed to jump-start the economy of eastern Germany. Much of the investment was for the purchase of eastern German companies, not yet for their rehabilitation. Many western German firms bought eastern firms on a standby basis, making sure they could produce in the east when the time came and paying enough wages to satisfy the Treuhand but not starting production. Many others, including Daimler-Benz, did not even meet the commitments that they had made when they had purchased the eastern German firms from the Treuhand. Thus, western German private investment was not strong enough to boost the eastern German economy.

As private funds lagged, and in part because those funds lagged, federal budget investments and expenditures began flowing into eastern Germany at a consistently high rate. Government funds were used essentially for two purposes: infrastructure investment projects (roads, bridges, railroads, and so on), and income maintenance (unemployment compensation, social security, and other social costs). The infrastructure projects sustained employment levels, and the income maintenance programs sustained income. But neither had an early growth payoff.

Although the precise level of German official expenditures in eastern Germany has been difficult to estimate because funds appropriated in one year might have been spent in another, it is beyond dispute that the federal government expended well over DM350 billion in eastern Germany during the first three years after economic, or monetary, unification. After 1992 this requirement has continued at an annual level of around DM150 billion, so that the sum of private and public funds put into eastern Germany during the half-decade between monetary unification in 1990 and the end of 1995 would probably amount to at least DM750 billion and perhaps as much as DM850 billion. Between one-fifth and one-fourth of those funds were private, and the remainder were government funds. This constituted an infusion of outside money of about DM50,000 for every resident of eastern Germany, a far greater level of assistance than contemplated for any other area that had been behind the Iron Curtain and a token of German determination to bring eastern Germany to western levels as quickly as possible.

As eastern Germany went into a deep recession during the first phase of unification, the western German economy went into a small boom. Western German GDP grew at a rate of 4.6 percent for 1990, reflecting the new demand from eastern Germany. The highest growth rate came during the second half of 1990, but growth continued at only a slightly slower pace into early 1991. Prices, however, remained relatively stable because the cost of living grew at only 2.8 percent despite some high wage settlements in some industries. Employment rose during the year, from 28.0 million to 28.7 million, and the unemployment rate sank to 7.2 percent. Notably, the number of registered unemployed in western Germany only declined by about 300,000, showing that at least half of the new jobs in western Germany had been taken by persons who had moved to or were commuting from eastern Germany.

The dramatic improvement in the western German figures resulted from the opening in eastern Germany of a large new market of 16 million persons and the simultaneous availability of many new workers from eastern Germany. Many easterners did not want the shoddy goods produced at home, preferring western consumer products and food. Moreover, many easterners were coming to the west to work. By the end of 1990, as many as 250,000 were commuting to work in the west, and that

An advanced model of a plant-protection tractor in use in Saxony
Courtesy German Information Center, New York

number was estimated to have grown to 350,000 or even 400,000 by the middle of 1991.

This meant that western Germany not only had a vast new market but also a growth of over 1 percent in its workforce, as sharp an increase as since the days of the economic miracle. It also increased its capital base because eastern German deposits were placed in western German banks that had come east and because those deposits moved back to the central German financial market at Frankfurt.

The Bundesbank became worried about three elements of the sudden boom: the sudden financial shifts between east and west, which led to a jump in money supply; government deficits resulting from large expenditures in eastern Germany; and the potentially inflationary effects of a rapid growth rate in the west. The bank warned that interest rates would have to remain high to keep price increases under control. The bank raised short-term interest rates sharply through 1991 and 1992, with the average rate of short-term interest climbing from 7.1 percent in 1989 to 8.5 percent in 1990, to 9.2 percent in 1991, and to 9.5 percent in 1992. The Bundesbank permitted rates to begin falling only in 1993—to 7.3 percent—when it believed that the inflationary pressures had been contained by the recessionary effects of the credit squeeze.

As the Bundesbank's policies began to take hold, growth slowed in western Germany, from 4.2 percent in the first quarter of 1991 to 0.8 percent in the last quarter of 1992. For all of 1992, the western German growth rate was 1.5 percent, a decline from the 3.7 percent rate of 1991 and even more from the 4.6 percent rate of 1990. The eastern German growth rate was 6.1 percent during 1992, well below the 7 percent to 10 percent growth rate originally anticipated for the region. The number of employed in western Germany fell for the first time in ten years, by 89,000 persons.

Despite the slowdown, during 1992 the German economy reached a milestone of sorts. With the addition of eastern German production, Germany's GDP rose for the first time above DM3 trillion. Of that total, the new *Länder* contributed a gross regional product of DM231 billion, or 7.7 percent. However, the total of German unemployed also reached a record number, 4 million. Two-thirds of that number were unemployed in western Germany; the other one-third were unemployed in eastern Germany. Eastern Germany contributed more to unemployment than to production.

The 1992 depression continued into 1993, so that the economy actually registered a negative growth rate of –1.2 percent. By 1994, however, after the Bundesbank had been lowering short-term interest rates for over a year, German growth resumed at an annual rate of about 2.4 percent, but unemployment declined only very slowly despite the uptrend in GDP growth. It was expected that stronger growth would begin reducing the numbers of unemployed by 1995 and that Germany would return to its postwar path toward prosperity. But the absorption of eastern Germany, and the methods by which it had been accomplished, had exacted a high price throughout all of Germany.

Structural and Technological Questions

Although Germany is one of the world's most powerful economies, there have been growing doubts within Germany about the state of its economy. The principal doubts have been about the ability of the German economy to modernize quickly enough to keep up in an increasingly competitive global environment. There is also a fundamental debate about the direction that the economy must take if it is to remain successful and prosperous. That debate includes a seminal discussion about Germany's place in the global division of labor, an issue of immense importance to an exporting nation such as Germany.

Those who have led the debate, and those who have insisted most firmly that Germany's economy must change, are those who have seen the world economy changing in directions that would increasingly relegate Germany to a second rank. They have seen the coming of a world in which the work performed by traditional German production sectors—whether coal, steel, chemicals, agriculture, electronics, or machinery—can be done better and more cheaply elsewhere. They believe firmly that Germany has to deemphasize some of those sectors and abandon others in order to move with the greatest speed and the most powerful possible commitment into new areas that will lead the growth of the world economy.

Five German institutes charged with analyzing economic issues have played a central role in the debate, issuing a series of reports and recommendations throughout the 1980s and 1990s in which they warned that the German economy had to change—and change quickly. They complained ever more insistently about what they described as the inadequate response of federal, *Land*, and local governments to the needs of the evolving global economy.

Those who opposed the arguments of the institutes fell into several categories. Some remained committed to traditional economic sectors, which they believed could still perform competitively, especially if enough effort was made to modernize and rationalize them or to find particular specialties. Others supported traditional sectors, not for economic but for social and political reasons. Still others believed that the issues had to be raised and understood but that action could and perhaps should be postponed.

The basic complaint about modernization has been that the German economy has not remained at the forefront of global development and progress and is not moving decisively into the ranks of the most advanced industrial societies, such as the United States, Japan, and the smaller Asian economies. The institutes have pointed out that new technologies—such as computer hardware and software—could not only improve traditional production but also could become new industries in themselves.

As part of their assertion that Germany was not modernizing quickly enough, the institutes have also expressed concern that the country has not given adequate priority to research and development and that German capital has not been venturesome enough. They have argued that funds have not gone sufficiently into the kinds of research or into the start-up ventures that have helped keep the United States at the forefront of international inventiveness even as that country's traditional industries have declined.

This does not mean that German industry does not invest in research and development. EU statistics have consistently shown that Germany has been either first or second in European research and development expenditures, with only France coming close enough to be a real competitor. But those same and related statistics also have shown that the German lead has been shrinking and that Germany does not have the lead in computer-oriented research and development. In particular, they have shown that Germany has not been doing well at the global level, lagging behind the United States and even further behind Japan in the pace at which it has been increasing its research expenditures. In advanced-technology areas, Germany has been trailing badly. The total German private and public research effort has consistently amounted to about 2.8 percent of GDP, but that is about the same percentage as the United States and Japan and is clearly not enough to allow the smaller German economy to keep up. A German patent office study showed that by 1989 West Germany had fallen behind in three of four major areas of domestic patent grants compared with Japan and the United States.

German technological progress has been uneven. The country has certainly remained competitive in biotechnology and general medical research. The same could be said about its competitive position in smaller robotic machine tools and in many areas of electronic and even specialized computer research. But this does not compensate fully for the lag in cellular communications, microtechnology, and computers.

The German government has been slow to assist firms in technological development. There has been strong German financial and scientific participation in a variety of European programs, such as Esprit, Eureka, Jessi, Race, or Brite—programs that are designed to internationalize research at the European level to enable the smaller European states to compete against the United States and Japan. These European efforts are significant, but their results as of the mid-1990s have not allayed the concerns of many Germans about falling behind.

The institutes have also addressed another problem, the German lag in establishing new ventures. This shortcoming goes to the core of the total functioning of the German system, including the conservatism of banking and financial practices. Germany has not found a way to create an environment in which small entrepreneurs in new fields arise in large numbers.

With unification as Germany's principal economic priority, the debate about structural reform has taken second place, and the government is giving it less priority than it received in the 1980s. But it remains an issue and will continue to be so as other parts of the world economy—including Eastern Europe—become more competitive.

The Role of Government and Other Institutions

The Federal Government Role

The German federal government plays a crucial role in the German economy, sometimes directly and sometimes indirectly through the effects of other policies on the economy. Unlike the Japanese government, there is no single ministry that attempts to direct industrial government and competitiveness, but government policy can have wide-ranging effects because of the many offices that play a role.

The three principal figures responsible for economic policy are the chancellor, the minister for economics, and the minister of finance. The three positions have rarely been held simultaneously by members of a single party and are usually divided among two or sometimes three parties. Economic policy therefore has to reflect the interests of at least two political parties, with all that this means in terms of compromise and conciliation. The coalition negotiations to form a new government after a national election are never more delicate or more difficult than when they touch on economic policies.

The main parties have different economic philosophies and pursue generally different objectives. The CDU and the CSU are conservative, business-oriented parties, but with a long tradition of support for social welfare programs. The FDP is liberal in the British sense, very much in favor of the free market and a minimum of government regulation. The SPD believes in combining political freedom with large social programs and government involvement in the economy. It is impossible for any of the three parties to be in a government with the others without yielding something, and government policy has therefore usually contained a mixture of sometimes contradictory objectives that then must be resolved by compromises within the cabinet.

The Chancellor

The way the chancellor and his office, the Chancellory, deal with the economy depends very much on the incumbent's interests and personal style. For example, under Helmut Schmidt (1974–82), who was very interested in economic matters, the Chancellory shaped, directed, and coordinated the economic policy of the entire government economic apparatus. It also kept close contact with the business and financial community, including the Bundesbank, and became deeply involved in long-range planning. Helmut Kohl (1982–), however, has operated very differently, using the Chancellory for limited day-to-day coordination but not attempting to use it to manage the economic policy of the government. He has used the political, not the bureaucratic, structure to make policy, working through the CDU/CSU and the FDP or through personal contacts. Although Kohl was definitely in charge of *die Wende* and other government policies, he has not usually presented himself as either the originator or the executor of economic and financial policy. He has chosen to control events from behind the scenes, reducing the government's visibility as well as its role.

The Minister of Finance and the Minister for Economy

In the cabinet, roles are more fixed, although they might change in accordance with personalities and political parties. The *primus inter pares* over the last several decades has been the minister of finance. He is responsible for the federal budget, which has become ever more important as the government's share of national income has grown and as governments increasingly use the budget to set priorities and guide national economic activity. The minister of finance also accompanies the chancellor to the annual financial summits and is the main German spokesperson in the meetings of the Group of Seven

(G–7—see Glossary), the world's principal economic powers. He is thus in a position to manage not only domestic but also international financial policy for Germany and to coordinate the two.

The minister for economics, once the government's chief economic policy maker (especially when the minister was Ludwig Erhard), has gradually lost power as many of the important functions have been transferred to other ministries—including new ministries concerned with environment and research. Since the 1970s, the minister for economics has functioned more like a United States secretary of commerce, remaining a principal channel for contact with industry, labor, and semipublic associations. But several of the ministers have complained in bitter frustration that they were not able to carry out the policies they wanted.

The Bundeskartellamt

The Bundeskartellamt (Federal Cartel Office) is the institution specifically instructed and empowered to prevent a return to the monopolies and cartels that periodically controlled much of the German economy between the 1870s and 1940s. The policies of the office, like the office itself, have been controversial, with some Germans wanting it to have greater power and others believing that it is already abusing its existing authority.

The Bundeskartellamt was established in 1957. Many, including Erhard, believed that it had not been given enough authority to restrict cartels and other monopolistic practices. The Western Allies had insisted that the fledgling Federal Republic have such a law, but West German business associations used their influence to undercut the authority of the Bundeskartellamt to the point where it has sometimes been described as a "Swiss cheese with countless holes." Some of the holes in the Swiss cheese were closed in 1973, when the Bundestag passed a merger law (*Fusionsgesetz*) intended to block monopolies in advance so that the Bundeskartellamt would not always have to act after the fact.

In retrospect, the laws and the office have performed a central and useful function, but they have not been able to prevent a gradual shift toward ever larger companies in Germany. The number of mergers in West Germany increased rapidly during the late 1980s, rising to over 1,000 per year. And the Bundeskartellamt has not been effective in curtailing the countless informal contacts and discussions that have characterized the German system (like other European systems) and that would be suspect and perhaps illegal in the United States.

Because the Bundeskartellamt tends to use nonconfrontational tactics, the office has often been denounced as ineffective. Critics contend that the office has actually blocked very few mergers or other forms of cooperation. They also assert that hidden monopolistic or oligopolistic practices have been creeping back into the German economy. But others argue that the very existence of the Bundeskartellamt has enhanced competition and that the office's predilection for solving problems through nonjudicial processes fits properly into the German system and is therefore effective in that system.

Despite its title, the Bundeskartellamt does not have the final authority over German mergers and acquisitions. That authority is reserved for the political level, the Ministry for Economics, which on more than one occasion has overruled the Bundeskartellamt. After the Bundeskartellamt had raised a number of searching questions about the legality and propriety of Daimler-Benz's 1989 acquisition of Messerschmidt-Bölkow-Blohm (MBB), and after it had even disapproved the acquisition, the minister for economics approved the merger on condition that Daimler-Benz and MBB sell off majority control in a small marine and technology division. The government justified the step by recalling that it had specifically sought the merger to support MBB—which was engaged in military production and could not be permitted to collapse—with Daimler-Benz's financial resources.

The Bundeskartellamt has faced a particularly difficult task in the integration of the East German and West German economies. Many eastern German firms could not survive unless they could merge with large western German firms. The process may, however, create new enterprises whose size and combination of resources could open the way for monopolistic or oligopolistic temptations. Powerful economic and political pressures for such mergers exist, especially to help revitalize eastern Germany, but they also raise serious questions about their potentially negative impact on competition. Under those circumstances, the Bundeskartellamt has acted with considerable circumspection, blocking some mergers but approving most of them.

The Bundeskartellamt faces an even greater problem in the growing Europeanization of German business under the aegis of deeper EU integration. It became clear by the early 1990s that the EU's European Commission in Brussels was prepared to permit greater cooperation between European firms in order to compete more effectively against the worldwide reach of the giant corporations of the United States and Japan. Such cooperation went against German cartel laws. To solve the problem, the Bundeskartellamt announced in early 1993 that it would permit greater degrees of cooperation between small- and medium-sized German firms if that cooperation actually led to greater intra-European competition.

Land and Local Governments

Because Germany has a federal system, state (*Land*; pl., *Länder*) and local governments also have important functions. This reflects the German tradition, which before Hitler combined a mix of national, *Land*, and local structures with carefully defined and deliberately circumscribed powers. *Land* and even local authorities are involved in many economic functions, such as social services, development and energy policy, education (including vocational training), public housing, environmental protection, and industrial policy. They also share certain tax revenues that are centrally collected but distributed among the central, *Land*, and local authorities in accordance with carefully negotiated ratios that were changed after unification slightly to the advantage of the new eastern *Länder*.

The *Länder* do not always act and think alike. Different old *Länder* have followed different economic policies since the early years of the Federal Republic. On the one hand, the minister presidents, or heads, of two *Länder*, Bavaria and Baden-Württemberg, have stressed industrial development policies that have departed radically from those of others, putting their *Länder* into the forefront of German technological development. On the other hand, the *Länder* of North Rhine-Westphalia and the Saarland for a long time concentrated their resources on subsidizing coal and steel production, entering the competition for new industries much later than other *Länder*. The possibility for creating separate *Land* policies has also encouraged some new *Länder* to try their own development policies. They have invited potential investors from other countries to visit them, and they have engaged in export promotion.

Government Subsidies

The *Länder* are not alone in subsidizing or supporting certain industries: the federal government does it to a massive and increasingly significant degree. Despite Germany's commitment to a social market economy, exceptions to market principles existed in West Germany and are proliferating in united Germany. German economic institutes and experts have repeatedly warned that authorities at various levels have supported many economic activities that should long ago have been discontinued or compelled to become competitive. Federal and *Land* authorities have ignored the complaints of the economists but have usually promised to reduce or eliminate subsidies as soon as feasible.

Before unification, the West German government and various *Länder* supported a number of industries and services, such as coal, steel, aerospace, shipbuilding, and agriculture, with the federal government supporting activities across the board and the *Länder* supporting locally important and influential industries. Between 1970 and 1989, the total volume of subsidies, including those paid through the European Community (EC—see Glossary), rose from DM12 billion to over DM45 billion. The level of subsidies rose almost uninterruptedly, even after Kohl assumed office and his government had committed itself to reducing them. Although some categories of subsidies—for example, those for agriculture—were not fully under West German but rather under EC control, even the portion specifically designated for German farmers also rose by 250 percent during the 1980s. Overall, the federal government provided about one-third of total West German subsidies. The other two-thirds came from the *Länder* and the localities. During the late 1980s and early 1990s, the total has generally averaged around 6 percent of West German GDP, although it has risen because of unification.

Despite the concern expressed about West German subsidies, a 1990 Organisation for Economic Co-operation and Development (OECD—see Glossary) survey of Germany concluded that German subsidies were not unusually high by the standards of the EC. The OECD described them as being around the average for OECD countries. Separate International Monetary Fund (IMF—see Glossary) and Ministry of Finance studies reached a similar conclusion, indicating that West Germany was actually somewhat below the average among EC members in the level of subsidies.

Although such conclusions might have offered some comfort as a matter of general policy, it remains true that some German industries—especially in the traditional coal and steel complex—are dependent on subsidies to such an extent that they would have to be closed if they no longer benefited from government support of one kind or another. But subsidies are also often paid even to some of the largest and most profitable German concerns, such as Daimler-Benz, Siemens, Bayer, and Volkswagen, for special production or research lines. Those companies have usually stated that the subsidies cover only a minute part of their expenditures.

After unification, the combined subsidies of western and eastern budgets rose even higher, and the new all-German government has found itself compelled to provide even more subsidies in order not to permit an excessive level of structural unemployment in the former East Germany. Official East German statistics suggested that the level of subsidies in the GDR budget was 30 percent, but in reality the level may have been much higher because of the generally low level of productivity in the GDR. Although no total figures for German subsidies have been available in the confusion and diversity of programs since unification, the government has already promised to keep a number of unprofitable East German ventures (such as the steel complex around Eisenhüttenstadt and the shipbuilding docks around Rostock) in production until they become competitive—which will not be for decades, if at all.

Government Expenditures and the National Debt

Beyond subsidies, German politicians, businessmen, and economists have consistently had difficulty calculating the most suitable role for the state in the German economy. Many economists believed that the role of the state had become too large in West Germany during the 1970s because of government ownership of large companies, because of subsidies, and because of the high social welfare programs established by the SPD-led governments. The right level after unification is even more difficult to define and to agree upon, because eastern Germany will need much more infrastructure construction and many more social programs than western Germany for many years to come.

As a share of national income, German government expenditures at all levels were 15 percent before World War I, 25 percent during the interwar period, 35 percent around 1960, 48 percent in 1975, and about 50 percent by 1980–81. The government's share of spending, although worrisome to the West Germans, still remained lower than that of several other European states, such as Sweden, the Netherlands, France, and Belgium. West Germany and Britain were the only major European states to reduce government spending as a share of GDP during the 1980s. But their government share still remained higher than that of two principal competitors, the United States, at about 37 percent, and Japan, at about 33 percent. The German share has risen well over 50 percent again during the early 1990s because of the costs of unification, and there is little if any prospect that it will decline again until the end of the decade.

Despite the declining deficits of the 1980s, the cumulative public-sector debt of various levels of German government has grown during virtually the entire existence of the Federal Republic. During the 1960s, the total debt doubled. During the 1970s, it doubled every five years. The growth rate in debt began to slow after the first years of the 1980s, but it began to rise rapidly during the 1990s as a result of unification. By the end of 1989, the West German government said that the total public-sector debt in Germany was DM1,020 billion, or 45 percent of what was then West German GDP. By the early 1990s, however, that figure had risen by several 100 billion deutsche marks and was estimated to be almost DM1.5 trillion, or 50 percent of united German GDP. It rose to over DM1.6 trillion by the end of 1993 and is expected to rise to over 60 percent of GDP by the mid-1990s and then to begin to decline slowly after that. Interest payments on the public debt have become the second largest single line item in the German budget, absorbing 14 percent of the budget.

The Associations

All participants in the German national economy organize themselves into various associations. They do so either voluntarily or, in some associations, as a legal requirement. The associations are commonly known in German as the *Verbände.* Over 1,200 are represented in Bonn. Each plays a chosen or assigned role, and together they help contribute to a broad framework of cooperation mingled with competition.

All the *Verbände* operate as lobbies in Germany itself, working with the parliament, the Bundestag, and the bureaucracy, and they also lobby appropriate EU offices in Brussels. But they are far more than lobbies. They act as sector and regional coordinators. Some not only exercise a voice toward the government but also represent a forum where industrialists or others can meet and talk about business affairs. Some serve as planning institutions, collecting and disseminating information on anticipated sales, production capacities, and investment goals. Others negotiate and settle conflicts between different firms or industries. They help to administer the German economic mechanism as a whole.

Among the main associations are the Federation of German Industry (Bundesverband der Deutschen Industrie—BDI) and the German Chambers of Industry and Commerce (Deutscher Industrie- und Handelstag—DIHT). The BDI is the central organization representing the interests and policies of German industry. Because of its role in organizing and representing German industry, the BDI has immense influence. Any German government, even one with an SPD majority, will consult with it before making any policy or introducing any legislation that could affect German industry or the German economy as a whole. So will key members of the Bundestag. The BDI has no individual members, but only other associations of one or another industry, so that it is in effect an association of associations.

The DIHT is the umbrella organization of the German Chambers of Commerce. It represents all business interests, but especially small business, on a regional as well as a sectoral basis. Membership is obligatory for German firms, and membership is on an individual or a company basis rather than on an association basis as in the BDI.

Some of the powers of the chambers of commerce in Germany would be exercised by government authorities in almost any other country. The chambers participate in vocational training programs, issue licenses and work permits, set store hours, solve disputes between members, issue certificates of origin, run stock exchanges, and so on. They are legally entitled to make their views known in a variety of governmental forums from the local to the national level, and they thus have direct as well as indirect influence over many elements of the economy. Their functions are central to the operation of the German system, as they have been throughout much of German history.

The chambers constitute an important link not only in the formal but also in the informal coordinating mechanisms that operate throughout the economy. Whereas the BDI might be more visible in national policy matters and might influence national government decisions more directly, the chambers and the DIHT have a more pervasive presence at the local and regional level than at the national level. They shape and often author most of the regulations that determine how commerce and industry can act, helping to establish the day-to-day rules under which production and trade take place.

Another important interest organization is the Federation of German Employers' Associations (Bundesvereinigung der Deutschen Arbeitgeberverbände—BDA). It coordinates the collective bargaining strategy of German employers, administers the strike fund, gives legal advice, and deals with matters relating to social policy. Eight member federations organize enterprises in industry, handicrafts, commerce, banking, agriculture, transportation, insurance, and publishing.

A broad division of labor exists among the separate German employers' associations. The BDI, for which the closest United States parallel is the National Association of Manufacturers, mainly addresses matters of broad economic policy. It is, however, much more influential than any parallel United States organization. It helps shape Germany's policies in the EU and is a voice for an open trading system. The DIHT might be compared to the United States Chamber of Commerce. It represents regional interests as well as the interests of small- and medium-sized enterprises. It exercises a great deal more influence and even authority locally. The BDA concentrates on labor and social legislation and also acts as the representative of employers with the trade unions.

German farmers are organized into the German Farmers' Association (Deutscher Bauernverband—DBV). This organization has over 1 million members. It has exercised a powerful influence on German and European agricultural policies, helping to keep production and consumption prices above world levels. The proportional influence of the DBV has grown since German unification because agriculture represented a more important share of eastern German than western German production (see Agriculture, this ch.).

The Culture of German Management

German management, as it has evolved over the centuries and has established itself since World War II, has a distinct style and culture. Like so many things German, it goes back to the medieval guild and merchant tradition, but it also has a sense of the future and of the long term.

The German style of competition is rigorous but not ruinous. Although companies might compete for the same general market, as Daimler-Benz and BMW do, they generally seek market share rather than market domination. Many compete for a specific niche. German companies despise price competition. Instead, they engage in what German managers describe as *Leistungswettbewerb,* competition on the basis of excellence in their products and services. They compete on a price basis only when it is necessary, as in the sale of bulk materials like chemicals or steel.

The German manager concentrates intensely on two objectives: product quality and product service. He wants his company to be the best, and he wants it to have the best products. The manager and his entire team are strongly product oriented, confident that a good product will sell itself. But the manager also places a high premium on customer satisfaction, and Germans are ready to style a product to suit a customer's wishes. The watchwords for most German managers and companies are quality, responsiveness, dedication, and follow-up.

Product orientation usually also means production orientation. Most German managers, even at senior levels, know their production lines. They follow production methods closely and know their shop floors intimately. They cannot understand managers in the United States who want only to see financial statements and "the bottom line" rather than inspect a plant's production processes. A German manager believes deeply that a good-quality production line and a good-quality product will do more for the bottom line than anything else. Relations between German managers and workers are often close, because they believe that they are working together to create a good product.

If there is a third objective beyond quality and service, it is cooperation—or at least coordination—with government. German industry works closely with government. German management is sensitive to government standards, government policies, and government regulations. Virtually all German products are subject to norms—the German Industrial Norms (Deutsche Industrie Normen—DIN)—established through consultation between industry and government but with strong inputs from the management associations, chambers of commerce, and trade unions. As a result of these practices, the concept of private initiative operating within a public framework lies firmly imbedded in the consciousness of German managers.

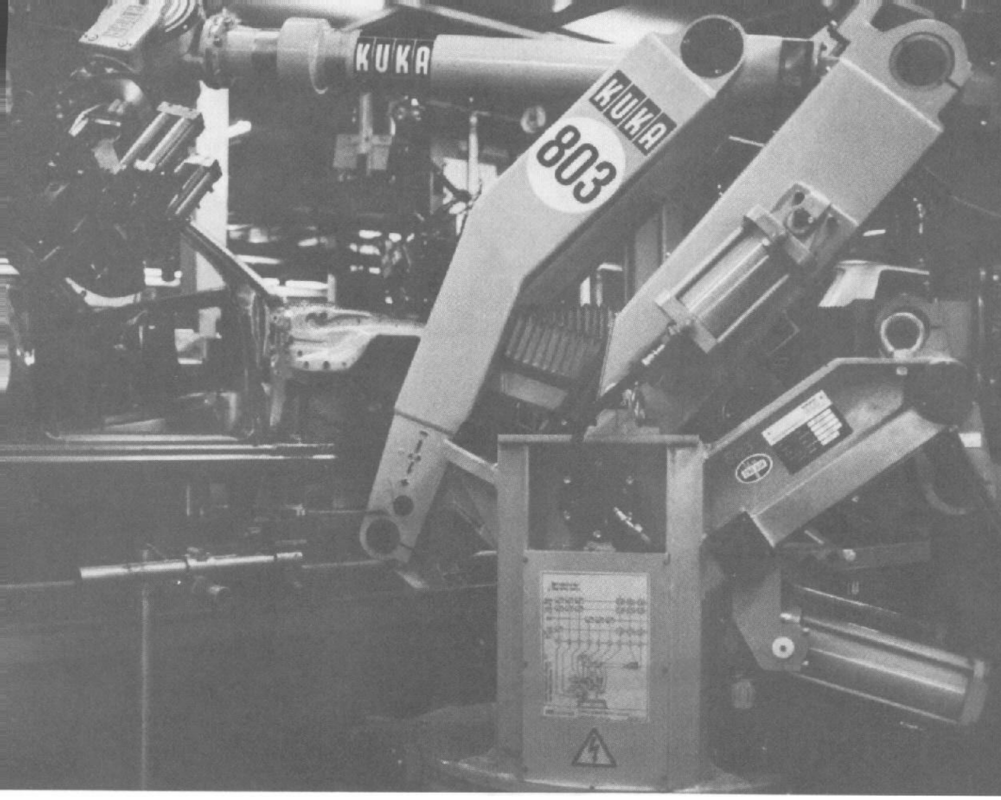
The German management style is not litigious. Neither the government, the trade unions, nor the business community encourages litigation if there is no clear sign of genuine and deliberate injury. Firms do not maintain large legal staffs. Disagreements are often talked out, sometimes over a conference table, sometimes over a beer, and sometimes in a gathering called by a chamber of commerce or an industrial association. Differences are usually settled quietly, often privately. Frequent litigation is regarded as reflecting more on the accuser than on the accused. Because of these attitudes, Germany has comparatively few lawyers. With one-third the population and one-third the GDP of the United States, Germany has about one-twentieth the number of lawyers.

German managers are drawn largely from the ranks of engineers and technicians, from those who manufacture, design, or service, although more nonengineers have risen to the top in recent years. They are better paid than other Europeans (except the Swiss), but on average receive about two-thirds of the income that their American counterparts expect.

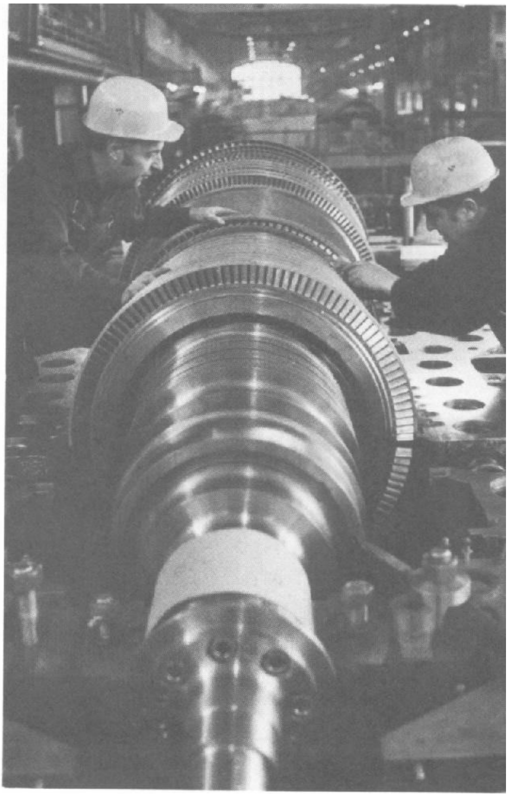
Because managers usually remain in one firm throughout their careers, rising slowly through the ranks, they do not need a visible bottom-line result quickly. Managers do not need to be concerned about how their careers might be affected by a company's or a division's progress, or lack of progress, for each year and certainly not for each quarter.

German taxation also induces management toward long-term planning. German tax legislation and accounting practices permit German firms to allocate considerable sums to reserves. German capital gains tax rules exempt capital gains income if the assets are held for more than six months or, in the case of real estate, for more than two years.

Because management has not been regarded in Germany as a separate science, it was rare until the 1980s to find courses in management techniques such as those taught at schools of management in the United States. Germans believed that management as a separate discipline bred selfishness, disloyalty, bureaucratic maneuvering, short-term thinking, and a dangerous tendency to neglect quality production. Instead, courses at German universities concentrated more on business administration, or *Betriebswirtschaft*, producing a *Betriebswirt* degree. Despite this, two West German schools for business administra-



A robot in use at a Daimler-Benz plant in Stuttgart
Turbine manufacture at the Kraftwerk-Union plant in Berlin
Courtesy German Information Center, New York



tion, the Hochschule für Unternehmensführung and the European Business School, were established during the 1980s, but they teach in ways that reinforce rather than overturn traditional German ways of management.

Out of this compendium of business practices arises what might be termed a German management style, with the following characteristics: collegial, consensual, product- and quality-oriented, export-conscious, and loyal to one company and committed to its long-term prospects. One could legitimately conclude from this that the German system could stifle change because it is not as innovative, aggressive, or results-oriented as the United States management style. That, however, would not be correct, for change can and does take place. It occurs gradually, not always obviously, under the mottoes of stability and permanence, with the least dislocation possible, and often under competitive pressures from abroad. German managers themselves occasionally speculate that change might come too slowly, but they are not certain whether or how to alter the system and its incentive structures.

Labor and Codetermination

Labor

German labor has as much of a culture as German management. The abilities and the attitudes of the labor force have contributed at least as much to the success of the German system as those of management, and perhaps even more so. Many workers, especially in small- or medium-sized firms, regard themselves as serious professionals with a stake in their company and are usually treated as such. They live in comfortable circumstances, not as the factory workers of old. They usually travel abroad, often own foreign property, and otherwise lead lives that had formerly been reserved for the middle class.

German workers have consistently had the highest level of education of any group of workers in Europe, with much of that education acquired after they finish formal secondary school training. Worker training usually lasts two to three years and may last longer for highly specialized vocations (see The Education System, ch. 4). About 2.5 million Germans, or almost half of the fifteen- to nineteen-year-old age-group of both genders, annually receive vocational training within a range of about 400 designated occupational specialties, often on the basis of contracts with preselected employers.

Of the many fields to choose from in German vocational training, most apprentices select from about twenty specializations. Young men prefer training in manufacturing, crafts, carpentry, electronics, or painting. Young women prefer training in sales, industrial purchasing, officework or banking, or medical assistance. Even while they are in training, the students might receive up to DM1,200 in salary per month, although most receive less than that, down to DM255.

After finishing vocational training, students can go to technical colleges located all over Germany, or to public health or nursing colleges, and they can move on to advanced specialization courses in programs for continuing education. Those systems exist separately from academic colleges and universities but can be as demanding.

The programs are expensive for industry as well as for government. One estimate was that West German industry before unification spent about DM35 billion annually to support the program. The philosophy governing the expenditure of time and money was articulated by the head of personnel at Volkswagen, who said: "Training costs money; not to train costs a great deal more money."

The high level of training of German workers produces a "quality time" labor productivity formula. The German worker spends fewer hours per year at work than any competitor, averaging an annual 1,708 hours compared with 1,763 in France, 1,778 in Britain, 1,912 in the United States, and 2,166 in Japan. Yet Germany has the highest share of world trade in goods with a high skill content: 20 percent, as against 17 percent for Japan, 15 percent for the United States, and 7 percent for France.

Many of western Germany's labor traditions have moved smoothly to eastern Germany since unification. Vocational training already existed in the GDR, and labor in East Germany was not as inefficient as management or as the often antiquated production machinery. Therefore, although there have been problems of adjustment, especially for older workers in the east who were not accustomed to the pace of a modern production site, on the whole the eastern labor force has adapted well.

Many of the generalizations that can be made about German labor cannot be applied equally to the foreign workers who constitute about one-tenth of the country's labor force. The 2 million foreigners employed in Germany often work in very large companies, on assembly lines, in mining and chemical operations with little prospect for advancement, or in some service sectors at menial tasks under difficult conditions. Approximately 25 percent of foreigners work in steel and iron foundries, another 25 percent in hotels and restaurants (often as cleaning staff), and another 15 percent on automobile assembly lines. Certain industries, such as steel production, textiles, or mining, could not function without them.

Among the principal reasons for the decline in Germany's economic growth have been the high costs associated with production. German labor costs per hour in the manufacturing industry have achieved the dubious honor of being the highest in the world—largely because of high social costs. As the Bundesbank's tight money policies have consistently made the deutsche mark ever stronger, German labor costs have grown even higher against those in other countries. In part because of the rise in the value of the deutsche mark, total German wage costs were estimated by 1992 to be about 50 percent higher than in the average West European state, the United States, or Japan, and many times higher than those prevailing in most Asian states, in Eastern Europe, or in the developing world. The Bundesbank estimated that those costs had risen by almost 10 percent between the beginning of 1991 and the beginning of 1993. Chancellor Kohl himself complained that German workers could not afford to continue to have "the shortest working week, the lowest number of working years, and above all, which is the worst, the shortest machine operating time . . . in all the European Community." But, although a number of German wage settlements in 1993 and 1994 raised wages by less than the anticipated inflation rate, there are no signs that German labor is prepared to lower its income to meet international competition. The average German worker believes that quality production and efficiency justify his or her high income.

Codetermination

Codetermination (*Mitbestimmung*), under which German workers or their representatives sit on the governing boards or the factory councils of most German firms, is a classic example of how the German system reconciles apparent opposites and points them to a common purpose and in a common direction. Codetermination did not come about in West Germany in a single step. It evolved and expanded through five different West German laws, beginning in 1951 and continuing in 1952, 1954, 1972, and 1976. The first three laws were passed by CDU-led coalition governments, the last two by SPD-led governments. All the codetermination statutes were applied to eastern Germany after unification. Through the combination of those laws, 85 percent of all German employees are included in some form of codetermination.

Codetermination takes place through two structures, the *Aufsichtsrat* (supervisory board) in a large enterprise and/or the *Betriebsrat* (factory council) in most companies. Over two-thirds of all German firms have a *Betriebsrat.* Only about one-fourth have an *Aufsichtsrat.* Many large firms have both. If a firm is large enough to have both, the workers are twice represented. Depending on the size of the firm, the *Aufsichtsrat* must have between one-third and one-half worker membership. The *Betriebsrat* is composed entirely of employee representatives.

The result of forty years of codetermination is the kind of bargain typical of the way the German economy is managed. Management can largely direct the functioning of the company. It makes investment, financial, operational, and market decisions, but it makes those decisions through a mechanism in which labor can have a voice. Labor can make certain that the conditions under which the workers operate are socially acceptable. It can also make certain that the workers benefit from the company's well-being. But labor in turn has a stake in ensuring that the demands and actions of the workers do not jeopardize the firm itself.

In addition to their participation in company management, German workers are also represented in trade unions. The principal organization is the Federation of German Trade Unions (Deutscher Gewerkschaftsbund—DGB), an umbrella organization that joins seventeen trade unions along industry lines that match those of the BDA (see Labor Unions, ch. 7). Trade union membership is not obligatory in Germany. Less than one-half of all West German workers belonged to the trade unions in 1989, but German unification has led to a rise in trade union membership in absolute and percentage terms because the East German workers were accustomed to union membership.

Agriculture, Forestry, and Fishing

Agriculture

Agriculture is a small sector of the German economy (see table 13, Appendix). It has declined in importance all during the twentieth century and by 1989 amounted to only 1.6 percent of West German GDP. Although agriculture's share of East German GDP was twice as high as in the west, even after the two economies are completely united, agriculture's share of GDP is expected to amount to only about 2 percent. However, despite the sector's small size, it remains politically important.

The number of farms had decreased steadily in West Germany, from 1.6 million in 1950 to 630,000 in 1990. In East Germany, where farms were collectivized under the socialist regime, there had been about 5,100 agricultural production collectives with an average of 4,100 hectares under cultivation. Since unification, about three-quarters of the collectives have remained as cooperatives, partnerships, or joint-stock companies. The others were returned to their original owners—if those owners could be found—or were privately sold, becoming about 14,000 private farms. In western Germany and in the newly privatized farms in eastern Germany, family farms predominate. For the 630,000 farms, there are 750,000 full-time employees. There are also, however, many more part-time employees, and most farms do not represent their owners' full-time occupation.

Although the number of farms has declined, production has actually increased through more efficient production methods. By the early 1990s, a single farmer could produce enough food for seventy-five persons, far more than was the case in the 1950s or 1960s.

Agricultural products vary from region to region. In the flat terrain of northern Germany and especially in the eastern portions, cereals and sugar beets are grown. Elsewhere, with the terrain more hilly and even mountainous, farmers produce vegetables, milk, pork, or beef (see table 14; table 15, Appendix). Almost all large cities are surrounded by fruit orchards and vegetable farms. Most river valleys in southern and western Germany, especially along the Rhine and the Main, have vineyards. Beer is produced mainly, but not exclusively, in Bavaria.

Since the 1960s, German agricultural policy has not been made in Germany but in the EC. All agricultural laws and regulations are written in Brussels, often after difficult negotiations between food-producing and food-consuming states. The main objective of those negotiations is to obtain high incomes for the farmers while keeping market prices low enough to avoid consumer protests. To make up the difference, the EC adopted the Common Agricultural Policy (CAP—see Glossary) subsidy program and the export subsidy program, both of which benefit German farmers as well as other EU farmers. In return, the German farmers have complied with European directives on the quality and quantity of production.

Forestry

Germany also has significant lumber production. Almost one-third of Germany's total land area, especially in the south, is forested. German forests produce nearly 40 million cubic meters of timber every year, satisfying two-thirds of domestic demand. However, Germany has to import most of its hardwood.

There has been growing concern for decades about environmental damage to Germany's forests. By the 1970s, trees were losing their needles or leaves and were growing less full than in the past (see The Environment, ch. 3). A number of laws and regulations have attempted to stem this phenomenon, which the Germans call *Waldsterben* (death of the forest). The Forest Preservation and Forestry Promotion Act was passed in West Germany in 1975 to prevent destructive and wasteful timber policies. It now applies to all of Germany. Under the act, forest owners must return cut areas to their original condition, converting forests into timber farms in which the cut trees are replaced by seedlings. This policy works better for pine than for other timber. However, despite legislation and the great attention paid to the forests, no lasting solution has yet been found. As a result of the decades of ecological damage, many German forests, including the highland Black Forest in the southwest, are badly depleted.

Fishing

The German fishing industry also suffers from depletion, because its principal fishing grounds have become overfished by the many modern fishing fleets that enter North European waters. German vessels have long fished the North Sea, the Baltic Sea, and the Atlantic Ocean off the British Isles and around Greenland, all areas where many competing fishing fleets also operate. The German ocean-fishing fleet has shrunk. Germany attempted through the EC to establish rules that would prevent overfishing, but those rules have proved difficult to enforce.

Industry

Manufacturing

The German economy is essentially a processing economy. This was true of both West Germany and East Germany before unification. It will remain true in the future, although the detailed shares of GDP remain to be determined by unification and may not be clearly evident until the mid- or late 1990s.

Before unification, 40 percent of the German workforce was involved in manufacturing, with the main industries being machine tools, automotive manufacturing, electrical engineering, iron, steel, chemicals, and optics. Although the industrial sector in the former East Germany is still evolving, manufacturing in that part of Germany is expected to concentrate in the same industries over time. Thus, the future German economy will retain a powerful industrial component that will likely total well above 30 percent of German GDP.

Almost all areas of western Germany have some industry. The main industrial areas are the Ruhr district in North Rhine-Westphalia, the traditional center of German coal, steel, and heavy industry; the concentration of industry around several large cities, such as Hanover, Munich, Frankfurt am Main, and Stuttgart; the chemical production areas that stretch mainly along the Rhine River in Baden-Württemberg and farther north; and the automotive manufacturing centers, increasingly concentrated in southern Germany in Bavaria and Baden-Württemberg.

In eastern Germany, the main industrial manufacturing areas are in Saxony, Saxony-Anhalt, and Thuringia, principally concentrated in the Leipzig, Dresden, Halle, and Chemnitz regions. Before World War II, Saxony was the technology center of Central Europe. The Elbe River, like the Rhine, attracted chemical and other industry along its shores. It is uncertain which eastern German industries will survive, but the firms in the southern part of the region appear to have better chances than those farther north. Even before unification, more industry was concentrated in the south than in the north. The districts in northern East Germany had industrial employment below 25 percent, those around Berlin had industrial employment between 25 and 35 percent, and those south of Berlin had over 35 percent employment in industry. No such clear geographical delineation for sector employment existed in West Germany.

The glory of German industry is not in the big firms that are well known around the world, such as Daimler-Benz, Volkswagen, Siemens, or Bayer (see table 16, Appendix). It is in the small- and medium-sized firms that constitute what the Germans call the *Mittelstand.* Although that term has political and social as well as management connotations, it has been widely accepted to mean companies that employ fewer than 500 workers. Such firms constitute 98 percent of all German companies, hire 80 percent of all employees, are responsible for a significant share of exports, and provide one of the firmest foundations of the middle class.

The government has supported and furthered the *Mittelstand,* in part for political reasons, but also because it makes a crucial contribution to the economy. The government has established special provisions that permit those firms to cooperate if they do not thereby hinder competition. It makes available special funds to promote research and development by *Mittelstand* companies. After unification, the government used investment and tax incentives to encourage *Mittelstand* companies to invest in eastern Germany.

The single most successful German industry is mechanical engineering, with a total turnover in 1991 of DM240 billion. Unlike many industries in Germany and elsewhere, it is dominated by small rather than large companies. It includes over 4,000 firms throughout Germany. Only 3 percent of the companies have more than 1,000 employees. German mechanical engineering has a range of more than 17,000 products. Almost two-thirds of the products are exported.

The best-known industry and the second-largest, with a turnover of DM217 billion in 1991, is automotive manufacturing. Such companies as Daimler-Benz, Volkswagen, and Bayerische Motorenwerke (BMW) are known throughout the world. Almost half of all German-produced automobiles are exported, mainly to other EU members and to North America.

Electrical engineering ranks third in importance among German industries, with a turnover of DM207 billion in 1991. The biggest single firm is Siemens, although Bosch also ranks among Germany's largest companies. Products range from giant electric generating turbines exported all over the world to smaller electric engines and some consumer goods.

The chemical industry, with a total output of DM166 billion in 1991, is based principally on three large corporations that have been leaders in the field for 100 years—Hoechst, Bayer, and BASF. There are also many medium-sized companies. About one-half of the industry's products are exported.

Other important industries are the traditional German industries of steel and coal mining, both heavily subsidized and still large employers. Precision engineering remains a strong area. Aerospace is a small but growing industry, also heavily subsidized, and German companies often join with companies from other EU countries—such as Airbus and military aircraft production (see fig. 10).

One reason to believe that the eastern and western portions of the united Germany will again knit together into one large manufacturing economy is that such an economy has been part of the German tradition for centuries and that both Germanys have specialized in the same general industrial sectors. Some analysts contend that the eastern economy will even have a competitive edge later in the 1990s because of the vast sums being invested in modernizing its industrial plant.

Energy and Natural Resources

Like most modern states, Germany relies principally on fossil fuels as sources of energy. About 40 percent of German energy consumption comes from petroleum, largely for trucks and automobiles. About 30 percent comes from domestic coal deposits, half from lignite, or brown coal, in the east and the other half from anthracite located in the west. Natural gas provides about 17 percent of energy consumed, and nuclear energy about 10 percent. Other sources of energy, such as hydroelectric, solar, or wind-powered electric power plants, are relatively insignificant. Most production is in private hands.

Electrical power comes almost equally from three sources: the largest (31 percent) is generated by lignite, the next largest (28 percent) from nuclear reactors, and the third largest (26 percent) from anthracite. Natural gas provides about 7 percent. Those proportions will undoubtedly shift over time because of the high pollution levels generated by the relatively inefficient lignite, especially in the new *Länder*, where it accounts for over 90 percent of electricity production (see table 17, Appendix). The public's aversion to nuclear power that developed in Germany in the 1980s will likewise cause this source of power to become less important. Natural gas will become more significant.

The necessary reduction of brown coal consumption is unfortunate for the nation's economy because it and anthracite are Germany's only significant natural resources. As of 1993, Germany was the world's largest producer of brown coal, mining nearly twice as much as the next greatest producer, Russia. Anthracite mining is also significant, and Germany was the world's ninth greatest producer of this substance in 1993.

Germany has over twenty nuclear reactors, most of them small and having production levels below 2,000 megawatts per reactor. It has virtually no domestic uranium deposits and must import enriched uranium for its reactors. Most of the reactors in operation in the early 1990s were built during the 1970s and early 1980s. Reliance on nuclear power has become controversial, however. Because of the controversy, no new nuclear reactor has entered service since 1988. A number of older reactors dating to the 1960s have ceased operations. A major international energy crisis would be needed to renew impetus in Germany's nuclear energy program because the country is densely populated, and most of its inhabitants do not want a reactor near their houses or offices.

Germany must import almost all the oil and gas that it uses. In 1993 the three largest suppliers of crude petroleum were Norway (18.4 percent of the total), the Commonwealth of Independent States (CIS—see Glossary) (17.4 percent), and Britain (12.4 percent) (see table 18, Appendix). Germany has its own modest oil deposits, estimated in 1990 at 50 million tons, in the North German Plain. It has a share of North Sea gas reserves and production, with reserves estimated in 1990 at 9.9 billion cubic meters. But these are not adequate long-term sources. Thus, Germany will increase its imports of oil and gas, most likely from Russia. East Germany relied heavily on Soviet gas before unification, and united Germany will want to purchase petrochemicals from Russia to enable Russia to pay for the German manufactures that Russia is purchasing.

Like all modern economies, Germany has become increasingly cost conscious and conservation conscious about energy consumption. Whereas GDP in West Germany rose by about 50 percent from 1973 to the early 1990s, energy consumption rose by only 7 percent.

The Financial System

The Bundesbank

The single most important economic institution in Germany outside the federal government is the central bank, the

Figure 10. Economic Activity, 1995

Deutsche Bundesbank (commonly called the Bundesbank). It has the dominant voice in German monetary policy. Through that voice, it establishes and maintains a firm policy in favor of solid currency value within Germany and increasingly within the EU and even the world at large.

If a central bank's reputation is its most precious asset, the Bundesbank is among the world's most highly endowed institutions. Its contribution to the economic and political stability of

West Germany and Western Europe in the postwar years was almost legendary and was given due respect even by those who disagreed with some or many of its policies.

Although the Bundesbank often appears to be the principal maker of German economic policy, its exact powers are carefully set forth and circumscribed in the 1957 law establishing the bank. The law assigned to the bank the responsibility for "the preservation of the value of German currency," a mandate that was so important that it was clearly intended to override the bank's other principal task, "to support the general economic policy of the federal government." Even the latter task was carefully limited by the specific provision that the bank "shall be independent of instructions from the federal government."

The government does have a role, if it wishes to exercise it. Government representatives can and at times do attend the meetings of the bank's governing board, the Central Bank Council (see Glossary), although the government cannot block the bank's actions but is authorized only to delay them for no longer than two weeks. There are also informal contacts between the government and the bank, and it is not unusual for senior officials at the Chancellory or the Ministry of Finance to know in advance what the council might be expected to decide at its next meeting.

The bank has more authority in the realm of monetary policy than any other major European central bank. It is most closely based, at least in its structure although not in its formal mandate, on the United States Federal Reserve Bank. It exercises more functions than the Federal Reserve, however, in part because it carries out some exchange responsibilities that are assigned to the United States Department of the Treasury. The Bundesbank issues money and makes monetary policy by controlling short-term interest rates such as the discount rate for loans to other banks and the Lombard rate (see Glossary) for short-term funding for business.

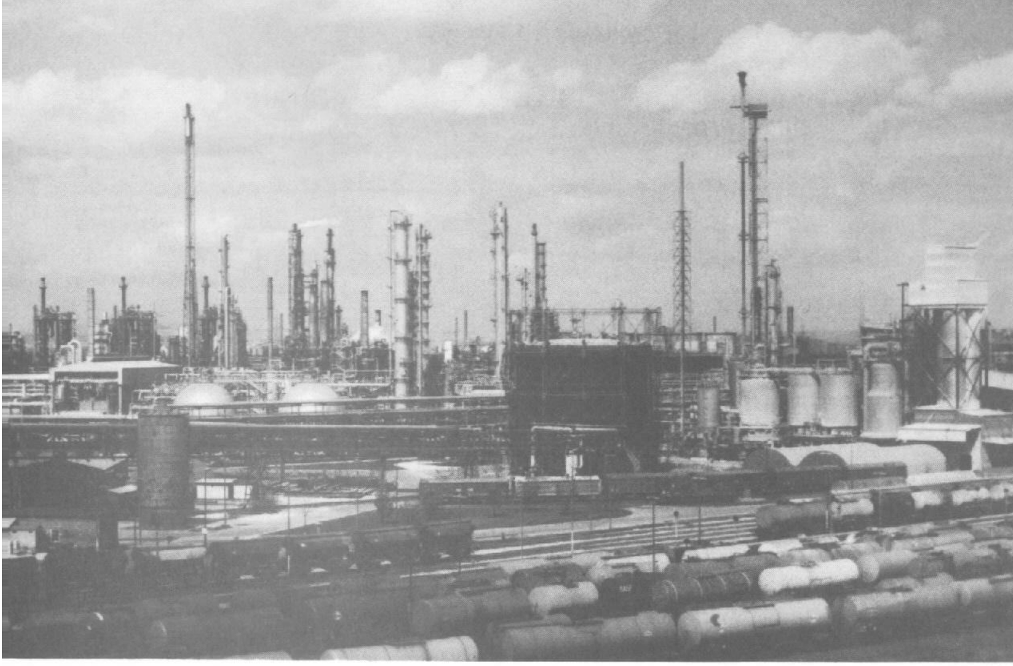
As of mid-1995, the president of the Bundesbank was Hans Tietmeyer, who made his mark in the economics and finance ministries as a career official and then as a state secretary. Kohl appointed him Bundesbank president in 1993. The Bundesbank's Central Bank Council has seventeen members, with the majority of nine being the presidents of regional or *Land* central banks. The representatives of these banks can, therefore, outnumber the eight members of the Central Bank Council who work out of the bank's executive office in Frankfurt am Main, the Direktorium (Directorate—see Glossary), giving the bank a strong orientation toward developments in the country as a whole, while public and foreign attention usually concentrates on the Directorate. *Land* central bank presidents are nominated by *Land* governments. They do not serve at any government's pleasure, including that of the *Land* that nominated them. The members of the council who are in the Directorate are appointed by the president upon the nomination of the chancellor, but even these members are not subject to government direction.

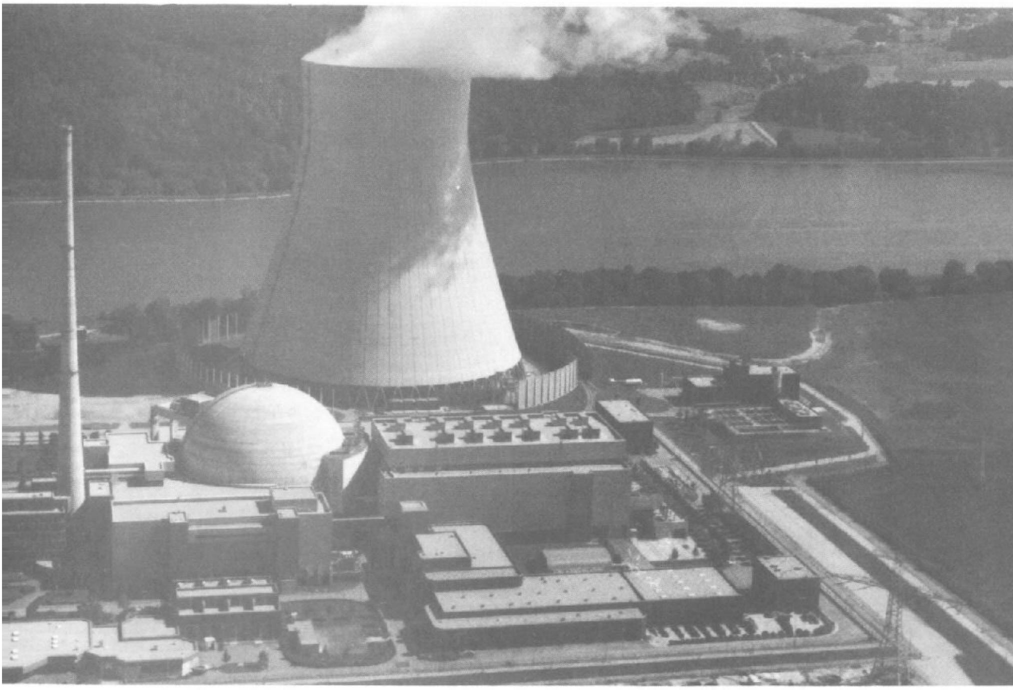
The single most important fact about the Bundesbank, however, is its powerful and consistent anti-inflationary philosophy. That philosophy, grounded in its absolute determination to avoid the social upheaval caused by the Great Inflation of the early 1920s, is central to the bank's thinking on every occasion and has given it enormous influence. Although a number of economists, especially some in the United States, have long argued that the Bundesbank's policies are excessively restrictive and potentially deflationary, the bank is popular with most German voters and with much of German business. The voters do not wish to see their savings eroded by inflation. Businessmen are inclined to believe that a lower inflation rate will permit them to hold down their costs and remain highly competitive over the long run although others might receive some temporary advantage from devaluation. Germans believe that a country with a stable currency will be able to have lower capital and labor costs because lower inflation expectations make lower interest rates and stable wages acceptable.

German demographic realities have added further reasons for anti-inflationary policies. As the population ages and as more Germans live on pensions or on fixed investment incomes, the importance of price stability has become a powerful consideration for a growing sector of the electorate. That sector of the electorate fully supports the Bundesbank's anti-inflationary policies.

Banking and Its Role in the Economy

The German economy is a bank economy, with the main role in finance and credit being played by commercial and savings banks while other forms of credit are secondary. Banks provide most of the country's investment capital because of the high German savings rate and because most Germans prefer to





A petroleum refinery in Ludwigshafen, Rhineland-Palatinate
Courtesy German Information Center, New York
A nuclear power plant outside Munich
Courtesy Inter Nationes, Bonn

put those savings into banks rather than into stocks or bonds. As with many other German economic phenomena, this bank role is not new. Banks have played a central role in German financial and economic history since the Middle Ages.

German banks function as universal banks, able to offer a full range of banking, saving, foreign exchange, and investment services to their depositors and clients. They hold funds or other assets, broker securities, underwrite equity issues, give advice on asset placement, manage accounts, and so on. About one-quarter of German banks are commercial. Most of the remainder are savings banks, mainly owned locally or regionally and operating under public statutes, or cooperatives that perform such specialized services as agricultural, crafts, or mortgage lending.

The three best known and most important German universal banks—the Deutsche Bank, the Dresdner Bank, and the Commerzbank—are omnipresent throughout unified Germany and have immense influence. These banks opened hundreds of new offices in the east during unification and sent large staffs of bankers to manage offices and to train permanent personnel there. In effect, they were the principal agents for control of Germany's economic unification.

But the "big three," as they are often known, are not the only large banks in Germany. A number of other banks, including regional banks, are even more important than the big three within their areas of operations. The DG Bank, which operates out of Frankfurt am Main, has a higher nominal capital stock than that of the Commerzbank. The Westdeutsche Landesbank, headquartered in Düsseldorf and owned in part by the *Land* of North Rhine-Westphalia, has a higher nominal capital stock value than that of the Deutsche Bank. The value of the combined nominal stock of the three major banks in Bavaria is even higher, and those banks have helped finance the economic boom in southern Germany. Other major banks exist in other *Länder*, often owned in part by the *Länder* themselves with additional capital coming from state-wide savings associations or other local institutions. An important element in the German savings system is the Postbank, the postal savings bank, with 27,000 employees. Almost one in three Germans has an account in the Postbank, using it for savings and for personal financial transactions such as paying monthly bills in preference to bank accounts. The Postbank has 24 million savings accounts and hopes to branch into other areas of financial services.

The most important and most controversial aspect of German banking is the role that banks play as shareholders and policy makers in the country's industrial firms. It has been estimated that banks directly or indirectly hold more than 25 percent of the voting capital in one-quarter of Germany's largest corporations and hold about 28 percent of all seats on the supervisory boards. The banks are empowered to vote not only their own shares but also, by proxy, shares that they hold for their clients. Although there are indications that the banks' ownership proportion of major firms has been reduced over time as other sources of investment funds have become more available, the combined influence and presence of the banks is considerable. They are even said to pool information on the basis of which they steer investments throughout the economy.

According to a Commerzbank listing of ownership of 10,000 large West German companies, the Deutsche Bank owns shares in seventy-seven different firms, the Dresdner Bank in fifty-five, and the Commerzbank in forty-eight. Other smaller banks are also widely invested. The Commerzbank listing did not show the bond or loan holdings of the banks or the votes they exercised in proxy, but it did show that in pure ownership terms alone the banks have a strong voice in a significant number of major German companies. The positions that the banks hold could afford wide opportunities to influence industrial decision making, although they are not the kinds of true monopoly positions that earlier German cartel arrangements offered.

A mid-1980s study by the government agency that examines potential monopolies, the Monopolkommission, looking only at major companies, concluded that the three major banks could vote well over three-quarters of the shares of many major German corporations and that all banks together had even greater voting authority. The power of the banks also is evident in the seats they hold on the boards of the country's most important corporations, with bank presidents or representatives sitting on the boards of every major German firm.

The banks do not appear to want to seize industrial power or make production decisions. They would be hard put to exercise monopoly power, and their actions on individual boards are clearly subject to enough scrutiny—at least by other board members—that improper actions would become widely known. German business is prepared to accept the power and influence of the banks and to see it perpetuated. Nonetheless, the direction of bank influence probably adds a conservative element to German economic decision making because banks traditionally prefer to avoid risk-taking in favor of slow but steady dividends and debt repayment. They also could be accused of becoming new masters of German cartel-like structures, with banks directing separate firms toward similar policies even if the firms themselves are not colluding.

The role of the banks in the economy has raised questions. Some political figures, including FDP leader Otto Lambsdorff, have charged that the banks have accumulated excessive power. Newspapers and magazines, including business journals, periodically make the same charge. But there are no indications that the system is changing or will change in response to those criticisms. One could even argue that it is more pervasive than ever, as banks now also play roles in managing former East German firms that were privatized with western bank funds.

Nonbank Financing

Ever since the collapse of the Berlin stock exchange after Hitler's seizure of power in 1933, Germany has lacked a major international market for bonds and equities. Nothing in Germany rivals those of New York or Tokyo, and even the London market does more overall trading than Frankfurt. London even trades almost one-third of all German shares. There are now ten regional exchanges in Germany, but no single exchange is very large.

To help promote nonbank financing and a greater German interest in equities, the German government has launched a drive for what it terms Finanzplatz Deutschland, making stock and bond trading easier in Germany and subordinating the roles of the smaller exchanges to the Frankfurt exchange as the major site for German nonbank finance. Proposals include a futures market, improved electronic links among regional markets, some computerized trading, longer opening hours, freedom for firms to issue commercial paper, and the elimination of a small but annoying German turnover tax on securities transactions. They also include tighter national supervision to prevent misuse of the exchanges and of new methods of finance. Finally, there are tight restrictions on insider training, and a supervisory organization that will correspond to the

Securities and Exchange Commission in the United States is being created.

The smaller regional exchanges have objected that some of the steps proposed under the Finanzplatz Deutschland proposal violate the federal principle on which postwar West Germany had been founded, and they have been supported by the *Land* governments that do not want Frankfurt to have too much power. Therefore, not all parts of the government plan have been carried out as soon as its proponents wished. Nonetheless, an important step has been taken in the merger of the Frankfurt stock exchange and the German futures and options exchanges, the Deutsche Terminbörse (DTB).

Despite such measures to encourage equity placements, most German firms still do not seek equity financing, and even if they do, they often work through banks to obtain it. West Germany had 370,000 limited liability companies or closed corporations (*Gesellschaften mit beschränkter Haftung*—GmbH) as against 2,300 corporations (*Aktiengesellschaften*—AG). Of those, only 619 had their shares quoted on the markets at the end of 1990, and the number thereafter grew only slowly. There has been no upsurge toward new equity finance as a result of unification, with many East German firms being taken over by West German firms and with banks supplying the needed financing as well as sitting on new boards. Although there are some signs that German firms appear to be turning increasingly to exchanges for funds, and the volume of such placements increased over the late 1980s and early 1990s, many firms still feel more comfortable with their established banking links.

A step that may lead to a greater financial role for Frankfurt in Germany itself as well as in Europe has been the EU's 1994 decision to place the new European central bank in Frankfurt when that bank is established. This would reinforce Frankfurt's place as the center of the European Monetary Union (EMU—see Glossary) and also as the center of German finance (see Germany and the European Monetary Union, ch. 6). Berlin's emergence as a center for trade and services with Eastern Europe might over time boost Berlin's prospects as an alternative center of German finance.

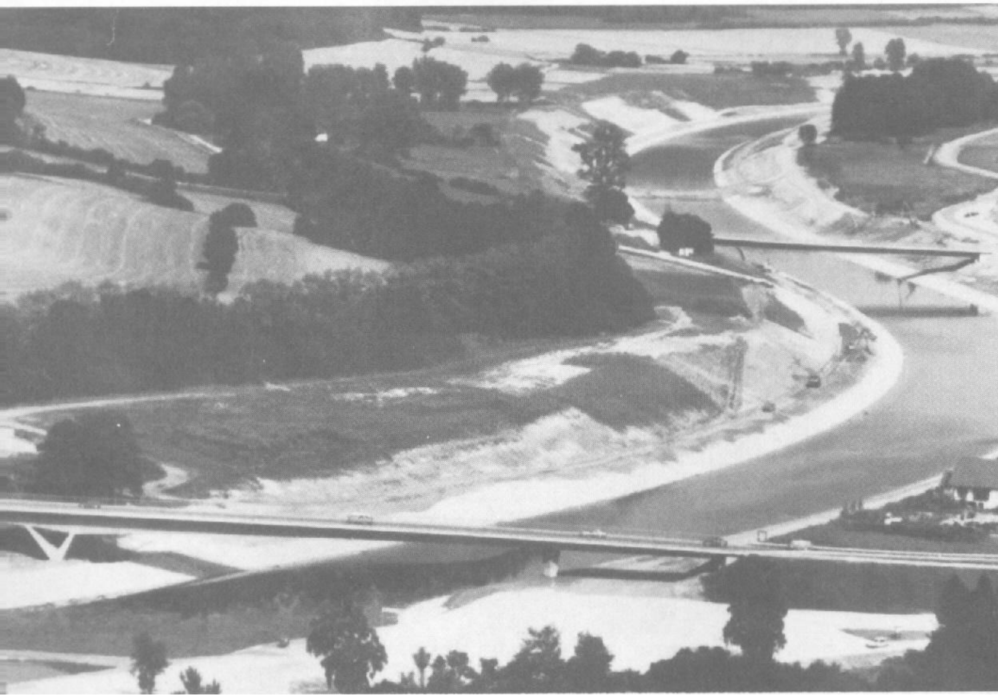
Other Services

Transportation

Germany has one of the world's largest and most sophisticated transportation systems. This reflects the intensely mobile nature of the German population, who are among the world's most active drivers, tourists, and travelers. It also reflects Germany's location in the center of Europe and the many far-reaching industrial and commercial relationships developed over centuries. Because of the density of the network, many towns, but especially such major cities as Berlin, Frankfurt am Main, Munich, and Hamburg, function as transportation and communications centers, lying either at the intersections of major east-west and north-south routes or on transshipment points of ship, barge, road, and railroad traffic. With Europe again uniting from the Atlantic to the Urals, Germany's position as a transportation and communications hub for the continent will become ever more important.

To cope with the additional demands caused by German and European unification, the German government has designated seventeen major transport routes to be either completed or rebuilt as soon as possible during the last decade of the twentieth century and the first decade of the twenty-first century. The first transport plan for newly united Germany was adopted in 1993 and will cost DM453 billion by the year 2012. More than half of the investment will be dedicated to rail and waterway travel, not road travel (see fig. 11).

Trucks have been the most important instrument for freight transport throughout Germany for decades. They carried 203 billion ton-kilometers of freight in 1992, with railroads second (83 billion ton-kilometers) and inland shipping (55 billion ton-kilometers) third. But the railroad system is also perceived as very important, and it will be extensively modernized. The Deutsche Bahn railroad company, formed in January 1994 from the East German and West German railroad systems and to be gradually privatized, has a network of over 40,000 kilometers at standard 1.435 meter gauge, of which 16,000 kilometers are electrified. Perhaps 8,000 kilometers of German railroad tracks will be eliminated through rationalization. To speed traffic, new high-speed railroad tracks have been designed to permit special trains to move at up to 250 kilometers per hour between such principal cities as Hamburg and Munich, with more tracks to follow. The purpose of these new trains is to relieve some of the pressure on airports by making surface transportation fast and attractive for distances of fewer than 500 kilometers.



A Lufthansa Boeing 737–300 at Berlin-Tegel Airport
Courtesy German Information Center, New York
The Rhine-Main-Danube Canal, which completes the link between the North Sea and the Black Sea
Courtesy Inter Nationes, Bonn

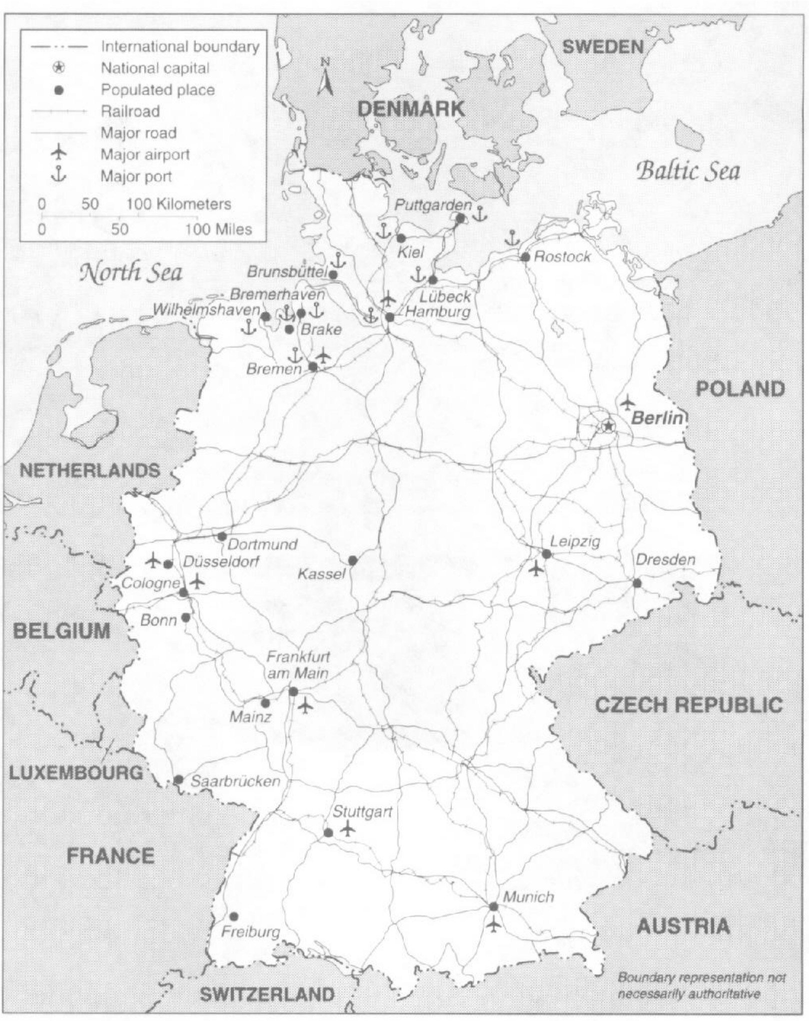


Figure 11. Transportation System, 1995

Germany has one of the densest road networks in the world and the largest after the United States. There were a total of 226,000 kilometers of roads in 1992, including more than 11,000 kilometers of four-or-more-lane superhighways. Nonetheless, especially in crowded areas and for the long routes toward southern Europe, many trucks are carried piggyback on trains to increase speed and to reduce pollution. The former East German system required several years of rebuilding after

Figure 12. Inland Waterways, 1995

unification to enable it to serve the infrastructural requirements of modern business travel.

Germany had 45 million motor vehicles in 1992, with 39 million automobiles. Automobiles accounted for some 685 billion passenger-kilometers in 1990, a number that could be expected to rise rapidly by the mid-1990s as the eastern German population begins to acquire automobiles at a rate similar to that of their compatriots in the west.

The German inland shipping system is one of the world's most highly developed, especially because of the large flat areas in northern and western Germany. Duisburg, located in northwestern Germany on the Rhine, is the largest inland port in the world. Germany has 6,900 kilometers of navigable inland waterways, including such principal canals as the Kiel Canal, the Mittelland Canal, and the Dortmund-Ems Canal. The Rhine-Main-Danube Canal, completed in 1992, joins the Main and the Danube rivers in northern Bavaria and for the first time permits river transport between the North Sea and the Black Sea (see fig. 12).

The main German seaports are those of the old Hanseatic League, with the best-known being Hamburg, Bremen-Bremerhaven, Wilhelmshaven, Lübeck, and Rostock. To compensate for their greater distance from the Atlantic Ocean (in comparison with Rotterdam), German ports have invested heavily in technology, equipment, and training that permit fast and economical loading and unloading.

Germany also has a large system of inland and international air travel. Lufthansa, the national airline, has an extensive domestic and global route system. In 1992 approximately 87.5 million passengers were registered at Germany's airports, and 1.5 million tons of air freight were carried from those airports. The largest international airport is Frankfurt-Rhein Main, located near Frankfurt am Main and one of the world's most important centers for both passengers and air freight. Other important airports are those at Düsseldorf, Munich, the three serving Berlin (Berlin-Tegel, Berlin-Schönefeld, and Berlin-Tempelhof), Hamburg, Stuttgart, and Cologne-Bonn. Berlin-Schönefeld, located to the south of Berlin, will be expanded to reestablish it as a major international air center.

Telecommunications

The German postal services are among the oldest in Europe. In 1990 Germany celebrated 500 years of organized mail service. At the same time, the German government broke up the Bundespost monopoly over all forms of communications and created three new structures to handle the services formerly handled by the Bundespost.

The largest of the new services is the Postdienst, with 390,000 employees. It is Germany's largest service enterprise, handling over 15 billion pieces of mail every year. The second largest is Telekom, the telephone/telex service, with a total of

260,000 employees. Telekom is intended to keep the German telecommunications system competitive with the new systems being developed in the United States and Asia. Germany has 35 million telephones, but service in eastern Germany took a long time to come up to western German standards. The third is the Postbank, with 24,000 employees, which manages the postal savings bank system in which about 30 million Germans have accounts (see Banking and Its Role in the Economy, this ch.).

Tourism

Germany is a principal attraction for foreign tourists, and the Germans themselves are among the world's most enthusiastic tourists. Although Germany attracts millions of foreign tourists, German tourists every year spend tens of billions of deutsche marks more than foreign tourists spend in Germany. In fact, tourism constitutes a major drain on German foreign exchange.

The areas that attract the most tourists to Germany are the Alps, the Rhine and Moselle valleys, and several large cities, especially Berlin. But those are not the only attractions. Music festivals such as those at Bayreuth and Munich draw many tourists. So do some of the old German medieval cities like Rothenburg ob der Tauber and Dinkelsbühl. Because of the wealth of hiking and bicycle trails, many tourists come to the Black Forest and to other German woodlands and mountains. Since unification, tourists have increasingly visited the former East German states and especially the Baltic beaches and such cities as Leipzig and Dresden.

Unlike Austria or Spain, Germany does not regard tourism as a major source of foreign exchange. Hotel stays by foreign visitors to Germany do not rise above 15 percent of total occupancy, as opposed to the two-thirds levels that they reach in those countries. But as many as 1.5 million jobs in Germany are connected in one way or another to the tourist industry.

* * *

The literature on the German economy is surprisingly limited, given its importance in Europe and the world as a whole. German economic unification produced a spate of books and articles, but most were out of date within months of publication. The most comprehensive current book in English is *The German Economy* by W.R. Smyser. Another survey is *The German*

Economy by Eric Owen Smith.There are also some current books that deal with specialized topics, such as *Banks, Finance, and Investment in Germany* by Jeremy S.S. Edwards and Klaus Fischer. The Bundesbank has attracted growing attention, with the most comprehensive work being *The Bundesbank* by David Marsh. The Organisation for Economic Co-operation and Development publishes an annual *OECD Economic Survey* on Germany as well as a special section on Germany in its biannual *OECD Economic Outlook.*

There is, however, a rich literature about the specifics of the German economy. The German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) publishes an extensive annual review of the German economy in German, and the German economic institutes continually publish specialized papers in German and sometimes in English. The Bundesbank and the German Ministry for Economics publish monthly and annual reports that concentrate on financial and macroeconomic information but also provide a general economic roundup. The bank also publishes a dozen statistical annexes every month. Both publish their basic reports in English as well as in German. Other German ministries as well as the German Federal Press and Information Office provide large quantities of information on a regular basis, but much of it is in primary form and requires analysis. (For further information and complete citations, see Bibliography.)

Chapter 6. International Economic Relations

The port of Hamburg

EVER SINCE ITS CREATION IN 1949, the Federal Republic of Germany (FRG), or West Germany, as it was also called until its unification in 1990 with the German Democratic Republic (GDR, or East Germany), has played an increasingly important role in the world economy. Consistently among the most important trading nations in the world, Germany often derives a higher share of its gross domestic product (GDP—see Glossary) from exports than any other major state. The Federal Republic plays an even more important role in international financial matters. Its currency, the deutsche mark, is the second most important currency in the world after the United States dollar.

Germany does not act alone in international economic matters. Instead, it usually acts through Europe. West Germany was a founding member of the European Coal and Steel Community (ECSC) and of the follow-on European Community (EC—see Glossary), known since late 1993 as the European Union (EU—see Glossary). Germany increasingly makes its international policies in conjunction and consultation with other EU members. More than half of its trade is with other EU states, and the deutsche mark is the anchor of the European Monetary System (EMS—see Glossary) and of its planned follow-on, the European Monetary Union (EMU—see Glossary).

Despite its central role in the world economy, Germany has never developed nor sought a high profile as a major international economic player. It receives much less attention than Japan in United States newspapers and economic journals, even though it wields as least as much influence in global financial affairs. This relative discretion reflects Germany's general reticence about projecting itself on the world stage in economic matters and the consistent German wish to integrate its economy into the EU.

Germany has benefited from a strikingly benign international economic climate for the past half-century. Despite occasional crises—such as the effects of the United States decision to end the dollar's link to gold in 1971 and of the "oil shocks" of the 1970s that resulted from exporters' sharp increases in the price of petroleum—the global economic scene has been remarkably stable in comparison with that of the 1920s and 1930s. This stability has favored the kind of international trading state that West Germany represented and that united Germany is expected to become once unification is complete.

Under United States leadership, the Western world with free-market economies established the International Monetary Fund (IMF—see Glossary) and the World Bank (see Glossary) in 1944. In 1947 these nations created a virtually universal trade structure, the General Agreement on Tariffs and Trade (GATT—see Glossary). The combination of open financial and trade systems has helped promote continuous and even dramatic expansion since World War II of world trade and the liquidity of international capital. Nothing could have better suited West Germany and now united Germany.

The productive capacities of both East Germany and West Germany always exceeded the absorptive capacity of their respective domestic markets. From the West German standpoint, this characteristic helped to fuel the German export drive and to generate investment capital. It also strengthened the deutsche mark and helped make the German economy internationally prominent.

Although Germany has a global currency and a world-class trade sector, the German economy remains essentially continental in focus. Because the economy lacks the size necessary to deal with the effects of truly massive currency flows, Germany has looked for partners in international economic matters as it has in international strategic and political matters.

The German government and the Bundesbank, Germany's central bank, are active participants in formal and informal international institutions and arrangements concerned with global finance and the coordination of national economic policies. West Germany was a founding member of the association of free-market economies known as the Group of Five (G–5), which later became the Group of Seven (G–7—see Glossary). But the German government has also had to acknowledge that it cannot direct the policies of the independent Bundesbank, which are more often based on Germany's domestic needs than on the wishes of the outside world.

Germany in the World Economy

Germany in World Finance and in the Group of Seven

Along with the United States and Japan, Germany has one of the world's biggest economies and most dominant central banks. Of the three, Germany has the smallest and most vulnerable economy. Germany's GDP of DM3 trillion (for value of the deutsche mark—see Glossary) is less than one-third of United States GDP and less than one-half of Japan's.

Despite Germany's relatively small size, it has consistently exerted a powerful influence on the world economy. Since the end of World War II, the Federal Republic has played a key role in beginning, managing, or ending each crisis and each phase experienced by the global monetary system.

The first phase was the Bretton Woods era, named after the New Hampshire resort where the Allied monetary conference of July 1944 created the IMF and shaped the global postwar order. The dollar was pegged to gold at a fixed rate of US$35 per troy ounce, constituting the official backing of the global monetary system; other currencies were linked to the system through their own fixed, dollar-pegged exchange rates. Countries could devalue or revalue with respect to the dollar, and the dollar price of gold could at least theoretically remain constant even as rates of exchange between separate currencies fluctuated.

By the late 1960s, there was a surplus of dollars in the international financial system. Largely for domestic reasons, the United States had put far more emphasis on expanding dollar liquidity than on maintaining dollar value. Growing fear of United States inflation had made those dollars less desirable, and many central banks held more dollars than they wanted. The United States proposed that other countries revalue their currencies as provided under the Bretton Woods Agreement. But those other countries, and West Germany in particular, were not prepared to revalue. Money poured into purchases of the deutsche mark, sometimes for the purchase of German goods, but more often to hedge against the dollar or to make a profit when—as was widely expected—the deutsche mark would have to be revalued. West German foreign-exchange reserves rose from US$2.7 billion in December 1969 to US$12.6 billion by December 1971, and to US$28.1 billion by September 1973. The steady flow of foreign money into deutsche marks not only undercut the Bretton Woods system (see Glossary) but also threatened to import inflation into Germany by expanding the German money supply.

West Germany tried to help support the dollar during the late 1960s and early 1970s. Bundesbank president Karl Blessing sent a letter to the chairman of the United States Federal Reserve Board pledging not to purchase United States gold but to maintain West German reserves in dollars. West German chancellor Ludwig Erhard (1963–66) agreed to make large purchases of United States dollar instruments and to make "offset" payments to lessen demands in the United States Congress for a reduction in United States forces stationed in West Germany. The United States and several other nations pressed West Germany to revalue in order to compensate for the dollar glut. Although the Bundesbank would have favored revaluation to reduce the risk of inflation, the West German government was afraid that a revaluation would cut into West Germany's global competitiveness and curtail exports.

Finally, after intensifying waves of speculation, the Bretton Woods system collapsed in August 1971. The United States stopped the sale of gold at US$35 per troy ounce and thus removed the fixed link between the dollar and gold. With that step, the system lost its anchor.

The deutsche mark remained under strain throughout the post-Bretton Woods period. It was alternately used in interventions to support the dollar or as a hedge against it. Other currencies again flooded into purchases of deutsche marks. To ease pressure within Europe, West Germany and other European states agreed to peg their currencies to a special system of relatively narrow exchange-rate bands formally entitled the "European narrow-margins agreement" but informally known as the "snake." But the snake also failed to hold. The domestic policies and even the economic philosophies of its leading member states—West Germany, France, Britain, and Italy—diverged too widely. The deutsche mark was the strongest currency, and others could not hold their value against it.

The United States and West Germany played key roles in trying to arrange a new global monetary system. But they had opposite objectives: the United States was determined not to have the dollar reassume responsibility for maintaining an international arrangement, fearing the great cost to its exports and economic stability. The United States government believed that countries with a trade surplus, such as West Germany, should accept part of the responsibility for solving exchange-rate crises and should be prepared to revalue, and it insisted on advance agreement for sanctions against any country that refused to do so. Despite its readiness to make minor exchange-rate adjustments for the sake of new currency alignments, West Germany refused to commit itself to any arrangement that would oblige it to revalue in the future.

In March 1973, the United States and other governments and central banks gave up trying to preserve the Bretton Woods system by setting new fixed exchange rates. With that decision, the next phase of the postwar international system, "floating," began. With floating, the relationship between the United States dollar and the deutsche mark became subject to market forces rather than official negotiations. West Germany was not certain whether floating would serve its needs but was not prepared to pursue any alternative.

Floating did not insulate domestic economies from international events and global economic forces. Although the floating era may have ended the period of fixed links to the dollar and to gold, it did not give countries complete monetary freedom. It only meant that adjustments would be made by the markets, not by government decree or agreement.Those adjustments would, at least theoretically, occur in reaction to trade and payments imbalances, correcting them over time. However, the situation did not work out as expected or planned. The increasingly important role played by capital flows, speculative or not, undercut the theoretically self-regulating mechanism of trade flows as the basis of currency values.

The economic consequences of floating for Germany were not uniformly beneficial. The Bundesbank welcomed floating because it gave the bank more flexibility. The bank, in fact, could virtually control the deutsche mark's exchange rate if it was prepared to manipulate interest rates to that end. But West German industry, and especially West German exporters, did not welcome the unpredictability that flexible exchange rates introduced into commercial arrangements and production plans.

West German exporters also faced a particular problem that persisted in the 1990s. The Bundesbank's favorite instrument for fighting inflation, a high real domestic interest rate, is also the instrument that attracts capital to the deutsche mark and keeps the currency valuable. Many businesspeople feared then, as they have since, that the Bundesbank's anti-inflationary policy would always keep the deutsche mark stronger than most other currencies and would thus jeopardize exports.

German exchange-rate policy has been constantly caught on the horns of that dilemma. When a decision absolutely needed to be made during the floating era, however, German governments and the Bundesbank have almost always chosen an anti-inflationary course of action. They have preferred a strong currency, which might adversely affect trade, to a weak one, which would jeopardize the stability of the German monetary system. With that choice, they set policy for others as well as for themselves. As long as the deutsche mark is strong and German interest rates remain high, even the United States can diverge from German policy only at the risk of seeing its own currency fall in value. Because of Germany's monetary dilemma, and because the German government as well as the nation's bankers and industrialists have recognized German limitations and vulnerabilities, all have been anxious to establish the highest possible level of international predictability. The Germans have become regular participants in international economic consultations, and they have emphasized the value of such consultations at every opportunity.

Global economic coordination after the end of the Bretton Woods system has resulted in the development of a number of coordinating institutions. One, first known informally as the Group of Five (G–5), consisted of the United States, West Germany, Japan, Britain, and France. After Canada and Italy joined, the association became known as the Group of Seven (G–7). The G–7 includes the finance ministers and central bankers of the principal economic powers, who meet periodically and consult regularly between meetings.

In addition to the meeting of G–7 finance ministers, there is an annual G–7 economic summit at which the heads of state or government of the same seven countries meet to coordinate economic and political policies or at least to attempt to understand each other better. The summits have been held annually since 1975 on a rotating basis among the summit states, usually in the capital. At the Naples summit of the G–7 in 1994, Russia joined the political discussions, essentially turning the gathering into the Group of Eight (G–8).

Three summits, those of 1978, 1985, and 1992, took place in Germany. Each was significant for different reasons. In 1978 Chancellor Helmut Schmidt (1974–82) committed West Germany to a more reflationary policy, to his later regret. Seven years later, Chancellor Helmut Kohl (1982–) and other summit principals made commitments toward supply-side policies that most participants agreed were then necessary and that both Kohl and United States president Ronald Reagan wanted to use to reduce the role of government in their national economies. Seven years later, at Munich in 1992, the G–7 agreed to provide aid to Russia. However, the summit did not reach agreement on the Uruguay Round of the GATT negotiations, and Chancellor Kohl did not carry out what the United States had regarded as his promise to persuade the French to reduce their insistence on large EC agricultural export subsidies.

German bankers and financial officials have usually spoken skeptically about possible results from the summits, making abundantly clear that the meetings do not affect their views, although they may subsequently adjust specific policies. Bundesbank president Hans Tietmeyer has stated that West Germany sees them as occasions for "cooperation," not "coordination." German global policy has thus been guided by broad efforts to coordinate specific policies, but with a firm wish to preserve German interests and its friendships with the EU members it considers its principal economic partners.

The Deutsche Mark as an International Currency

At the core of Germany's success and influence lies its currency. The deutsche mark gave concrete expression to West Germany's international financial and economic success and also contributed to it. Since unification, it has become even more important as a symbol as well as an instrument of Germany's new central role in Europe. The success of the deutsche mark has been anchored in the success of West German exports, in the Bundesbank's solicitous management of the currency's value, and in the confidence generated by the country's prosperity.

The deutsche mark has been a model of stability since it became fully convertible in 1958. No other major currency, including the Japanese yen or the Swiss franc, has been stronger. The United States dollar, the cornerstone of the global system, has lost about two-thirds of its value against the deutsche mark since 1958.

The deutsche mark has become the second-largest currency component of global monetary reserves, second only to the United States dollar. Less than 10 percent of the world's monetary reserves were held in deutsche marks throughout most of the 1970s, but the amount rose to 15 percent by the end of 1987. By the end of 1989, around 20 percent of all global monetary reserves were in deutsche marks. The deutsche mark's position in global monetary reserves largely reflects the extensive deutsche mark holdings in European foreign-exchange reserve accounts as well as the desire among all industrial state treasuries and central banks to hold a stable currency in their reserves. According to the United States Federal Reserve Board, the United States government holds more than US$13 billion of its reserves in deutsche marks, an amount greater than its holdings in Japanese yen.

The deutsche mark is not used as widely for transactions as it is to supply central-bank reserves. Global commodity prices are still largely denominated in United States dollars. Whatever the deutsche mark's strengths may be, it does not offer the kind of liquidity that the dollar does. Invoicing in deutsche marks is concentrated on Germany's own commerce, but almost 15 percent of world trade is conducted on a deutsche mark basis. The deutsche mark figures much less significantly than the dollar in the creation of international credits or in debt servicing. But a growing quantity of international bond issues—including some being floated in the United States—are denominated in deutsche marks. Major United States banks offer deutsche mark accounts for Americans who want to hedge some of their assets against a fall in the dollar. The World Bank has floated Euro-deutsche mark bonds, as have various United States corporations. In Europe the deutsche mark has virtually become a parallel currency, with prices in Western Europe and Eastern Europe increasingly quoted in deutsche marks as well as in local currencies.

Bundesbank officials worry constantly that the growing circulation of the deutsche mark makes it difficult to control the supply of the central bank's own currency. Deutsche marks held abroad, circulating abroad, and perhaps even used for currency intervention abroad are still part of the total German money supply. Sudden, large flows could have undesirable impacts on German interest rates or German prices, materially complicating the execution of German monetary policy. The bank fears that any decline in the deutsche mark's value or in the German current-account surplus could set off a selling wave that would force it to intervene massively and perhaps unsuccessfully. Bundesbank president Tietmeyer has warned that the high deutsche mark holdings abroad place a particular burden on the Bundesbank because any loss of faith in the German currency could provoke large-scale selling. The deutsche mark has thus become a burden for Germany as well as a blessing. The Bundesbank stated in May 1991 that one reason it had to maintain high interest rates was to avoid the kind of decline and subsequent market effects that Tietmeyer had cited. The German currency risks finding itself on a treadmill where the

Frankfurt am Main, a typical German mixture of old and new, has a medieval square, the Römerplatz, and a skyline of skyscrapers, headquarters of large banks.
Courtesy German Information Center, New York

stronger it gets, the stronger it must remain until the German monetary authorities no longer dare to reduce interest rates significantly for fear that they might spark a deutsche mark sell-off.

The IMF recognized the reality of German monetary power in 1990, when it promoted Germany and Japan to share the second rank just below the United States and ahead of Britain and France. German government and banking officials were not certain that they welcomed such prominence, but they were prepared to accept it as a reflection of international appreciation of German monetary policies.

The West German role in the development of the global financial and monetary system has been replete with ironies. No state consistently had a greater interest in developing a stable system and in cooperating in such a system. Nonetheless, West German policy helped undermine and even destroy some of the arrangements that West Germany wanted to maintain. During the Bretton Woods era, pressures on the dollar almost always expressed themselves in massive purchases of deutsche marks. The strength of the deutsche mark weakened the system because any currency—including the United States dollar—could come under attack if it were not defended and preserved as solicitously as the deutsche mark was by Germany. The only currencies and systems that survived this pressure were those whose governments determined from the beginning that they would follow a strict monetary discipline similar to that applied by the Bundesbank to the deutsche mark.

Germany in the European Economy

Germany in the European Community

If Germany's global role is beset with complications, its European role seems relatively clear. Germany has always concentrated its economic interests and activities, whether in trade, investment, or finance, within whatever form was being taken by West European integration.

Although German economic and political interests cover all of Europe, they have been most immediately reflected in the EU and the European Monetary System (EMS). The Germans have found that these two systems complement each other. But the German government and German business and banking establishments have long had separate attitudes toward the two institutions, and they play a different role in each.

The EC was West Germany's economic home, and the country remains one of the organization's strongest supporters. Chancellor Kohl on several occasions made special efforts to promote European cooperation, especially concentrating on the drive to create a European Single Market and on the negotiation and ratification of the Treaty on European Union (commonly known as the Maastricht Treaty—see Glossary) (see The European Single Market, this ch.). Kohl also intervened on occasion to avert potential conflicts between Germany's European interests and its ties with the United States, although he had great difficulty resolving the dispute over agricultural trade that broke out between the United States and France during negotiation of the Uruguay Round of the GATT talks. He also followed up German unification with efforts to draw the EU further toward Eastern Europe.

Germans have consistently pressed for closer integration of the states of Western Europe, officially and in public opinion. They have also been among the staunchest European advocates of open trade between Europe and the outside world. German officials and political leaders have strongly and consistently asserted that United States fears about a "Fortress Europe" are misplaced. Whereas several other European states—especially France and Italy—have tried to limit imports of various foreign products to the EU, the German government has argued for open markets, imposing fewer controls or restrictions on trade than most European states.

West Germany, and especially West German industry, carved out an important export niche within the EC. In the process, it made the EC an essential market for German goods and an important factor in German prosperity. Because one-third of West German GDP was exported and because one-half of all exports went to countries of the EC, at least one of every six West German jobs depended directly on the EC market. Many other jobs depended on imports from EC states or on the general prosperity the EC had brought to all its members.

The intimate connection with the EC was reflected in West German trade statistics (see table 19, Appendix). Not only did more than half of West German exports go to other EC countries, but many West German industries relied on the EC for a major share of their total market—whether domestic or international. Before unification in 1990, 48 percent of West Germany's production of office machinery was exported to other EC countries, as was 24 percent of its chemical goods and machinery, 23 percent of its motor vehicles, 17 percent of its electronic goods, 16 percent of its textiles, and 14 percent of its iron and steel.

But if West European trade was vital to West Germany and remains so for united Germany, West Germany was vital to the success of the EC. Even before German unification, there were more Germans—more than 60 million—than any other nationality in the EC. With unification the figure came to about 80 million. West Germany alone already had the largest share of the EC's GDP, over 25 percent; the largest amount of private consumption, more than DM1.2 trillion in 1988; and the largest investment in other EC countries, DM56.7 billion. Because the German share of EC production and consumption was expected to grow in the aftermath of unification, the EC recognized the impact of this process by allotting united Germany a larger number of seats—ninety-nine—in the European Parliament than any other state.

The Federal Republic was often termed the EC's "paymaster." Its net contribution to the EC budget was often four times as large as the next-largest contribution because West Germany never drew as heavily as such states as France or the poorer Mediterranean countries on either the agricultural or the developmental support programs. West Germany regularly provided over 25 percent of the EC budget, with no other state contributing more than 20 percent; and united Germany's projected share of the 1994 EU budget was 30 percent, or DM44.1 billion. Although Germany was receiving some EU aid in 1994 to develop the economy of the former East Germany, united Germany will in the future be expected to contribute an even larger share to the EU than West Germany did—in part because Germany itself is larger and in part because many prospective East European members will need support. This was one reason Germany strongly supported the EU membership applications of such relatively well-to-do states as Norway, Sweden, Finland, and Austria. Germany's contribution to the EU is becoming increasingly controversial, however, as more and more Germans complain about the growth of the EU budget. Several German political figures, including Bavaria's political leader, Minister President Edmund Stoiber, have said that Germany must reduce its contribution.

Because of the multifaceted economic relationships between Germany and other EU countries, different ministries in Bonn can have different and even conflicting interests and policies concerning various items on the European agenda. Many ministries have their own direct links to the EU bureaucracy in Brussels, and the German government has occasionally spoken with several voices at different levels until the problems were brought to the attention of senior officials in Bonn and priorities were established. By the same token, German ministries have at times used elements within the European bureaucracy to support their views at home. It has been left to the three ministries with the broadest responsibilities—the Ministry for Economics, the Ministry of Finance, and the Ministry of Foreign Affairs—to try to keep these separate issues in a total national-interest perspective. Those ministries have also had to block collusion between European and German bureaucracies to devise new subsidies and new ways to protect or subsidize special German or European interests.

Management of the EU's Common Agricultural Policy (CAP—see Glossary) illustrates some of the conflicts in intra-German interests. That system, by its commitment to subsidize both production and exports, has become increasingly expensive. It consumes more than half of the EU budget, or more than US$35 billion a year. Germany's Ministry of Agriculture has often tried to use the EU to drive support prices higher and to prevent or restrict foreign imports. The Ministry of Finance, by constrast, has sought to reduce the CAP in order to cut the German contribution to the EU.

The European Single Market

To advance the EC toward a truly integrated and borderless internal market—the European Single Market—the EC's European Commission (see Glossary) in 1985 submitted a white paper to the European Council (see Glossary) in which it listed a series of 225 steps needed to create such a market. It also proposed a schedule for completing these steps in time for the internal market to begin functioning by the end of 1992. The council accepted the commission's proposals, with West Germany strongly supporting the concept. West Germany later advanced the process significantly during its presidency of the council in the second half of 1988.

Once Germany was united, it remained among the European states the most determined to implement the conditions of the European Single Market. Even before the formal implementation of the single market on January 1, 1993, Germany had already incorporated 80 percent of the single-market regulations into its own legislation, a higher percentage than any European state except Denmark or France. Notably, the German government also applied those new regulations in the five new states (*Länder*; sing., *Land*) of the former East Germany, as well as in the old *Länder* of western Germany.

Not all Germans welcomed the coming of an open internal market. Many worried that the guidelines for such a market would give so much power to the bureaucrats within the European Commission that economic initiative within the member states might be stifled. Many German businesspeople dreaded the prospect of more EU offices in Brussels enforcing more regulations. Some *Länder*, especially Bavaria, as well as a number of German communities, became disturbed by prospects that the EU would in the future have such immense powers over economic life that the German federal system itself could be placed in jeopardy. As a result, Germans have become strong advocates of the principle of *Subsidarität* (subsidiarity), under which matters not specifically covered by EU laws are left to the practices and the laws of the individual national states.

Despite steady German government support for the internal market, attitudes in German business and economic circles also have remained mixed, depending on the size and interests of the affected firms. The largest German firms with strong export positions strongly favor the internal market. The mid-sized firms, which are unable to relocate their main production sites or develop subsidiary sites abroad, have a more cautious reaction. Smaller firms, especially those involved in handicrafts or services, are fearful of the competition that might come from other European countries with lower production costs.

Just as firms of different sizes have reacted differently to the internal market, so have firms in different industries. The producers of Germany's most competitive products—whether automotive manufacturers, toolmakers, chemical firms, or electronics firms—regard the single market as an opportunity. By constrast, Germany's relatively inefficient service firms, whether in telecommunications, banking, or insurance, see the market as a threat because it would eliminate national regulations that had given them privileged positions.

German trade unions particularly fear the internal market. They have warned that it will cause production to move to countries and regions where wages are lowest and social benefits most limited. Despite the existence of strict EU standards governing the rights and privileges of workers, the trade unions have consistently warned of "social dumping," the temptation for manufacturers to look for those sites where regulations are less stringent or are less vigorously enforced than in Germany.

German environmentalists, for their part, fear that German manufacturers might shade their environmental commitments in order to keep their costs as low as possible against competitors who face fewer environmental problems in less densely settled countries (see The Environment, ch. 3). Environmentalists have also expressed concern that manufacturers will be tempted to locate production facilities abroad, where environmental standards might be less rigorously enforced or where less severe population and land-use pressures might make pollution seem less onerous. As German trade unions fear social dumping, the environmental groups fear "environmental dumping."

With the continued development of the internal European market, many Germans began to perceive another danger—that the EU might become so internally focused that it could become too protectionist. The Board of Advisers to the German Ministry for Economics warned in 1990 that such protectionist thinking, if not promptly countered, could jeopardize European prosperity. German industry and trade associations have expressed similar concerns, warning that the protectionist risk of the internal market must be fought at every level to avoid driving Germany ever more into a limited European mold. German industry has consistently pointed out that Germany stands to lose far more than any other European state if the global trading system collapses because of the protectionist proclivities of the EU.

The increasing power of protectionist forces in the EU has raised concerns in Germany about the potential for the emergence of three separate and competitive regional trading areas, the EU, the Americas, and Asia, with some form of negotiated—or managed—trade among them. Any such arrangement negotiated by the EU would establish quotas for each side, and Germany almost certainly would not obtain as large a share of any European quota as that which German exporters could obtain on their own.

Regardless of its concerns about protectionism, the German government has continued to insist that it will fulfill its commitment to complete European integration and the single market. Political considerations, especially Germany's relationship with France, have helped to shape and support that policy as much as economic considerations have. But the Germans have noticed with concern that France is often the state that tries to make the EU more protectionist. The Germans believe that they cannot support such French efforts, even if they cannot block them. German minister of foreign affairs Klaus Kinkel has warned that Germany does not agree with all French views on international trade rules, but Chancellor Kohl remains reluctant to press France toward a more open global trading system.

Kohl, in fact, has sought to use EU cooperation to help cement a close German relationship with France. He and French president François Mitterrand promised in early 1994 that they would use the successive German and French presidencies of the European Council during the last half of 1994 and the first half of 1995 to plan and execute a joint program for the further development of the EU.

Germany and the European Union

Kohl believed that it was important for a united Germany to have a firm anchor in the West, especially in a structure for West European and, later, European, integration (see European Union, ch. 8). He therefore played a major part in gaining Europe-wide approval of the Maastricht Treaty negotiated at the European Council summit in December 1991. He refused to be deterred after a first Danish referendum rejected the treaty, insisting that Germany proceed to ratification. The two houses of parliament, the Bundestag and Bundesrat, vindicated Kohl's position, approving the Maastricht Treaty by overwhelming majorities despite reservations in some *Länder* that it might undermine the German federal system by giving the EC and its European Commission greater powers over the separate *Länder* than even the Bonn government possessed.

Germany also strongly supported the creation of the European Economic Area (EEA—see Glossary), established in 1993 to create a trade area consisting of the EC and most of the states of the European Free Trade Association (EFTA—see Glossary). It later advocated the entry of four EFTA members—Norway, Sweden, Finland, and Austria—into the EU. By the same token, Germany has favored developing close links between the EU and the East European states, although German farmers and steel manufacturers have joined other EU producers in seeking to block those East European imports that would be most competitive with their own output.

During the entire process of creating a more integrated Europe, Kohl and Minister of Foreign Affairs Kinkel continuously stressed the German commitment to integration. Kohl has told the Bundestag that Germany's national future lies in Europe, and he has used every possible opportunity to point out that Germany's firmly anchored position within Europe has been mainly responsible for giving Germany peace, prosperity, and its chance at unification.

Germany in the European Monetary System

West Germany helped to start the European Monetary System (EMS) in the late 1970s and has long provided the anchor of its principal operating element, the European exchange-rate mechanism (ERM—see Glossary). It has exercised considerable and sometimes even dominant influence on the evolution of European monetary affairs. Nonetheless, the EMS was much more difficult for West Germany to propose or even to accept than the EC. Although much of West German business and government felt very much at home in the EC from the beginning, Germany had reasons to be much more anxious about monetary cooperation.

The concepts of the EMS and the EU are very different, although they may be complementary, and they look especially different to Germans. A common trading area within Europe helps Germany to do what it does best: produce and export. Although Germans have had to open their own borders to others, they have always been confident about meeting such a challenge.

Money, however, is something else again, especially in Germany. West Germany's strict monetary policy was seen by many West Germans as the guarantor of the Federal Republic's stability and prestige. Any West German political or economic debate assumed the solidity of the deutsche mark. European monetary cooperation could only be acceptable in West Germany if it jeopardized neither the deutsche mark nor the policy that had given the currency its success and had given West Germany its prosperity and domestic tranquillity.

Many West Germans feared that European monetary cooperation would have a pernicious effect on West Germany's own money by posing a risk to the independence and integrity of West German financial and monetary policies. They believed, and not without reason, that many other states in Europe did not share West Germany's belief in monetary stability as the principal objective of financial policy. They looked with particular suspicion at Britain, Italy, and the smaller countries of southern Europe.

The West German government and the Bundesbank tried, therefore, to ensure that no European monetary arrangement would interfere with West Germany's freedom to choose its monetary objectives and policies. They consistently tried to construct arrangements that would give them a dominant influence over European policy or, if that was impossible, would at least enable them to continue pursuing their traditional goals. The West German government and the Bundesbank did not always agree about what constituted satisfactory

Lübeck, a Baltic port, has linked Germany to the outside world since the Middle Ages. On the left: old salt warehouses; on the right: one of the city's gates, the Holstentor.
Courtesy Lübeck-North America Representation, New York

arrangements, however, with the bank usually being more cautious than the government. Nonetheless, West Germany helped to establish the system of European monetary cooperation and was among its main beneficiaries.

A number of proposals for European monetary cooperation were advanced and discussed as the European Coal and Steel Community (ECSC) came into being in 1951, as other plans for West European cooperation were considered, and as the Bretton Woods system began to crumble in the 1960s. None came to fruition, but they provided some of the intellectual foundations for later efforts. It was only in 1972, after the collapse of the Bretton Woods system, that the first arrangement for true European coordination was put into place—the European narrow-margins agreement, which came to be known as the "snake" (see Germany in World Finance and in the Group of Seven, this ch.). West Germany helped to establish the system, a joint European float whose purpose was to ensure that European currencies would not fluctuate more against each other than against the United States dollar.

The deutsche mark became the strongest currency in the snake. It remained at the top of the snake's trading range, in part because of West Germany's export surplus but especially because West German domestic monetary policy inspired confidence that the deutsche mark's value would be protected and might even rise against other currencies. Others soon learned that staying in the snake meant a commitment to emulate the policies of the Bundesbank or to suffer the exchange-rate consequences of any divergence. Because most countries could not do this, the snake had to be abandoned as a major international currency arrangement. But a truncated snake did survive, in part because some smaller countries were prepared and to some extent were obliged to follow the West German lead, and in part because, despite its imperfections, it offered a modicum of stability.

As the 1970s drew to a close, there were debates about monetary policy in almost every European country. Whatever the imperfections of the snake, it was clear to many states that any port in a storm might be better than none. The oil shocks confronted Western states with pressures that paradoxically could be both recessionary and inflationary. Some countries, such as the United States, chose to counteract the recessionary pressures. Others, such as West Germany, chose to counteract the inflationary threats. Most European countries increasingly found the West German approach more congenial than that of the United States.

The main debate in West Germany, as in several other large European countries, was between those who came to be known as the "monetarists" and those who came to be known as the "economists." The monetarists believed that introducing fixed exchange rates would force countries to pursue similar economic policies and that this would make interventions less necessary, and perhaps even unnecessary. The economists argued that common economic policies had to precede fixed exchange rates because the exchange-rate system would break down otherwise. They thought that a common currency should cap a structure of common policy, not help to build it.

Most West German economists as well as government and Bundesbank officials belonged solidly in the economist camp. They did not want to join in any European monetary collaboration until European states had shown that they would coordinate economic policies. The experience with the snake, and the costly and frequent interventions that it had required before it finally broke down, only hardened their attitudes.

It was against this background of deep skepticism that Chancellor Helmut Schmidt decided in 1978 and 1979 to cooperate with French president Valéry Giscard d'Estaing in creating the EMS. Because of opposition from the Bundesbank and the Ministry for Economics, Schmidt conducted the crucial initial phase of the negotiations in great secrecy, keeping them secret from the German bureaucracy and the Bundesbank.

The EMS established not only a zone of monetary cooperation but also a European currency known as the European currency unit (ECU—see Glossary). It was designated to represent a basket of currencies from the EMS countries, to be used initially for certain clearing and credit transactions and ultimately as a common European currency. Deutsche marks became the largest element in the backing of the ECU.

When the EMS and its companion, the ERM, were formally established on March 25, 1979, Schmidt's role committed Germany to their success. Thus, West Germans became involved in an area of European economic policy that was of the utmost sensitivity to them. They did not do so without some reservations. But they saw no alternative.

The EMS and especially the ERM succeeded in making Western Europe something of a zone of stability around the deutsche mark. After a difficult beginning, marked by frequent currency realignments during the early and mid-1980s, the exchange rates of the ERM currencies were much more stable relative to each other than in relation to the United States dollar or the Japanese yen until 1992.

However one might choose to allot credit for the success of the EMS and ERM, they represented both a theoretical setback and a practical triumph for the Bundesbank, because they showed that the monetarist school might well have been correct and that a stable ERM, accompanied by a commitment to hold to the agreed rates, could compel states and their central banks to pursue congruent policies as long as they were determined to stay within a system. The effectiveness of the EMS and ERM also suggested that a system of fixed exchange rates might act as a catalyst in facilitating policy because it would give states an additional reason to coordinate and could be said to provide a sanction if they failed to coordinate.

It has often been said that the ERM represents a "deutschemark zone" within the EU. The deutsche mark has been the EU's lead currency, the principal intervention currency, the principal reserve currency, and its psychological as well as practical anchor.

During the twelve years from the onset of the ERM to the Maastricht summit in 1991, the revaluation of the deutsche mark against other ERM currencies had been 38 percent (including 58 percent against the Italian lira and 45 percent against the French franc), but most of the revaluation had taken place early in that period, with the practice becoming much less common after the mid-1980s. At the end of the 1980s, it could be said that the ERM had been a considerable success for all the states involved. But it had mainly been a success for West Germany, demonstrating the benefits to others of associating themselves with West Germany's economic philosophy.

The members of the EC decided even before the end of the 1980s to explore further monetary cooperation as the community advanced toward the single market. In June 1988, at the European Council meeting in Hanover, they established a commission chaired by the president of the European Commission, Jacques Delors, to study and propose "concrete stages leading toward economic and monetary union." Delors's report, submitted on April 17, 1989, envisaged a transition in three stages toward an EMU with a single common currency. The objectives of the first stage, to commence on July 1, 1990, were to expand the ERM to include all EC members, to permit free capital flows, and to take other measures toward coordinating economic and monetary policies. In the second stage, for which no starting date was then proposed, a European system of central banks would be created, leading to the formation of a single central bank. In the third stage, a single currency managed by a European central bank would be created, and even greater powers would be granted to the EC to establish common financial policies among its members.

After the Delors Plan was announced, the West German government and the Bundesbank reacted cautiously, although both the Ministry of Finance and the Bundesbank had helped to draft the report. Having been pleased with the achievements of the ERM, the West Germans were prepared to examine an arrangement that would go further toward monetary union. But they were not ready to agree to anything that would upset what they regarded as the foundations of their own prosperity. The Bundesbank in particular wanted to make certain that any European system would reflect its own thinking.

Germany and the European Monetary Union

Germany played a major role in shaping the currency provisions of the Treaty on European Union signed in December 1991 in Maastricht, the Netherlands, especially in making certain that those provisions would assure a stable European currency. In broad terms, the agreement, often referred to as the Maastricht Treaty, provided for the same three phases earlier proposed in the Delors report, although with later deadlines for each phase. It also provided for a transitional stage to economic and monetary union to begin in January 1994 with the creation of the European Monetary Institute. The institute was given a mandate to coordinate EU members' monetary policy, to oversee preparations for the transfer to a European currency, and to create the right conditions for the final stage of monetary reform—a European System of Central Banks (ESCB), a single European Central Bank (ECB), and a common currency.

The ESCB and ECB agreed upon at Maastricht are the types of institutions the Bundesbank might welcome. Their common mandate was to assure price stability and a stable European currency, although the ECB was also instructed to ensure sustainable growth with high employment. The structure of the ECB itself was to resemble that of the Bundesbank (see The Bundesbank, ch. 5). Its council, like the Bundesbank's executive Direktorium (Directorate—see Glossary), would consist of an executive board and the presidents of those national banks whose currencies qualified for entry into the EMU. The ECB would be independent of political control, and the central banks of all European states would be independent of such control even before the end of the first stage of the EMU. Thus, the principles guiding the Bundesbank and the deutsche mark would also guide the ECB and the future European currency.

The Maastricht principals agreed that the final stage in the movement toward the EMU would begin in 1997 if the European Council decided that a majority of EU members had met five convergence criteria: inflation within 1.5 percent of the average of the three best (i.e., lowest) rates; long-term interest rates within 2 percent of the three best rates; a budget deficit of less than 3 percent of GDP; a national debt of less than 60 percent of GDP; and a stable currency, as shown by conformity with the narrow band of the ERM and an absence of devaluations within two years of the council's decision to move toward a European currency. If the majority of EU members did not meet these convergence standards, the EMU was to start in 1999 with as many members as had met the criteria. Britain was authorized to leave the system. At France's insistence, however, Germany was required to enter the EMU if France entered, thus ensuring that the Bundesbank could not conduct a policy independent of a European system.

The convergence criteria reflect the Bundesbank's determination to make certain that no unstable currencies enter the EMU. The criteria also put pressure on European governments and central banks to begin conforming to Bundesbank principles before a monetary union is accomplished.

The Maastricht formula represents a compromise between the monetarist and the economist camps on the issue of European integration. It pleased the monetarists—and thus the French—by establishing a strict calendar for the transitional stages to the EMU and by using monetary policy and the desire for a common currency to compel the European economies' acceptance of convergence. The formula pleased the economists—and thus the Bundesbank—by making EMU membership subject to the kind of criteria that would force governments and central banks to pursue similar policies even before the final stage of the EMU. Most important, from the standpoint of the economists and the Bundesbank, it created a standard for EMU membership.

Although the Maastricht arrangements were designed to please the Bundesbank and to assuage German concerns, the German people reacted negatively. Popular media depicted "Germany's beloved deutsche mark" vanishing into the distance or sinking into a swamp, and opinion surveys revealed fears that the politicians had surrendered the cornerstone of German prosperity for the sake of a united Europe. If the Maastricht provisions for the EMU had been subject to a referendum in Germany, they almost certainly would have failed to gain a majority.

The German government had to offer repeated assurances that it would never give up the deutsche mark for another currency that was not as strong or as stable. It took some time for the German public even to entertain the notion that savings might one day be held in a currency other than the deutsche mark, and the public consistently made clear that it would accept that prospect only if that currency were as strong as the deutsche mark.

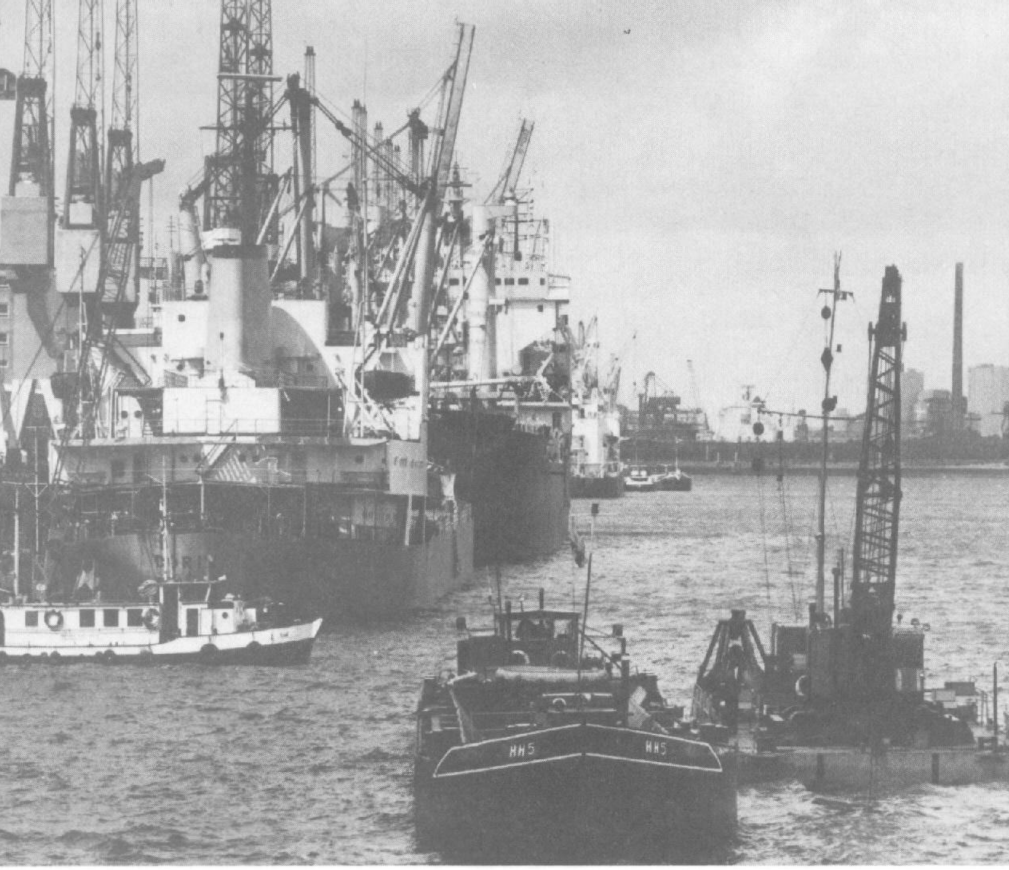
The Bundesbank's Central Bank Council followed the Maastricht summit with a formal statement reiterating a number of well-known Bundesbank positions. In the statement, the council expressed regret that monetary union was moving forward more rapidly than a "comprehensive political union." It stated that such a political union was necessary if monetary union were to be effective. The council also warned that the success of any decisions taken on the path toward the envisaged economic and monetary union had to be judged "solely on their stability performance" and that "the fulfillment of the entry criteria of the convergence conditions must not be impaired by any dates set." The Bundesbank stressed that the policy unit of the EMU would be the ESCB—in which the Bundesbank could expect to have a strong voice—with the ECB to be subsidiary to the ESCB and thus subject to the Bundesbank's influence. It also stressed that the deutsche mark and the European currency would coexist for some time at fixed exchange rates until all the conditions had been set for a European currency that would actually displace all national currencies. The Bundesbank also reiterated the importance of having the ESCB and ECB remain completely independent of national governments.

Both the German government and the Bundesbank wanted the new ECB to be located in Frankfurt am Main. To this end, the Bundesbank and German officials indicated that they would make every effort to enhance the appeal of Germany and Frankfurt in particular as financial centers, although the bank warned that Germany should not take steps that could jeopardize financial stability for the sake of competitiveness by loosening German financial standards. The Institut für Kapitalmarktforschung (Institute for Research on Capital Markets) urged fast action to boost Frankfurt, warning that a more financially integrated Europe would tend toward a single financial capital and that London and Paris were not only better placed than Frankfurt but also were making much greater efforts to emerge as dominant financial centers.

But Bundesbank officials had more on their minds in early 1992 than the Maastricht conditions for the EMU and the location of Europe's future financial center. The bank was attempting to establish German monetary union within the recently united Germany, as well as to prepare for European unity, and was finding neither task particularly easy. The Bundesbank could have been expected to react guardedly to the Maastricht Treaty no matter what its terms might have been. But the fact that the treaty was signed as the bank was trying to deal with the German government's large fiscal deficits and the resulting upsurge in the German money supply made the Bundesbank both more hesitant about proceeding toward the EMU and more assertive in its insistence on what it considered the proper conditions.

Since the early 1970s, the Bundesbank had effectively controlled European monetary policy. The deutsche mark had been the anchor currency of the snake and of the EMS and ERM. But the Bundesbank would become only one of many banks with a voice on the new council. The president of the ECB might well be a German, and the ECB might be based in Germany, but many different banks would have a voice in European monetary policy, in effect removing the Bundesbank's virtual monopoly of authority. Some of those banks, even if they were to meet the Maastricht convergence criteria, might occasionally want to pursue policies different from those of the Bundesbank.

More problematic for the Bundesbank was the recognition that those other banks, through their influence on European monetary policy, would have a voice in German monetary policy, because the EMU could not function if separate states and central banks could ignore any ECB policy they disliked. The



The port of Bremen
Courtesy German Information Center, New York

Bundesbank might not only lose control over European money but perhaps over German money as well. Such a situation could violate the bank's own basic mandate, and it would certainly violate its stability doctrine if the ECB failed to pursue what the Bundesbank perceived as the right kind of policy.

The Bundesbank responded to these multiple challenges by setting forth on a course that was designed to put the indelible imprint of its philosophy on the new bank and the new currency, or, if that were not possible, either to break up the EMU or to make it so selective that only a few countries could join. Thus the bank became engaged in a rigid, even doctrinaire, assertion of the primacy of currency stability. It proceeded to raise short-term interest rates throughout 1991 and much of 1992, before and after Maastricht. Although it did so primarily for domestic reasons, it was certainly mindful of the effect that its policies would have on other European currencies.

As German interest rates rose, other European currencies and central banks found it difficult to match German policies at home. The recession that had hit Germany spread throughout Europe, in part for cyclical reasons but also because of the forced emulation of Bundesbank policies by countries interested in joining the EMU. As the recession spread, several countries could not support their currencies except at the cost of an ever-greater slowdown.

An exchange-rate crisis erupted in September 1992, after several countries had decided that they could no longer keep up with German interest rates. As those central banks began to lower short-term rates, investors began to abandon their currencies, and speculators began to dump them. In response to desperate pleas from abroad and from large segments of the German political and economic communities, the Bundesbank lowered its Lombard rate (see Glossary), but only by a quarter point. Within days, the Italian lira had to be devalued and taken out of the ERM. The British pound also came under attack. This triggered "Black Wednesday," September 16, 1992, when the pound crashed while the Bundesbank refused to support it. As a result, Britain withdrew the pound from the ERM.

Only the French franc and the smaller currencies traditionally tied to the deutsche mark (such as the Belgian franc, the Dutch guilder, and the Danish krone) did not devalue, thus remaining in the ERM. All other EC currencies effectively devalued against the deutsche mark. The defense of the French franc cost the Bundesbank and the Banque de France tens of billions of deutsche marks, on which they realized a small profit after the French currency had stabilized. More important, however, it cost the Bundesbank its reputation for objectivity, at least in London, because the British complained that their currency had not been supported as the franc had been.

In August 1993, a similar crisis erupted, but this time the currency under attack was the French franc. With French inflation rates lower than those of Germany, the Banque de France began lowering short-term interest rates during the spring of 1993 and continued lowering them throughout the summer. The French bank may have assumed that the background of firm French monetary policy since the mid-1980s would give it some leeway to lower short-term rates below the Bundesbank levels without weakening the franc. In the event, this proved incorrect. A full assault on the franc erupted in August. Even a coordinated intervention by the Bundesbank and other institutions failed, and the franc weakened rapidly.

To help protect the franc, and to avoid having to expend more resources in a futile fight, the ERM countries agreed that they would widen the bands in which currencies could diverge from each other from 2.25 percent to 15.0 percent. They assumed, correctly, that this change would stop the speculative assault on the franc. However, it also signified the collapse of the franc, one of the main currencies of the EMS. Only a few minor currencies remained as stable as the deutsche mark. However, the franc was able to recover later in 1993 to virtual parity with the deutsche mark.

The two ERM crises left the prospects for the EMU uncertain. It seemed unlikely that more than two or three minor currencies would be able to meet the convergence criteria by 1997, and the system could not then come into effect because it would not include the majority of the countries of the EU. Under those circumstances, the earliest possible date for the EMU to take effect would be 1999, and even that target date would come into question if the EMU at that point were to encompass nothing more than the deutsche mark, the French franc, and some minor currencies. The German minister for economics, Günter Rexrodt, predicted in mid-1994 that the EMU might not come about until 2001 or later.

The Bundesbank had shown its readiness to exercise its power to shape and even to dictate the policies of other central banks. It had shown that, if Europe were no longer to be dominated by the Bundesbank itself, it should at least be dominated by the Bundesbank's ideals. The bank's Central Bank Council hoped that others would come to appreciate the value of stable money through the experience of having unstable money. But in case all central banks did not agree, Bundesbank president Tietmeyer said after the September 1992 crisis that the bank was prepared to accept what he called "*gestaffeltes Vorgehen*" (membership by stages), a process by which some states would join before others. The bank was clearly prepared to forego the EMU, or at least to postpone it, if the EMU might bring unqualified members into a common European currency system. And it was prepared to split the EMU, if necessary, to create at least a partial zone of European currency stability.

The bank's stern views should not lead to the conclusion that the Bundesbank opposes a European currency. Indeed, several senior Bundesbank figures have at various times expressed their conviction that a common European currency is desirable. Such a currency would ease one of the burdens felt by the Bundesbank: it must now defend stability with only its own reserves and those of its immediate allies instead of with the reserves of an entire continent. Former Central Bank Council member Leonhard Gleske once spoke with envy about how the large domestic market of the United States helped the dollar adjust more easily than any single European currency to global fluctuations and crises. Gleske also observed that one of the objectives of a European currency would be to assume the leading international role that even the deutsche mark could not assume and that such a European currency could gradually replace the dollar as a transactions and reserve currency. This prospect must be a powerful incentive for the Bundesbank, which has long distrusted United States monetary and fiscal policies.

The crises of 1992 and 1993 did not discourage other EU members from accepting Bundesbank discipline. They agreed later in 1993 to place the new European Monetary Institute as well as the future ECB in Frankfurt. That decision was a vote of confidence, or at least acceptance, for Bundesbank policies and attitudes, because Frankfurt is not only the home of the Bundesbank but is also regarded as the capital of German monetarist thinking.

A full EMU will come about when the Bundesbank is satisfied that all European governments are fully committed to stability and when they have shown this commitment by adhering to the convergence criteria and by passing whatever other tests the bank may yet pose. As Bundesbank officials have said on every possible occasion, the Bundesbank believes that a stable currency is more important than a common currency. And the German government, although it supports the EMU, must accept the Bundesbank's policies if it is to secure the support of the German people for a common European currency.

Foreign Trade and Investment

Trade Philosophy and the Trade Balance

West Germany has been one of the world's major trading nations, almost from the first days of the economic miracle that began in the early 1950s (see The Economic Miracle and Beyond, ch. 5). It also had high trade and current-account surpluses during most of these years, especially during the latter half of the 1980s (see table 20, Appendix). It was the world's largest exporter in 1988, second largest after the United States in 1989, and first again in 1990 if East German exports before monetary unification in mid-1990 are included. West Germany was also consistently one of the world's largest importers.

Ludwig Erhard set the tone for the future of German trade policy and practice when he was minister for economics in the early days of the Federal Republic. He made his own sentiments very clear, saying in 1953 that "foreign trade is not a specialized activity for a few who might engage in it, but it is the very core and even the precondition of our economic and social order." Commentators and authors on the German economy speak of a German "export mystique," of deliberate domestic underconsumption to facilitate exports and increase competitiveness, and of an "almost unconscious" German mercantilism. The export sector has a powerful voice in German economic and commercial policy making, including a special Foreign Trade Advisory Council located in the Ministry for Economics. Senior German political figures rarely make visits abroad without including select German businesspeople in their official delegations.

The German economy has failed to heed the export mystique only once, when the Hitler regime (1933–45) sought autarchy, or economic independence from the global economy. Between 1910 and 1913, exports accounted for 17.8 percent of Germany's GDP. Their share declined to 14.9 percent in the second half of the 1920s and fell to only 6 percent in the second half of the 1930s, but by 1950 accounted for 9.3 percent of West Germany's GDP. Once the postwar economic boom got under way, exports rose to 17.2 percent of GDP in 1960, to 23.8 percent in 1970, to 26.7 percent in 1980, and to approximately 33 percent in 1990.

Investment goods produced by West German industry were the most successful export items and contributed most heavily to the country's large trade surplus, although West Germany was competitive across a wide range of goods. The country imported more agricultural and processed food products than it exported (see table 21, Appendix).

A number of West German industries dedicated significant percentages of their production for export: shipbuilding, 62 percent; air and space, 59 percent; automotive products, 48 percent; machine tools, 45 percent; chemicals, 44 percent; iron and steel, 37 percent; and precision mechanics and optics, 31 percent.

Several of the industries with a high export share, such as shipbuilding and airframes, were heavily subsidized in West Germany and have continued to be subsidized in united Germany. They are competitive in world markets on the basis of those subsidies. The subsidies demonstrate the extent of the German export commitment. West Germany would have had a substantial trade surplus even without the subsidized products of those industries, but it did not wish to sacrifice their global market share.

After German unification, Germany's trade surplus shrank for several years. Whereas West Germany had shown a dramatically high trade surplus during the late 1980s until 1990, reaching almost US$80 billion in 1988, united Germany by 1991 was showing a much smaller surplus. Nonetheless, it was widely expected that large surpluses would return by the mid-1990s as the *Länder* of the former East Germany began to export more and required fewer imports.

Especially crucial to the future foreign trade position of united Germany will be the competitiveness of industry in the new *Länder* of the former East Germany, which could not be predicted with any reliability in the years immediately following unification. During 1993 only 2 percent of German exports came from the new *Länder.* It was unclear whether this area's competitiveness had been destroyed, or whether the West German producers that had bought East German firms had decided to continue to export from their western firms instead of from their newly acquired eastern firms. Whatever happened, it is worth remembering that the new *Länder,* like the western *Länder,* had generated a consistent trade surplus in capital and transport equipment, industrial consumer goods, and chemicals before unification. They could be expected to return to competitiveness in at least some of those areas. East Germany also suffered from several major shortages before unification, having trade deficits in fuels, raw materials, semimanufactures, agricultural products, and processed foods. Most of those deficits would persist even after unification.

With Germany united, the government expects trade with Eastern Europe to increase well over the levels West Germany had enjoyed and ultimately to exceed the level of separate East German and West German trade with Eastern Europe before unification. In fact, Germany's most important and most consistent policy since 1990 has been to improve its connections to Eastern Europe without loosening its links to the West and thus to bring Eastern Europe and Western Europe together. After the fall of communism, German business representatives began visiting Eastern Europe in large numbers to establish or reestablish trade connections and to inspect potential investment sites or joint ventures.

German economic links and outposts are being reestablished in Central Europe and Eastern Europe. The Czech Republic is again becoming an integral part of the industrial complex centered in Bavaria and Saxony, as Bohemia and Moravia were before World War I. The frontier region between Poland and Germany is already one of the most active border investment and trading centers in the world, beginning to emulate the Mexico-United States border and the Hong Kong hinterland as a place where Western capital meets non-Western labor and where goods are processed and exchanged freely. Cross-border traffic in goods and persons is burgeoning. German trade and investment being planned for the countries of the former Soviet Union and for Eastern Europe will make united Germany by far the largest single Western trading partner as well as the largest Western creditor of those states.

Germany has provided more aid and investment to the former Soviet republics than any other West European state, contributing US$52 billion in aid to Russia and other members of the former Soviet Union between 1989 and 1993 as well as US$25 billion to the states of Central and Eastern Europe. More than one-half of East European and Baltic trade with the EU is with Germany. Other types of economic activities are also becoming common. For example, by 1994 the Deutsche Bank had opened a branch office in Prague and planned to open others throughout Eastern Europe.

As part of that effort to speed the East's integration with Western Europe, Germany has not only endorsed but has often sponsored association agreements with the EU for the states of Eastern Europe and the former Soviet Union. It has also sponsored several East European applications for EU membership. Kohl himself told Hungarians and Czechs in April 1994 that the EU without their countries would be a "torso." A month earlier, he told the Baltic states that they belonged in the EU as much as the Mediterranean states. Kohl also strongly advocated Russian membership in the annual Group of Seven (G-7) meetings—at least for political discussions.

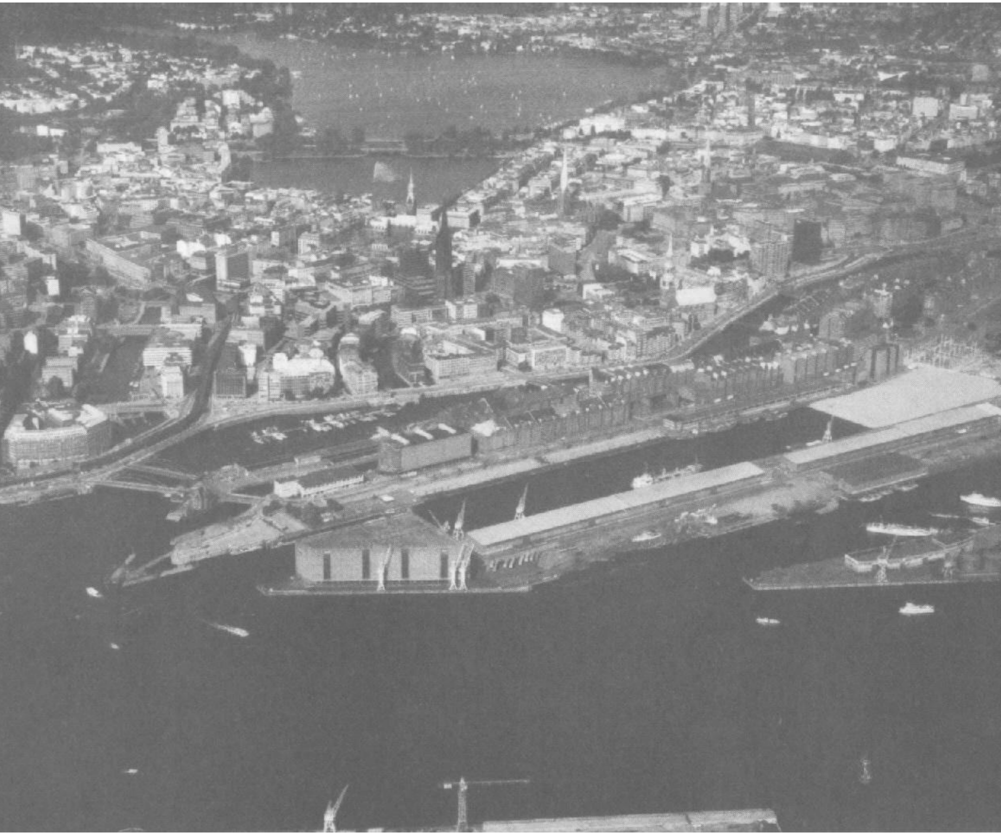
The credits that Germany has been giving to its Eastern trading partners are not without risk. Russian and East European debt has been accumulating for several decades. Virtually every East European state had trouble servicing its debts during the early 1990s, and special arrangements had to be made to reschedule Poland's debt. Nonetheless, the German government and German banks were prepared to extend further credits despite nagging doubts about when the credits would be repaid. German determination to increase trade with Eastern Europe and to invest more in that area reflects tradition as well as economic and political interest. Moreover, Germany is better located than any other West European state to trade with Eastern Europe, especially because Berlin remains one of the most attractive potential production, assembly, service, and transportation centers for East European trade.

International Investment in and by Germany

Before unification, West Germany had been a principal exporter of capital. This status was indicative of the capital surplus the country's firms and banks held abroad as a result of export earnings, but it was also a sign of the growing disparity between production costs in West Germany and abroad. Many West German manufacturers preferred to produce in other countries where lower costs might give them a greater competitive edge than they might have operating from a West German base. Therefore, during most of the years between 1960 and 1989, and especially during the 1980s, the amount of West German investment abroad exceeded the level of foreign investment in West Germany.

West German and later German direct investment abroad remained high even around the time of unification, totaling DM37.4 billion in 1990, DM37.1 billion in 1991, and DM28.1 billion in 1992. During those years, foreign direct investment in West Germany or unified Germany never exceeded DM6.2 billion per year.

The nature of West Germany's investment abroad was different from foreign investment in West Germany. About one-fourth to one-third, and sometimes as much as one-half, of West German investment abroad during the 1970s and 1980s represented direct investment in production facilities, the remainder being investment in various forms of long-term credits such as equities, bonds, and long-term bank deposits. However, relatively little foreign investment in West Germany



Central Hamburg
Courtesy Hamburg-North America Representation, New York

during that period was in production facilities, with the annual share ranging from about one-twentieth to one-sixth of all foreign investment. Instead, the dominant form of investment in West Germany was in West German equities and bonds.

Foreign investment in German stocks and bonds was especially heavy during the early 1990s. During 1991 that investment amounted to DM37.4 billion; in 1992 it rose to DM62.0 billion. Both amounts were far higher than foreign investment in German securities during any earlier year. As a result, Germany had a long-term capital surplus of DM46.6 billion during 1992, the highest amount West Germany or unified Germany had ever recorded and a striking departure from West Germany's chronic capital deficit.

According to Bundesbank statistics, one-fifth of all German securities at the end of 1990 belonged to foreigners, and one-half of all German publicly offered obligations between 1986 and 1990 had been bought by foreigners. Much of the investment appears to have been motivated by the expectation that the deutsche mark would appreciate and that investment in German funds would thus produce an exchange profit as well as regular income. Much of it may also have reflected the sense that German long-term interest rates would decline as the burdens of unification eased.

Because of the large amount of German direct investment abroad, German income from foreign investments exceeds income of foreigners investing in Germany. Bundesbank statistics showed that the net return on West German capital abroad had risen to almost DM25 billion by 1989. If Germans were going abroad to invest, they were drawing a significant return income.

In 1988, of West German foreign investment, 52 percent was in Europe (with 41 percent in EC countries), 40 percent was in the Americas (with 28 percent in the United States), and only 6 percent was in Asia (with 2 percent in Japan). The favorite sites for West German foreign investment were France and Britain. A fast-growing amount was going to Eastern Europe. A survey conducted by a German economic institute showed that more than twice as much new German investment at the end of 1993 was going to the states of Central Europe and Eastern Europe as to West European states, with the largest amount by far going to the Czech Republic.

The structural problems of German production were compelling German investors to abandon production in Germany—including eastern Germany—and were making locations in other countries more competitive. Even before unification, many German industrialists and investors had been moving German production facilities to other EC states, especially Spain and Portugal, or to the United States or other countries where labor costs were lower. German efficiency, thoroughness, and quality control could only compensate up to a point for the cost advantage that producers in other countries increasingly enjoyed. The combination of high labor costs, a high level of subsidization, and a strong currency was putting German producers at a growing disadvantage at precisely the moment when the costs of unification were becoming particularly burdensome.

Foreign Aid

Although Germany is a leader in foreign trade, it has never been generous with foreign aid. West German official developmental assistance between 1976 and 1989 ranged between 0.40 and 0.47 percent of German GDP, well below the 0.70 standard proposed by the United Nations (UN). German aid sank to 0.36 percent of GDP in 1993 as the costs of unification reinforced the reluctance of the German government to grant assistance. But German private contributions to international causes, especially for humanitarian purposes, are consistently high. During 1992 those contributions matched the level of official assistance.

Because Germany was not involved in the wave of decolonization that followed World War II, it has not had the special links to former colonies that have helped to motivate and channel aid by such former colonial powers as France and Britain. The largest portion of West German aid, over 40 percent, went to Africa during the 1980s. Earlier, West Germany had sent more aid to Asia, but that portion fell to 30 percent during the 1980s because the Asian economic boom made aid less necessary. Relatively little aid went to the Americas.

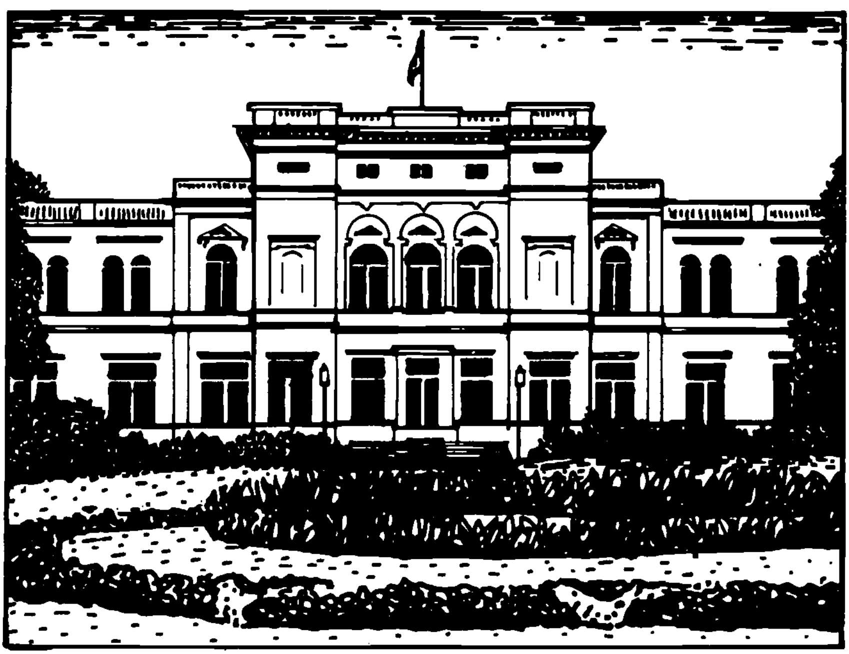
* * *

The literature on German external economic relations is as limited as the general literature on the German economy. The most comprehensive current books in English are *The German Economy* by W.R. Smyser and *The German Economy* by Eric Owen Smith. An annual economic survey of Germany published by the Organisation for Economic Co-operation and Development (OECD) contains current information on German external economic relations, as does the OECD biannual, *OECD Economic Outlook*. The Bundesbank publishes a monthly statistical compilation on German trade, current account, and foreign investment balances, but only in German.

Two books about the specific German role in European economics are *The Federal Republic of Germany and the European Community* by Simon Bulmer and William Paterson and *Germany's International Monetary Policy and the European Monetary System* by Hugo M. Kaufmann. A work that offers discussion of the competitive weaknesses of the German economy is *Die japanisch-amerikanische Herausforderung* by Konrad Seitz. Several books on the European economy and the EU offer some information about Germany's role in European economics. These include *The National Economies of Europe*, edited by David A. Dyker, *The*

Economics of European Integration by Willem Molle, and *Euro-Politics*, edited by Alberta M. Sbragia. Books of this kind appear regularly and provide a continuing picture of the growing German role in European economics. (For further information and complete citations, see Bibliography.)

Chapter 7. Government and Politics



Villa Hammerschmidt, the residence of the federal president in Bonn

AS OF MID-1995, GERMANY was a country coming to terms with the recent unification of its western and eastern portions following four decades of Cold War division. Achieved in October 1990, German unification consisted, in effect, of the incorporation of the German Democratic Republic (GDR, or East Germany) into the Federal Republic of Germany (FRG, or West Germany). Thus, the unified country, rather than reflecting a mix of both states' systems, largely represented a continuation of the West German political and economic system. West German chancellor Helmut Kohl preferred this "fast track" to unification, outlined in Article 23 of the West German Basic Law, or constitution, because he feared that international circumstances might change and the chance for unification might be missed. The alternative path to unification, detailed in Article 146, would have required the replacement of the Basic Law with a constitution developed specifically for a unified Germany.

During the summer of 1990, the governments of the two German states drafted a 1,000-page treaty outlining the terms of political union. The document explained how the political structures and policies of West Germany would be extended to the east, how other institutions—such as the education system—would be coordinated, and which issues would be resolved later—for instance, abortion policy. The parliaments of both German states ratified the treaty, and the territory of East Germany joined the Federal Republic under Article 23 on October 3, 1990.

The West German system of government, outlined in the Basic Law, reflects in particular a desire to transcend the interwar period of democratic instability and dictatorship. A federal system of government, considered vital to a stable, constitutional democracy, was put in place as a direct response to lessons learned from the Nazis' misuse of centralized structures. After four years of Allied occupation, the FRG was established in 1949. The country attained sovereignty in 1955 when the Allies transferred responsibility for national security to the newly formed armed forces, the Bundeswehr.

Creating a climate of political stability was a primary goal of the authors of West Germany's Basic Law. Among other things, the Basic Law established the supremacy of political parties in the system of government. In the resulting "party state," all major government policies emanated from the organizational structure of the political parties. In the decades since 1949, West Germany's parties have tended toward the middle of the political spectrum, largely because both the historical experience with fascism and the existence of communist East Germany greatly diminished the appeal of either extreme. This reigning political consensus, challenged briefly in the late 1960s by the student protest movement and in the early 1980s by economic recession, has led many observers to judge the "Bonn model" a success. However, it remains an open question whether the legal, economic, and political structures of the past will serve the unified Germany as well in the future.

Constitutional Framework

The Constitution

The framers of the Federal Republic of Germany's 1949 constitution sought to create safeguards against the emergence of either an overly fragmented, multiparty democracy, similar to the Weimar Republic (1918–33), or authoritarian institutions characteristic of the Nazi dictatorship of the Third Reich (1933–45). Thus, negative historical experience played a major role in shaping the constitution.

Articles 1 through 19 delineate basic rights that apply to all German citizens, including equality before the law; freedom of speech, assembly, the news media, and worship; freedom from discrimination based on race, gender, religion, or political beliefs; and the right to conscientious objection to compulsory military service. In reaction to the experience of the Third Reich, the framers of the Basic Law did, however, place limits on extremist political activities that might threaten to subvert the democratic political order. Article 18 states: "Whoever abuses freedom of expression of opinion, in particular freedom of the press, freedom of teaching, freedom of assembly, freedom of association, privacy of posts and telecommunications, property, or the right of asylum in order to combat the free democratic basic order, shall forfeit these basic rights." Article 18 was employed twice in the 1950s to ban political parties of the extreme right and left. Article 18 is seen as an essential component of a *wehrhafte Demokratie*—a democracy that can defend itself, unlike the Weimar Republic.

Article 20 states that "the Federal Republic of Germany is a democratic and social federal state." The word "social" has been commonly interpreted to mean that the state has the responsibility to provide for the basic social welfare of its citizens. The Basic Law, however, does not enumerate specific social duties of the state. Further, according to Article 20, "All state authority emanates from the people. It shall be exercised by the people by means of elections and voting and by specific legislative, executive, and judicial organs."

Most of the Basic Law's 146 articles describe the composition and functions of various organs of government, as well as the intricate system of checks and balances governing their interaction. Other major issues addressed in the Basic Law include the distribution of power between the federal government and the state (*Land*; pl., *Länder*) governments, the administration of federal laws, government finance, and government administration under emergency conditions. The Basic Law is virtually silent on economic matters; only Article 14 guarantees "property and the right of inheritance" and states that "expropriation shall be permitted only in the public weal."

Any amendment to the Basic Law must receive the support of at least two-thirds of the members in both federal legislative chambers—the Bundestag (Federal Diet or lower house) and the Bundesrat (Federal Council or upper house). Certain provisions of the Basic Law cannot be amended: those relating to the essential structures of federalism; the division of powers; the principles of democracy, social welfare, and fundamental rights; and the principle of state power based on law. Of the many amendments to the Basic Law, among the most notable are the "defense addenda" of 1954–56, which regulate the constitutional position of the armed forces, and the "Emergency Constitution" of 1968, which delineates wider executive powers in the case of an internal or external emergency.

Federalism

Germany has a strong tradition of regional government dating back to the founding of the German Empire in 1871. Since unification in 1990, the Federal Republic has consisted of sixteen *Länder*: the ten *Länder* of the former West Germany, the five new *Länder* of the former East Germany, and Berlin. (However, Berlin and the eastern *Land* of Brandenburg are slated to merge in either 1999 or 2002.) The *Land* governments are based on a parliamentary system. Most *Länder* have unicameral legislatures, whose members are elected directly by popular vote. The party or coalition of parties in control of the legislature chooses a minister president to lead the *Land* government. The minister president selects a cabinet to run *Land* agencies and carry out the executive functions of the *Land* government. Minister presidents are highly visible national figures and often progress to federal office, either the chancellorship or a position in the federal cabinet.

The Basic Law divides authority between the federal government and the *Länder*, with the general principle governing relations articulated in Article 30: "The exercise of governmental powers and the discharge of governmental functions shall be incumbent on the *Länder* insofar as this Basic Law does not otherwise prescribe or permit." Thus, the federal government can exercise authority only in those areas specified in the Basic Law. The federal government is assigned a greater legislative role and the *Land* governments a greater administrative role. The fact that more civil servants are employed by *Land* governments than by federal and local governments combined illustrates the central administrative function of the *Länder*.

The Basic Law divides the federal government's legislative responsibilities into exclusive powers (Articles 71 and 73), concurrent powers (Articles 72, 74, and 74a), and framework powers (Article 75). The exclusive legislative jurisdiction of the federal government extends to defense, foreign affairs, immigration, transportation, communications, and currency standards. The federal and *Land* governments share concurrent powers in several areas, including civil law, refugee and expellee matters, public welfare, land management, consumer protection, public health, and the collection of vital statistics (data on births, deaths, and marriages). In the areas of mass media, nature conservation, regional planning, and public service regulations, framework legislation limits the federal government's role to offering general policy guidelines, which the *Länder* then act upon by means of detailed legislation. The areas of shared responsibility for the *Länder* and the federal government were enlarged by an amendment to the Basic Law in 1969 (Articles 91a and 91b), which calls for joint action in areas of broad social concern such as higher education, regional economic development, and agricultural reform.

All policy areas not assigned to federal jurisdiction are within the legislative purview of the *Länder*. These areas include education, law enforcement, regulation of radio and television, church affairs, and cultural activities. The *Länder* retain significant powers of taxation. Most federal taxes are collected by *Land* officials.

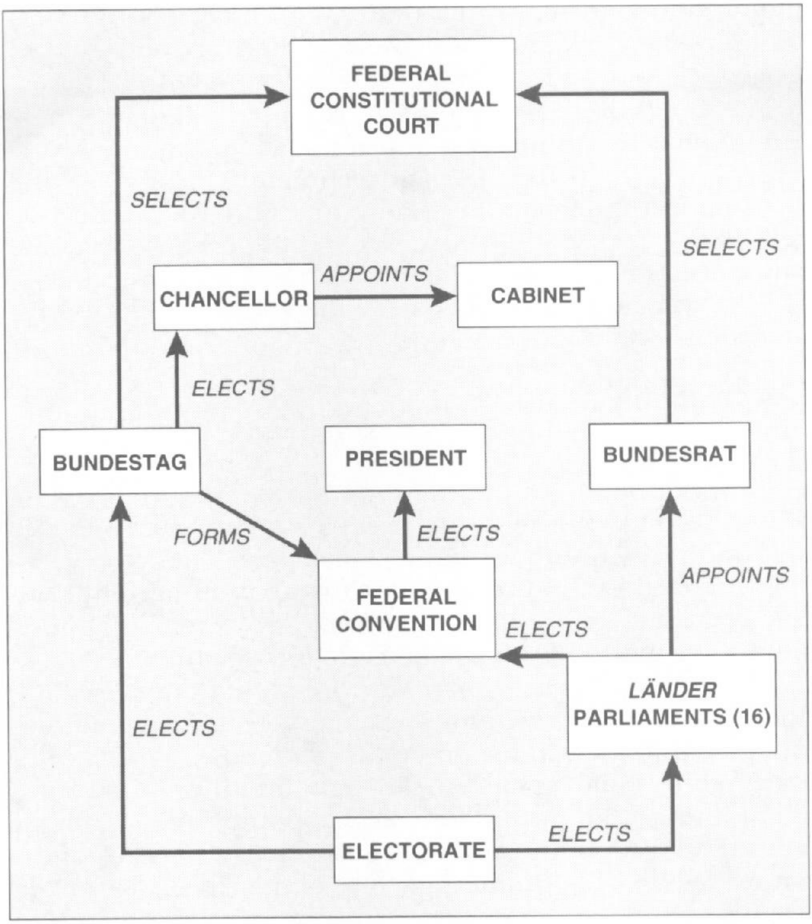
The *Land* governments also exercise power at the national level through the Bundesrat, which is made up of representatives appointed by the *Land* governments. In this way, the *Länder* affect the federal legislative process (see The Legislature, this ch.). Half of the members of the Federal Convention, which elects a federal president, are *Land* officials, and the *Land* governments also take part in the selection of judges for the federal courts.

Government Institutions

The President

The Basic Law creates a dual executive but grants most executive authority to the federal chancellor, as head of government, rather than to the president, who acts as head of state (see fig. 13). The presidency is primarily a ceremonial post, and its occupant represents the Federal Republic in international relations. In that sphere, the president's duties include signing treaties, representing Germany abroad, and receiving foreign dignitaries. In the domestic sphere, the president has largely ceremonial functions. Although this official signs legislation into law, grants pardons, and appoints federal judges, federal civil servants, and military officers, each of these actions requires the countersignature of the chancellor or the relevant cabinet minister. The president formally proposes to the Bundestag a chancellor candidate and formally appoints the chancellor's cabinet members, but the president follows the choice of the Bundestag in the first case and of the chancellor in the second. If the government loses a simple no-confidence vote, the president dissolves the Bundestag, but here, too, the Basic Law limits the president's ability to act independently. In the event of a national crisis, the emergency law reforms of 1968 designate the president as a mediator who can declare a state of emergency.

There is disagreement about whether the president, in fact, has greater powers than the above description would suggest. Some argue that nothing in the Basic Law suggests that a president must follow government directives. For instance, the president could refuse to sign legislation, thus vetoing it, or refuse to approve certain cabinet appointments. As of mid-1995, no



Source: Based on information from Russell J. Dalton, *Politics in Germany*, New York, 1993, 48; and Arno Kappler and Adriane Grevels, eds., *Facts about Germany*, Frankfurt am Main, 1994, 145.

Figure 13. Structure of the Government, 1995

president had ever taken such action, and thus the constitutionality of these points had never been tested.

The president is selected by secret ballot at a Federal Convention that includes all Bundestag members and an equal number of delegates chosen by the *Land* legislatures. This assemblage, which totals more than 1,000 people, is convened every five years. It may select a president for a second, but not a third, five-year term. The authors of the Basic Law preferred this indirect form of presidential election because they believed it would produce a head of state who was widely acceptable and insulated from popular pressure. Candidates for the presidency must be at least forty years old.

The Basic Law did not create an office of vice president. If the president is outside the country or if the position is vacant, the president of the Bundesrat fills in as the temporary head of state. If the president dies in office, a successor is elected within thirty days.

Usually one of the senior leaders of the largest party in the Bundestag, the president nonetheless is expected to be nonpartisan after assuming office. For example, President Richard von Weizsäcker, whose second term expired in June 1994, was the former Christian Democratic mayor of Berlin. Upon becoming president in 1984, he resigned from his party positions. Weizsäcker played a prominent role in urging Germans to come to terms with their actions during the Third Reich and in calling for greater tolerance toward foreigners in Germany as right-wing violence escalated in the early 1990s. Although the formal powers of the president are limited, the president's role can be quite significant depending on his or her own activities. Between 1949 and 1994, the Christian Democratic Union (Christlich Demokratische Union—CDU) held the office for twenty-five years, the Free Democratic Party (Freie Demokratische Partei—FDP) for fifteen, and the Social Democratic Party of Germany (Sozialdemokratische Partei Deutschlands—SPD) for five (see table 2, Appendix).

Elected by the Federal Convention in May 1994, Roman Herzog succeeded Weizsäcker as President on July 1, 1994. Previously president of the Federal Constitutional Court in Karlsruhe, Germany's highest court, he was nominated for the presidency by the CDU and its sister party, the Christian Social Union (Christlich-Soziale Union—CSU).

The Chancellor and the Cabinet

The federal government consists of the chancellor and his or her cabinet ministers. As explained above, the Basic Law invests the chancellor with central executive authority. For that reason, some observers refer to the German political system as a "chancellor democracy." The chancellor's authority emanates from the provisions of the Basic Law and from his or her status as leader of the party or coalition of parties holding a majority of seats in the Bundestag. Every four years, after national elections and the seating of the newly elected Bundestag members, the federal president nominates a chancellor candidate to that parliamentary body; the chancellor is elected by majority vote in the Bundestag.

The Basic Law limits parliament's control over the chancellor and the cabinet. Unlike most parliamentary legislatures, the Bundestag cannot remove the chancellor simply with a vote of no-confidence. In the Weimar Republic, this procedure was abused by parties of both political extremes in order to oppose chancellors and undermine the democratic process. As a consequence, the Basic Law allows only for a "constructive vote of no-confidence." That is, the Bundestag can remove a chancellor only when it simultaneously agrees on a successor. This legislative mechanism ensures both an orderly transfer of power and an initial parliamentary majority in support of the new chancellor. The constructive no-confidence vote makes it harder to remove a chancellor because opponents of the chancellor not only must disagree with his or her governing but also must agree on a replacement.

As of 1995, the Bundestag had tried to pass a constructive no-confidence vote twice, but had succeeded only once. In 1972 the opposition parties tried to replace Chancellor Willy Brandt of the SPD with the CDU party leader because of profound disagreements over the government's policies toward Eastern Europe. The motion fell one vote shy of the necessary majority. In late 1982, the CDU convinced the FDP to leave its coalition with the SPD over differences on economic policy and to form a new government with the CDU and the CSU. The constructive no-confidence vote resulted in the replacement of Chancellor Helmut Schmidt with Helmut Kohl, the CDU party leader. Observers agree that the constructive no-confidence vote has increased political stability in Germany.

The chancellor also may make use of a second type of no-confidence vote to garner legislative support in the Bundestag. The chancellor can append a simple no-confidence provision to any government legislative proposal. If the Bundestag rejects the proposal, the chancellor may request that the president dissolve parliament and call new elections. Although not commonly used, this procedure enables the chancellor to gauge support in the Bundestag for the government and to increase pressure on the Bundestag to vote in favor of legislation that the government considers as critical. Furthermore, governments have employed this simple no-confidence motion as a means of bringing about early Bundestag elections. For exam-

Richard von Weizsäcker, president, 1984–94
Courtesy German Information Center, New York

ple, after Kohl became chancellor through the constructive no-confidence vote in August 1982, his government purposely set out to lose a simple no-confidence provision in order to bring about new elections and give voters a chance to validate the new government through a democratic election.

Article 65 of the Basic Law sets forth three principles that define how the executive branch functions. First, the "chancellor principle" makes the chancellor responsible for all government policies. Any formal policy guidelines issued by the chancellor are legally binding directives that cabinet ministers must implement. Cabinet ministers are expected to introduce specific policies at the ministerial level that reflect the chancellor's broader guidelines. Second, the "principle of ministerial autonomy" entrusts each minister with the freedom to supervise departmental operations and prepare legislative proposals without cabinet interference so long as the minister's policies are consistent with the chancellor's larger guidelines. Third, the "cabinet principle" calls for disagreements between federal ministers over jurisdictional or budgetary matters to be settled by the cabinet.

The chancellor determines the composition of the cabinet. The federal president formally appoints and dismisses cabinet ministers, at the recommendation of the chancellor; no

Bundestag approval is needed. According to the Basic Law, the chancellor may set the number of cabinet ministers and dictate their specific duties. Chancellor Ludwig Erhard had the largest cabinet, with twenty-two ministers, in the mid-1960s. Kohl presided over seventeen ministers at the start of his fourth term in 1994.

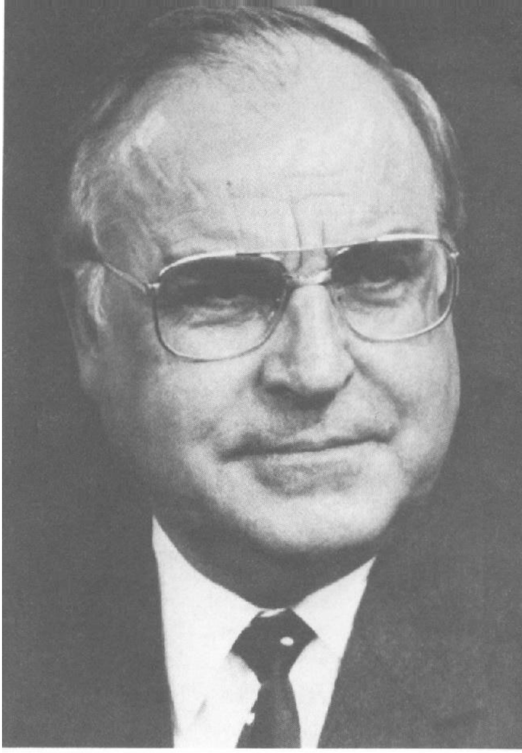
The power of the smaller coalition partners, the FDP and the CSU, was evident from the distribution of cabinet posts in Kohl's government in 1995. The FDP held three ministries—the Ministry of Foreign Affairs, Ministry of Justice, and Ministry for Economics. CSU members led four ministries—the Ministry of Finance, Ministry for Health, Ministry for Post and Telecommunications, and Ministry for Economic Cooperation.

The staff of a cabinet minister is managed by at least two state secretaries, both of whom are career civil servants responsible for the ministry's administration, and a parliamentary state secretary, who is generally a member of the Bundestag and represents the ministry there and in other political forums. Typically, state secretaries remain in the ministry beyond the tenure of any one government, in contrast to the parliamentary state secretary, who is a political appointee and is viewed as a junior member of the government whose term ends with the minister's. Under these top officials, the ministries are organized functionally in accordance with each one's specific responsibilities. Career civil servants constitute virtually the entire staff of the ministries.

The Legislature

The heart of any parliamentary system of government is the legislature. Germany has a bicameral parliament. The two chambers are the Bundestag (Federal Diet or lower house) and the Bundesrat (Federal Council or upper house). Both chambers can initiate legislation, and most bills must be approved by both chambers, as well as the executive branch, before becoming law. Legislation on issues within the exclusive jurisdiction of the federal government, such as international treaties, does not require Bundesrat approval.

The federal government introduces most legislation; when it does so, the Bundesrat reviews the bill and then passes it on to the Bundestag. If a bill originates in the Bundesrat, it is submitted to the Bundestag through the executive branch. If the Bundestag introduces a bill, it is sent first to the Bundesrat and, if approved there, forwarded to the executive. The Joint Con-



Helmut Kohl, federal chancellor, 1982–
Courtesy German Information Center, New York

ference Committee resolves any differences over legislation between the two legislative chambers. Once the compromise bill that emerges from the conference committee has been approved by a majority in both chambers and by the cabinet, it is signed into law by the federal president and countersigned by the relevant cabinet minister.

Bundestag

The Bundestag is the principal legislative chamber, roughly analogous to the United States House of Representatives. The Bundestag has grown gradually since its creation, most dramatically with unification and the addition of 144 new representatives from eastern Germany, for a total of 656 deputies in 1990. A further expansion in 1994 increased the number to 672. Elections are held every four years (or earlier if a government falls from power). Bundestag members are the only federal officials directly elected by the public. All candidates must be at least twenty-one years old; there are no term limits.

The most important organizational structures within the Bundestag are parliamentary groups (*Fraktionen*; sing., *Fraktion*), which are formed by each political party represented in the chamber. The size of a party's *Fraktion* determines the extent of its representation on legislative committees, the number of committee chairs it can hold, and its representation in executive bodies of the Bundestag. The head of the largest *Fraktion* is named president of the Bundestag. The *Fraktionen*, not the members, receive the bulk of government funding for legislative and administrative activities.

The leadership of each *Fraktion* consists of a parliamentary party leader, several deputy leaders, and an executive committee. The leadership's major responsibilities are to represent the *Fraktion*, enforce party discipline, and orchestrate the party's parliamentary activities. The members of each *Fraktion* are distributed among working groups focused on specific policy-related topics such as social policy, economics, and foreign policy. The *Fraktion* meets once a week to consider legislation before the Bundestag and formulate the party's position on it.

The Bundestag's executive bodies include the Council of Elders and the Presidium. The council consists of the Bundestag leadership, together with the most senior representatives of each *Fraktion*, with the number of these representatives tied to the strength of the party in the chamber. The council is the coordination hub, determining the daily legislative agenda and assigning committee chairpersons based on party representation. The council also serves as an important forum for interparty negotiations on specific legislation and procedural issues. The Presidium is responsible for the routine administration of the Bundestag, including its clerical and research activities. It consists of the chamber's president and vice presidents (one from each *Fraktion*).

Most of the legislative work in the Bundestag is the product of standing committees. Although this is common practice in the United States Congress, it is uncommon in other parliamentary systems, such as the British House of Commons and the French National Assembly. The number of committees approximates the number of federal ministries, and the titles of each are roughly similar (e.g., defense, agriculture, and labor). Between 1987 and 1990, the term of the eleventh Bundestag, there were twenty-one standing committees. The distribution of committee chairs and the membership of each committee reflect the relative strength of the various parties in the chamber. In the eleventh Bundestag, the CDU/CSU chaired eleven committees, the SPD eight, the FDP one, and the environmentalist party, the Greens (Die Grünen), one. Unlike in the United States Congress, where all committees are chaired by members of the majority party, the German system allows members of the opposition party to chair a significant number of standing committees. These committees have either a small staff or no staff at all.

Although most legislation is initiated by the executive branch, the Bundestag considers the legislative function its most important responsibility. The Bundestag concentrates much of its energy on assessing and amending the government's legislative program. The committees play a prominent role in this process. Plenary sessions provide a forum for members to engage in public debate on legislative issues before them, but they tend to be well attended only when significant legislation is being considered. The Bundestag allots each *Fraktion* a certain amount of time, based on its size, to express its views.

Other responsibilities of the Bundestag include selecting the federal chancellor and exercising oversight of the executive branch on issues of both substantive policy and routine administration. This check on executive power can be employed through binding legislation, public debates on government policy, investigations, and direct questioning of the chancellor or cabinet officials. For example, the Bundestag can conduct a question hour (*Fragestunde*), in which a government representative responds to a previously submitted written question from a member. Members can ask related questions during the question hour. The questions can concern anything from a major policy issue to a specific constituent's problem. Use of the question hour has increased markedly over the past forty years, with more than 20,000 questions being posed during the 1987–90 Bundestag term. Understandably, the opposition parties are active in exercising the parliamentary right to scrutinize government actions.

One striking difference when comparing the Bundestag with the United States Congress is the lack of time spent on serving constituents in Germany. In part, that difference results from the fact that only 50 percent of Bundestag deputies are directly elected to represent a specific geographic district; the other half are elected as party representatives. The political parties are thus of great importance in Germany's electoral system, and many voters tend not to see the candidates as autonomous political personalities but rather as creatures of the party. Interestingly, constituent service seems not to be perceived, either by the electorate or by the representatives, as a critical function of the legislator. A practical constraint on the expansion of constituent service is the limited personal staff of Bundestag deputies.

Bundesrat

The second legislative chamber, the Bundesrat, is the federal body in which the sixteen *Land* governments are directly represented. It exemplifies Germany's federalist system of government. Members of the Bundesrat are not popularly elected but are appointed by their respective *Land* governments. Members tend to be *Land* government ministers. The Bundesrat has sixty-nine members. The *Länder* with more than 7 million inhabitants have six seats (Baden-Württemberg, Bavaria, Lower Saxony, and North Rhine-Westphalia). The *Länder* with populations of between 2 million and 7 million have four seats (Berlin, Brandenburg, Hesse, Mecklenburg-Western Pomerania, Rhineland-Palatinate, Saxony, Saxony-Anhalt, Schleswig-Holstein, and Thuringia). The least populous *Länder*, with fewer than 2 million inhabitants, receive three seats each (Bremen, Hamburg, and the Saarland). This system of representation, although designed to reflect *Land* populations accurately, in fact affords greater representation per inhabitant to the smaller *Länder*. The presidency of the Bundesrat rotates annually among the *Länder*. By law, each *Land* delegation is required to vote as a bloc in accordance with the instructions of the *Land* government.

Because the Bundesrat is so much smaller than the Bundestag, it does not require the extensive organizational structure of the lower house. The Bundesrat typically schedules plenary sessions once a month for the purpose of voting on legislation prepared in committee. In comparison, the Bundestag conducts about fifty plenary sessions a year. Bundesrat representatives rarely attend committee sessions; instead, they delegate that responsibility to civil servants from their ministries, as allowed for in the Basic Law. The members tend to spend most of their time in their *Land* capitals, rather than in the federal capital.

The legislative authority of the Bundesrat is subordinate to that of the Bundestag, but the upper house nonetheless plays a vital legislative role. The federal government must present all legislative initiatives first to the Bundesrat; only thereafter can a proposal be passed to the Bundestag. Further, the Bundesrat must approve all legislation affecting policy areas for which the Basic Law grants the *Länder* concurrent powers and for which

The old Reichstag building is to become the seat of the Bundestag when it moves to Berlin in the late 1990s.
The plenary chamber of the Bundestag in Bonn
Courtesy German Information Center, New York

the *Länder* must administer federal regulations. The Bundesrat has increased its legislative responsibilities over time by successfully arguing for a broad, rather than a narrow, interpretation of what constitutes the range of legislation affecting *Land* interests. In 1949 only 10 percent of all federal laws, namely, those directly affecting the *Länder*, required Bundesrat approval. In 1993 close to 60 percent of federal legislation required the upper house's assent. The Basic Law also provides the Bundesrat with an absolute veto of such legislation.

The political power of the absolute veto is particularly evident when the opposition party or parties in the Bundestag have a majority in the Bundesrat. When this is the case, the opposition can threaten the government's legislative program. Such a division of authority can complicate the process of governing when the major parties disagree, and, unlike the Bundestag, the Bundesrat cannot be dissolved under any circumstances.

This bicameral system also has advantages. Some observers emphasize that different majorities in the two chambers ensure that all legislation, when approved, has the support of a broad political spectrum—a particularly valuable attribute in the aftermath of unification, when consensus on critical policy decisions is vital. The formal representation of the *Länder* in the federal government through the upper chamber provides an obvious forum for the coordination of policy between the *Länder* and the federal government. The need for such coordination, particularly given the specific, crucial needs of the eastern *Länder*, has become only more important.

The Judiciary

The judiciary's independence and extensive responsibilities reflect the importance of the rule of law in the German system of government. A core concept is that of the *Rechtsstaat*, a government based on law, in which citizens are guaranteed equality and in which government decisions can be amended. Federal law delineates the structure of the judiciary, but the administration of most courts is regulated by *Land* law. The *Länder* are responsible for the lower levels of the court system; the highest appellate courts alone operate at the federal level. This federal-*Land* division of labor allows the federation to ensure that laws are enforced equally throughout the country, whereas the central role of the *Länder* in administering the courts safeguards the independence of the judicial system from the federal government.

Principles of Roman law form the basis of the German judicial system and define a system of justice that differs fundamentally from the Anglo-Saxon system. In the United States, courts rely on precedents from prior cases; in Germany, courts look to a comprehensive system of legal codes. The codes delineate somewhat abstract legal principles, and judges must decide specific cases on the basis of those standards. Given the importance of complex legal codes, judges must be particularly well trained. Indeed, judges are not chosen from the field of practicing lawyers. Rather, they follow a distinct career path. At the end of their legal education at university, law students must pass a state examination before they can continue on to an apprenticeship that provides them with broad training in the legal profession over several years. They then must pass a second state examination that qualifies them to practice law. At that point, the individual can choose either to be a lawyer or to enter the judiciary. Judicial candidates must train for several more years before actually earning the title of judge.

The judicial system comprises three types of courts. Ordinary courts, dealing with criminal and most civil cases, are the most numerous by far. Specialized courts hear cases related to administrative, labor, social, fiscal, and patent law. Constitutional courts focus on judicial review and constitutional interpretation. The Federal Constitutional Court (Bundesverfassungsgericht) is the highest court and has played a vital role through its interpretative rulings on the Basic Law.

The ordinary courts are organized in four tiers, each of increasing importance. At the lowest level are several hundred local courts (*Amtsgerichte*; sing., *Amstgericht*), which hear cases involving minor criminal offenses or small civil suits. These courts also carry out routine legal functions, such as probate. Some local courts are staffed by two or more professional judges, but most have only one judge, who is assisted by lay judges in criminal cases. Above the local courts are more than 100 regional courts (*Landesgerichte*; sing., *Landesgericht*), which are divided into two sections, one for major civil cases and the other for criminal cases. The two sections consist of panels of judges who specialize in particular types of cases. Regional courts function as courts of appeals for decisions from the local courts and hold original jurisdiction in most major civil and criminal matters. At the next level, *Land* appellate courts (*Ober-*

landesgerichte; sing., *Oberlandesgericht*) primarily review points of law raised in appeals from the lower courts. (For cases originating in local courts, this is the level of final appeal.) Appellate courts also hold original jurisdiction in cases of treason and anticonstitutional activity. Similar to the regional courts, appellate courts are divided into panels of judges, arranged according to legal specialization. Crowning the system of ordinary courts is the Federal Court of Justice (Bundesgerichtshof) in Karlsruhe. It represents the final court of appeals for all cases originating in the regional and appellate courts and holds no original jurisdiction.

Specialized courts deal with five distinct subject areas: administrative, labor, social, fiscal, and patent law. Like the ordinary courts, they are organized hierarchically with the *Land* court systems under a federal appeals court. Administrative courts consist of local administrative courts, higher administrative courts, and the Federal Administrative Court. In these courts, individuals can seek compensation from the government for any harm caused by incorrect administrative actions by officials. For instance, many lawsuits have been brought in administrative courts by citizens against the government concerning the location and safety standards of nuclear power plants. Labor courts also function on three levels and address disputes over collective bargaining agreements and working conditions. Social courts, organized at three levels, adjudicate cases relating to the system of social insurance, which includes unemployment compensation, workers' compensation, and social security payments. Finance, or fiscal, courts hear only tax-related cases and exist on two levels. Finally, a single Federal Patents Court in Munich adjudicates disputes relating to industrial property rights.

Except for Schleswig-Holstein, each *Land* has a state constitutional court. These courts are administratively independent and financially autonomous from any other government body. For instance, a *Land* constitutional court can write its own budget and hire or fire employees, powers that represent a degree of independence unique in the government structure.

Sixteen judges make up the Federal Constitutional Court, Germany's highest and most important judicial body. They are selected to serve twelve-year, nonrenewable terms and can only be removed from office for abuse of their position and then only by a motion of the court itself. The Bundestag and the Bundesrat each choose half of the court's members. Thus, partisan politics do play a role. However, compromise is built into the system because any court decision requires a two-thirds majority among the participating judges. The court is divided into two senates, each consisting of a panel of eight judges with its own chief justice. The first senate hears cases concerning the basic rights guaranteed in Articles 1 through 19 of the Basic Law and concerning judicial review of legislation. The second senate is responsible for deciding constitutional disputes among government agencies and how the political process should be regulated.

Unlike the United States Supreme Court, the Federal Constitutional Court does not hear final appeals—that function belongs to the Federal Court of Justice. The Basic Law explicitly confines the jurisdiction of the Federal Constitutional Court to constitutional issues. By the late 1980s, the majority of the articles in the Basic Law had been subjected to judicial review, and the constitutionality of federal and state legislation had been considered in hundreds of court cases. When lacking the legislative clout to challenge a government policy, the opposition in the Bundestag traditionally has turned to the Federal Constitutional Court to question the constitutionality of legislation.

The Civil Service

As of June 1992, about 6.7 million Germans were employed by federal, *Land*, or local governments in Germany; close to 5 million of these were in the western part of the country, and 1.6 million were in the east. The vast majority (over 4.5 million) were employed at the *Land* and local levels. Included at the federal level were roughly 642,000 postal workers and 434,000 railroad workers. Of these civil servants, about 5.6 million were working full time and 1.1 million part time. Public servants have considerable social status in Germany.

Civil servants are categorized into three groups. Slightly over 2 million are career civil servants (*Beamten*; sing., *Beamte*); about 3 million are employees (*Angestellten*; sing., *Angestellte*); and roughly 1.5 million are workers (*Arbeiter*). *Beamten* are divided into four "career groups": higher service, executive service, clerical service, and basic service. A public servant rarely moves from one category to another during his or her career.

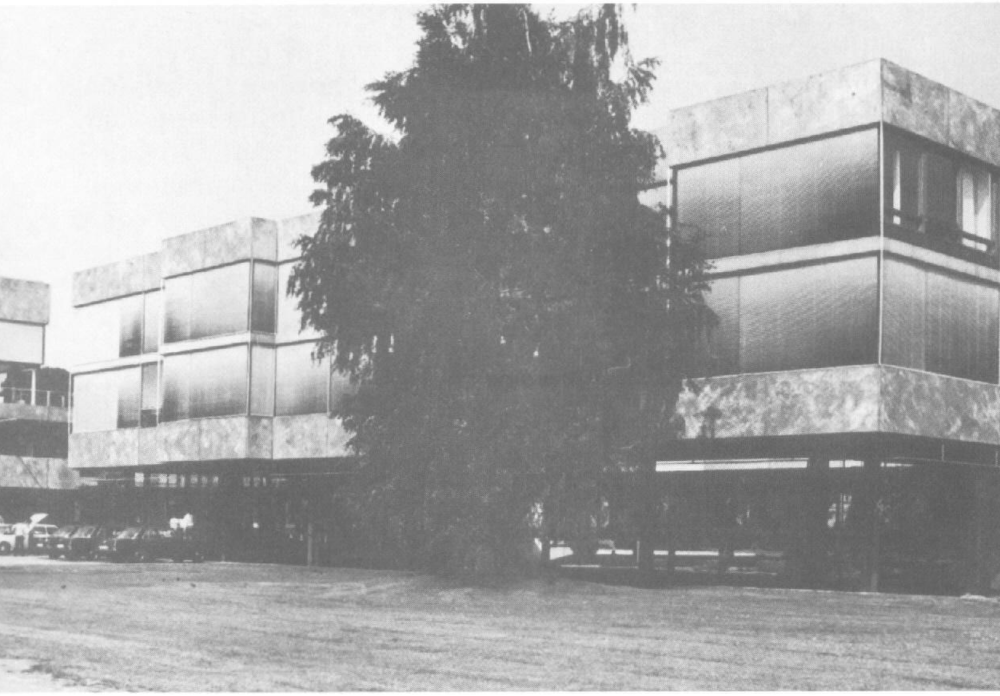
Beamten, or career civil servants, constitute the highest level of the administrative elite and enjoy special privileges. They are appointed for life and also receive a noncontributory pension that substantially increases their salaries in comparison with those of public servants in other categories. *Beamten* can be found everywhere, from low-level jobs in the post office to the most senior positions in government ministries, the equivalent of supergrade administrative positions in the United States government. These upper-level *Beamten* occupy most of the significant administrative posts within the bureaucracy and thus influence both formation and application of policy. Almost all *Beamten* at that level of *Land* and federal administration have a university degree, typically with a concentration in law or economics.

In exercising *Land* authority, *Beamten* must obey the orders of their superiors, possess no right to strike, are bound to defend the constitutional order, and are legally responsible for the application of administrative law. In 1972 the federal and *Land* governments issued an executive decree that institutionalized the ban against employing antidemocratic extremists in the public service. This highly controversial law (known as the Radikalenerlass or Berufsverbot) mandated that all candidates for positions as *Beamten* be screened and those already employed be examined, if deemed necessary, for evidence of extreme political views. Other public servants may also be scrutinized "in accordance with the contracts regulating each case."

Public servants may run for public office, and many do so. For example, the Bundestag is often referred to as the parliament of civil servants because a high percentage of its members are *Beamten*. During the twelfth Bundestag (1990–94), almost one-third of the deputies were *Beamten*. The largest portion of that group, 10 percent, consisted of teachers.

Land and Local Government

The Basic Law stipulates that the structure of *Land* government must "conform to the principles of republican, democratic, and social government based on the rule of law" (Article 28[1]). Twelve of the *Länder* are governed by a cabinet led by a minister president together with a unicameral legislative body, the Landtag (pl., Landtage). The relationship between the legislative and executive branches mirrors that in the federal system: the legislatures are popularly elected, typically for four years, and the minister president is chosen by a majority vote among Landtag members. The minister president appoints a cabinet to run *Land* agencies and carry out the executive duties of the *Land* government. Bavaria is the only *Land* with a



The Federal Constitutional Court in Karlsruhe in session
Exterior of the Federal Constitutional Court
Courtesy German Information Center, New York

bicameral legislature; the Landtag is popularly elected, but the second chamber, the Senate, consists of representatives of the major social and economic groups in Bavaria. In the city *Länder* of Berlin, Bremen, and Hamburg, the executive branch consists of a popularly elected senate. The senates' members carry out duties equivalent to those of the ministers in the larger *Länder*. The senate chooses a senate president in Bremen and a mayor in Berlin and Hamburg to serve as chief executive. *Land* cabinets consist of about ten ministers; the most important is the minister of the interior, who directs the internal administration of the *Land* and commands the police.

Politics at the *Land* level often carry implications for federal politics. Opposition victories in Landtag elections—which take place throughout the federal government's four-year term—can weaken the federal government coalition. This was the case for the fall from the chancellorship of Konrad Adenauer in 1963 and that of Willy Brandt in 1974. The *Land* elections are also viewed as a barometer of support for the policies of the federal government. If the parties of the governing coalition lose support in successive *Land* elections, those results may foreshadow difficulties for the federal government. The outcome of *Land* elections also directly affects the composition of the Bundesrat. In the early 1990s, the opposition SPD commanded a two-thirds majority in that legislative chamber, which made it particularly difficult for the CDU/CSU-FDP government to achieve the constitutional changes it sought.

Three levels of government are subordinate to the administrative authority of the states. First, the largest *Länder* are divided into districts. These districts decentralize *Land* administration and are run by district presidents who are appointed by the *Land* minister president and report to the *Land* minister of the interior.

Second, each *Land* is divided into *Landkreis* (pl., *Landkreise*) governments, each consisting of an elected council and an executive, who is selected by the council and whose duties are comparable to those of a county manager supervising local government administration. The *Landkreise* have primary administrative functions in specific areas, such as highways, hospitals, and public utilities.

Third, some *Landkreise* are divided further into *Gemeinden* (sing., *Gemeinde*), or municipal government authorities. *Gemeinden* consist of elected councils and an executive, the mayor, who is chosen by the council. In some small municipalities, the mayor is popularly elected. *Gemeinden* have two major policy responsibilities. First, they administer programs authorized by the federal or *Land* government. Such programs typically might relate to youth, public health, and social assistance. Second, Article 28(2) of the Basic Law guarantees *Gemeinden* "the right to regulate on their own responsibility all the affairs of the local community within the limits set by law." Under this broad statement of competence, local governments can justify a wide range of activities. For instance, many municipalities develop the economic infrastructure of their communities through the development of industrial parks. Local authorities foster cultural activities by supporting local artists and building arts centers. Local government also provides basic public utilities, such as gas and electricity, as well as public transportation. To increase administrative efficiency, West Germany consolidated the *Gemeinden*, reducing the total number from roughly 25,000 in the late 1960s to about 8,500 by the early 1990s. With unification, however, the number of *Gemeinden* for all sixteen *Länder* rose to about 16,000 because of the large number (more than 7,500) of small *Gemeinden* in former East Germany.

The Electoral System

The Basic Law guarantees the right to vote by secret ballot in direct and free elections to every German citizen eighteen years of age or older. To be eligible to vote, an individual must have resided in a constituency district for at least three months prior to an election. Officials who are popularly elected include Bundestag deputies at the federal level, Landtag representatives or senate members at the *Land* level, and council members at the district and local levels. Executive officials typically are not chosen in popular, direct elections; however, in a minority of municipalities the mayor is elected by popular vote. Elections usually are held every four years at all levels. Elections at the federal, *Land*, and local levels are not held simultaneously, as in the United States, but rather are staggered. As a result, electoral campaigns are almost always under way, and each election is viewed as a test of the federal government's popularity and the strength of the opposition. All elections are held on Sunday.

Voter turnout, traditionally high—around 90 percent for national elections—has been decreasing since the early 1980s. Voters are most likely to participate in general elections, but even at that level turnout in western Germany fell from 89.1

percent in 1983 to 84.3 percent in 1987, and to 78.5 percent in 1990. The 1990 general election was the first following unification; turnout was the lowest since the first West German election in 1949. The most consistent participants in the electoral process are civil servants, and a clear correlation exists between willingness to vote and increasing social and professional status and income. Analysts had been predicting a further drop in turnout, the result of increasing voter alienation, for the national election in October 1994; in fact, turnout increased slightly to 79.1 percent.

In designing the electoral system, the framers of the Basic Law had two objectives. First, they sought to reestablish the system of proportional representation used during the Weimar Republic. A proportional representation system distributes legislative seats based on a party's percentage of the popular vote. For example, if a party wins 15 percent of the popular vote, it receives 15 percent of the seats in the Bundestag. The second objective was to construct a system of single-member districts, like those in the United States. The framers believed that this combination would create an electoral system that would not fragment as the Weimar Republic had and would ensure greater accountability of representatives to their electoral districts. A hybrid electoral system of personalized proportional representation resulted.

Under the German electoral system, each voter casts two ballots in a Bundestag election. The elector's first vote is cast for a candidate running to represent a particular district. The candidate who receives a plurality of votes becomes the district representative. Germany is divided into 328 electoral districts with roughly 180,000 voters in each district. Half of the Bundestag members are directly elected from these districts. The second ballot is cast for a particular political party. These second votes determine each party's share of the popular vote.

The first ballot is designed to decrease the anonymity of a strict proportional representation system—thus the description "personalized"—but it is the second ballot that determines how many Bundestag seats each party will receive. To ensure that each party's percentage of the combined district (first ballot) and party (second ballot) seats equals its share of the second vote, each party is allocated additional seats. These additional party seats are filled according to lists of candidates drawn up by the state party organization prior to the election. Research indicates that constituency representatives in the Bundestag

The city hall in Hamburg dates from the late nineteenth century.
Courtesy Hamburg-North America Representation, New York

are more responsive to their electorate's needs and are slightly more likely to follow their constituents' preferences when voting than deputies chosen from the party lists.

If a party wins more constituency seats than it is entitled to according to its share of the vote in the second ballot, the party retains those seats, and the size of the Bundestag is increased. This was the case in both the 1990 and 1994 federal elections. After the 1990 election, the total number of seats in the Bundestag rose from 656 to 662. In 1994 sixteen extra seats were added, leading to a 672-member Bundestag; twelve of those seats went to Kohl's CDU and accounted for Kohl's ten-seat margin of victory.

One crucial exception to Germany's system of personalized proportional representation is the so-called 5 percent clause. The electoral law stipulates that a party must receive a minimum of 5 percent of the national vote, or three constituency seats, in order to get any representation in the Bundestag. An exception was made for the first all-Germany election in December 1990, with the Federal Constitutional Court setting separate 5 percent minimums for the old and new *Länder*. Thus, a party needed only to win 5 percent of the vote in either western or eastern Germany in order to receive seats in the Bundestag.

The 5 percent clause was crafted to prevent the proliferation of small extremist parties like those that destabilized the Weimar Republic. This electoral hurdle has limited the success of minor parties and consolidated the party system. Often voters are reluctant to vote for a smaller party if they are unsure if it will clear the 5 percent threshold. Smaller parties, such as the FDP, encourage voters to split their ticket, casting their first ballot for a named candidate of one of the larger parties and their second ballot for the FDP.

Small parties rarely win the three constituency seats that automatically qualify a party for parliamentary representation according to its overall share of the national vote. This rarity occurred in the 1994 national election. The Party of Democratic Socialism (Partei des Demokratischen Sozialismus—PDS), the renamed communist party of the former East Germany, won 4.4 percent of the national vote, an insufficient total to clear the 5 percent hurdle. The PDS surprised seemingly everyone, however, by winning four districts outright (all in eastern Berlin), entitling it to thirty seats in the Bundestag.

Germany holds no by-elections; if Bundestag deputies resign or die in office, they are automatically succeeded by the next candidate on the party's list in the appropriate *Land*. There are also no primary elections through which voters can choose party representatives. Rather, a small group of official party members nominates constituency candidates, and candidates appearing on the *Land* party lists are chosen at *Land* party conventions held six to eight weeks before the election. Party officials at the federal level play no part in the nominating procedure. Roughly two-thirds of the candidates run as both constituent and list candidates, thus increasing their chances of winning a legislative seat. If a candidate wins in a constituency, his or her name is automatically removed from the *Land* list. There is considerable jockeying among party factions and various interest groups as candidates are selected and placed on the *Land* lists. Placement near the top of the list is usually given to incumbents, party members of particular political prominence, or members who have the support of a key faction or interest group. Thus, aspiring politicians are quite dependent on their party, and successful candidates tend to evince loyalty to the party's policy platform. Candidates must be at least twenty-one years old.

Political Parties

Observers often describe political parties as critical stabilizing institutions in democratic systems of government. Because of the central role played by German political parties, many observers refer to Germany as a "party state." The government of this type of state rests on the principle that competition among parties provides for both popular representation and political accountability for government action.

On the role of parties, Article 21 of the Basic Law stipulates that "the political parties shall participate in the forming of the political will of the people. They may be freely established. Their internal organization must conform to democratic principles. They must publicly account for the sources of their funds." The 1967 Law on Parties further solidified the role of parties in the political process and addressed party organization, membership rights, and specific procedures, such as the nomination of candidates for office.

The educational function noted in Article 21 ("forming of the political will") suggests that parties should help define public opinion rather than simply carry out the wishes of the electorate. Major parties are closely affiliated with large foundations, which are technically independent of individual party organizations. These foundations receive over 90 percent of their funding from public sources to carry out their educational role. They offer public education programs for youth and adults, research social and political issues, and facilitate international exchanges.

Party funding comes from membership dues, corporate and interest group gifts, and, since 1959, public funds. Figures on party financing from 1992 show that dues accounted for over 50 percent of SPD revenues and 42 percent of CDU revenues. Federal resources accounted for 24 percent of SPD revenues and 30 percent of CDU revenues; donations accounted for 8 percent and 17 percent, respectively. The parties must report all income, expenditures, and assets. The government substantially finances election campaigns. Any party that gains at least 0.5 percent of the national vote is eligible to receive a set sum.

This sum has increased over time and, beginning in January 1984, amounted to DM5 (for value of the deutsche mark—see Glossary) from the federal treasury for every vote cast for a particular party in a Bundestag election. Parties at the *Land* level receive similar public subsidies. The political parties receive free campaign advertising on public television and radio stations for European, national, and *Land* elections. Airtime is allotted to parties proportionally based on past election performance. Parties may not purchase additional time.

Several events, including a party-financing scandal in the early 1980s and an electoral campaign in Schleswig-Holstein marked by dirty tricks in the late 1980s, have contributed to increased public distrust of the parties. A 1990 poll showed that West Germans, in ranking the level of confidence they had in a dozen social and political institutions, placed political parties very low on the list.

Although only 3 to 4 percent of voters were members of a political party, all the major parties experienced a decrease in party membership in the early 1990s, possibly a result of the increased distrust of political parties. SPD membership fell by 3.5 percent in 1992 to 888,000. At the end of the 1970s, the party had had more than 1 million members. CDU membership fell by 5 percent in 1992 to 714,000, while that of the FDP fell by about one-fifth to 110,000.

Article 21 of the Basic Law places certain restrictions on the ideological orientation of political parties: "Parties which, by reason of their aims or the behavior of their adherents, seek to impair or abolish the free democratic basic order or to endanger the existence of the Federal Republic of Germany, shall be unconstitutional. The Federal Constitutional Court shall decide on the question of unconstitutionality." This provision allowed for the banning of the neo-Nazi Socialist Reich Party in 1952 and the Communist Party of Germany (Kommunistische Partei Deutschlands—KPD) in 1956.

The decision to regulate the organization and activities of political parties reflects lessons learned from Germany's experience during the post-World War I Weimar Republic, when a weak multiparty system severely impaired the functioning of parliamentary democracy and was effectively manipulated by antidemocratic parties. After World War II, many parties dotted the West German political landscape, but electoral laws allowed only parties with at least 5 percent of the vote to have representation in national and *Land* parliaments. Over time, the smaller parties faded from the scene. From 1962 to 1982, the Bundestag contained representatives from only four parties: the CDU, the CSU, the SPD, and the FDP (see table 4, Appendix). The Greens gained enough of the national vote to win seats in 1983, and unification brought additional parties into the Bundestag in late 1990. At the federal level, the CSU coalesces with the CDU, the largest conservative party. The SPD is the major party of the left. The liberal FDP is, typically, the critical swing party, which can form a coalition with either the CDU/CSU or the SPD to create the majority needed to pass legislation in the Bundestag.

Christian Democratic Union/Christian Social Union

Following World War II, the Christian Democratic Union (Christlich Demokratische Union—CDU) was founded by a diverse group of Catholics and Protestants, businesspeople and trade unionists, and conservatives and moderates. The party espoused a Christian approach to politics and rejected both Nazism and communism. CDU members advocated conservative values and the benefits of a social market economy—that is, one combining capitalist practices and an extensive welfare system. Konrad Adenauer, the CDU's first leader and West Germany's first chancellor, envisioned the CDU as a conservative catchall party (*Volkspartei*) that would attract a majority of the electorate.

The CDU is a national party except in the *Land* of Bavaria, where it is not active, in deference to its sister party, the Christian Social Union (Christlich-Soziale Union—CSU). Bavaria has the largest concentration of conservative, rural, Catholic voters, and the CSU has dominated politics there since 1957. The CSU was personified by its leader, Franz-Josef Strauss, until his death in 1988. By 1994 no clear heir to Strauss had emerged, but the CSU nonetheless retained its absolute majority in the *Land* election of September 1994 (see table 21, Appendix). Germany's population increased through unification, and thus it has become more difficult for the CSU to pass the 5 percent electoral threshold at the national level. However, the CSU performed strongly in the 1994 national election, garnering 7.3 percent of the vote. The CDU and the CSU form a single *Fraktion* in parliament, choose a common candidate for chancellor, and have always governed in coalition. Below the federal level, the two party organizations are entirely separate.

From 1949 until 1963, Adenauer and his CDU dominated German politics (see West Germany and the Community of Nations, ch. 2). At the time of the 1961 election, Adenauer was eighty-five years old, and the opposition SPD was gaining in popularity. Ludwig Erhard, a CDU member credited with engineering Germany's postwar economic miracle, succeeded Adenauer as chancellor in 1963 (see table 3, Appendix). An economic recession then hastened the end of the CDU/CSU's hold on power. November 1966 brought the creation of the Grand Coalition between the CDU/CSU and the SPD with Kurt Georg Kiesinger (CDU) as chancellor and Willy Brandt (SPD) as vice chancellor (see Ludwig Erhard and the Grand Coalition, ch. 2). The FDP was relegated to the opposition benches. After the 1969 election, the SPD formed a coalition with the FDP, leaving the CDU/CSU in opposition for the first time in West German history.

For thirteen years, the CDU/CSU waited to regain power. By the early 1980s, the CDU had adopted a new party program consisting of conservative economic policies, resembling those of Margaret Thatcher and Ronald Reagan, and moderate social and foreign policies. Helmut Kohl, as leader of the CDU/CSU *Fraktion* in the Bundestag, was also rebuilding a political bridge to the FDP. In 1982, as West Germany's economy weakened, the liberal SPD and the economically conservative FDP could not settle on a package of economic remedies. The FDP chose to leave the coalition and form a new government with the CDU/CSU. The constructive vote of no-confidence was used successfully for the first time to unseat Helmut Schmidt as chancellor; Kohl replaced him. West Germans ratified this change through early elections called for March 1983 (see The Christian Democratic/Christian Socialist-Free Democratic Coalition, 1983– , ch. 2).

By the late 1980s, the CDU/CSU was growing increasingly unpopular. The CDU/CSU was also facing a new challenge from the right in the form of a new extreme right party, the Republikaner. In a series of *Land* elections, the Republikaner successfully eroded some of the CDU/CSU's support. The collapse of the German Democratic Republic, however, provided Kohl with a historic opportunity to reverse the fortunes of his party. While most Germans reacted to the change in the geopolitical landscape with amazement, Kohl seized the moment and actively advocated early unification (see Unification, ch. 8). The first, free, all-Germany election since November 1932 took place in December 1990. In essence, this election became a referendum on the process of unification; the CDU/CSU emerged victorious, with Kohl promising greater prosperity for all Germans. As the costs of unification, in economic, social, and psychological terms, became more apparent to both western and eastern Germans, the CDU began suffering setbacks in *Land* and local elections. Nonetheless, Chancellor Kohl was able to claim a narrow victory in the national election of October 1994. Kohl's governing coalition benefited from an increasingly positive economic outlook in Germany and from the fact that the opposition Social Democratic candidate, Rudolf Scharping, was seen by many as lackluster (see Political Developments since Unification, this ch.).

The organizational structure of the CDU is a product of the party's evolution. In its early years, the CDU was a loose collection of local groups. Over time, a weak national party emerged to complement the strong *Land* party organizations. In the early 1970s, the CDU built up its national organization to compete with the more tightly structured SPD. Membership and party income increased accordingly. The Federal Executive is the primary executive organ of the CDU. It consists of about sixty individuals, including the party chair (elected for two years), several deputy chairs, a general secretary, a treasurer, the CDU's main legislative representatives, and the leaders of the *Land* party organizations. Because the Federal Executive is too large and does not meet frequently, a smaller subset called the Presidium, composed of the highest ranking CDU officials, actually sets party policy and makes administrative decisions. Each *Land* except Bavaria, where the CSU is active, holds semiannual party congresses and has an executive committee. These party structures are primarily responsible for the selection of party candidates for Bundestag elections. Every two years, the CDU holds a full party congress of several hundred party activists. Kohl has served as national chairman of the CDU since 1973, headed the parliamentary *Fraktion* from 1976 until 1982, and continues to lead the party as chancellor. Kohl's single-handed management of the party has given him a political dominance within the CDU that only Adenauer surpassed.

The CDU maintains several auxiliary organizations designed to increase the party's attractiveness to particular societal groups and to represent their views within the party. CDU statutes list seven organizations representing youth, women, workers, business and industry, the middle class, municipal politics, and refugees. Other, unofficial groupings exist as well. The most powerful of the auxiliary organizations has traditionally been the one representing business and industry. Although these auxiliary organizations are legally autonomous from the CDU, a high percentage of their members are also members of the CDU.

Social Democratic Party of Germany

Founded in 1875, the Social Democratic Party of Germany (Sozialdemokratische Partei Deutschlands—SPD) is Germany's oldest political party and its largest in terms of membership. After World War II, under the leadership of Kurt Schumacher, the SPD reestablished itself as an ideological party, representing the interests of the working class and the trade unions. The party's program, which espoused Marxist principles, called for the nationalization of major industries and state planning. A strong nationalist, Schumacher rejected Adenauer's Western-oriented foreign policy and gave priority to unifying Germany, even if that meant accommodating Soviet demands. Despite the SPD's membership of almost 1 million in 1949, it was unable to dent Adenauer's popularity. Schumacher's death in 1952 and a string of electoral defeats led the SPD to rethink its platform in order to attract more votes. The Bad Godesburg Program, a radical change in policy, was announced at the SPD's 1959 party conference. The new program meant abandoning the party's socialist economic principles and adopting the principles of the social market economy. The party also dropped its opposition to West German membership in the North Atlantic Treaty Organization (NATO—see Glossary). Like the CDU, the SPD was becoming a catchall party (*Volkspartei*)—albeit of the left.

Introduction of the Bad Godesberg Program, together with the emergence of a dynamic leader in the person of Willy Brandt, marked the beginning of improved fortunes for the SPD. Although the party gained support from election to election, suspicion about its ability to govern persisted. Joining the CDU/CSU in the Grand Coalition in November 1966 proved critical in erasing doubts among voters about SPD reliability. After the 1969 election, the FDP decided to form a coalition with the SPD—a governing configuration that held until 1982 (see The Social Democratic-Free Democratic Coalition, 1969–82, ch. 2).

Brandt served as chancellor from 1969 to 1974. His most notable achievements were in foreign policy. Brandt and his key aide, Egon Bahr, put into place an entirely new approach to the East—Ostpolitik—premised upon accepting the reality of postwar geopolitical divisions and giving priority to reconciliation with Eastern Europe. Brandt addressed long-standing disputes with the Soviet Union and Poland, signing landmark treaties with both countries in 1970. His efforts won him the Nobel Prize for Peace in 1971. The Brandt government also negotiated the Basic Treaty with East Germany in 1972, which formally granted recognition to the GDR. On the domestic side, the SPD-FDP coalition succeeded in almost doubling social spending between 1969 and 1975.

Helmut Schmidt succeeded Brandt as chancellor in 1974. Although Schmidt won a reputation as a highly effective leader, the SPD experienced increasingly trying times. The oil crises of the 1970s undermined economic growth globally, and West Germany experienced economic stagnation and inflation. A critical problem for the SPD-FDP coalition government was a difference in opinion over the appropriate response to these problems. Divisions over economic policy were exacerbated by a debate within the party over defense policy and the stationing of United States intermediate nuclear forces in West Germany in the early 1980s. In 1982 the Free Democrats decided to abandon the coalition with the SPD and allied themselves with the CDU/CSU, forcing the SPD out of power. Schmidt, although regarded as a statesman abroad and an effective leader at home, became increasingly isolated within his own party, and he chose not to campaign as the SPD chancellor candidate in the March 1983 elections. Hans-Jochen Vogel was the SPD standard-bearer in that election, and the party suffered a serious loss.

The SPD has been wrought by internal crises since the late 1970s, and these divisions have continued into the 1990s. The party is split into two factions, one giving priority to economic and social justice, egalitarianism, and environmental protection, and the other most concerned with controlling inflation, encouraging fiscal responsibility, and playing a significant part in the European security system. The SPD faces a challenge on the left from the Greens and on the right from the CDU/CSU and the FDP. Rather than move to the left, the SPD chose a centrist strategy in the 1987 national election and earned only a small increase in voter support.

In 1990 the nomination of Oskar Lafontaine as chancellor candidate suggested a tactical shift to the left aimed at attracting liberal, middle-class voters. The national election in December 1990 became, in essence, a referendum on unification, and the CDU's Kohl, who had endorsed a speedy union, far outstripped the more ambivalent and pessimistic Lafontaine in the polls. The SPD did not receive the support it had expected in the heavily Protestant eastern *Länder.* Leadership of the SPD passed to Björn Engholm, a moderate, who resigned in May 1993 in the wake of a political scandal.

Rudolf Scharping, the moderate and relatively unknown minister president of Rhineland-Palatinate, was elected by SPD members—the first time in the history of the party that its members directly chose a new leader—to replace Engholm in late June 1993. Scharping opposed Kohl in the 1994 national election. The SPD candidate began 1994 with a strong lead in public opinion polls, but, beginning in late April, the SPD's support began a sustained decline for several reasons. For one, the increasingly positive economic situation was credited to the governing coalition. For another, Scharping was perceived by many Germans to be a lackluster candidate; further, he was not wholly successful in portraying himself as the conciliator who had brought harmony to a traditionally fractious SPD. Following the election, Scharping became the leader of the SPD's parliamentary group in the Bundestag.

The organizational structure of the SPD is highly centralized, with decisions made in a top-down, bureaucratic fashion. Technically, the SPD's highest authority is the party congress, which meets biannually. Arguably, its only significant function is to elect the thirty-six-member Executive Committee, which serves as the SPD's primary executive body and its policy maker. The members of the Executive Committee typically represent the various political factions within the party. The core of the Executive Committee is the nine-member Presidium, which represents the inner circle of party officials and is generally composed of the party leadership. The Presidium meets weekly to conduct the business of the party, deal with budgetary issues, and handle administrative and campaign matters. The Presidium is also responsible for endorsing policy originating either with an SPD government or with the leadership of the parliamentary *Fraktion* when the party is in opposition. In almost all cases, decisions made in the Presidium are ratified by the Federal Executive and the party congress. All SPD organizations below the national level elect their own party officials. The district, subdistrict, and local levels are all subordinate to the *Land* executive committees, which direct party policy below the national level and are relatively independent of the federal party officials. Like the CDU/CSU, the SPD maintains specialized groups representing particular professions, youth, women, trade unions, refugees, and sports interests. In the case of the SPD, these groups are closely tied to the SPD bureaucracy, and only the Young Socialists and the trade union group have policy-making roles.

Free Democratic Party

The Free Democratic Party (Freie Demokratische Partei—FDP) is much smaller than the CDU or SPD, but its limited electoral strength masks the party's inordinate influence. Prior to the 1994 election, the FDP had experienced its worst results in national elections in 1969 (5.8 percent) and 1983 (7 percent). Both of those poor showings occurred following an FDP decision to switch coalition partners. Beyond these two exceptions, between 1949 and 1990 the FDP averaged 9.6 percent of the vote in national elections. Given its pivotal role in governing coalitions, the FDP has held over 20 percent of the cabinet posts during its time in government.

The FDP served in coalition governments with the CDU from 1949 to 1956 and from 1961 to 1966. As of mid-1995, it has governed with the CDU since 1982. The FDP governed in coalition with the SPD from 1969 to 1982. The remarkable amount of time that the FDP has spent in government has been a source of continuity in the German political process. FDP ministers carry a detailed knowledge of government personnel and procedures unsurpassed among the other parties.

The central role played by the FDP in forming governments is explained by the fact that a major party has been able to garner an outright majority of Bundestag seats only once (the CDU, in 1957); thus, the CDU and the SPD have been compelled to form coalition governments. Therefore, the FDP has participated in every government except the one from 1957 to 1961 and the Grand Coalition of 1966–69. Because the SPD and CDU/CSU enjoyed roughly equal electoral support, the FDP could choose with which major party it wished to align. This ability to make or break a ruling coalition has provided the small FDP with considerable leverage in the distribution of policy and cabinet positions. To take one example, as of mid-

1995, the FDP, in the person of Klaus Kinkel, led the Ministry of Foreign Affairs, which it has held since 1969. The most prominent member of the FDP, Hans-Dietrich Genscher, served as foreign minister from 1974 until his resignation in 1992.

The FDP was created in 1948 under the chairmanship of Theodor Heuss, who served as the first president of the Federal Republic, from 1949 to 1959. The party's founders wanted the FDP to revive the liberal party tradition of pre-World War II Germany. Although there was some initial debate over what was meant by "liberal," the party did articulate a political philosophy distinct from that of the two major parties. The FDP gave precedence to the legal protection of individual freedoms. Unlike the SPD, it supported private enterprise and disavowed any socialist leaning, and, unlike the CDU/CSU, it envisioned a strictly secular path for itself. In the early 1990s, the Free Democrats remained closer to the CDU/CSU on economic issues and closer to the SPD on social and foreign policy. Many Germans view the FDP as the party of the middle, moderating the policies of both major parties.

Following the 1949 national elections, the FDP emerged as a natural ally of the CDU/CSU, most importantly because of a congruity of economic policy. During the mid- to late 1960s, the FDP, under the leadership of Walter Scheel, went through a transformation of sorts, shedding its conservative image and emphasizing the reformist aspects of its liberal tradition. Its new focus on social concerns resulted in an SPD-FDP coalition in 1969. The party's new direction was ratified at the FDP's 1971 party congress, which endorsed a program of "social liberalism." As economic conditions worsened in the early 1980s, however, the FDP returned to its earlier advocacy of economic policies more conservative than those endorsed by the SPD. The FDP was most concerned with the growing budget deficit, whereas the SPD gave priority to the impact of the economic downturn on workers. The FDP abandoned the coalition with the SPD in September 1982, shifting allegiance to the CDU/CSU. The FDP lost considerable electoral support in the 1983 federal election but regained strength in the 1987 election.

The Free Democrats benefited initially from unification, garnering 11 percent of the vote in the first all-Germany elections in December 1990. In part, the FDP's popularity in the east was directly attributable to Genscher, an eastern German by birth who played a leading role in negotiations over the international agreements that made unification possible.

In light of the FDP's strong showing in the 1990 election, it is perhaps surprising to note that, by the time of the 1994 national election, the FDP was, in many ways, a party in crisis. It had lost representation in every *Land* that held elections in 1994, and thus the FDP has no seats in any eastern *Land* legislature. Minister of Foreign Affairs Kinkel had been elected party chairman in 1993, and some critics felt that the two posts had overwhelmed him, leading him to perform inadequately in both. Other observers, however, argued that it was the party's message, rather than its messenger, that needed revamping. Increasingly, the FDP found it difficult to differentiate its policy from that of Kohl's CDU. Given the fact that the FDP had performed so poorly at the *Land* level in 1994, there was much speculation as to whether the party would cross the 5 percent hurdle in the national election. FDP politicians breathed a collective sigh of relief when the party garnered 6.9 percent of the vote when Germans went to the polls in October 1994. Reportedly, the FDP had over 500,000 CDU voters to thank for this outcome, because they gave their second votes tactically to the FDP to ensure a victory for Kohl. One poll showed that 63 percent of those who voted for the FDP gave the CDU as their preferred party.

The structure of the FDP is decentralized and is loosely organized at all levels. The party basically is a federation of *Land* organizations, each maintaining a degree of well-guarded independence. The national party headquarters lacks the power to orchestrate activities at the *Land* level, and the formal party institutions—the Federal Executive, Presidium, and party congress—are weak. The FDP deemed this lack of centralization necessary to accommodate differences within the party, particularly between economic conservatives and social liberals. The FDP has never sought to be a mass party, and its members accordingly have little influence on decision making.

The Greens

In the early years of the FRG, several minor parties representing a range of political views from the neo-Nazi right to the communist left played a role in the political system. Support for these parties dwindled over time, and, after 1961, the FDP was the only smaller party to cross the 5 percent threshold necessary to gain Bundestag representation. The presence of the 5 percent clause in federal, *Land*, and most local election laws was a significant reason for the decline of minor parties. The major parties have encouraged this trend by sponsoring certain regulations—for instance, in the areas of federal financing for political parties and procedures for nominating party candidates—that have also made it more difficult for minor parties to survive.

A challenge to West Germany's established party system emerged in 1983 when a relatively new party, the Greens (Die Grünen), entered the Bundestag. The Green movement had been gaining support steadily since the late 1970s, and by the end of 1982 the Greens were represented in six of West Germany's eleven *Land* parliaments. The Greens' platform gave priority to environmental concerns and an end to the use of nuclear energy as a power source. The party also opposed the stationing of United States intermediate-range nuclear weapons in Western Europe. On the basis of this platform, the Greens won 5.6 percent of the vote in the 1983 federal election. The success of the Greens at the federal level—which continued in the 1987 national election with the party winning 8.3 percent of the vote—led to a "greening" of the established parties, with environmental awareness increasing across the political spectrum. The Greens also livened up the Bundestag, appearing in jeans and sweaters rather than business suits and bringing plants into proceedings.

The Greens were plagued by a split between the Realos (realists) and the Fundis (fundamentalists). The Realos are pragmatists who want to serve as a constructive opposition and ultimately exercise power. The more radical Fundis are committed to a fundamental restructuring of society and politics; they do not want to share power with the Social Democrats—their obvious allies—or in any way legitimate the existing political system.

The Greens did not embrace the unification of Germany and opposed any automatic extension of West German economic and political principles to the east. The West German Greens chose not to form an electoral alliance with their eastern counterparts, Alliance 90 (Bündnis 90), prior to the 1990 elections because of their opposition to union. This lack of enthusiasm for unification alienated the Greens from much of their own constituency. The party's chances for success in the December 1990 all-Germany election were further undermined by the SPD's choice of Lafontaine as its candidate for chancellor. Lafontaine moved the SPD to the left, successfully co-opting "green" issues. The West German Greens received only 4.8 percent of the vote in the 1990 election, an outcome that left them with no seats in the Bundestag. Alliance 90, composed largely of former dissidents and focusing heavily on civil rights, received 6 percent of the eastern vote and therefore received eight seats in the Bundestag. Had these two parties run in coalition, they could have secured about forty parliamentary seats. Alliance 90 had grown out of the major human rights groups that demonstrated against the communist system and effectively brought down the Berlin Wall in 1989. Like the West German Greens, Alliance 90 had not wanted quick unity with the west either, but the sentiment of the majority of eastern Germans was clear.

Young middle-class voters living in urban areas form the core of support for the West German Greens. Alliance 90 also receives much of its support from this group, although one-third of its supporters are over fifty years of age. Employees of the public sector are disproportionately strong supporters of both parties. Election results suggest that neither working-class voters nor independent businesspeople are likely to vote for either party.

The devastating loss for the West German Greens in the 1990 election brought the conflict between Realos and Fundis to a head, with the pragmatic wing emerging as victor. The party conference in April 1991 ratified a set of Realo reforms. In the series of *Land* elections that followed (Hesse, Rhineland-Palatinate, Hamburg, and Bremen), the Greens did well. This trend continued in 1992 as the Greens received an impressive 9.5 percent of the vote in the wealthy, southwestern *Land* of Baden-Württemberg. In the rural, northwestern *Land* of Schleswig-Holstein, the Greens garnered 4.97 percent of the vote, coming within 397 votes of surpassing the 5 percent hurdle.

In January 1993, the West German Greens merged with Alliance 90 in preparation for the spate of federal and *Land* elections scheduled for 1994. The new party is listed officially as Alliance 90/Greens (Bündnis 90/Die Grünen), but members informally call it the Greens.

Overall, the Greens performed well in the series of *Land* elections in 1994. Following the 1994 national election, with 7.3 percent of the vote, the Greens emerged as the third strongest party in the federal parliament. The obvious coalition partner for the Greens is the SPD, though one increasingly hears talk of possible CDU/Green coalitions. Indeed, the Greens have moderated many of their positions, a reflection of the dominance in the party of the Realos. The best known figure in the party is Joschka Fischer, a prominent Realo and a former environment minister in the *Land* of Hesse.

The Republikaner and the German People's Union

On the opposite end of the political spectrum from the Greens are two parties of the far right, the Republikaner (Die Republikaner—REP), with about 23,000 members, and the German People's Union (Deutsche Volksunion—DVU), with 26,000 members. As of mid- 1995, these two parties had not gained sufficient support to win seats in the Bundestag, but the DVU was represented in *Land* parliaments in Bremen (with 6.2 percent of the vote in 1991) and Schleswig-Holstein (with 6.3 percent of the vote in 1992); the Republikaner held seats in Baden-Württemberg (with 10.9 percent of the vote in 1992). The Republikaner received 2.1 percent of the vote in the all-Germany election of December 1990 and 1.9 percent in the October 1994 election.

In the early 1990s, the rallying cry of the far right was "Germany for the Germans." This slogan appeals to many Germans, particularly young, male, rural, less educated, blue-collar workers who fear for their economic future and regard the large pool of asylum-seekers as competitors for housing, social programs, and jobs. These particular Germans are also uneasy about greater integration within the European Union (EU—see Glossary), which, in their minds, requires Germany to forfeit too much of its identity and share too much of its prosperity. According to some observers, the far right's electoral support represents, in part, a protest vote against the mainstream parties. German politicians repeatedly remark on the electorate's *Politikverdrossenheit*—a deep disaffection with all things political.

Franz Schönhuber, a one-time Bavarian television moderator and former officer in the Nazi Waffen-SS, formed the Republikaner in 1983 from a group of discontented members of the CSU. Schönhuber published a book in 1981 boasting of his experiences in the Waffen-SS but has staunchly denied that his party has neo-Nazi leanings. Elected to the European Parliament in 1989, Schönhuber, over seventy years old in mid-1995, tried to portray the party as a mainstream group that does not promote bigotry but merely protects German national interests. The party platform speaks for itself. In it, the Republikaner blame foreigners, who make up about 8 percent of the German population, for the housing shortage, street crime, and pollution. Among other things, the party has proposed banning Islamic community centers from sponsoring political or cultural activities other than prayer, and it has advocated putting asylum-seekers in collection camps "to minimize the native population's existing and growing antipathy toward foreign residents." The party platform also proposes creating separate classes for foreign schoolchildren, and it rejects "the multicultural society that has made the United States the world's largest showplace of crime and latent racial conflict." Reportedly, the Republikaner attracted about 5,000 new members in eastern Germany in 1992 and 1993. Schönhuber contends that support in the east comes from young Germans between twenty and thirty years of age, whereas in the west support comes from members of his own generation. Schönhuber, the party's only nationally known figure, was deposed as party leader in the fall of 1994 because he had proposed that his party join forces with the more extreme DVU.

Gerhard Frey, the Munich publisher of two weekly neofascist newspapers, *Deutsche National-Zeitung* (print run 63,000) and *Deutsche Wochen-Zeitung* (20,000), founded the DVU in 1971. The DVU espouses many of the views held by the Republikaner, but it goes one step further in tacitly supporting violence against asylum- seekers and foreign workers. Frey, over sixty years old in mid-1995, has sought to distance himself from pro-Nazi sentiments while simultaneously insisting that most Germans want to live in a racially pure country.

Germany's domestic intelligence agency, the Federal Office for the Protection of the Constitution (Bundesamt für Verfassungsschutz—BfV), announced in April 1992 that the DVU was under surveillance to determine if the party met the legal definition of "antidemocratic," a classification that would permit the government to ban it. A similar investigation of the Republikaner was announced in December 1992. Such surveillance legally can include government infiltration of the party, monitoring of mail and telephone calls, and interrogation of party members. The BfV has classified both parties as "right-wing extremist" and "constitutionally hostile."

Party of Democratic Socialism

The communist party that ran East Germany was the Socialist Unity Party of Germany (Sozialistische Einheitspartei Deutschlands—SED). Founded in 1946, the SED controlled the government and the electoral process and supervised the omnipresent State Security Service (Staatssicherheitsdienst—Stasi). To be considered for important positions in East German government and society, membership in the party was a requirement (see The Ulbricht Era, 1949–71, ch. 2).

When the East German public toppled the communist regime, the SED and its extensive organizational structure also came unraveled. Membership fell dramatically; local and regional party groups disbanded. In a desperate attempt to save itself, the SED sought to reconstruct itself for the new democratic climate. It changed its name in February 1990 to the Party of Democratic Socialism (Partei des Demokratischen Sozialismus—PDS). The old party guard was replaced by moderate leaders, such as the new chairman, Gregor Gysi. The PDS won 11 percent of the vote in eastern Germany in the 1990 all-Germany election, an outcome that entitled the party to seventeen seats in the Bundestag. In the Bundestag, the PDS has advocated communist values and has energetically criticized the Kohl government. The PDS's all-Germany tally reached only 2.4 percent because of a showing in western Germany of 0.3 percent.

The party's electoral base is limited to the east, particularly areas in which substantial numbers of former SED members live. In mid-1995 the PDS had roughly 130,000 members in the east, giving the PDS the largest membership of any party in eastern Germany. The party's strongholds are Saxony, Berlin, and Brandenburg. The party continues to have a tiny following in the west, with 1,200 members.

Two main factors account for the success of the PDS in the east: the PDS inherited the infrastructure and local grassroots organization of the SED, and the PDS has come to be seen by many in the east as the only party that represents specifically eastern German interests and that stresses the positive aspects of eastern German life. Over 90 percent of PDS members belonged to the SED, and 66 percent are over the age of sixty. The established parties have largely ostracized the PDS.

The PDS garnered 4.4 percent of the vote in the 1994 national election, an outcome that, as predicted, left the party beneath the 5 percent hurdle. However, the party won parliamentary representation, thanks to a pecularariarity of the German electoral law: the fact that the PDS won four districts outright (all in eastern Berlin) entitled it to thirty seats in the Bundestag. Much credit for the strong showing of the PDS in the east has been given to the party's leading figure, the lawyer Gysi, an articulate and charismatic member of parliament.

Extraparty Political Forces

German society is highly organized into associations that represent the occupational, socioeconomic, religious, and recreational interests of individuals—a tradition that dates back to the corporate guild system of the Middle Ages. Most Germans belong to at least one voluntary association, and many belong to several. The vast majority of these organizations (such as sports clubs) have little political significance, but an important core of groups combines a strong organizational base with a particular interest in policy issues. The size of these interest groups varies. Smaller groups represent subsectors of the population, such as farmers. The large associations include trade unions, professional associations, and religious groups. More than 1,000 of these interest groups are registered formally as lobbyists with the federal government, and hundreds more are active at the *Land* level.

The primary interest associations in Germany are organized differently from interest groups in the United States. The United States offers a pluralist model of interest groups, in which loosely structured factions compete within the policy process to represent the same social interests. The government offers a neutral forum in which these groups vie for influence on policy. In contrast, many of the major interest associations in Germany reflect a neocorporatist model of interest articulation that channels interests into a number of unified, noncompetitive associations.

Four large, national "peak" associations (*Spitzenverbände*; sing., *Spitzenverband*) represent groups of similar interest associations as a whole. The labor unions, business, the churches, and the agricultural lobbying organizations each has its own *Spitzenverband*. Membership in one of these peak associations is often mandatory for individuals in a given social or occupational sector. Most peak associations are also organized hierarchically, with the national office determining the objectives and directing the strategy of the association as a whole.

The influence of the interest associations is institutionalized in several ways. Political parties provide one major channel of influence. Although the associations eschew formal party ties and claim to remain above partisan politics—for instance, they do not officially endorse a party at election time—ties between these associations and the parties are close. To take one example, the labor unions maintain a highly developed relationship with the Social Democrats, and a large percentage of SPD party activists are union members. Another forum for interest group activity is the Bundestag. The interest associations not only monitor legislation, lobby members, and testify at hearings, but they also maintain formal affiliations with deputies. Since 1972, when the Bundestag first started keeping records, roughly 50 percent of the members reported either being employed by an interest group or holding an executive position in a group. About 25 percent of the members are affiliated with economic groups, such as labor unions or the business lobby, and about 17 percent are affiliated with religious or cultural associations. Members of key committees such as agriculture, labor, and education are particularly likely to have ties to the relevant groups. The government ministries themselves provide yet another means by which interest groups influence the policy process. The neocorporatist system encourages formal ties between the two. For instance, ministries are required by law to consult with the peak associations about draft legislation that would affect them. To fulfill this obligation, the federal ministries have established standing advisory committees, which include representatives of the relevant interest groups.

Business and Industry

There are three levels at which business and industrial interests seek representation. First, business wants its perspective heard as the government formulates policy. Second, business needs representation in negotiations with labor unions. Third, business may desire support in cultivating new clients or suppliers. Each of these objectives is met by a separate umbrella organization.

The Federation of German Industry (Bundesverband der Deutschen Industrie—BDI) is the most important representative of business interests in the policy-making process. The BDI is the national peak association for thirty-nine separate national trade associations, including associations for the automobile and machine tool industries. Thus, it is the primary representative of the business community in the political process and the principal intermediary between business and government. The importance of the National Association of Manufacturers (NAM) in the United States pales in comparison with that of the BDI in Germany. In western Germany, the BDI's associations represent over 90 percent of all industrial firms; by contrast, the NAM accounts for only a fragment of United States industry. Although private businesses were still in the early stages of development in eastern Germany in the early 1990s, most trade associations have already set up offices there to coordinate the new industries.

The Federation of German Employers' Associations (Bundesvereinigung der Deutschen Arbeitgeberverbände—BDA) is the second important representative of business. The BDA is a peak association of sixty-four employers' associations, consisting of seventeen regional organizations, including the employers' associations of each *Land,* and forty-seven national trade associations organized by economic sector. The BDA represents the full range of business activity in Germany, but most of its members are in industrial associations. Almost every medium or large employer is a member of a BDA association. The BDA provides advice and serves as a coordinating mechanism for employers on social and labor policy. Among other things, the BDA negotiates general salary guidelines with unions, and it lobbies *Land* and federal governments on legislation affecting the interests of its members, such as social security and labor practices.

The German Chambers of Industry and Commerce (Deutscher Industrie- und Handelstag—DIHT) is the third leg of businesses' representational triad. All companies paying business taxes are required by law to join the local chamber and pay membership dues. Thus, several million firms belong to the eighty-four district and local associations of the DIHT, including the fifteen postunification chambers in eastern Germany. Beyond its national role, the DIHT represents German business abroad, as well as on international trade issues. The DIHT has been particularly engaged in attracting foreign investment to the east.

Labor Unions

During the Weimar Republic, labor unions were divided along partisan lines, a situation that led to competition among the socialist, communist, Catholic, and liberal trade associations. After World War II, labor leaders wanted to break with the past and form a trade union federation independent of political parties. The result was the establishment of the Federation of German Trade Unions (Deutscher Gewerkschaftsbund—DGB) in 1949.

Four principles guided the founders of the DGB. First, the labor movement wanted representation through an organization that was unitary and autonomous, with no ties to particular religions or political parties. Second, labor leaders decided to organize the unions along industrial lines so that all workers at one firm would belong to the same union irrespective of their individual occupations. For instance, an electrician at an automobile plant would join the metalworkers' union. This organizing principle provides unions with greater bargaining power when negotiating with employer associations, because one union represents the entire workforce of an industry. Third, a decentralized system of interest representation was created. Individual unions typically emulate the federal structure, with local, district, *Land*, and national offices. Each level has some input into the shape of union policy. Fourth, the unions chose to rely on legislation for the protection of workers' rights, rather than on direct negotiations with business representatives. Thus, when the unions enter into contract negotiations with employers, they can focus on improving workers' economic welfare.

The DGB is the national peak association of the German labor movement and encompasses sixteen unions, from metalworkers to leather workers. The DGB represents virtually all organized industrial workers, most white-collar employees, and many government workers. As of mid-1995, out of a total workforce of 35 million, 9.8 million workers were members of these labor unions. Although the DGB does not represent even half of the German workforce, its unions negotiate the collective bargaining agreements covering over 90 percent of all jobs. Thus, the work of the labor unions affects nearly all workers. The DGB lost over 2 million members between the end of 1991 and the end of 1994. The vast majority of these members (1.7 million) were from eastern Germany, which has been in the throes of radical economic restructuring and has suffered high unemployment. Some DGB officials express the hope that, once the economy in the eastern part of the country stabilizes, DGB membership will grow.

In 1995 the three largest unions were the Metalworkers' Union with just under 3 million members, the Public Services and Transport Workers' Union with 1.9 million, and the Chemicals, Paper, and Ceramics Workers' Union with 742,000. Roughly 31 percent of all members are women.

DGB members can be divided into "activist" and "accommodationist" factions. The activists, led by the Metalworkers' Union and the Industriegewerkschaft Medien, the union for workers in the media, aggressively challenge business interests and are major advocates of social reform. For example, the Metalworkers' Union led the drive for codetermination (*Mitbestimmung*) in the early 1950s, for substantial wage gains in the 1960s, and for the thirty-five-hour workweek in the 1980s (see Codetermination, ch. 5). The activist unions are more likely to strike if collective bargaining fails to achieve desired results. In contrast, the accommodationist unions, including those representing chemical workers, construction workers, textile workers, and food-processing workers, prefer to cooperate with employers to achieve stable, sustainable economic growth. The individual unions have responded differently to German unification as well. Activist unions have been assertive in pushing for wage equalization between east and west, an effort that culminated in a massive strike in the metalworking industry in eastern Germany in May 1993.

Two other, significantly smaller peak interest associations represent labor sectors independent of the DGB. The German White-Collar Employees' Union (Deutsche Angestellten-Gewerkschaft—DAG) is composed solely of salaried employees, principally high-level technocrats and managers in private enterprise. The Federation of German Civil Servants (Deutscher Beamten Bund—DBB) has competed successfully with the DGB to represent civil servants. The DBB is better described as a lobbying organization, because civil servants can neither strike nor engage in collective bargaining.

The Churches

Religious associations represent a third major group of organized interests in the German policy process. The experience of the Third Reich had a profound influence on the postwar development of Protestant and Roman Catholic churches in the Federal Republic (see Religion, ch. 3). Both espoused the view that moral responsibility extends to political responsibility and that passivity toward the political process is inappropriate.

Both also desired greater ecumenism in German society. The establishment of the CDU perhaps best illustrates this last point. The CDU sought to include both Roman Catholics and Protestants in a catchall party that was committed to Christian values. The two churches maintain distinct identities, but the major cleavage in German society is no longer between religious denominations, but between religious and secular interests.

In postwar West Germany, many people felt that organized religion was an important element in the country's newly forming political ethos. Unlike the United States, West Germany acknowledged no separation of church and state. The state formally recognized the political role of the churches, establishing a special legal status for them as public law corporations. Under a German system developed in the nineteenth century, unless church members formally leave the denomination into which they were baptized, they must pay an annual church surtax equal to 8 or 9 percent of their income tax. The federal government collects this surcharge and remits the proceeds to the churches to finance their activities. In 1992 the figure totaled about US$10 billion for Protestant and Catholic churches combined. Churches are included on government commissions and supervisory bodies that influence social and family policy, education, and related topics.

Not surprisingly, the relationship between church and state in East Germany was markedly different. The communist regime wanted control over all aspects of society, and the existence of autonomous churches was unacceptable. In the 1950s, the regime sought to limit the role of the churches to the religious sphere, keeping them out of politics or education. The state proved unable to suppress the churches fully, however, and by the 1970s the SED had resigned itself to accommodating them.

Roman Catholics constituted only 7 percent of the population in the east; thus, it was the Protestant church, with broad backing among East Germans, that played an important social and political role. The Protestant church retained some autonomy from the state, and by the late 1980s the church had become gathering places for dissidents. In 1989 weekly peace services at churches in big cities, such as East Berlin and Leipzig, became hotbeds of opposition to the regime and led to the mass demonstrations that ultimately brought down the communist regime.

The Evangelical Church in Germany (Evangelische Kirche in Deutschland—EKD), the peak association for the seventeen autonomous provincial churches in West Germany, was established in 1948. The structural unity of the German Protestant church officially ended in 1969, when the eight provincial churches in East Germany withdrew from the EKD and formed the Federation of the Evangelical Churches (Bund der Evangelischen Kirchen—BEK). German unity ushered in the reunification of these two federations in 1991, under the auspices of the EKD. As the formal political representative of German Protestant churches, the EKD represents its member congregations in all formal agreements with the government on church-state affairs. On religious and social matters, however, the EKD serves only as a coordinating agent for its largely independent member churches.

The principal organizational forum for the German Roman Catholic Church is the Bishops' Conference, at which all German bishops convene semiannually. Since unification, the eastern bishops also have attended these meetings. As elsewhere in the Catholic world, all decisions on theological matters and general policy emanate from the Vatican; the annual Bishops' Conference addresses current pastoral and religious issues within Germany.

In West Germany, the Roman Catholic Church was traditionally much more active politically on a day-to-day basis than the Protestant denominations. The Bishops' Conference maintains a permanent secretariat in Bonn to monitor activity in parliament and in the federal ministries. Catholic leaders regularly lobby the government on pending legislation relating to social or moral issues. The EKD participates less actively in the political process, but it is more inclined than its Catholic counterpart to speak out on controversial political issues that have spiritual implications. Examples include the Protestant church's strong stance against the remilitarization of West Germany in the 1950s and its continued activism in the areas of peace and nuclear nonproliferation.

Agriculture

Although agriculture accounts for only 5 percent of the labor force in western Germany, the agricultural lobby has long been known as the best organized and most successful in Bonn. The peak association of this lobby, the German Farmers Association (Deutscher Bauernverband—DBV), focuses exclusively on farm issues. The DBV has consistently convinced the government to guarantee the financial welfare of farmers through generous programs of price supports, subsidies, and agricultural grants. These programs have made German food costs among the highest in Western Europe, but no strong call for reform has ever emerged. The minister of agriculture is often a farmer and, regardless of whether the CDU or the SPD is in power, that minister has single-mindedly pursued policies beneficial to farmers.

Citizens' Initiative Associations

In the early 1970s, a new form of political participation in the form of citizens' initiative associations sprang up throughout West Germany. These associations, in essence nontraditional interest groups, were loosely and often temporarily organized groups of citizens mobilized in response to one particular local issue. Concerns ranged from school reform, urban redevelopment, and traffic to environmental protection. The staying power of these associations reflected a dissatisfaction with established political institutions. Unlike traditional interest groups, these associations aimed to improve the quality of life, rather than the material well-being, of their supporters. Although their ultimate goal is to produce a new social model, these groups tend to be more skilled at critiquing the existing order than at constructing a new one. Activists in these organizations tend overwhelmingly to be young and highly educated, espousing a New Left ideology. Citizens' initiative associations employ diverse tactics, ranging from lobbying and circulating petitions to organizing mass demonstrations and protest marches. Three major political movements have grown out of these associations: the environmental lobby, the women's movement, and the peace lobby.

With public consciousness of the environment growing substantially in the 1970s and 1980s, a new set of nationwide organizations was formed, including the Federal Association of Citizens' Initiatives on Environmental Protection (Bundesverband Bürgerinitiativen Umweltschutz—BBU), Greenpeace, and Robin Wood. The BBU was at its strongest in the late 1970s, when it coordinated more than 1,000 local citizens' initiative associations and when almost 1 million people were affiliated with the environmental movement. By the late 1980s, the BBU was associated with several hundred local groups whose cumulative membership reached only 150,000. Environmental activists have focused on a range of issues, including nuclear power, acid rain, and *Waldsterben* (death of the forest).

The women's movement, organized in the late 1960s and early 1970s, sought to fight discrimination against women in the workplace and at home. Guarantees of gender equality in the Basic Law had done little to alter the traditional male bias within society. The women's movement in western Germany developed a two-pronged approach to securing equality for women: programs for raising the consciousness of women, and programs aimed at legislative reform. The first approach focused on the personal development of women and has met with success at the local level, with most larger cities offering a women's center, women's bookstores, self-help groups, and a network of other women's organizations. The attempt at the national level to mobilize the movement's supporters and bring about legislative change remains underdeveloped.

The peace movement blossomed in the early 1980s in response to the controversy over the stationing of intermediate-range nuclear weapons in West Germany. Mass demonstrations called for the government to pursue arms control negotiations to eliminate these weapons altogether. Instead, the Bundestag voted for deployment in October 1983, and, with its major objective lost, the peace movement lost momentum. The end of the Cold War brought a reduction in East-West tensions and the conclusion of substantial arms control agreements. These developments have further deprived the peace movement of focus. The peace movement was able to mobilize activity against the Persian Gulf War in early 1991, however.

Autonomous citizens' initiative associations were unacceptable in East Germany. The communist government established official organizations—the Society for Nature and the Environment, the Peace Council, and the Democratic Women's Federation of Germany—to co-opt the issues. The peaceful revolution of 1989 that brought down the communist regime in East Germany showed both the willingness among eastern Germans to demonstrate and protest in large numbers, as well as the power of such citizen action. Nonetheless, the levels of protest and direct action are lower in the east than in the west. However, as easterners become more accustomed to the freedoms afforded in a democracy, it is thought that they might become more inclined to exercise them.

The Mass Media

Newspapers

West Germany has always had highly developed mass media. The independence of the press and its freedom from censorship are guaranteed in Article 5 of the Basic Law. Conversely, the communist regime in East Germany tightly controlled the media. Despite government censorship, East Germans were voracious newspaper and magazine readers. More than three dozen newspapers enjoyed a combined circulation of almost 10 million in the GDR.

The complexion of the print media in eastern Germany changed markedly with unification. By mid-1991 only 100,000 copies of East Germany's most widely circulated newspaper, *Neues Deutschland*, the newspaper of the communist party, were being printed daily, down from roughly 1 million in the recent past. Western consortia bought many of the other established urban newspapers and brought in new management. According to a public opinion survey during the 1990 national election, 68 percent of western Germans and 88 percent of eastern Germans read a newspaper on a regular basis. Not surprisingly, Germany boasts among the highest per capita newspaper circulations within Europe.

The press is privately owned, and most Germans rely on local or regional newspapers for their information. Five daily newspapers enjoy good reputations nationally because of their sophisticated domestic and international coverage: *Frankfurter Allgemeine Zeitung* (FAZ), *Süddeutsche Zeitung*, *Frankfurter Rundschau*, *Handelsblatt*, and *Die Welt*. The FAZ is probably Germany's most prestigious daily newspaper and is the one newspaper read by virtually all members of the political and business establishment. Although independent of any political party, its views are similar to those of the right-of-center CDU. *Handelsblatt* is the leading business daily. *Die Zeit*, a weekly newspaper, provides an erudite review of news and culture from a perspective sympathetic to Social Democratic views. Weekly editions of *Die Zeit* are often more than 100 pages, with in-depth articles filling an entire page. Former chancellor Schmidt is one of its publishers; the paper's circulation is 493,000. Because these newspapers appeal to an elite readership, their circulation figures are much lower than that of the tabloid press. *Bild Zeitung*, with a daily circulation of close to 5 million, is Germany's most widely circulated daily. It puts a sensationalist spin on topical issues and tends to support right-of-center policies.

Both *Bild Zeitung* and *Die Welt* are published by the Axel Springer Group, based in Hamburg. Axel Springer, now deceased, built an enormous media empire, which also includes the two largest Sunday newspapers, *Bild am Sonntag* and *Welt am Sonntag*, two Berlin daily newspapers, and many popular magazines. Springer publications are generally considered to have a strong conservative bent.

The liberal counterpart to Axel Springer and his successors has been Rudolf Augstein, founder and publisher of the weekly *Der Spiegel*, a highly respected and influential newsmagazine combining news coverage with investigative journalism. The magazine's decidedly liberal critique of politics and politicians has often steeped it in controversy (see Ludwig Erhard and the Grand Coalition, ch. 2). In 1994 its circulation stood at over 1 million copies. *Der Spiegel* is distributed in 165 countries, and close to 15 percent of its sales are outside Germany.

In 1993 competition for market share held by *Der Spiegel* emerged with the publication of *Focus*, a newsmagazine fashioned after *Time* and *Newsweek*, with shorter articles and a more colorful layout than that offered by *Der Spiegel*. *Focus* appeared on newsstands in January 1993, was less expensive than *Der Spiegel*, and, after a few months, was faring better than expected. By mid-April *Focus* was maintaining a circulation of 600,000 and had exceeded its annual target for pages of advertising sold. Since its founding in 1946, *Der Spiegel* has successfully faced down competition from more than fifty publications. However, the circulation of *Focus* is growing while that of *Der Spiegel* is falling.

Although newspapers owned by political parties were common during the Weimar period, the partisan press is much less significant in the Germany of the 1990s. *Vorwärts* is the official newspaper of the SPD, and *Bayernkurier* serves the CSU. *Rheinischer Merkur* has informal links to the CDU, and *Neues Deutschland* offers views of the PDS.

Radio and Television

Radio and television are administered in a decentralized fashion as prescribed in the Basic Law. The intent behind the pattern of regional decentralization is to prevent the exploitation of the media by a strong national government, as had happened under the Nazi dictatorship. Germany has two public broadcasting corporations. The first, ARD, was established in 1954 and encompasses eleven regional public television and radio stations. ARD employs roughly 23,000 people and has an annual budget of about US$6 billion. The second, ZDF was founded in 1961 and is structured as a single corporation, not as a consortium. A third channel broadcasts cultural and educational programs for all *Land* corporations.

The *Land* broadcasting corporations have similar organizational structures. Each governs itself under the direction of a broadcasting council consisting—in most *Länder*—of representatives of the major social, economic, cultural, and political groups, including political parties, churches, unions, and business organizations. The broadcasting corporations are financed largely through monthly fees (DM23.80 per household as of late 1994) charged to television and radio owners. Public television is allowed to devote no more than thirty minutes per day to commercial advertisements. No advertisements are aired after 8:00 P.M. on weekdays or on Sundays. Advertising provides roughly one-third of television revenues and one-fourth of radio revenues. What distinguishes public television from commercial television is the ability to offer greater coverage of public service activities and cultural events.

Most eastern Germans were familiar with western German television even before unification because broadcasts from the west could be received in most of East Germany. According to a 1990 survey, 49 percent of western Germans and 70 percent of eastern Germans watched a nightly news program at least five times each week. Surveys also indicate that television is the most important source of political information: 51 percent of Germans rank television first, ahead of newspapers and magazines (22 percent), conversation (16 percent), and radio (6 percent).

Private broadcasting was virtually nonexistent in West Germany until 1981, when the Federal Constitutional Court recognized the right of the *Länder* to grant broadcasting licenses to private companies. Enabling legislation took the form of a new broadcasting treaty enacted by the *Länder* in 1987 that allowed the creation of private broadcasting companies to compete with public stations. In general, private broadcasters do not have an internal supervisory council, but the *Länder* in which they broadcast can exercise supervisory rights.

Commercial broadcasters finance their operations solely with advertising revenues. Beyond the substantial capital costs associated with starting up a new television channel, private broadcasters have to rely on satellite and cable transmission because the airwaves do not offer unlimited capacity. Thus, viewers have to pay an additional fee to get access to private channels. In 1983 the federal post office undertook a large-scale program of wiring the country for cable television. In March 1993, of the 27 million households in western Germany that had televisions, 70 percent had access to cable service; of the 6.4 million households in eastern Germany, 12 percent had access to cable. However, at that point only about 60 percent of those eligible households had chosen to subscribe to cable.

In 1985 SAT–1 became Germany's first private satellite television station. A group of publishing firms, including Springer, owns SAT–1; the channel offers a program of popular entertainment and news. Other stations subsequently sprang up, including 3–SAT, a joint production of German, Swiss, and Austrian national television; RTL, or Radio-Television-Luxembourg; and various European satellite stations. In early 1993, two all-news channels made their debut: Time Warner and CNN own one, n-tv; and German publishing giant Bertelsmann and the *Süddeutsche Zeitung* are major financial backers of Vox, the second news channel. Vox failed quickly, however, closing its doors in April 1994. On the whole, private channels nonetheless are prospering. The percentage of Germans watching public channels has dropped to less than one-half since the start of private broadcasting in 1987.

Political Developments since Unification

The political institutions of unified Germany are remarkably similar to those of the former West Germany, reflecting minor adjustments to accommodate the larger population rather than making fundamental changes. The unfolding drama of unification is much more evident when one takes into consideration Germany's political landscape, including elections, political climate in the unified country, and issues that have dominated that landscape.

The Bundestag election of December 2, 1990, was the first all-Germany election since 1932. The election returned to power the governing coalition of the CDU/CSU and the FDP. The central issue of the campaign was unification. Parties that strongly supported unification scored well; those that were ambivalent or opposed to unification, such as the SPD and the Greens, fared poorly.

Helmut Kohl's political fortunes soon declined, however, in the wake of problems with the unification process. Increasing unemployment in the east, and anger in the west about a tax increase that Kohl had pledged to avoid before the 1990 election, caused the CDU to lose a series of *Land* elections after unification. As a result, in 1991 the ruling coalition lost its majority in the Bundesrat when the CDU lost power in the *Länder* of Hesse and Rhineland-Palatinate (Kohl's home *Land*). This development made it more difficult for the Kohl government to gain approval for key legislative initiatives.

The year 1994 was nicknamed the "super election year" because Germany conducted approximately twenty elections at the local, *Land*, federal, and European levels, culminating in the national election in October. In eight *Land* elections throughout 1994, the SPD fared better than did the CDU. The SPD thus increased its majority in the Bundesrat. The FDP performed miserably at the *Land* level, failing to gain the required 5 percent for representation in all eight elections. Given this poor showing, many observers question the staying power of the FDP as a political force in Germany. Observers were surprised by the strength of the former Communists (PDS) in the eastern *Länder*; all five new *Länder* held elections in 1994, with the PDS garnering from 16 to 23 percent of the vote in each (see table 21, Appendix). The PDS increased its share of the vote over the results in 1990 and solidified the party's position as the third strongest political force in eastern Germany. On November 9, 1994, Germans celebrated the fifth anniversary of the fall of the Berlin Wall. However, much still divides eastern and western Germans, not least economic success, and the PDS was able to capitalize on eastern resentments.

Germans voted in national elections on October 16, 1994. Chancellor Kohl was challenged by Rudolf Scharping, the minister president of the western *Land* of Rhineland-Palatinate and the chairman of the SPD. Election themes included unemployment and economic growth, particularly in light of unification, as well as law and order. Except for the future of the EU, foreign policy issues did not figure in the election campaign.

Scharping began 1994 with a strong lead in public opinion polls, but, beginning in late April, the SPD's support began a sustained decline for several reasons. First, the CDU benefited from an increasingly positive economic outlook in Germany. Second, Scharping was seen by many to be a lackluster candidate; further, he was not wholly successful in portraying himself as the conciliator who had brought harmony to a traditionally fractious SPD. Chancellor Kohl, however, was seen to embody stability, continuity and predictability; one of his election slogans was "no experiments." Third, the CDU/CSU launched a fierce campaign against the PDS, whose members had belonged to the Communist SED, calling them "red-painted fascists," and Kohl succeeded in incriminating the SPD, at least marginally, in this seeming Communist revival. The SPD provided Kohl with this opportunity by forming a minority government with the Greens in the eastern *Land* of Saxony-Anhalt that depended on the votes (or abstention) of the PDS to remain in office. This CDU/CSU tactic was aimed, effectively it would seem, at those western German voters who, despite Scharping, questioned the SPD's commitment to centrist policies.

Kohl's governing coalition claimed a narrow victory; its majority in the Bundestag was reduced from 134 to ten seats (see table 4, Appendix). The Greens and the former Communists also won representation in the Bundestag. The far-right Republikaner, seen as a spent political force, failed to clear the 5 percent hurdle necessary to enter the Bundestag. Voter turnout, up slightly from the 1990 election, was 79.1 percent. Following the election, Scharping became the leader of the SPD's parliamentary group in the Bundestag, which will allow him to keep a high national profile in preparation for the next national election. The coalition government of Kohl's CDU, the CSU, and the FDP will focus on creating jobs, trimming bureaucracy, fighting crime, and expanding the EU eastward.

The FDP's seemingly chronic inability to win representation in *Land* parliaments means that it is increasingly losing its regional bases and its reservoirs of future political talent. If and how the FDP can regenerate support remains to be seen. Recent CDU overtures to the Greens—until recently an unthinkable development—also suggest a CDU awareness of the possible need for an alternate coalition partner in the future. The 1994 election may thus mark the beginning of some profound changes in political alignments in Germany.

Unified Germany's second national election suggests that the country's east-west divide has not narrowed. The strongest evidence is the success of the PDS in winning parliamentary representation. In eastern Germany, the PDS received 19.2 percent of the vote, compared with only 0.9 percent in the west. The national tally of 4.4 percent was insufficient to clear the 5 percent hurdle for parliamentary representation, but the PDS benefited from an oft-forgotten electoral law that automatically qualifies a party for representation according to its overall share of the national vote when the party wins three electoral districts outright (first votes). The PDS surprised seemingly everyone in winning four districts outright (all in eastern Berlin), entitling it to thirty seats in the Bundestag.

The future of the PDS is unclear and may well depend on whether the CDU and the SPD develop programs that attract current PDS constituents. Kohl's coalition lost twice as many votes in the east as in the west, winning 49.9 percent of the vote in the west and 42.5 percent in the east. The SPD faces the challenge in the east of competing against two other parties of the left, the PDS and the Greens. When considering the success of the PDS, however, one must recall that 80 percent of eastern Germans did not vote for the former Communists. At present, PDS leaders are working to rid the party of its Stalinist heritage; if successful, the PDS would certainly have a broader appeal.

As of mid-1995, right-wing extremist parties held seats in three of sixteen *Land* parliaments (Baden-Würtemberg, Bremen, and Schleswig-Holstein) and appeared to be fading from the German political landscape. The most significant of these parties, the Republikaner, with about 23,000 members, attracted support principally by criticizing a government policy that allowed hundreds of thousands of asylum-seekers into Germany. However, the Kohl government engineered a revision of the German constitution in 1992 that severely restricts the right to asylum (which had been the most liberal in Europe), thus largely calming public concerns. The far right has thereby lost its major platform and has been tainted by violent attacks against foreigners in Germany. In-fighting has also divided the party and resulted in the ouster of leader Franz Schönhuber, a former Waffen-SS member and the party's one nationally known figure (see The Republikaner and the German People's Union, this ch.). In the October 1994 election, with close to 80 percent voter turnout, the Republikaner received only 1.9 percent of the national vote, thus once again failing to win representation in the Bundestag. This outcome cemented a downward trend, which had been evinced in the European Parliament election and *Land* elections throughout the year. That downward trend is particularly notable in light of the fact that extreme right parties have met with considerable electoral success in several West European countries, such as France, Belgium, and Italy.

A plethora of controversial issues has marked political debate in united Germany, for example, the right to political asylum, the upsurge in right-wing violence, and the tensions surrounding the unification process itself. The Basic Law originally contained a liberal regulation on the right to asylum, and in 1992 a total of 438,191 asylum-seekers streamed into Germany—up from 256,112 in 1991. Most asylum-seekers were from Romania, the former Yugoslavia, and Bulgaria. Many Germans complained that the German law permitted many people who were not political refugees, but rather economic migrants, to take advantage of the country's generous welfare system and compete with Germans for scarce housing. Extreme right-wing parties capitalized on this widespread resentment against asylum-seekers in April 1992 elections in two western *Länder.*

On December 6, 1992, Kohl's governing coalition and the opposition Social Democrats agreed on a constitutional amendment to limit the right to asylum. The asylum compromise between the government and the opposition included several important changes. First, asylum-seekers from European Community (EC—see Glossary) states or states that accept the Geneva Convention on Refugees and the European Human Rights Convention have no right to asylum in Germany. Second, any refugee passing through "safe third countries," which include all of Germany's neighbors, is ineligible for asylum. An individual may appeal this decision but may not stay in Germany during the course of that appeal. In exchange for these concessions, the Social Democrats won agreements to place an annual limit of 200,000 on the immigration of ethnic Germans eligible for automatic German citizenship and to ease the terms of citizenship for longtime foreign residents of Germany (see Immigration, ch. 3). Parliament approved the new asylum law in late May 1993, and it took effect on July 1. About 10,000 protesters surrounded the Bundestag on the day of the vote, but apparently about 70 percent of Germans approved the more restrictive asylum law. The number of foreigners seeking asylum in Germany has fallen substantially since the new law went into effect.

Another pressing issue has been the escalation of right-wing violence. In 1992 right-wing extremists committed 2,584 acts of violence in Germany, an increase of 74 percent from 1991. Seventeen people were killed in the 1992 attacks, six in 1991.

About 60 percent of the attacks occurred in western Germany and 40 percent in eastern Germany—home to only 20 percent of the population. About 90 percent of the right-wing attacks in 1992 were directed against foreigners—above all, at asylum-seekers and their lodgings. People under the age of twenty-one committed 70 percent of these attacks.

In November 1992, three Turkish residents were killed in a firebombing in Mölln in western Germany. Of the 80 million people living in Germany in 1993, about 1.8 million were Turks, making that ethnic group the country's largest minority. Two-thirds of those Turks had lived in Germany at least a decade. The overwhelming majority of Germans condemn xenophobia and neo-Nazism, and after the Mölln attack, over 3 million Germans demonstrated across the country against right-wing violence. Following the violence in Mölln, the government began a crackdown on far-right violence. The federal prosecutor took over for the first time the investigation of an antiforeigner attack. The decision was made to charge the perpetrators with murder, rather than manslaughter, as had been done following previous arson attacks leading to fatalities. In December 1993, a judge imposed maximum sentences on the two men convicted in the Mölln killings. Other measures taken by the government included banning four small neo-Nazi organizations and outlawing the sale, manufacture, and distribution of the music of several neo-Nazi rock bands.

Despite the government's actions, the number of right-wing attacks increased in the first six months of 1993. The most serious incident occurred on May 29, 1993, when right-wing youths firebombed a house in Solingen in western Germany, killing five Turks. In late December 1993, four right-wing youths were charged with murder in the Solingen attack. In late October 1993, United States citizens for the first time became the target of right-wing violence. Two skinheads harassed African-American members of the United States Olympic luge team, which was practicing at an eastern German training center. When a white luger intervened on his teammates' behalf, he was severely beaten by the skinheads.

By the end of 1993, the surge in right-wing violence appeared to be abating. The federal police reported that, in the first eleven months of 1993, rightist crime dropped by 28 percent compared with the same period in 1992. As of December 2, 1993, eight people had died in rightist violence compared with seventeen in 1992. A police spokesman stated that

An estimated 10,000 mourners, including Minister of Foreign Affairs Klaus Kinkel, paid their respects in Hamburg to the memory of three Turks killed in late 1992 by right-wing extremists.
Courtesy German Information Center, New York

the decline reflected decisive executive action, including faster police responses, tougher sentences, and bans on neo-Nazi groups.

Much of the public debate on how to address the causes of right-wing violence has focused on how better to integrate foreigners into German society. Chancellor Kohl announced some steps to make it easier for foreigners to become German citizens. He stopped short, however, of advocating dual citizenship. Concern exists in law enforcement circles that neo-Nazis are building an underground network of small, organized cells patterned in part on those of the Red Army Faction (Rote Armee Fraktion—RAF), the far-left organization that carried out bombings, assassinations, and kidnappings in the 1970s and 1980s (see The Student Movement and Terrorism, ch. 2;

Dissidence and Terrorist Activity, ch. 9). The establishment of such a network would make it much more difficult for the authorities to monitor neo-Nazi activities.

A final issue dominating Germany's political scene has been the ongoing challenge of implementing unification. Among other things, the two Germanys have had to enact uniform legislation, decide on what city should serve as their capital, and bring the former leaders of East Germany to justice.

Unification left Germany with a population possessing widely different views on matters such as the family, religion, and the work ethic. A particularly sensitive issue has been abortion. East Germany, which permitted free abortion on demand up to the twelfth week of pregnancy, had a markedly more liberal policy on abortion than did West Germany. In June 1992, the Bundestag, in an attempt to unify abortion policy, approved an abortion law—opposed by Chancellor Kohl—that granted a woman the right to an abortion up to the twelfth week of pregnancy, provided she accepted counseling first. Thirty-two of the 268 CDU legislators, primarily from eastern Germany, broke ranks with the party leadership and approved the bill.

On August 4, 1992, the Federal Constitutional Court issued an injunction against the parliament's decision, and abortion continued to be available on demand in the east and largely prohibited in the west, pending a final court judgment. On May 28, 1993, the Federal Constitutional Court struck down the compromise law on the basis of the Basic Law's explicit protection of the rights of the unborn child. The ruling held that abortion was no longer a criminal offense but that abortions would only be allowed in the first three months of pregnancy for women who first participated in a formal consultation process. Further, the ruling barred insurance funds from paying for abortions and *Land* hospitals from performing them. The ruling went into effect on June 16, 1993. Women's groups, opposition politicians from the west, and easterners from across the political spectrum expressed outrage at the court's decision. At some point in the future, the Bundestag is still expected to pass a uniform abortion law for the entire country.

Another question that arose with unification was where to locate the new German capital. The Bundestag voted in June 1991 to move the capital from Bonn to Berlin, fulfilling a long-standing promise of West German politicians across the board. The vote in favor of Berlin was surprisingly narrow, with 338 legislators supporting Berlin and 320 supporting Bonn. Many of the parliamentarians who voted for Bonn spoke of the symbolic importance of the capital's geographical location, with Bonn bearing witness to the critical importance of the Atlantic Alliance and Germany's commitment to Western democracy. Many who supported Berlin saw their choice as a necessary act of conciliation toward eastern Germans and a necessary step toward Germany's return to the world stage as a "normal" nation.

The quick move to Berlin that many eastern Germans had hoped for was thwarted by a quiet, yet effective, campaign led by Bonn bureaucrats and certain key politicians who opposed the Bundestag decision on several grounds. First, members of this group cited the huge expense of moving the government, estimated at just under US$19 billion by the Ministry of Finance. Second, they argued that Berlin's historical associations as the capital of a united Germany were negative and that Germany should avoid doing something to suggest to its neighbors a return to expansionist or aggressive tendencies. Third, many officials balked at the personal inconvenience of moving to Berlin if they owned homes in the Bonn area or otherwise faced having to uproot their families from the rather provincial Rhineland and relocate in a booming metropolis.

After two years of indecision, the Kohl cabinet announced in October 1993 that the government would complete the move to Berlin by December 31, 2000; the move will begin in 1998. The opposition Social Democrats had threatened to make the government's reluctance to move an issue in the 1994 national election campaign. Foreign embassies and private companies had delayed their moves to Berlin while waiting for an official announcement of a timetable. The cabinet decision sent a decisive message to investors and property developers who believed the move would attract greater investment in the five eastern *Länder*. The Bonn lobby won certain important concessions as well: eight government ministries will keep their headquarters in Bonn, and the remainder will retain offices there. Kohl received sharp criticism about the distant deadline from some commentators, who argued that the government's hesitation to complete the move was impeding the social and psychological unification of east and west.

Many Germans see the prosecution of former East German officials as a necessary part of coming to terms with divided Germany's past. On November 12, 1992, a trial opened in Berlin involving six defendants, including former East German leader Erich Honecker, former minister of state security Erich Mielke, and former prime minister Willi Stoph. These men were put on trial for the killings of East Germans trying to cross the border to the west. Two days later, however, Mielke and Stoph were declared unfit to stand trial for health reasons. Charges were then dropped against Honecker because of his advanced cancer, and he was allowed to join his family in Chile in early 1993. The remaining three defendants—all former members of East Germany's National Defense Council—were convicted in September 1993, receiving prison sentences ranging from four-and-one-half years to seven-and-one-half years.

From the start, the legal basis for the trials was questionable. German law does not apply to acts committed by East German citizens in a state that no longer exists. Thus, the defendants had to be prosecuted for transgressions of East German law, and East Germany's border law allowed guards to shoot anyone trying to flee. The Berlin prosecutors argued that the law was evil and ought not to have been obeyed, a form of reasoning with which the judges agreed. Many legal scholars believe that the convictions could be reversed on appeal, however. In part, the prosecution of these former East German leaders grew out of public indignation over the trials of border guards while senior policy makers were going free. By late 1993, ten border guards had stood trial. Nine received short, suspended sentences or acquittals; one received a sentence of six years for having shot and killed a fugitive who had already been caught and was under arrest. In the fall of 1993, the Bundestag extended the statute of limitations by three years for minor crimes by former East German officials and by five years for more serious crimes.

Most observers of Germany believe the country will solve the economic and political challenges associated with the unification process. However, polls indicated that, as time passed, eastern and western Germans seemed to see the gap between them widening rather than narrowing. In an April 1993 poll, when asked whether eastern and western Germans felt solidarity or antagonism toward one another, 71 percent in the west and 85 percent in the east answered "antagonism." In the coming years, perhaps the greatest challenge to Germans of the east and west will be to master the task of achieving social harmony. Only then can they become one nation.

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A rich literature on German government and politics is readily available in English. The Press and Information Office of the Federal Republic of Germany offers the public a wide range of documents, including the Basic Law, free of charge. That office also publishes the *Week in Germany*, which covers current events. The *Financial Times* and the *International Herald Tribune* provide good daily coverage of German news as well.

English-language studies of the political system are published regularly. One of the most comprehensive and readable texts available is *Politics in Germany* by Russell J. Dalton. Another general volume providing valuable information is *Developments in German Politics*, edited by Gordon Smith, William E. Paterson, Peter H. Merkl, and Stephen Padgett. A more specialized, comparative parliamentary study is *The United States Congress and the German Bundestag*, edited by Uwe Thaysen, Roger H. Davidson, and Robert Gerald Livingston. *The Constitution of the Federal Republic of Germany* is a comprehensive examination of the Basic Law by the noted constitutional scholar David P. Currie. Three journals—*German Politics*, *German Politics and Society*, and *West European Politics*—are useful sources of information as well. (For further information and complete citations, see Bibliography.)