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PLAN B

What Britain can learn from the German economic recovery

Joe Cox

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About Plan B

In October 2011 Compass published *Plan B: a good economy for a good society*. You can download a copy at http://www.compassonline.org.uk/publications/ and a one page summary is available on page 9. The report was based on the work of 20 leading economists and on its launch was backed by over 100 economists. It stands as the most detailed alternative economic strategy to the Government's 'Plan A' austerity model and all of the predications it made about the dire economic and social effects of austerity are being proved right. Compass is now developing more detailed ideas and policy on how Plan B can be feasibly implemented in Britain today.

Acknowledgements

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About the author

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Introduction

It is increasingly fashionable for the British Labour Party to talk in terms of 'Neue Labour' but the admiration of the German economic model is not confined to those within the Labour Party or even those on the centre-left. Despite this reality this paper is not an 'ideology free' piece sketching out our admiration of the German economy for its own sake. Compass is committed to building a good society based on greater equality, democracy and sustainability and we recognise that the left urgently needs to build a feasible and desirable alternative political economy if we are to achieve everything we hope to.

The German economy currently looks like a relative utopia of growth and low unemployment, all of which allows the sustainable funding of a generous social safety net. Much commentary and research of late has tried to distil what the lessons are for the UK and we hope that this short paper adds to this broad conversation taking place amongst the left at the moment by focusing on the five key areas that Britain can learn from, namely;

1. Local banking
2. Employee empowerment
3. More control over working hours
4. Benign constraints on employers
5. Industrial policy

At the same time it is worth noting that the German social market model is a complete system and should be understood as such. Further caveats are important, as Dr. Michael Dauderstaedt, Head of Division for Economic and Social Policy at the Friedrich Ebert Stiftung made clear at a recent Compass seminar in February the German economy is by no means perfect. Many German trade unions still believe that Germany isn't investing enough in skills and training. The co-determination model which balances the interests of capital and labour functions less well in the service sector which now counts for 70% of German employment. Furthermore, although there is no doubt globalisation has been good for Germany (put crudely because there is huge demand for BMW's amongst the newly global rich) many on the German left argue that the rich and business have benefitted more from this economic model than ordinary Germans. Indeed, bearing down on wages has been a central factor in ensuring that Germany's export led model can succeed and as a result between 2000 and 2008 income inequality and poverty grew faster in Germany than in any other OECD country.[1]

Germany has its fair share of economic and social challenges (like almost every other nation) but a startling fact continues to ring out; Germany's unemployment rate is now lower than it was before the financial crisis struck. The 2008 crisis was a fork in the road for the German economy; before that moment the neoliberal norms largely accepted across much of Europe and the world were beginning to undermine the German social market model. But when the crisis struck in 2008 Germany already had its consensus model to fall back on. This is important to acknowledge because it indicates that Germany's economic and social system is not something that is culturally engrained or uniquely 'German' – it is something that has been built, nurtured, challenged and re-challenged.

1. Local Banking

It is becoming almost painful to have to keep re-writing and re-reading about the huge problems with the UK banking sector. Beyond the obvious problems of the instability caused by short term capital speculation and the fact that the banking sector is too big to fail, the two further flaws of UK banking can be summed up as 'remoteness' and 'short-termism'.

British banks aren't just too big to fail, (which encourages them to pursue easy money in the knowledge that they will probably be bailed out if they fail) they're too big to exist, or at least exist and function effectively. This is a fundamental reason why even the part-nationalised banks (RBS and Lloyds Banking Group) are ill-equipped to fund SMEs (small and medium sized enterprises). Lending and speculation based on computer models requires less expertise and fewer structural costs per transaction so universal banks are not incentivised to serve communities and businesses.

In Germany, strong local and regional banks are underwritten by local public authorities and supported by institutions at regional and local levels.[2] Capital is embedded at a local level in over 400 public savings banks, known as Sparkassen, and 1,258 credit cooperatives operate according to local banking laws, which ensure that these banks satisfy the credit demands of local business and pursue a business strategy that serves their geographical community.

In Germany in 2010 just over 40% of all loans to SMEs were provided by the Sparkassen. In contrast UK SMEs have a huge reliance on the big four banks for credit. The Competition Commission investigation into the supply of banking services to SMEs in 2002 found that in every region of the UK, 90% of services were supplied by the big four banks, a trend which has only increased since 2008.[3] This problem is becoming increasingly severe as interest rates charged to UK SMEs are at a three year high and lending has been declining every month since October 2009.[4]

Public savings banks have historical precedence in Germany (they have been around since the 18th century) but that doesn't preclude the model being replicated in Britain. In Germany a set of regulations have been created that oblige local banks to invest primarily in local businesses; the banks cannot be sold, they must fulfil a "public legal obligation" and any trading surpluses should be used to build up financial buffers and to pursue their wider social objectives. A similar set of regulations would have to be put in place in the UK for local institutions or communities to be incentivised to create local banks that are sufficiently different to what they can already create. The failure of the £100 Million 'Banking on Essex' joint venture between Essex County Council and Santander, an effort to help small companies struggling to win investment because of the financial crisis is illustrative of this point. Banking on Essex's lending criteria was very similar to Santander's usual criteria and it had no public interest obligation thus it provided little incentive for local businesses the use it or the local community to support it.[5]

Perhaps a more immediate solution to Britain's dearth of credit for SMEs would be the creation of a British Investment Bank (BIB). The huge success of the KfW Bankengruppe, the German government-owned development bank that was formed in 1948 under the Marshall Plan could certainly be replicated in the UK. Its unremunerated equity, raised cheaply by the German government on capital markets allows KfW to provide loans at lower rates than commercial banks would. The UK government is currently borrowing at negative interest rates so it is perfectly positioned to take advantage of such a mechanism.[6]

In 2011 the KfW made investments of EUR 23 billion in renewable energy, energy efficiency in housing and SMEs. This led to the creation of 52,000 jobs in 2011 alone (74% of which were in SMEs). It has also financed the renovation of 10% of German housing stock since 2010. These were investments that created jobs and reduced carbon emissions as well as household energy bills.[7]

The KfW does not 'pick winners', it provides an interest rate subsidy to commercial lenders who then deal directly with the borrowers. This ensures there is no distortion of competition and there is diversification of risk.

There are already well thought through proposals, most notably the Blueprint for a British Investment Bank on how one could be established and structured.[8] The government could introduce a BiB quickly by equipping the soon to be launched Green Investment Bank with more capital, allow it to raise money and create credit. A BiB could issue bonds with a full government guarantee. So long as that borrowing went to finance investments with an expectation of returns, it would not be part of the general government deficit. It may even reduce the UK's deficit – the KfW Bankengruppe made a profit of EUR 2.6 Billion in 2010.[9]

A BiB pulling in the same direction as the regulatory framework that exists in the UK (including the Climate Change Act and the Energy Act) could begin to seriously tackle our energy challenges. The BIB would be able to commit state funds to developing new low carbon technologies – thus providing a degree of patience and certainty to the transition to a low carbon economy, without which the private sector finds it difficult to invest.[10]

The KfW and the German regional banks have a symbiotic relationship. As there is no significant regional banking network in the UK the big universal banks must be forced to refocus their efforts onto narrow banking to ensure they serve the real economy. The Vickers Commission proposed that the government should divide the retail and investment banking functions of the universal banks by 2019; the government should strengthen these proposals to ensure the full separation of retail and investment banks before 2019. This would create a whole new tier of British banks that are focused solely on retail banking. A new tier of retail banks working with the support of a BiB would help provide the more stable capital that the UK's SMEs and communities so desperately need. In addition, the investment bank and international operations of RBS could be sold to recover a good sum for the exchequer, but keeping RBS in public ownership and devolving it into a system of locally governed banks would benefit customers and local economies much more than selling it to the highest bidder.[11]

2. Employee empowerment

Mobilising the creativity of workers is fundamental to German prosperity. This promises to continue to be the case in the future as throughout the world innovation driven by free experimentation and collaboration becomes more important. One study has suggested that employees who are 'fully engaged' can be 43% more productive as a result but less than half of all UK workers feel that the organisation that they work for deserves their loyalty. One estimate of the cost of this disengagement is £36 billion per year.[12] Yet co-determination is more than about collaboration and experimentation, it is about conflict. The conflict between capital and labour is often institutionalised in the structure of German businesses. This conflict plays out in spheres where both sides are often able to rein in the more short-termist thinking that both capital and labour is sometimes guilty of. This can be seen by the fact that the UK lost nearly six times as many working days due to strike action than Germany did between 2004–2006.[13] It is partly for this reason that the social market system was championed in the post war not just by the SDP (Social Democratic Party) but by the CDU (Conservative Christian Democrat Party).

The TUC report German lessons: developing industrial policy in the UK provides a fascinating insight into how co-determination works on the ground:

> "The Works Council and Supervisory Board at Volkswagen are both very important, even by the standards of German industrial relations. Because of its size, there are 65 Works Council reps (62 of which are IG Metall members) and 20 members of the Supervisory Board, 10 from management and 10 employee representatives. Any decision needs a majority, meaning that there must be at least one Works Council member to vote for it. However, if there is no majority for a decision after a first round of consultation, a second round takes place. At the end of the second round, the Chairman has two votes, meaning management's proposal can be pursued. In practice, decisions are rarely taken on that basis. Furthermore, the state of Lower Saxony is a shareholder in Volkswagen, giving it two management seats on the Supervisory Board. Given that Volkswagen has five plants in Lower Saxony, the state's interest is often in employment issues, making it likely to be sympathetic to union concerns. Finally, major decisions like the opening of new plants or the de-location of plants require two thirds majorities, so can be blocked by trade unions."[14]

The checks and balances within this process don't lead to sclerotic and sluggish decision making as one may envisage. Rather it ensures that worker interests as well as public interests are upheld, often leading to longer term considerations than quarterly profits.

Co-determination also reduces wage inequality within companies. The Hans Bockler Stiftung has found that "the gap between pay groups/grades is smaller in workplaces with a works council, and the overall pay range is also less."[15] Whilst helping to tackle excessive pay co-determination also benefits women and low earners in particular. The same study found that "employees in the bottom fifth of the pay distribution table (bottom quintile) earn on average 14% more when they are in workplaces with works councils. And if this group is split by gender, women do even better: they get 19% more on average, while the men get 11%".[16]

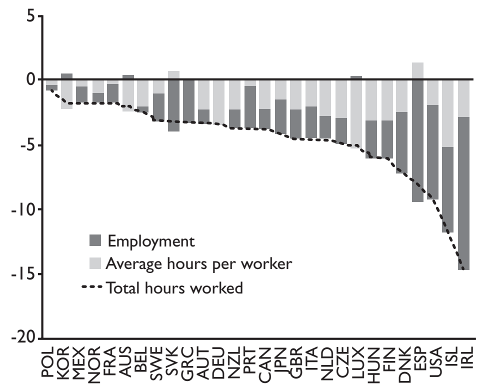
There is no doubt that there would be employer's organisations, business leaders and ideological opponents of this strategy but a more responsible capitalism must work for more than just management and shareholders. It is also the reality that many British workers have little power in their workplaces and do not belong to a trade union so introducing and familiarising workers with a system of co-determination will be an ongoing struggle. For this reason a good first step could be for the UK to pass legislation which requires all companies that have over 1,000 staff to establish an elected works council that meets with employers quarterly. The European Works Council Directive states that every multinational company that has at least 1000 employees in Europe and has 150 employees in at least two member states has to set up a European Works Council (a meeting between employers and employee representatives that takes place at least once a year).[17] This legislative extension could be a first tentative step that allows employees, trade unions and employers to become accustomed to co-determination with the end goal being a British equivalent of the German co-determination model.

3. More control over working hours

Environmental constraints and the challenge of stubbornly high unemployment (even when the economy is growing) means that in Plan B[18] we recommended a slow but steady move towards much shorter and more flexible paid working hours. In 2010 German employees worked on average 228 fewer hours a year than UK employees.[19] This means that paid work is shared between more people than in the UK helping to reduce unemployment whilst at the same time allowing those in employment a better work/life balance. German workers are also more productive.

In exceptional circumstances such as Germany's last recession reducing working hours on a short term basis helped firms retain jobs and ensure production could be scaled up once demand picked up again. Under the *Kurzarbeit*, or 'short working hours' system companies only pay for the hours that their employees actually work with government subsidies making up the shortfall in wages. This cuts labour costs substantially, allowing German businesses to retain workers. It is estimated that the *Kurzarbeit* scheme is responsible for saving around 400,000 jobs during the last recession.[20] The government put around six billion Euros into the scheme but this helped almost 1.5 million workers. Companies who took part in the scheme also contributed around five billion Euros.[21]

Figure 1: Hours worked, % change from peak to trough



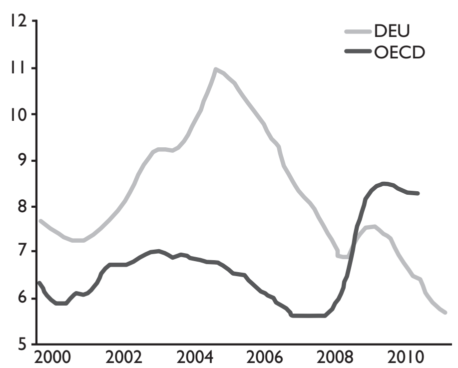
The widespread use of working time accounts (accounts in which employees recorded overtime in lieu of holiday during the boom years) also allowed employees to draw down on these accounts when demand for production declined.[22] Providing workers in the UK with working time accounts would ensure that greater attention was paid to the huge scandal of unpaid overtime in the UK. Last year nearly 2 billion hours of unpaid overtime were worked, this is the equivalent of a million extra jobs.[23] Furthermore government subsidies for short term working during times of recession could help dampen cyclical unemployment (leading to lower benefit bills for the exchequer).

The wider distribution of paid work as a result of reduced working hours in the UK would help us to begin to try to break out of the viscous cycle whereby the UK needs to grow its economy every year to maintain employment levels, an unsustainable trend in the long term.

4. Benign constraints on employers

Whilst the New Labour government re-regulated the labour market somewhat, it thought that giving workers 'too many' rights would ultimately be self-defeating as businesses would relocate and investment would dry up. As a result (according to the OECD) the UK still has one of lowest-regulated labour markets in the developed world.[24] This model of light regulation has been pushed even further by the Coalition government who are now further reducing employment rights in the false belief that it will mean the UK is more competitive and firms are then more likely to create jobs. The German recovery has blown this theory out of the water; in two years since the economic downturn Germany has expanded employment by 1.8m while the UK, US, Italy, France and Spain have lost 7 million jobs. Germany's youth unemployment is one third the OECD average and one eighth that of Spain.[25]

Figure 2: Unemployment rate, %



Employment protection laws protect employment as it disincentivises firms to let workers go during slumps or even just to increase profit margins. Employee protection also encourages employers to invest in their employee's long term development as the cost of staff turnover is higher. It is important to note that there has been deregulation of employment rights in Germany (the so called Hartz reforms in the mid 2000s) but employee rights are still higher than in the US and UK. The system of 'benign constraints' that operates in Germany makes the cost of sacking workers high. A good example of this is the "Sozialplan" (social programme) which is enforced if mass dismissals subsequent to company changes occur. It is meant to prevent or alleviate subsequent economic disadvantages in light of mass dismissals but it also discourages them. Contents of the social programme could include compensation payments to employees who have been made redundant or whose income have been cut, paid leave of absence from work, working conditions for transfers, regulations concerning transition companies, absorption of employees' new-application expenses, regulations concerning further-education measurements, supportive payments for travel expenses, moving support, moving expenses, articles on protection of vested rights, i.e. company pension, company social payments, hardship regulations, early-retirement regulations and partial payments of short-time workers' money.[26] These added expenses discourage the fast turnover of staff whilst encouraging long term investment in the productivity and skills of employees.

5. Industrial policy

The UK government has used the power of the state to support and encourage various business sectors throughout the twentieth century from pre-war militarisation, bailout of Rolls Royce in the 1970s to the big bang deregulation of finance in the 1980s. Whilst these strategies may have had differing levels of success in terms of social and economic development the important role of the government in the economy should not be in any doubt.

The German government is clear about what it sees its role in the economy: it wants to address market failures, create good jobs, ensure regional balance and transition to the low carbon economy. The UK government is currently less sure what the government's role in the economy should be. As argued in Plan B the UK government's 'value free' procurement strategy has meant that virtually the only criteria for investment is the short term costs of delivery.[27] Externalities, as well as medium and longer term considerations such as the UK's skills base were not given as much prominence as they should have been.

The UK government could do a lot worse than emulate the German industrial policy. A vital aspect of industrial policy is regulation and procurement. Germany is currently undertaking a huge energy transformation which is being described as being "as challenging as the first moon landing". Following the Fukushima disaster Germany took the decision to phase out nuclear power and replace it with renewable energy. Investment in renewables in the coming years is calculated to be around 8% of 2011 GDP.[28]

The impact that this is having on German business is remarkable with some of Germany's biggest businesses entering the renewables business. According to Bloomberg Businessweek:

> "Robert Bosch GmbH (RBOS), the world's biggest car parts supplier based in Stuttgart, has invested about 1.5 billion euros into its solar energy business by purchasing companies and building new plants. Hochtief AG (HOT), Germany's biggest builder, has commissioned four heavy-duty ships to erect wind farms at sea including the 200 million euro "Innovation."
>
> Volkswagen AG (VOW)'s Audi luxury car division plans to build a plant that uses water and carbon dioxide to convert electricity into natural gas, backed by 5 million euros of investment from EON in a pilot plant based on a similar technology."[29]

It is hard to envisage that this investment would have been forthcoming without the German government's energy transformation. These large German businesses will now be diversifying into new markets and developing much needed 'green products' and renewable energy. This contrasts starkly with the UK government's energy policy which seems to be contradictory. Subsidies for solar power have recently been dramatically cut and electricity market reform may deter investment in renewables and favour nuclear power.[30] Furthermore the government's 'gas generation strategy' announced in the 2012 budget continues to undermine investment and confidence in low carbon energy generation. The UK government should make a clear commitment towards decarbonisation of the energy sector and ensure policy flows consistently from this premise.

Often as a result of procurement requirements in Germany large companies train more workers than they need which means that some workers go on to work for or form SMEs (many of which couldn't afford to train those workers to the same standard) or work further down the supply chain.

A simple (and I would imagine hugely popular) government procurement policy would require every pound of taxpayer's money to contribute to skills, jobs and sustainable economic activity within Britain.

Conclusion

The two vital factors that have enabled the Germany economic model two flourish are firstly, the German state knows that it inevitably has a vital role in determining the economic future of the country and does not shy away from this. Secondly, Germany has institutions and institutional arrangements which can embed and control capital to ensure it is harnessed to work in the interests of society. For this reason it is important that the German social market system is not seen as just a set of policies which any government can cherry pick. It is a living, breathing system that has been built, nurtured, challenged and re-challenged.

How the German economy will fare in light of long term trends is difficult to forecast. How will Germany deal with rising commodity and energy prices? How will the continuing rise of the BRICs and the increasingly sophisticated nature of their manufacturing processes affect Germany's exports? How does the need to avert catastrophic climate change and ecosystem destruction affect the export-led growth model? These are challenges faced by many advanced economies all over the world but the export led growth model may make Germany particularly susceptible to environmental constraints.

That said, the one feature that marks the German economy out from the British one that should hold it in good stead going forward is its in built resilience. German banking ensures that regional economies and SMEs are better served than their UK equivalents. Co-determination will ensure that future challenges are negotiated in a more informed and democratic manner. Shorter working hours will help to dampen the effects of unemployment in the wake of any falling demand and a clear industrial policy in favour of a clean energy means that German industry is well placed to make the most of the forthcoming opportunities. The UK should take note.

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PLAN B

WHAT IS IT?

WHAT IS PLAN B?

An alternative economic model to the Government's strategy of drastically cutting public spending in order to try and eliminate the budget deficit within five years.

WHAT'S WRONG WITH PLAN A?

Plan A is failing to provide economic growth or jobs and could in fact increase the deficit. The cuts are also having a devastating effect on the public services that most of us rely on.

The impact of the government's decision to reduce spending by £130 billion over 5 years is now beginning to tell, the cuts are reducing GDP by up to 2% per year.

WHAT WOULD PLAN B ENTAIL IN THE SHORT TERM?

- The cuts would be reversed until the economy is growing strongly.
- A new round of Quantitative Easing (money created by the central bank) would be directed to a Green New Deal, to insulate and prepare large numbers of buildings to generate renewable energy.
- Increasing some benefits for the poorest who are then likely to spend any extra income, this would help get the economy moving again.

HOW WOULD PLAN B PAY DOWN THE DEFICIT?

- It would cancel Private Finance Initiative debts, saving the nation £200bn in debt repayments.
- By Introducing a Financial Transaction (Robin Hood) tax on the banks.
- The £70 billion in yearly uncollected tax would be closed.

Plan B would mean that the Government pays down the deficit through growth and spending adjustments only when the economy is in good enough shape to.

HOW WOULD PLAN B CREATE JOBS?

Stopping the cuts and investing in a Green New Deal would help create new jobs and save hundreds of thousands of existing ones.

Plan B would also create a new British Investment Bank that focuses strategy on low carbon sectors such as housing, transport and renewables. This would help create the conditions for start-up businesses to develop.

HOW DOES THIS DIFFER FROM 'BUSINESS AS USUAL?'

In the context of climate change and the globalising economy there is no short term fix for Britain, we cannot go back to 'business as usual'. Instead short-term measures have to create the conditions for a good economy that is in tune with the needs of people and the planet. That's why plan B would:

- Reform the banking sector to reduce the likelihood of another crash and focus investment on the productive economy.
- Focus on the 'core economy' of families and move beyond 'GDP' as the sole measure of economic success and rebalance of time spent working and 'living'.
- Reduce wage inequality and make companies more efficient through worker participation.

WHAT OTHER MEASURES ARE THERE?

It is not just the economy that needs thorough going reform but the state. Via Plan B, the state will spend more effectively and efficiently.

Investment will be focused on preventing illness and social disruption rather than wasting money on symptoms. For example a small investment to stop obesity could more than halve the £4.8bn cost to the NHS.

Public services will also be transformed through the widespread use of co-production techniques, emulating successful examples like Newcastle where savings have been re-allocated to deep rooted social problems such as long-term care.

For more information go to:

action.compassonline.org.uk/planb

#timeforplanb

PLAN B

FRIEDRICH EBERT STIFTUNG

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