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American and British commentators have told three stories about the German economy over the past decade, all of them derogatory. Articulating a standard conservative view, Adam Posen of the Peterson Institute for International Economics in 2006 characterized Germany's performance as "lastingly poor." In a similar vein, Jude Blanchette, blogging for the libertarian Mises Institute, predicted in 2003 that nothing but "rot and indolence" lay ahead.

Another version of the indictment states that even though Germany was once an economic powerhouse, its best days are over. Thus in 2003, Larry Elliott of *The Guardian* reported that the German economy had "sputtered to a virtual halt" and, in the view of many, had succeeded to Britain's 1970s-era role as the "sick man of Europe."

A third story holds that, to the extent Germany is surviving at all, it is only by giving up the distinctive elements of its economic model and embracing American norms. Edmund L. Andrews, for instance, claimed in *The New York Times* in 2000 that "the structure and ethos underlying Fortress Germany have begun to crack like a house on a California fault line." Supposedly the Germans were taking a leaf out of Silicon Valley's book by moving to a freewheeling employment model, and many recent university graduates were forsaking a secure, carefully nurtured career with a long-established employer for a bumpier ride with an entrepreneurial start-up.

Yet, as the Chicago-based Germany-watcher Gary Herrigel points out, none of this is true. "The Germans have certainly reformed their system to make it more flexible," he says. "But they have had no intention of adopting the American model. They have not been moving in the direction of more free-market mechanisms or the individualization of the economy."

It is high time the German economy got some respect. It has been faring much better lately than either the United States or Britain, despite the scornful predictions of Anglophone economic observers. The problems attributed to the German economic model since reunification have been greatly exaggerated, if not entirely imaginary, and German corporations are now exceptionally well positioned to capitalize on recovery once global demand picks up. The rest of the world can learn vital lessons from this success through good global economic times and bad.

The case against the German model relies largely on one data point: Germany's official growth rate has often lagged in recent years. But the growth story is more nuanced than most English-speaking observers have realized. And by virtually every other measure, the German economic model stacks up well against that of the United States:

Per-capita income. Measured at ruling exchange rates as of 2008, Germany's per-capita income was $44,600. That was within hailing distance of America's $47,500 -- an impressive performance in itself and all the more so when you realize that the typical German worker put in just 1,432 hours in 2008 versus 1,792 hours for the typical American.

Life expectancy. Germans now live nearly 14 months longer on average than Americans. By contrast, as recently as the early 1980s, life expectancy in the former West Germany trailed the United States by fully 17 months (and, of course, East Germany was even further behind). A nation's life expectancy is a function of several key aspects of national well-being, and as such it is a useful reality check on purely money-based economic rankings. In particular, it tests a nation's ability to provide its citizens with decent health care.

Trade. Germany's trade performance over the longer term has been nothing short of spectacular. From 1998 to 2008 the German current account went from a deficit of $5.9 billion to a surplus of $267.1 billion. The contrast with the United States could hardly be starker: The American current account deficit shot from $233.8 billion in 1998 to $568.8 billion in 2008.

Innovation. Germany is a leader in key new technologies, including renewable energy such as solar and wind power. Germany is also the political and economic driving force behind the Large Hadron Collider, the huge new European particle accelerator that is exploring some of the most fundamental questions in physics, and the resulting breakthroughs should redound disproportionately to Germany's advantage.

Jobs. Even in the case of unemployment -- a yardstick that for most of the two decades since reunification had been a major embarrassment for Berlin officials -- Germany is now doing better than many other nations. As of December 2009, the jobless rate, at 8.1 percent, was well below America's 10 percent.

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The idiosyncrasies of the German economic model are striking and in many ways, make it seem behind the times. Few Germans own credit cards, and cash is still king. Then there is the somber German Sabbath. Thanks to a powerful alliance of labor unions and religious conservatives, most stores remain closed on Sunday.

Even when the stores are open, their pricing is not always a case study in efficient markets. The other day in Berlin, for instance, I noticed that a 100-tablet pack of aspirin cost 15.95 euros. For this sort of money -- about $23 -- you can buy more than 20 times as many tablets in the States. American expatriates in Germany complain of a long list of similarly inflated prices for everything from guitar strings to Ziploc bags.

Such divergences from American expectations are merely the surface manifestations of a radically different economic culture. The German economy has succeeded because it remains decidedly German. That begins with the close relationship -- too close, in many American eyes -- between German banks and German industry. In the so-called *hausbank* ("house bank") system, most corporations have a long-standing, largely exclusive arrangement with one main bank. The hausbank owns significant stakes in many of its corporate customers and thereby exercises considerable behind-the-scenes influence.

Admittedly, the hausbank system is not as all-encompassing as it once was. In an effort to minimize conflicts of interest in its investment-banking operations, Deutsche Bank in particular divested key shareholdings some years ago. But as the Göttingen-based scholar Andreas Busch has pointed out, the significance of Deutsche Bank's policy change has been exaggerated in the English-language press. "One swallow does not make a summer," he says. "Deutsche Bank does not figure as large in the German economy as many foreign observers imagine. The burden of proof here lies with those who argue that the core of the system has been hit." He adds that the hausbank system is still central to the financing of many small and medium-sized enterprises (what in German are known collectively as the *mittelstand*). On Busch's figures, the mittelstand accounts for 70 percent of employment and about half of the total output of the enterprise sector.

Then there is Germany's notably labor-friendly employment system. Despite some regulatory relaxation in recent years, German workers enjoy much greater job security than do their American counterparts. As Herrigel points out, even in the midst of the current downturn, which has proved temporarily devastating for many manufacturing companies, there have been remarkably few layoffs. Instead, Germans have moved toward work-sharing via the *kurzarbeit* (literally, "short work") system.

Labor also enjoys a powerful voice in Germany's two-tier boardrooms. In the case of the largest corporations, half of all seats on the supervisory board are reserved for employee representatives. In most cases one of these employees is a management nominee, but the others are genuine employee representatives. Labor enjoys considerable veto power, and on key issues, its wishes can be overridden only if management and shareholders forge a completely united front. The board oversees and appoints a management board that runs day-to-day affairs.

As viewed by orthodox American economists, the patients are running the asylum. But few aspects of the German model seem more secure than this system of co-determination in corporate governance. German corporations have consistently increased their global market share over the years. In the steel industry, for instance, ThyssenKrupp now outproduces United States Steel 3 to 1. In the electrical industry, Siemens is a bigger exporter than ever, while General Electric long ago shuttered most of its American factories in a controlled retreat into outsourcing and diversification.

Then there is Germany's performance in the automobile industry. Volkswagen, Mercedes-Benz, Porsche, and BMW remain at the top of their game, even as Detroit has been brought to its knees. In the last year, a German government "cash for clunkers" program -- the model for the U.S. program introduced last summer -- proved highly effective in supporting domestic demand. In export markets the German carmakers really show their mettle. In a normal year, BMW, for instance, sells three times as many cars abroad as at home. Overall, the German industry accounts for a global market share of about 17 percent -- not bad for a nation with just 1.2 percent of the world's population. Admittedly, about half of German-brand cars are produced in foreign assembly plants, but such plants rely heavily on German-made components.

Even in services, where the American model is supposedly indisputably superior, German corporations don't seem at a serious disadvantage. In the airline industry, for instance, Lufthansa is still airborne after more than 80 years, while its once much larger and more powerful American rivals on the Atlantic route, Pan Am and TWA, have long been grounded. Lufthansa ranks sixth in the world in passenger miles and has been expanding by acquisition in

Austria, Switzerland, Britain, Belgium, and the U.S. (where it has bought a 15.6 percent stake in JetBlue).

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To be sure, not everything has been going swimmingly for the German economy. In particular, the German banking system has hardly emerged unscathed from the recent global financial earthquake. But how could it? After all, Germany now ranks second only to China among the world's capital-exporting nations. In that capacity it has had to recycle vast funds into capital-importing nations, including the two largest and most profligate, the United States and Britain. Given that both nations are suffering their worst financial strains since the Great Depression, Germany could not realistically have walled itself off from the world financial crisis. But the German banking system's domestic operations have remained relatively healthy. The two notable bank meltdowns -- Bayerische Landesbank and Landesbank Baden-Württemberg -- were caused by problems largely incurred abroad, in the American sub-prime mortgage market in the former case and in the derivatives market in the latter.

Of course, for all Germany's success by other measures, it has lagged in growth of gross domestic product. Between 1998 and 2008, it grew in real terms by an average of just 1.5 percent a year. By comparison, the United States grew by fully 2.6 percent. But these numbers are not meaningful without considerable adjustment. GDP growth is a function not only of rising output per capita but of population growth. Much of America's growth between 1998 and 2008 came from a cumulative population increase of 13 percent. By contrast, Germany's population rose by less than 0.3 percent. (Though American conservatives like to lambaste Germany for its super-low population growth, many Germans take the view that, in a world of scarce resources, slow population growth is less a curse than a blessing.)

Clearly we have to adjust for the population effect. When we do, we discover -- confoundingly, for American orthodoxy -- that on a per-capita basis Germany actually very slightly outperformed the United States between 1998 and 2008 (with growth averaging just less than 1.5 percent versus America's less than 1.4 percent).

For close observers like Herrigel of the University of Chicago, Germany's performance over the last decade has always seemed more solid than that of the United States. "The task of calculating U.S. growth in recent years has been greatly distorted by the financial bubble," he says. "Germany's growth has been a lot more healthy, and the wealth created has been much more sustainable."

For two decades now, German policy-makers have been wrestling with one of the most perplexing challenges in economic history: how to integrate the backward states of the old East Germany into a highly advanced First World economy. Along the way the authorities consciously chose to let economic growth take a backseat as they battled pressing political concerns. Most obviously they opted at the outset in 1990 to value the old East German mark at a 1-to-1 parity with the West German mark, fully aware that the consequence would be long-term unemployment in the East. But the decision achieved a crucial immediate political objective in forestalling a sudden, potentially highly destabilizing population lurch from East to West. The skills that older East German workers were equipped with, however, were useless in an advanced First World market economy and, with no case for paying such workers anything like West German wages, unemployment remained high for years. If any advanced nation has had an excuse for a subpar economic performance, it has been Germany.

Yet today, Herrigel says, "I have traveled very extensively in the country and it is everywhere very, very prosperous. There are no pockets of extreme poverty such as we have on Chicago's West Side. Many parts of America have conditions more like those in developing rather than developed economies."

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The secret of the German system's success is, in large part, a strong national commitment to advanced manufacturing. At last count the industry still made up about 20 percent of Germany's total output, compared with little more than 11 percent in the United States. The pivotal significance of a strong manufacturing sector is understood by virtually all thoughtful Germans even if it is scorned by many of America's most influential economists.

Pat Choate, a Washington-based author and longtime advocate of a strong American manufacturing base, points out that manufacturing can be -- and often is -- both far more capital intensive and far more know-how intensive than the advanced services such as software and financial engineering on which the United States has staked its future. "The Germans, like the Japanese, have a structural advantage," Choate says. "They have concerned themselves with the structure of their economy, while we have been indifferent. It would be unthinkable for the German government to facilitate the outsourcing of industry as the Clinton and Bush administrations did."

Choate adds that German manufacturers enjoy a key advantage in research and development thanks to close links with universities. "The German system of research institutes goes back to the Kaiser Wilhelm institutes of the 19th century and continues today," he says. "Germany is a major source of basic research and then practical development. We got a boost before and after World War II when so many of their scientists came here, but we have failed to link our research universities with industry as ... the Germans [have]."

Meanwhile, on examination, many of Germany's economic failings turn out to be strengths in disguise. Take, for instance, the almost complete absence of credit cards. This is generally taken by American observers to be merely a reflection of an antiquated German economic culture. But Luigi Guiso, a Florence-based expert on economic culture, points out that there is probably more to it than this. As a matter of policy, the German banking system has hindered the rise of credit cards and has instead promoted debit cards. Credit cards reduce the savings rate whereas debit cards boost it, providing German banks an abundant source of funding to support their corporate clients.

All this makes more sense when you realize that in many areas of advanced manufacturing, the global economic cycle is particularly severe. Thus, even the most capably managed companies sometimes need considerable financial support to ride out downturns. This is where Germany's continuing high savings rate comes into its own. The savings are disproportionately channeled -- via Germany's bank-dominated system of patient capital -- into supporting advanced manufacturers. These then typically come back stronger than ever in the next up-cycle. By contrast, their competitors in nations like the United States and Britain have too often had to fend for themselves. Over the last half century, each succeeding recession has left American and British manufacturers more financially exposed. As a result, Germans have consistently increased their market share in advanced manufacturing. There is a long list of specialty items in which even remarkably small German makers now dominate world markets. Examples run the gamut. Windmoeller & Hoelscher, for instance, enjoys a 90 percent share of the world market for machines that make heavy-duty paper bags. Achenbach Buschhütten has a similar share of the world market for aluminum-rolling mills. Herbert Kannegiesser dominates the world market for hotel laundry equipment.

Although most economists of the Anglo-American tradition regard Germany's job-protection arrangements as a major competitive disadvantage, these represent yet another way in which the German model is focused on the economy as a whole. From the point of view of a shareholder interested merely in short-term profits, it may be inconvenient that a corporation cannot readily lay off workers in a downturn, but for the whole economy, the result is clearly to dampen the negative effects of the economic cycle.

More important, because workers enjoy considerable job security, it is much easier for management to introduce new, more efficient production technologies. Workers tend to embrace new technologies as the best way to ensure their job's long-term viability. Moreover, the infrequent worker turnover at German companies is a key reason why German employers are willing to invest heavily in employee training. As Herrigel points out, there is far less risk than in the United States that workers will take their skills to a rival employer. "Germany has constructed a whole system to prevent poaching by rival employers," he says. "There is no such thing as free riding, whereby an employer can poach away workers by offering them a few pennies more per hour. The whole German economy depends on skilled labor, and there is a robust program of vocational training in which every employer participates."

Even the co-determination system works well. Although in theory workers might be tempted to use their boardroom power to award themselves unrealistically large wage hikes, in practice this rarely happens. Instead, workers take a moderate approach in the interests of their employer's long-term health. The result is that German corporate executives generally regard co-determination as an aid and not a hindrance as it helps ensure worker flexibility when work procedures need to be changed or tasks reassigned.

One of the more consequential effects of co-determination is on corporations' outsourcing policies. Where the most sophisticated production technologies are concerned, workers have a strong interest in preventing technology transfers abroad, which are rightly seen as undermining the viability of jobs at home. In opposing such transfers, workers are acting precisely in the national interest. By contrast, the American model, in which companies like IBM, Boeing, and Hewlett-Packard readily transfer even many of their most advanced production technologies to foreign subsidiaries, clearly hastens the demise of American economic leadership.

German labor tends to respond resourcefully in the face of outsourcing threats. Herrigel cites the example of one engineering company he studied, which cancelled an outsourcing plan after consultation with workers. "This was a company that made huge ball bearings for the shipbuilding industry, and the task of polishing and assembling the bearings was considered too labor intensive for German workers," he recalls. "As a result of works-level consultation, however, the trade union suggested new, more efficient work procedures that made it preferable to retain the entire production in Germany."

Perhaps the ultimate proof that all this adds up to an extraordinary engine of economic success is in Germany's export performance. In 2008, for instance, German exports reached fully $1.49

trillion, which comfortably topped America's $1.27 trillion. Put another way, on a per-capita basis Germany out-exported the United States by more than 4 to 1 ($18,200 per capita versus $4,160). Wolfgang Lutterbach of the German Confederation of Trade Unions puts it succinctly: "How can we be champions in so many international markets and not be efficient?"

As of 2010 the Germans are evidently more efficient than ever. David Marsh, a London-based consultant and author of *The Bundesbank: The Bank That Rules Europe*, sums up the story: "After the reforms of the last decade -- but also after the setbacks of the credit crisis and ensuing recession -- the German model has emerged in better shape than before, to face the exigencies of global competition. About 90 percent of the German model -- crucially, the web of understandings between different sections of business, employees and government -- has survived intact."

Correction: Due to an editing error, the following line, "In 2008, for instance, German exports reached fully $1.49 trillion, which comfortably topped America's $1.27 trillion," read billion, rather than trillion.

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