GERMANY AND ITALY AS "MODELS" OF POLITICAL ECONOMY

Philippe Schmitter

European University Institute

The political economy of Europe – both West and East – has generated many "models" of enviable performance since its recovery from World War II in 1945 and, once again, since the end of the Cold War in 1989. A large number, perhaps a majority of its member states, have been declared superior, admirable or even miraculous at some point during that period and, hence, worth emulating (which is presumably what a "model" is supposed to do). The fact that, in virtually every case, the country involved subsequently fell into disgrace and even become a "model" of unenviable performance has been less well-noted.

As this moment, Germany seems to many in Europe (and specifically in Italy) to enjoy such an exalted status. How long this will be the case is unforeseeable, but that it will not do so permanently seems very likely from past experience. Seen from the Italian perspective, the key question is not how long will it last, but what will be its impact while it still exists. Not only is it the largest political economy (in both size of GNP and population) in Europe, but also it is the dominant member of the European Union. *Ergo,* Germany has a unique capability for affecting the performance and reputation of its neighbors. Small country "models" are much less appealing or threatening to a country like Italy.

In practice and for public consumption, "models" of politico-economic performance are based on reputation. It is enough that they are admired and envied by significant others. In theory and for analytical purposes, "models" are based on two distinct suppositions: (1) That it is the complementary nature of formal institutions and informal practices – political as well as economic -- of the country that is responsible for this superior outcome; and (2) That these conditions are sufficiently generic that they can potentially be imitated. [i] The literature, perhaps because it is dominated by economists who only regard politics as a potentially obstructive factor, tends to stress the usual economic outcome variables: high GNP growth, less inflation, full employment, export competitiveness and, occasionally, more equitable distribution of benefits. This ignores the fact that at least in contemporary Europe these favorable outcomes are contingent on the democratic performance of their respective political institutions and policies. Hence, a successful "Model" – especially one with some chance of enduring – also depends on the presence of such things as competitive elections between credible political parties, the legitimacy accorded by citizens to those who win them, the stability and effectiveness of the government produced by these winners, the existence of stable and non-violent relations between capital and labor and, finally, an honest public administration and legal system that impartially implements policies and protects citizen rights regardless of the party in power.

Needless to say, this theoretical convergence and subsequent complementarity between favorable economic outcomes and political conditions that make them more likely is not easy to produce – and to sustain. In actual practice, many national political economies have attained "model" status without having enjoyed all of them. Most recently, for example, some of the most admired economies have a very poor record with regard to the fair distribution of benefits. They have gained in export competitiveness at the expense of domestic well-being by means of "internal devaluation," i.e. reducing salaries below increases in productivity and cutting social benefits. Some of the more successful polities have exhibited alarming tendencies toward a reduction in the credibility of traditional centrist parties and emergence of new extremist populist ones, more contentious relations between capital and labor and more instability in forming and sustaining government – not to mention growing ineffectiveness of public policies.

As far as elite and public opinion in Italy is concerned, the Federal Republic of Germany is indisputably the best current "model" of political economy in Europe. While it is widely admired, it is also widely feared. What makes this status so controversial is not simply that there is considerable ambiguity about whether it should or could be imitated without generating quite different effects for the Italian population, but also that it comes with some serious historical memories and contemporary worries. Italians retain very negative memories of the period of Nazi occupation from their surrender in 1943 to the end of the war in 1945 – and these are constantly being reinforced by the repetition of events celebrating the exploits of the *partigiani* who opposed it. The novel element, however, in the equation is the perceived role of Germany in dominating the economic and monetary policies of the European Union.[ii] It is one thing to admire a country's performance and to be prepared to adjust or emulate one's institutions and policies accordingly; quite another to suffer not only the direct effect of superior competitiveness, lower rate of inflation, and lesser disruption of production, but also the imposition of its "model" on a supra-national institution that has an authoritative impact on the polices of its member-states. In this case, it is not a matter of learning from a "model" and voluntarily imitating it, but of being compelled to adopt it.

Therefore, the public's perception in Italy of the German model has become increasingly confounded with the role of Germany as the hegemonic power in the European Union. The rigidity with which the (unattainable) 3% current budgetary deficit is imposed on Italy is attributed virtually exclusively to German pressures – despite the fact that Germany itself in less fortunate times was one of the first to violate it and despite the fact that there are several other EU member states who uphold it. The European Central Bank is widely regarded as modelled on and dominated by the Bundesbank – even if the present president of its Board is an Italian. Even when Mario Draghi promises to do "everything possible" to defend the Euro, very few in Italy have any hope that he will be allowed to go beyond the strict limits imposed by its founding treaty or its current German-dominated Board of Directors.

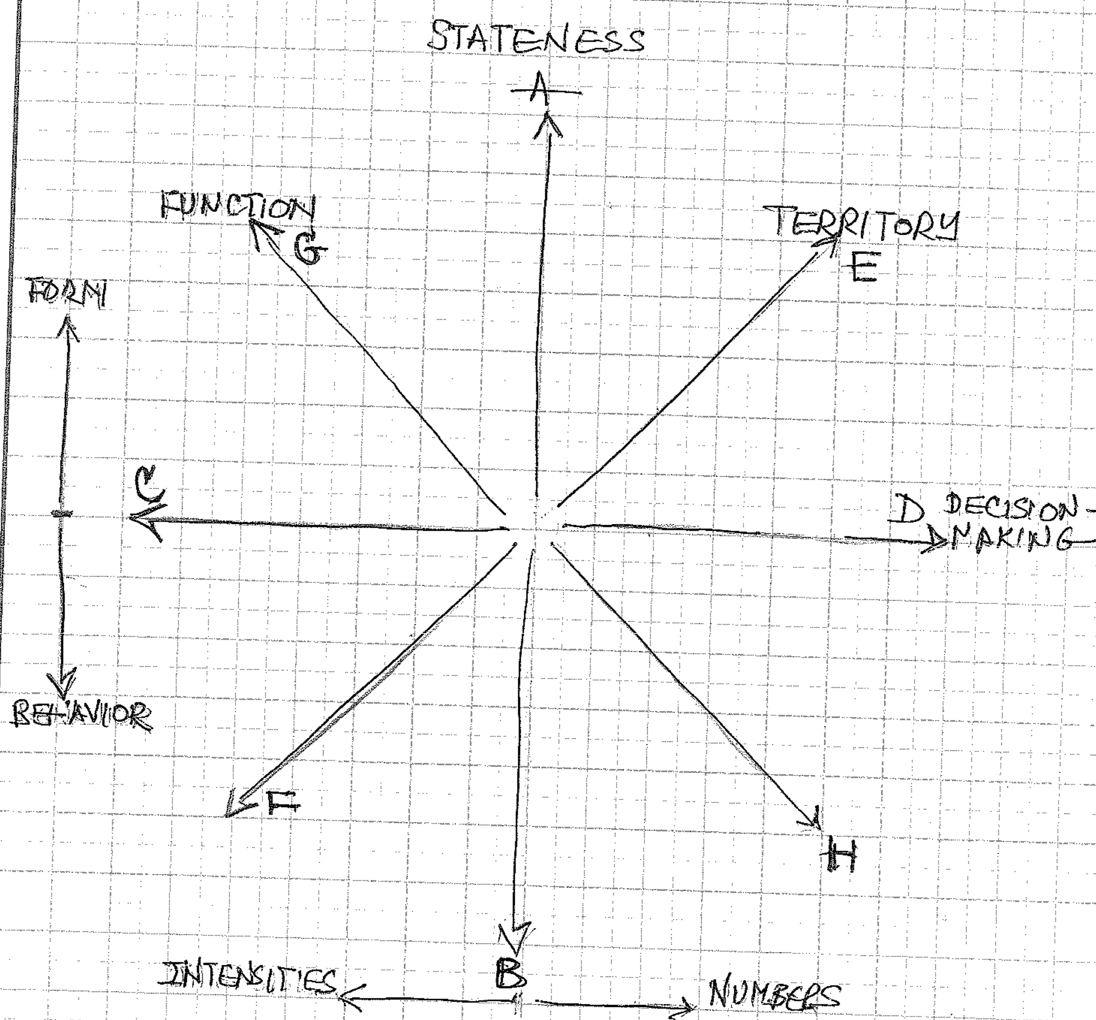
What is a good deal less known to the general public is how much the Italian economy has become dependent on the German one. By far the largest share of its exports go to Germany and many of the latter's most successful "diverse quality products" have a lot of Italian components in them. As for its political influence, within and beyond the EU, this declined dramatically during Silvio Berlusconi's tenure as President of the Council of Ministers to the point that when compared to the relatively stable, scandal-free, centripetal, two-party, parliamentary and multi-layered system of Federal Republic, Italy seemed an almost antithetical counter-example: erratic, scandal-prone, polarized, increasingly fragmented, pseudo-presidential and administratively centralized. With the advent of the technocratic government of Mario Monti, but especially since the election of Matteo Renzi with an almost unprecedented 40% of the popular vote, the country seems to have entered into a transitional period with a leader who commands more respect from his European interlocutors and one who is committed to major institutional and policy reforms. Very quickly after taking office, Renzi moved to form an informal alliance with France and other Southern European member states as a counterweight to German hegemony – without, so far, much effect.

Varieties of Capitalism and Types of Democracy

One of the basic contentions upon which this article rests is that the status of "model of superior performance" depends not exclusively on the nature or complementarity of economic institutions – as the existing literature on varieties of capitalism assumes – but upon the interrelationship between economic and political institutions. In other words, a national political economy will perform better when it has something approaching a double complementarity – first, among its economic institutions and among its political institutions and, then, between the two subsets.[iii]

FIGURE 1

THE GENERIC 'PROPERTIES' FOR COMARING VoCs &ToPs



Recent research conducted by myself and Arpad Todor has attempted to measure and test for this relationship. It begins with a conceptual plot of four "radial" variables at the national level, each of which is divided into two "spokes." Our pretense is that this captures the key sources of variation in both capitalism and democracy, first, in terms of spokes: (1) Stateness; (2) Decision-making; (3) Territorial representation; and (4) Functional representation and then, by dividing each of them into two spokes, one measuring institutions and the other measuring performance. The extremes of variation are labeled "social capitalism-liberal capitalism," and "social democracy-liberal democracy." When the data are plotted, the best performing units should be those that have two macro-configurations: (1) the spider web of indicators for capitalism and democracy should come closest to forming a circle, presumably indicating the extent to which they coherently approach the two better-performing -- social or liberal -- extremes; and (2) the extent to which their respective spider webs match when they are superimposed on each other.

In Figures Two and Three, I have plotted the two cases of Germany and Italy. When applying the "Inter-Ocular Impact" test, i.e. simply eye-balling the data, they would appear to have a surprising number of similarities.[iv]

1. In both countries, the economic institutions and performances are more "liberal" than are the more "social" political ones. Neither comes close to having the allegedly desirable "circular" fit between the two, although German's fit is closer to it.

2. Neither country's Variety of Capitalism or Type of Democracy forms the sort of round circle that is supposed by theorists to be the key to good performance, although both have a greater degree of "political circularity" with Italy's democracy being closer to the "social" end of the continuum and German's closer to the "liberal" end. Both have peculiarly "elongated" profiles of economic institutions and performances, determined in large part by the nature of their functional representation.

3. The stateness of the economy in both countries is about equally high when measured by the role of publicly-owned banks, but surprisingly more liberal in the case of Italy when measured by a composite index of "economic freedom" developed by the Heritage Foundation. CAN YOU CHECK THE RAW DATA ON THIS???

4. The stateness of the political regime shows both countries as close to the mean for the OECD countries as a whole, but Germany having a slightly higher

level of expenditures of all levels of government as a percentage of GNP, but surprisingly -- since it often assumed that Italy has an excessively over-manned public adminstration – it is Germany that has a higher proportion of government employees in the total labor force. AGAIN COULD YOU CHECK THE RAW DATA?

5. The differences in economic decision-making are asymmetric. Both Germany and Italy are high on the composite indicator of corporate governance (indicating that their firms are more state protected from hostile takeovers or shareholder pressure), but when it comes to concentration of ownership (presumably, the higher it is, the more social is the variety of capitalism), Italy comes out far ahead.

6. When it comes to political decision-making, the two are both close together. They both have about the same number of formal veto points their institutions and both have experienced long periods of hegemony by the leading party in executive power from 1950 to 1998 – although this obviously ignores the much greater rapidity with which specific governments came and went in Italy.

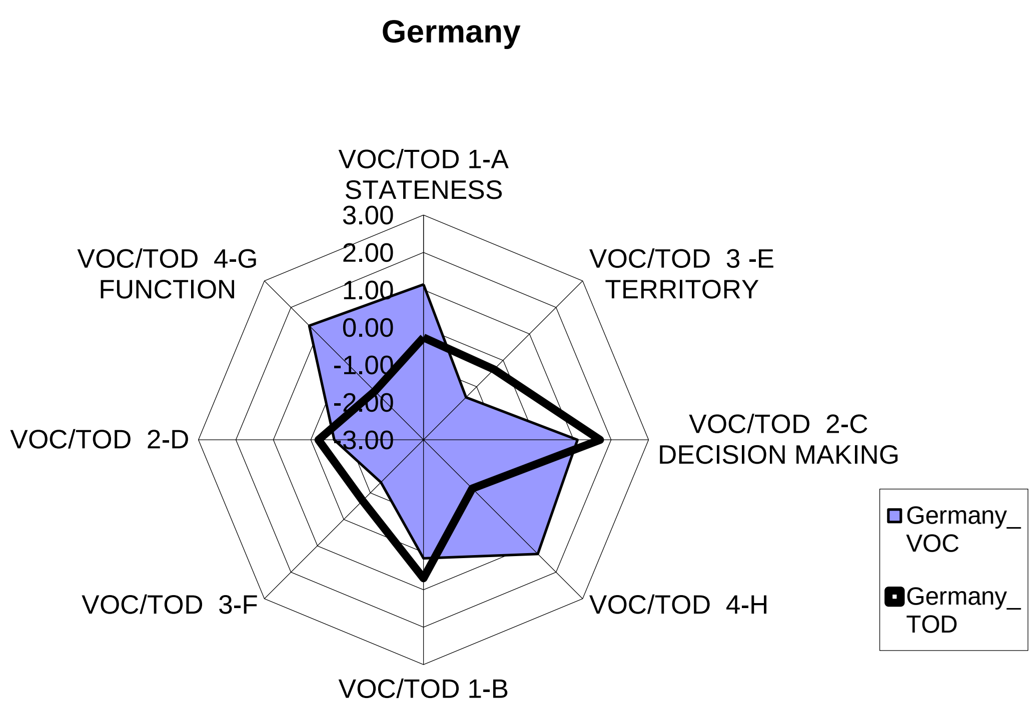
7. It has not proven easy to conceptualize and measure the territorial element to the respective economies for the simple fact that economists and those who gather data for them are calculatedly indifferent to this aspect of

capitalism. However, using two proxies, “market capitalization as a % of GNP” and a “Composite Indicator of Shareholder Rights,” one finds Germany and Italy virtually identical in the both dimensions and more “liberal” than most of their OECD brethren.

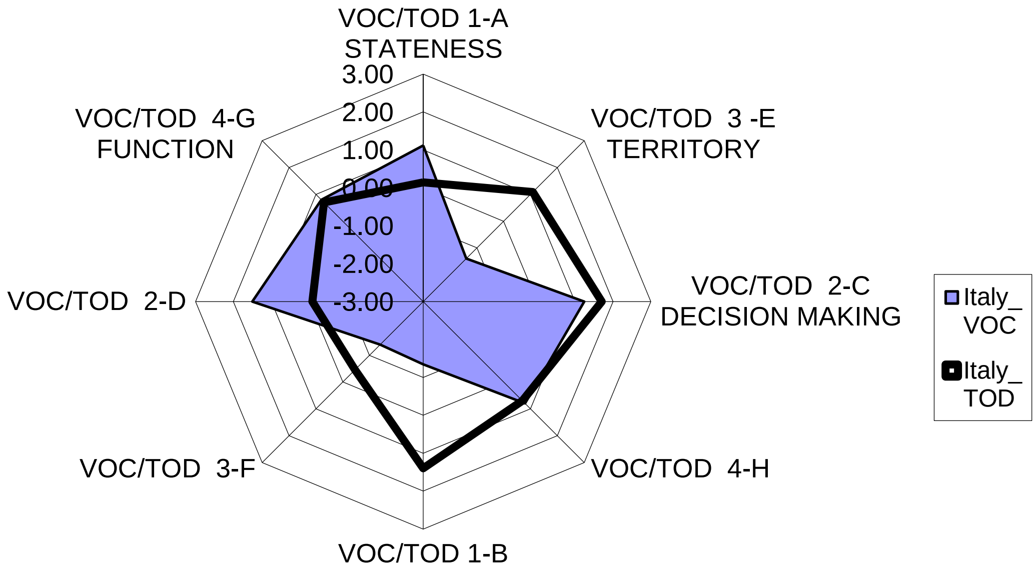
8. Territory has always been a central dimension in discussions of type of democracy. Parties tend to vary in their presence and success across component units, especially in federal systems such as the German one, and the relation between voting strength and allocation of seats in the legislature is also a highly differential matter depending on the design of territorial constituencies and electoral laws. In Figures Two and Three, we find that Germany comes much closer to the liberal democratic model and Italy to the social democratic one. The latter has a much larger number of effective political parties in parliament (as of 1990) which tends to correspond with the “social” profile and its usually more proportional electoral system. In terms of disporportionality in the distribution of seats across sub-national units, Italy is about average for the sample and Germany is better than average. This is unusual in federal regimes and it might just be another of the political advantages enjoyed by the German political economy.

9. Finally, we come to the radial that has figured prominently in the debates about both varieties of capitalism and types of democracy, namely, the manner in which capital and labor bargain with each other to affect wages, working conditions and, sometimes, even general economic and political policies. This "functional" dimension varies greatly across contemporary capitalist democracies from a social or corporatist extreme at which such bargaining is comprehensive and binding to a pluralist liberal one which is highly fragmented and voluntary. Thanks to its prominence, we have many potential indicators to choose from. In terms of its economic model, Germany comes out as more "social" on a labor coordination index that measures the extent to which bargaining between capital and labor is coordinated across sectors and territories and slightly more "social" according to an indicator of employment protection. However, Italy is far from being located at the other "liberal" extreme on either indicator.

When we switch to the political equivalent of functional representation, we again find Germany closer to (but not that near to) the model of "liberal democracy." Its place on an indicator of corporatism from the 1970s to the 1990s is lower than that of Italy and far inferior to the positions of Austria or the Scandinavian countries. When it comes to membership in trade unions as a proportion of the active labor force ca. 1990, Germany is only very slightly more “social” than Italy. Membership in both countries has declined since 1990; more so in Italy than in Germany where trade unions not only have retained large memberships in key economic sectors, but their position within the enterprise is much more assured, thanks to post war laws on co-determination.



Italy



Conclusion

What have we learned from this brief exercise in comparative political economy? Germany may have a solid reputation as a model today, but the objective charateristics of its institutions and practices do not conform to theoretical expectations. In other words, it seems to works in practice (for now), but not in theory (forever). Yes, the country has piled up remarkable export surpluses – while supressing domestic wages and purchasing power and helped no doubt by the artificial low exhange rate guaranteed by its membership in the Eurozone. And, yes, certainly compared to Italy, it has enjoyed much fuller employment, a more balanced state budget, much less of an increase in public endebtedness and at least stable but not declining general prosperity. It would, however, be hard to describe its institutions as "circular" reflecting some natural complementarity among them. Germany's spider web seems more the product of improvisation and experimentation than the abstract locic of a "coordinated market economy" or of "social capitalsm"or, for that matter, of "social democracy." My assumption is that its decidedly heterogeneous profile represents a country that has adjusted its radials and spokes to conform to the diversity of its distinctive historical and cultural circumstances, not some abstract model of how capitalism or democracy works best. This tentative conclusion suggests that it will be futile fo others to copy the German model. They will have to adjust their respective radials and spokes to their distinctive histories and cultures.

Moreover, contrary to the literature that celebrates its status as a "coordinated market economy" and, hence, its presumed enjoyment of a permanent comparative advantage, there is little reason to be confident that this will persist in the future. German workers may rebel against wage containment and cuts in social services; "diversified quality production"may prove to be unsustainable when faced with more innovative or more price competitive firms in other countries; the Eurozone could collape and with it German's exchange-rate advantage – especially if its citizens reject the sort of supra-national democratic institutions and/or solidaristic redistribution of benefits that would be needed to sustain it politically.

Unfortunately, we have not been able to trace the emergence of these traits over time to discover if it was changes in political institutions and outcomes that preceeded and presumably caused subsequent changes in economic ones – or vice versa. This shallow timeframe also prevents us from tracing the sequence of adaptation to changes in the global political economy since the mid-1970s. No one can deny that Germany has adapted more successfully to both European integration and globalization than, say, Italy or, for that matter, most of the other European political economies – but why this was so can not be discerned from our static plots. After all, it was not that long ago that the Federal Republic was regarded as "the sickman of Europe" and Italy was basking in the "miraculous" status of its recovering economy!

ENDNOTES

[i] Interestingly, the two European countries that have enjoyed, not the best, but the most consistently good politico-economic performance during this period: Switzerland and Norway, are almost never cited as "models" for the simple reason that the conditions responsible for their success –reliable financial institutions and bank secrecy in the one case and oil and gas production in the other – cannot easily be emulated elsewhere in the region.

[ii] As one recent headline in La Repubblica put it, “The Clock of the EU is observing only German Time” (13 October 2014). As yet, to our knowledge, no one has accused Germany of converting the EU into its “Fourth Reich,” as happened in Greece. The populist (and anti-Euro) politician, Beppe Grillo, however, has repeated accused Matteo Renzi, the present Prime Minister, of being the “puddle of Angela Merkel” and worse.

[iii]On this issue, the work of David Soskice and Peter Hall is seminal. They have baptized the German model as that of a “coordinated market economy” (CME) in opposition to a “liberal market economy” (CME) such as the United States or the United Kingdom. Both are considered to owe their success to the “complementarity” of their economic institutions. Nothing explicit is said about the need for the existence of “complementary political institutions,” although there are implicit hints to that effect. David Soskice & Peter Hall (eds.) Varieties of Capitalism. The Institutional Foundations of Comparative Advantage (Oxford: Oxford University Press, 2001).

[iv] For various reasons – mainly scarcity of resources – the data were gathered at a single point in time: ca. 1990. Germany during the Cancellorship of Gerhard Schroeder later in the 1990s introduced a number of changes in labor market policies making them more liberal than they are depicted in Figure Two. In Italy, Prime Minister Silvio Berlusconi was more preoccupied with advancing his many investments or keeping himself from criminal punishment to have introduced any such reforms. It has fallen to the present Prime Minister Matteo Renzi to begin to make such changes – against strong resistance from within his own party.