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VIEWPOINT

The Big Engine That Can't

Gerhard Schröder's policies could drive the whole European economy off the rails

Josef Joffe

FOR AGES, THE FRENCH USED TO LOOK ACROSS THE RHINE with envy and awe. Like the rest of Europe, they thought of Germany as a perfectly run conglomerate that generates rich dividends and churns out high-class products like BMWs and SAP software. Now, French Prime Minister Jean-Pierre Raffarin is blasting Germany for "a brutal policy that puts Europe's growth at risk." The extraordinary attack, launched at a dinner with top French businesspeople in Paris last week, capped a terrible week for Chancellor Gerhard Schröder.

Schröder is scraping bottom. If elections were held today, his Social Democrats would be decimated. Softly, softly, the Chancellor's minions are beginning to speculate about his replacement. Enraged, Schröder even threatened to resign, then vowed he would not. Raffarin is right. While the French have lowered taxes and labor costs, as Raffarin emphasized in his broadside, the German government has tried to impose, by one count, 48 different kinds of new taxes and levies. Among the E.U.-15, Germany has the second-lowest growth rate. Full employment is a faint memory, and the real jobless rate is lodged above 10% (if one counts make-work and early-retirement schemes). Of course, recession is everywhere, but Germany is stuck in a special rut. Hegel, the most German of German philosophers, put it thus: "The cause of the collapse of all social systems is the exaggeration of their driving principles."

Success in post-Nazi Germany was built on two simple precepts: decentralize power and insist on consensus, which opens all decisions to the veto of any well-organized group. And there are two unwritten articles in the social contract: one, no change; two, if change is unavoidable, losers must be compensated. Thus, total subsidies run to $145 billion a year, which is a hefty price to preserve what no longer works. If you're out of work you get two-thirds of your last after-tax income as a handout. Labor laws make firing difficult and costly; hence the economy is skewed toward underemployment. In 1950, government spending took up 30% of GDP; now it is almost 50%. A half-century ago, all transfer payments (for unemployment, social security and such) amounted to 17% of GDP; now that German incomes are among the world's highest, the transfer rate is one-third of GDP.

In the past, Germany was able to fund this largesse by giving to Peter without robbing Paul, because the economic pie was growing. Now with empty coffers and growth stuttering, the government can no longer bribe its way toward change. Peter and Paul will both have to pay. Job-destroying labor laws must go; regulations and subsidies that protect the old and inhibit the new must be scrapped. To do so, the government must take on

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Germany's frozen consensus system. But remember that old social contract: if compensation is impossible, so is change.

This is why Schröder's coalition has looked like the Keystone Kops ever since its re-election on Sept. 22. Unable to curtail expenditures or to go into serious deficit spending (verboten under the E.U.'s Stability and Growth Pact), the government has had to propose a slew of onerous new taxes. These forays last for about 72 hours, after which they are changed or dropped in response to protests from whatever group was targeted. Last summer, Schröder came up with a job-creation plan that would have lowered some wages and introduced some labor flexibility. But unions are resisting. Three-quarters of Schröder's Social Democratic deputies in parliament are union members.

Germany, good for a third of the E.U.'s GDP, is dragging down the rest of Europe. Schröderland is the big engine that can't—in part because its driver, the Chancellor, can't. Right now, he can't even discipline his own comrades, some of whom—already eyeing a future without "Gerd"—are subtly staking out positions to his left and his right. German rigidity—the "exaggeration" of Hegel's "driving principles"—can be expressed numerically. It takes a growth rate of 2-2.5% before jobs start picking up. But the economy is growing at .4%, with no upturn in sight. Any good news? As Janis Joplin sang, "Freedom's just another word for nothing left to lose." Given his abysmal poll ratings, Schröder can't go much lower. But that doesn't mean he'll feel free enough to do the right thing: make that blood, sweat and tears speech and mobilize public opinion to outflank the veto system. This is surely no way to get re-elected, but it is the way to go down in the history books as the man who turned Germany around. ■

Josef Joffe is editor of the German weekly Die Zeit

HOME TRUTHS: French Prime Minister Raffarin, right, described German Chancellor Gerhard Schröder's economic measures as a threat to the E.U.'s prospects for growth

FABRIZIO BENSCH—REUTERS (RIGHT); PIERRE ANDRIEU—AFP