Germany's Psychosis of Defeat

A long-time admirer tells how Germany, like the United States in the 1970s, faces a profound crisis of confidence.

BY RICHARD W. FISHER

Can Germany hold its own in the new world of a reconfigured Europe, an ascendant China, and a 21st-century America? Is German economic decline exaggerated? Or inevitable? These were questions I addressed recently at a meeting of Atlantik-Brücke, the German-American friendship organization.

The answer to the first two questions is "no." Unless it rapidly changes course, Germany cannot hold its own in the present world of a newly configured Europe, a rapacious China, and a flexible, highly adaptive American economy. German economic decline is, if anything, understated rather than exaggerated. And the decline of Germany's economy and Germany's role in the world is all but inevitable unless dramatic reforms are taken very soon.

How is that for a happy beginning?

POINT OF VIEW

I am a Texan. As you have seen from the actions of two Texan presidents, Lyndon Johnson and George W. Bush, we are blunt people. But, unlike my far more distinguished and accomplished brethren, I have a long involvement with, and genuine love for, Germany. To frame what follows, permit me a little personal history.

I was introduced to Germany by John McCloy. When I graduated from Stanford Business School in 1975, I was taken on as the assistant to Robert Roosa at Brown Brothers Harriman, the great private bank. Roosa was a giant of a man in international finance; he was also a generous man. As his assistant, I was immediately swept into his considerable circle of what we referred to then as his "world beater" friends. McCloy was one of them. Over lunches with Bob and the other partners at the bank,

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Jack McCloy would describe his work as High Commissioner after the War and his admiration for Konrad Adenauer and for the many successors he had known—every chancellor, right up to Helmut Schmidt who was in power at the time. McCloy told us, "Germany is the heart of Europe. It is the backbone of the European economy. No country in Europe is more important to the United States."

And he said, "Our alliance with Germany needs close attention, nurturing, and vigilance…because its strength embodies profound advantages, while its weakness could involve far-reaching dangers and risks."

Otto Graf Lambsdorff, Germany's then-economics minister, and the other German leaders whom I met through Roosa were impressive men—they were indeed "world beaters"—and through them I came to understand how Germany had been able to claw its way back from the utter destruction of World War II to become what we considered to be the paradigm of industrial efficiency: a locomotive of global economic growth, a formidable member of the G6 (we only had six then), and a stout and fearless ally of the United States during the Cold War.

It was Roosa who sent me to Washington to be Mike Blumenthal's assistant at the U.S. Treasury Department, and through Blumenthal I was selected to participate in the American Council on Germany/Atlantik-Brücke Young Leaders conference in 1977 in Berlin.

I remember two things about that introduction to Berlin almost three decades ago. The first was the elevator in Axel Springer Haus: nothing more than a vertical conveyor belt, and riders risked life or at least limb if they did not jump off quickly on whatever floor they wanted. The other was a dinner with Richard von Weizsäcker, who would later become first president of a reunified Germany. He took me on a tour of his office, and into the corner nook that jutted over the Berlin Wall. "Standing here, I hope you will understand the anguish that we Germans live with every day," he said. "We will never be a great nation again until we are united with our families in the East."

Indeed, I was there on the steps of the Reichstag as the clock struck midnight between October 2–3, 1990, when unification was celebrated. The delirious crowds bore torches and waved the German flag, celebrating what many had never dreamed would happen in their lifetimes.

Over the years and along the way, I had the privilege of meeting Chancellor Helmut Schmidt and watching him work both in Washington and Bonn and at the G7 summits with President Carter. Karl Carstens was a guest in my home when he came to celebrate the sesquicentennial of German immigration to Texas in 1986. On trips to Bonn I was the beneficiary of a few one-on-one blistering tutorials on German foreign policy (pre-Croatia) by Foreign Minister Hans-Dietrich Genscher. I sat in Chancellor Kohl's inner office in Bonn, heard the recitations of "Hoover Soup" and other deprivations and images he experienced after the war, and sensed first-hand his abiding passion for international affairs and specifically, for Europe.

The Germany I remember and the Germany I come back to are different places. This Germany is no longer a world beater, no longer a land of giants. It is a place so weakened economically and so riddled with outdated operating methods that it threatens the prosperity of Europe, the Euro-Atlantic alliance, and the global balance of economic power.

Absent change, Germany most certainly cannot hold its own in the new world of a reconfigured Europe, an ascendant China, and 21st-century America.

Data tell us why. Here are excerpts from a superb report prepared last year by Professor Stephen Silvia for the American Institute for Contemporary German Studies.

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Up the Ladder

For inspiration, read **Winston Churchill's** speeches of 1905 and 1906. He speaks of "the super-fine processes." In response to those who wanted to protect England from competition by restricting trade flows, he brilliantly suggested that England should let other governments have their taxpayers "subsidize with their tax money, not ours," the production of cheap goods. And then England would import them and refine them and use them to develop "super-fine" products that could then be sold at higher prices and fatter margins. Moving up the "super-fine" or value-added ladder, of course, requires an educational system that will enable society to be able to do so.

—R. Fisher

just since reunification, but for decades. From 1980 to 1989, the real GDP of the Federal Republic grew at an average annual rate of 1.9 percent, lower than the average growth rate of the eleven first-tier participants in the Euro area, and well behind the United Kingdom and the United States. German unification then produced a two-year boomlet, with growth accelerating to over 5 percent in 1990 and 1991. But then sluggishness reasserted itself. Germany's real GDP expanded by only 1.4 percent from 1992 to 2002, and has since been flat.

Germany is becoming less and less able to generate employment. Employment as a share of the labor force declined on average by 0.3 percent per year between 1980 and 1990, then by a decline rate of 0.7 percent per year for the following decade, and has since remained unchanged.

Germany's relative competitive position has been eroding for over ten years. Its wages and social overhead combined are the highest in the world. This would be fine if it was offset by productivity, for after all, in the first three decades after the Second World War, German labor productivity soared by 3 percent per year. But that has not been sustained. Total factor productivity grew by 1 percent per year on average in the 1990s. German workers are less productive than many think, and they work too little.

The only way to create lasting and more productive jobs is to increase research and development. This is Economics 101. Yet the German corporate sector's R&D spending as a percentage of GDP in 1999 was 1.5 percentage points lower than it was in 1989, grouping it with only Italy and the Netherlands in continental Europe as having a declining R&D-to-GDP ratio. Despite Germany's reputation for technical prowess, it places exactly in the middle of the top thirteen OECD countries with regard to the share of researchers in the workforce. Between 1991 and 2000, the share of researchers in the German workforce actually declined. And the results show. By the end of the 1990s, it had slipped to twelfth place regarding the share of patents that are most frequently cited.

Germany's financial architecture is dysfunctional. It is underserved at the investment end, and over-served with 2,591 banks at the retail end. There is still no vibrant equity and venture capital culture. There are gross distortions from what Professor Silvia cleverly calls "Teutonic cronyism." One needn't go to Berlin's Maxim Gorki Theater to see Lutz Hübner's *Bank Play* to understand the message sent to all by the scandal of Bankgesellschaft Berlin. One need only look at the credit crunch affecting the Mittelstand, Germany's most productive and promising sector. Credit and investment capital is not flowing to

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where it can be most effectively utilized. Recently, a businessman told me that he had gone into a bank and said, "I would like a loan." The bank clerk replied, "So would I."

There remain countless impediments to business efficiency, ranging from permit requirements to burdensome product approval processes, restrictions on marketing, pricing, and other rules and regulations that, superimposed on EU rules and regulations, create a mare's nest of complications that tie the hands of entrepreneurs and productive workers.

Corporate governance procedures are opaque and antiquated. To be sure, quarterly reporting moves the ball forward. But co-determination, the Works Constitution Act, its unique brand of collective bargaining, and other residuals from what made Germany hum with harmony and efficiency during the Wirtschaftswunder, when the industrial age belonged to "the West," are hindrances in an era requiring Germany to move up the value-added ladder to the info- and bio- and nano- and financial age, where the requirement for success is what goes on inside the head rather than what derives from the strength of workers' arms and legs. Parenthetically, if you want to be inspired by great economic literature, go back and read Winston Churchill's speeches of 1905 and 1906. He speaks of "the super-fine processes." In response to those who wanted to protect England from competition by restricting trade flows, he brilliantly suggested that England should let other governments have their taxpayers "subsidize with their tax money, not ours," the production of cheap goods. And then England would import them and refine them and use them to develop "super-fine" products that could then be sold at higher prices and fatter margins. Moving up the "super-fine" or value-added ladder, of course, requires an educational system that will enable society to be able to do so.

And yet Germany's educational system is overcrowded, underfunded, and suffocating from bureaucracies that respond more to statutes than to the future needs of students. Germany's poor showing in the 2002 PISA international competition of primary and secondary education reveals the neglect of its once-mighty educational infrastructure. But the demise of the German university system is the most alarming. While a handful of academies like the Technical University of Munich under its president, Dr. Wolfgang Herrmann, and centers like the Max Planck and Fraunhofer Institutes turn out world class research for German industry, the harsh truth is that it would be hard to name a single German university that would rank in the top one hundred in the world in terms of the broad education one needs for success in the modern interconnected world. And university rules governing employment and intellectual property make it very difficult to commercialize research. The best and brightest minds look longingly at distant shores where academic research is better funded and more richly rewarded. How can Germany move up the value added ladder under such circumstances?

Finally, there are now more people over sixty years old in Germany than there are people under twenty. The mathematic implications are straightforward: by 2040, there will be only two working age people for every retiree (that is, if those of working age do not emigrate, who knows where—to Poland? Or someplace else where they can make and keep money or work in truly liberal universities?). This has enormous implications for retirement, pension, labor, education, infrastructure, and other policies, all of which have budgetary implications. Small wonder that *Das Methusalem-Komplott* (*The Methuselah Complex*) has been a bestseller in German.

It is time for Germany's leaders to be serious and discipline themselves, to stop talking and moaning about their predicament.

(Before the Cuban immigration wave into Florida, we used to jokingly refer to its aged demography as "God's Antechamber." Perhaps the title best rests now with Germany.)

Against this background, can Germany hold its own with the rest of the world? Ludwig Georg Braun gave more than an inkling of a German answer when he politely advised the members of the Chambers of Commerce, "not to wait for better policies but to act now and make full use of the opportunities of enlargement."

His was hardly "an unpatriotic act"—nor would Josef Ackermann's be if he indeed decided to move a merged Deutsche Bank to Luxembourg or Vaduz. It is an expression of despair.

At almost the same time as Mike Blumenthal sent me to Berlin, he took me with him to China to negotiate with Deng Xiaoping in 1979. I remember the first meeting we had with Deng. He entered the room and said, "Where are these mighty capitalists that we are supposed to be so afraid of?" And then he sat down and laid out his "capitalist road," his plan for "liberating" the Chinese economy, a plan which over twenty-five years has yielded 8 percent average economic growth—a cumulative six-fold expansion in the size of the Chinese economy. George Shultz told me earlier this year of his last meeting as U.S. Secretary of State with Deng Xiaoping. He asked Deng what he thought of Gorbachev's glasnost. Deng's reply was that, "Gorbachev has it all backwards. First you liberate the economy. Then you can liberate the body politic."

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Deng was a communist; we are capitalists. But Deng understood the basis of the well-being of any people, and that is a strong economy. Germany cannot hold its own without a wholesale revamping—without reinventing its economy.

This is the challenge of German political leadership, be it for Angela Merkel or Roland Koch or Wolfgang Clement or Joschka Fischer or maybe perhaps even President Horst Köhler. Beyond them, it is the challenge of young leaders whose future is truly at stake, like Karl-Theodor Guttenberg and Eckart von Klaeden and others of the successor generation.

I understand the German fear of "strong leadership." I know that the bogeyman of "der Fuhrer" lives in many German closets. But one hundred and thirty-three years after the Franco-Prussian War and the Treaty of Frankfurt, eighty-six years after Compiegne, and sixty years after D-Day and the Nazi surrender in that little red schoolhouse in Reims, the meaning of what Helmut Kohl and François Mitterrand, building on the work of their predecessors, achieved is clear: there is no risk of war between the great Western European powers.

The likelihood of strong German leadership turning warlike and to territorial expansion is less than *de minimus.*

The likelihood that continued poor leadership will lead to German ruin, however, is certain.

Germany has been impacted by the psychosis of defeat. It was defeated first by the Japanese in consumer electronics, then by Intel and Microsoft and the technology giants of the United States, then by bankers from New York, London and Zurich, and now it is besieged by the Chinese. For a while, Germany was carried far by the impressive accomplishment of the Wirtschaftswunder. It propelled Germany from the devastation of World War II and became the standard of the industrial age—a sort of alchemy was created by a cooperative mixing of the government, industrial and labor sectors, yielding the gold of economic prosperity.

But we no longer live in an industrial age. That is now the province of lower-cost labor and technically capable people who have been liberated by the end of the Cold War: the eastern side of Europe at least up to the Urals, the emergence of the southern countries of Europe as they move into the modern era of Europe, the implementation of the plans of Deng Xiaoping in China, and, now, in response to the successful example of China, the emergence of India. This is the province of others who are building themselves up from the devastation of the Soviet domination or Communist misrule or simple bad management, just as the Wirtschaftswunder was a product of necessity from the devastation of Germany during the Second World War.

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We now have literally billions of people eager to improve their lot in life by becoming productive members of the global work force. Labor in the ten new EU member countries is available for a fifth of the cost of German labor; Chinese labor is available for less than 5 percent—

one-twentieth—the cost of German labor. No amount of currency revaluation of the renminbi and no amount of foolish bluster about the need to raise taxes in Poland or Estonia or the Euro-acceding countries will make up for this reality. With the end of the Cold War and with the entry into the global economic system of a whole new set of eager, hungry countries, ownership of the lowest value-added manufacturing processes has shifted elsewhere from the Old West. Inevitably, these new competitors will creep up the value-added ladder, hollowing out the comparative advantage once held by the former leaders of the industrial age. This means that not only must there be a change in "product mix" of the German economy, but the old methods of business and financial and labor organizations must also change. It means that the mentality of government must change and perhaps even its structure.

English is the Latin of the 21st century.

The massive changes required of Germany will be hard. It is always easier to choose a certain present over an uncertain future. The beginning of the end of an old regime, of the old way, of business as usual, is always a troubled time. It requires new thinking, bold thinking. Transitions are full of pitfalls, of risk, of pain. Germany must stop hiding behind both the failures and the successes of its past. It must identify a leader or leaders who will take the kernels of promise that begin with Agenda 2010 and truly make this the beginning of the end of a Germany that no longer delivers. It must make this the end of the beginning of reform. It must get on with the real reform and a vital, renewed Germany that can lead Europe upward rather than downward.

That phrase "the beginning of the end," and the well-known litany that followed in Churchill's stirring speech about the Battle of Egypt in 1942, is not intended to conclude with an alliterative flourish. Like all good speakers and writers, Churchill was inspired by a more profound source. The phrase "the beginning of the end" is adapted from the Bible: I Peter, Chapter 4, Verse 7, to be precise. And the chapter concludes with an additional plea: "come, be serious and discipline yourselves."

It is time for Germany's leaders to be serious and discipline themselves, to stop talking and moaning about their predicament, to stop making convenient patchwork solutions to sustain themselves in office or position themselves for the next election, to stop feigning ignorance of the severe consequences of maintaining the status quo, to hope against hope that exogenous forces (like last year's floods in the East) somehow will miraculously bail them out. It is time to get on with making the changes necessary to save a great nation from economic and geopolitical mediocrity.

Standing up to George Bush will not create a single German job or secure the future of a single German child. "Standing up to America" will not determine Germany's future, other than possibly fueling support in the United States, for an even more rapid withdrawal of American troops. Nor will seeking a permanent seat on the UN Security Council. Only bold reform of the domestic structures in Germany will do the job.

Earlier this year, a participant at the meetings of the Trilateral Commission in Poland, a Frenchman, noted ironically that as Europe seeks to be the counterweight to America, American English has become the *lingua franca* of Europe. English is the Latin of the 21st century. So I conclude with a little bastardized Texanized Latin: sed possum explicare, non sed possum comprehendere." Or, "Bubba, I can explain it to you but I can't understand it for you."

I have given—from someone who greatly loves Germany—an explanation of Germany's predicament. But I have said nothing new, and nothing the most thoughtful Germans do not say themselves. The "explicare" part is the easy stuff. The "comprehendere" part and acting upon it is the tough part. It is Germany's to do. Only Germans can understand what it will take to get on with the job.

This year, America mourned the passing of Ronald Reagan. Regardless of what one thinks of his politics, Ronald Reagan's gift as a leader was his willingness to frontally and unabashedly address the economic malaise that was rampant in the United States. Unlike his predecessor, he did not just talk about it (although when he did, he did so eloquently). He acted upon it, with indifference to his critics and to prevailing political and economic orthodoxy.

Today, Germany faces the kind of profound crisis of confidence the United States faced in the late 1970s. Just as Reagan moved the United States toward the vision of a brighter future, Germany's leaders need now to inspire the people of their great country by deeds, in addition to words.

So, come Germany, be serious and discipline yourself. For the sake of Europe, the Atlantic Alliance and of the world. For your sake. And ours. Get on with it. ◆