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How clean was the slate? Some notes on the Olsonian view of the postwar German economic miracle

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How Clean Was the Slate?
Some Notes on the Olsonian View of
the Postwar German Economic Miracle*

by
Karl-Heinz Paqué

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This paper is no more than a critical comment on Mancur Olson's interpretation of the exceptional growth performance of the West German economy in the 1950s. The main point of our critique is that Olson's theory - though elegant and intriguing in its own right - places the emphasis on factors which are relevant in a fundamental theoretical sense, but which can hardly figure as the core of an explanatory account of the observed growth pattern in the post-war period and in later times. In fact, a different, more narrowly economic framework of interpretation is proposed in which the Olsonian factors are put in proper perspective.

The paper is divided into three parts. In part 1, we summarize the main tenets of the Olsonian theory and their empirical implications. In part 2, we confront this theory with the facts of post-war Germany. In part 3, we propose our own interpretation of these facts and draw some wider conclusions.

1. The Olson Hypothesis

In his seminal book *The Rise and Decline of Nations* (1982)¹, Mancur Olson develops a specific theory of economic growth, which is in essence an application and extension of the theory of interest groups, collusions, and distributional coalitions of his book *The Logic of Collective Action* (1965).² With some courageous simplifications that are justified only with regard to the particular topic and purpose of this paper, the core of this LOCA/RADON-theory of growth may be summarized in four propositions, of which the first goes back to LOCA, the remaining three to RADON.

- 1. Selective incentives:* Due to standard free-riding problems, the existence of a large group with a common interest does only give rise to collective action in the pursuit of its interest if the group can provide sufficient selective incentives for the individuals to contribute to the provision of the respective public good.

¹ In the following paragraphs abbreviated as RADON.

² In the following paragraphs abbreviated as LOCA.

2. *Time and stability*: As the provision of selective incentives (with appropriate arrangements of coercion) takes time and requires a more or less constant institutional setting, stable societies with unchanged boundaries tend to accumulate ever more distributional coalitions (collusions and organizations for collective action) over time.
3. *Efficiency*: On balance, distributional coalitions reduce efficiency - both in static and dynamic terms - through a variety of channels; in particular, they are relatively slow decision makers, which tend to fix prices rather than quantities, they seek to pursue egalitarian aims, they slow down societies' capacity to adjust to new technologies and to reallocate resources accordingly, and they favour extensive regulation and government intervention.
4. *Encompassment*: To the extent that the relevant distributional coalitions are encompassing, their group interests tend to coincide with society's interests so that, economically speaking, the negative externalities are internalized and the efficiency loss is avoided.

These four hypotheses together form the core of a genuine theory of economic efficiency and growth of geographical and political entities, or, more poetically, of the rise and decline of nations. According to this theory, economies prosper whenever they are relieved from the burden of collective action of interest groups by whatever exogenous shocks (e.g. a revolution, a war) that destroy the traditional network of collusive arrangements and distributional coalitions. Conversely, they suffer in the course of the gradual (re)building of this network in extended phases of political and social stability. They are spared this process of sklerosis if, from the start, the relevant distributional coalitions are encompassing.

So much for the main elements of Olson's theory and their general implications for the link between what might be called the degree of distributional or institutional sklerosis of a country and its growth performance. It is important to realize that Olson regards this degree of sklerosis not just as another explanatory variable to be put side by side to a long list of others, but rather, econometrically speaking, as the deep cause that drives economic growth, with all other factors either being virtually irrelevant (such as, e.g., the availability of raw materials and natural resources) or in the last resort being an (endogenous) consequence of the particular institutional setting (like, e.g., the level and speed of physical and human capital accumulation).³

³ See, most clearly, his critique of the new growth theories in Olson (1993).

As it stands, Olson's theory is an impressively parsimonious construction which, if successful, would really conform to Milton Friedman's celebrated methodological postulate that social scientists should aim at explaining much by little.⁴ Its internal logic is impeccable - not least because it is based on the solid ground of well-established public goods theory. Thus the propositions 1, 3 and 4 appear to be fairly easy to swallow for an economist accustomed to applying the strict criteria of constrained optimization not only to firms and households, but also to whatever coalitions or collusions.

With proposition 2, things are somewhat different and more problematic, because it involves a very powerful premise that does not follow from standard economic reasoning, namely that the provision of selective incentives takes time. *Prima facie*, this may appear to be a completely innocent truism because any institutional arrangement involving a large number of participants seems to require extended organizational efforts to mature. On closer inspection, however, it becomes hard to recognize where precisely the economic reasons for collective action lagging behind the respective collective interest should be located, and what the quantitative dimension of the lag should be (a year? a decade? a century?). As so often when lags enter the picture in economics, the matter turns out very fuzzy, and Olson does not provide any systematic guidance on the issue

In his *RADON*, Olson presents some empirical observations to support his view, but these are not really convincing - less because they are casual, which can hardly be avoided given the broad nature of the issue, but rather because they do not separate and isolate the (Olsonian) gradual extension of collective action from the (non-Olsonian) growth of the collective interest itself. E.g., Olson's most prominent example for the time-consuming nature of forming distributional coalitions is the gradual rise of unionization in the 19th and 20th century in the major European countries and the United States.⁵ However, this very rise allows two conflicting interpretations: an Olsonian one - implicitly assuming that the collective interest was there in the first place, but took much time to be translated into collective action due to the difficulties of providing a rational set of selective incentives - and a more standard non-Olsonian one - assuming that it was the collective interest itself that took much time to grow more or less *pari passu* with the process of industrialization and, as a mere consequence, collective action rose

⁴ See Friedman (1953).

⁵ Olson (1982), pp. 38-40.

slowly as well. To us, the second interpretation looks somewhat more plausible because, historically, unionization appears to be closely linked to the growing quantitative importance of an 'urban class' of skilled workers who were not easily substitutable either by unskilled labour from the rural hinterland or by machinery equipment (to which they were complementary precisely because of their skills). In fact, at least in Germany, unions were founded first in those branches of economic activity where this skill-based monopoly power was relatively high like, e.g., book-printing. In this interpretation, the slow rise of unionism becomes a mere reflection of the rise of skill-based monopoly power and the concomitant rise of the returns to collective action, not of a gradual victory over the difficulties of organizing a collective action that was profitable from the start.

It is important to recognize that these two divergent interpretations have also vastly different empirical implications for the crucial experiment of a wholesale destruction of distributional coalitions (due to, say, war, occupation, revolution etc.). If it is the returns to collective action themselves that matter, then the institutional void will end as soon as the interests that prevailed before are reestablished, with the appropriate selective incentives to back up collective action following suit without significant delay. There will be no slow and protracted attempts to rebuild the network, but rather a once-for-all shift back to the old institutions (or the 'modern' substitutes for them), if the interests remain unchanged, or no such institutions at all, if the interests have been removed. Only if they gradually reemerge will there be a process of sklerosis, and the relevant story to be told will then be one of a genuine shifting balance of interests in society, not one of 'distributional lacunae' and, for that matter, 'institutional hysteresis'. It is then not quite an Olsonian story. If, in turn, it is not the returns to collective action, but the (free-rider) problems of setting up a viable system of distributional coalitions which prevents the reemergence of powerful interests in politics and in the economy, then - and only then - the story is to be told in Olsonian terms.

In our view, it is a serious shortcoming of a LOCA/RADON-theory of growth that the important proposition 2 is neither theoretically substantiated, nor supported by any powerful piece of evidence. In fact, Olson does at no point make a clear-cut distinction between the two kinds of sklerosis we described above. This is important to keep in mind when dealing with the empirics of the matter in the following paragraphs of this paper.

2. Olson's Theory and the West German Facts

An Olsonian account of West German economic history after World War II could be summarized in basically three propositions: (a) Through Nazi-dictatorship and war-time physical and social destruction and the subsequent Allied occupation of the country, the traditional network of distributional coalitions in Germany was fatally weakened in the decade or so after the war so that the economy could for a while grow unburdened by the static and dynamic efficiency losses induced by institutional sklerosis. (b) To the extent that the distributional coalitions reappeared early on, they did so in a much more encompassing form that helped to prevent a persistent divergence between the respective coalitions' and society's interests to emerge. (c) Over time, the economy was gradually subjected again to the growth-impeding network of distributional coalitions which typically gain ground in stable societies; thus, after all, the German miracle began to fade from the 1960s on. In the following paragraphs, we shall not provide a rich and robust test of these propositions. We shall rather confine ourselves to some major facts and interpretations that shed light on the *core* of the matter.

(a) *A liberation from interest groups?*

Any serious discussion of the role of World War II as a historical watershed of whatever kind must first recognize the fact that, in its most fundamental legal, political and economic characteristics, the Bonn republic as it emerged through the reestablishment of a market economy in 1948 and a parliamentary democracy in 1949 was - first and foremost - a descendent of the Weimar republic of 1919-33. This is not to say that there may not have been substantial differences between the two, which may also matter in the sense of Olson's theory; it is to say, however, that the basic point of reference and even the starting-point for deliberate deviations were the Weimar institutions. In this sense, *both* the Nazi period and the Allied occupation with their systems of administrative control of political and economic life were pauses - though very different ones - in an otherwise continuous tradition. Both left traces that changed the track of German society for good; but for neither can it be claimed that they influenced the institutional framework of later West Germany more than the 'hysteretic' shadow of the Weimar republic did. After all, the great institutional transformations in Germany had happened at earlier times: politically from autocracy to democracy towards the end of World War I, legally to a modern 'Rechtsstaat' with an elaborate national system of codified private and public law in imperial times, economically

towards a 'corporatist' industrial society with a prominent role of collective bargaining in the early 1920s. Thus there was never really an institutional void that had to be filled with newly invented laws, a situation many post-socialist countries of eastern Europe face today - notably the successor states of the Soviet Union that were not yet parliamentary democracies and market economies in the interwar period. For the Allies and the Germans after the war, it was more the question whether, when and to what extent the pre-Nazi regime would be re-implemented, and which particular changes would have to be made to avoid some most unfortunate developments of the Weimar period.

In this respect, it is of course the period of Allied occupation from May 1945 until the economic liberalization in June 1948 and the election to the first federal parliament in September 1949 that deserves careful examination. Taking a bird's eye view of this period, it is remarkable how much scope and leeway for collective action the Allies (always excluding the Russians in the eastern zone that was later to become the German Democratic Republic) left to newly founded or re-founded German interest groups, and how strongly these organizations represented their traditional pre-Nazi interests. Politically, this can be explained by the specific aims of the Allied forces: after a first virtually complete standstill of German political and economic activities in mid-1945 right after the end of World War II, the country was simply to be put to work again, and this was to be done without reactivating a Nazi influence; for this purpose, the extensive use of personnel and expertise of pre-Nazi vintage and origin was obviously indispensable, and the price to be paid in terms of a resurgence of lobbies, coalitions and collusions was viewed to be bearable as long as no overly centralized German organization could challenge the Allies' internal enforcement power.

In the light of Olson's theory, three types of organizations stand out in importance as distributional coalitions: political parties, unions and business associations. All three reemerged early on with ideas, ideologies, practical purposes, and a personnel that were in full continuity to Weimar times.⁶

Let us first look at political parties. The major left-wing parties - the Social Democrats and the Communists - were able to reestablish the core of their party organizations by early 1946, and they did so in more or less the same highly

⁶ For an authoritative account of the resurgence of these organizations after World War II, see Eschenburg (1983), pp. 171-218.

centralized institutional form as before: only in the first few weeks and months after the war did Allied restrictions force them to confine their refounding activities to the local level. The main reason for the fast reactivation of these parties was their thorough opposition to the Nazi-regime and, ironically, the rather strong persecution they suffered in the twelve years of Nazi-dictatorship: condemned to the existence of underground movements, both parties and their membership developed a sophisticated infrastructure of clandestine activity, which could rather easily be turned into an official political organization as soon as the Nazi regime was over. Economically speaking, these parties had not to incur any substantial start-up costs of collective organization, and as their membership had developed and conserved a strong feeling of ideological identity as well as mutual trust and understanding - typical for left-wing movements that in imperial times grew out of a persistent opposition to the ruling class - there were simply no obstacles to a genuine organizational restoration. As to the personnel, there were losses due to the Nazi persecution and the war, but, nevertheless, virtually all major personalities of post-war social democracy and communism in West Germany were well-known politicians from the Weimar republic (including the charismatic and influential first post-war leader of the Social Democrats Kurt Schumacher).

On the conservative and liberal side of the political spectrum, the process of organization took somewhat longer, but probably not more than roughly two years: when, by early summer 1947, all newly established states (Länder) had held their first post-war election of state parliaments, the new party structure had already taken shape, with the dominant political forces being the Christian Democrats, the Social Democrats and, to a lesser extent, the Free Democrats, which were all to remain the major political parties for the next four decades. Unlike in the case of the Social Democrats (and, for that matter, the Communists), however, the new organization of conservative and liberal forces involved a process of consolidation: contrary to the Weimar republic, both political liberalism and conservatism were to be united under two 'umbrella parties' that were to bind together different ideological wings, which had been represented by different parties in earlier times.

In the case of the liberals, the consolidation involved the merging of a more right-wing nationalist version of liberalism that had its strongholds in northern and north-western Germany, with a more left-wing southern version. In the case of the conservatives, it involved above all the merging of the core of the catholic party

'Zentrum', which had grown out of the resistance against protestant cultural dominance in imperial times and which had its strongholds in the catholic parts of western and southern Germany (notably in the Christian labour movement of the southern industrial heartlands) with the more protestant conservatism of northern Germany. While some splinter parties of the old Weimar tradition survived for a while (including a shadow version of the old 'Zentrum'), the newly founded umbrella organizations were basically successful in uniting the two respective political movements and thus laid the ground for their cooperation and in fact coalition in successive federal governments. In this respect, there was a shift towards more encompassing political organizations in the Olsonian sense.

Note, however, that this shift towards encompassment did *not* arise out of anything like a genuine institutional void, and was not a consequence of Allied pressure. (If anything, the Allies still favoured relatively weak parties that did not endanger their monopoly of power!) Instead, it had much more the character of a deliberate lesson learned from the poor record of parliamentary instability of the Weimar period: precisely because the main personalities behind the refounding of the parties had been active politicians in the Weimar period - some of them like the later chancellor Adenauer even in imperial times -, they did vividly remember the deficiencies of the Weimar system with its dominance of political splinter groups, its lack of party discipline, its fragmented parliament and its weak executive. This did not only lead to the introduction of strong safeguards for stable government in the later constitution (such as, from the second federal election on, the use of a 'five-percentage clause' to limit the number of parties in parliament in a system of proportional representation); it also gave party founders a strong sense of urgency to overcome sectarian interests and ideologies and to bundle political forces. In this sense, it was precisely *not* the historical discontinuity of a lost war and Allied occupation that favoured a salutary change, but the continuity of historical experience and the memory of a brave 'ancien régime' whose construction principals and democratic culture had turned out to be severely deficient in practice.

So much for the political parties. As to business and employers' associations, the process of refounding took much longer - mainly because the Allies were particularly cautious in allowing official links between private firms in view of their political aim to restrict German economic power and at any rate not to support tendencies towards a re-cartelization. In fact, most industry-wide associations and their two major national umbrella organizations - the 'Federation

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of German Industry' (BDI) and the 'Federation of German Employers' (BDA) were founded right after the new West German state had taken shape in autumn 1949 - and with it the so-called principle of autonomous wage bargaining which assigned again a prominent role to collective negotiations.⁷

Nevertheless, it would be misleading to regard the occupied post-war German economy in the years 1945-48/49 as a place where the traditional links of communication and coordination between private firms had been cut off. Rather the empirical picture is one of an implicit transfer of these functions from the former associations to the chambers of industry and commerce, i.e. to those 'classical' corporatist institutions which had been founded in the mid-19th century and which were essentially service agencies to provide business with advice, information, contacts to local and regional authorities and, if necessary, with a lobby voice in politics. These typically German organizations, which had (and still have) a semi-public status and therefore can recruit members on a compulsory basis within their officially defined realm of activity, have always been well-known for the relatively high quality of their staff and a wide-ranging influence in administrative matters. This is why, from the very beginning, the Allies were unable to bypass these organizations, which had survived Nazi-dictatorship more or less intact and thus had conserved their stock of knowledge concerning the working of the German economy down to the nitty-gritty legal and administrative details on the local level. As far as major Nazi-party members had held important positions in the chambers, they were exchanged, but this did hardly touch upon the basic infrastructure the chambers provided for business. Of course, it is very hard to evaluate to what extent the chambers could really serve as valuable substitutes for standard business associations; however, their very activity indicates that the 'pause' of Allied occupation was after all not a genuine discontinuity of business coordination and communication. In fact, the swiftness with which employers' associations and the federation of German industries took over their specific interest group tasks in the newly founded Federal Republic of the early 1950s does not give the impression of a set of organizations that starts anew and still searches for an identity and a specific purpose. It rather looks as if the ground was very well prepared at that time, and that business organizations took over again their well-defined traditional place.⁸

⁷ Note that, until the second half of 1948, wages were controlled anyway.

⁸ On the matter of continuity of business interest groups during Allied occupation, see Homburg, Schüssler (1977) quoted in Eschenburg (1982).

As to the re-emergence of unions - certainly the most prominent type of distributional coalitions in Olsonian theory - the record looks very similar to that of the left-wing political parties after the war (notably the Social Democrats): a very fast reconstruction of the basic organizational structure under the guidance of personalities who had played major parts in the labour movement of the Weimar republic (notably Hans Böckler) and who had survived the Nazi-period in underground activity. Due to their consistent opposition to the Nazi regime, the unions were viewed very favourably by the Allies - above all by the union-friendly British labour government - and they were accepted as an important pillar of a new German economy and society. On a local level, constituent meetings of unions took place as early as summer 1945, and a conference of union deputies of the British zone (which included the industrial heartland of the Rhine/Ruhr-valley) was held in December 1945. At this conference, the basic principles of organization of unionism in Germany were laid out in a first statute, which was approved by the British in January 1947. In the American zone, the development was a bit slower and a bit more decentralized - no genuine zone-wide organization was permitted to operate - but except in Bavaria, all major industrial unions were established in these regions in the course of 1946 (in Bavaria not before spring 1947). Interzonal conferences of unions were held regularly from December 1946 on. In addition, union membership grew very fast: in the first full year of its existence (1950), the DGB had 5.5 mio. members - two years later even about 6 mio. - which amounted to a higher density rate than at any time up to the present.⁹ In short: at least with respect to the quality and the degree of organization, it is very difficult to uphold the view that German unions were in any sense weak for more than a very brief initial period of Allied occupation.

In a much more narrow sense, however, the unions were handicapped by a very mundane event: the virtual destruction of their strike funds through the currency reform of June 1948. For a while - maybe something like one or two years - most unions were simply not financially potent enough to carry out any major strike, and that may well have contributed substantially to a rather smooth working of the bargaining process and relatively modest wage settlements.¹⁰ However, this more financial constraint falls well short of any more fundamental weakness of the

⁹ In 1950-52, about 38-39 per cent of all employees were organized in the DGB, a share that gradually declined to roughly 30 per cent by the mid-1960s and - after a sharp rise in the early 1970s - levelled off at about 33 per cent. If the union of white-collar workers (DAG) and the small christian unions are included, the density rate was somewhat higher throughout, with about the same intertemporal pattern. For statistical details, see Hemmer, Schmitz (1990).

¹⁰ See Giersch, Paqué, Schmieding (1992), p. 73.

unions' position that could help to explain a larger chunk of the beginning West German economic miracle of the 1950s. After all, with unions being organizationally strong, one might then have expected sharp wage increases and labour conflicts as soon as the strike funds were filled again, and this did obviously not happen.

If unions were not in any sense weakened, the focus of an Olsonian defence may shift to structural changes in their organization that might have made them less militant in their pursuit of group interests. Just as the liberal and conservative parties, they may have become more encompassing.

(b) *Encompassing unions?*

Historically, there were three major attempts of the unions after World War II to make their organizations more encompassing. The first and most radical one was to establish one 'central union' (Zentralgewerkschaft) comparable to the Swedish LO that was supposed to carry out wage negotiations on a nation-wide basis in the future. These efforts failed because of Allied resistance against any such large-scale concentration of power in whatever hands. Recognizing the Allied veto as insurmountable, the union leaders (notably their inofficial chairman Hans Böckler) settled for a construction of autonomous industry unions under one umbrella organization, which then later became the DGB. As its predecessor in the Weimar republic, the ADGB, the new umbrella organization did in general not have a mandate to conclude wage agreements so that the actual economic clout remained with the industry unions, among them the large metal workers' union (IG Metall, the largest industrial union in the world), which was to play a dominant role as a pacemaker in the mostly annual bargaining rounds all over the following four decades. As the ADGB in the Weimar republic so the DGB grew into the role of a political arm of the union movement that coordinated general aims and targets without interfering into actual bargaining matters. Hence, in this respect, the discontinuity to earlier times appears to be not very significant.

The second attempt was to replace the Weimar-type crafts-based unions by strictly industrial ones. In this sense the union leadership was fully successful and not much controversy arose about this shift of organizational principles.¹¹ The main reason for the smooth transition was that, in the early 1930s, there had already been a consensus on the necessity of this kind of reform, but the rise of Hitler and

¹¹ See Hemmer, Schmitz (1990), pp. 27-28.

the subsequent suppression of the union movement prevented its being realized. On first glance, this post-war reform seems to be a far-reaching step in the Olsonian sense towards a more encompassing representation of interests.¹² However, the extent of the organizational innovation should not be overrated because major branches of industry had adopted a factual industry organization of labour for a long time. E.g., metal workers, who at times made up 30 per cent of all union members in the Weimar republic, were organized in the 'German Metal Workers Union' (the predecessor of the IG Metall and already at that time the largest single industrial union in the world, and a bargaining pacemaker!), which was founded in 1891 as an industrial union and which carried out its collective bargaining consistently on an industrial basis. Of course, the backbone of this union (as of all others) were skilled workers, who made up about 2/3 of the membership, but actual negotiations covered all skill groups (including unskilled and semi-skilled workers).¹³ Hence, after all, the gap between the Weimar and the Bonn collective bargaining culture was probably much narrower than, say, between the traditional crafts-based British and the German system, be it of the Weimar or the Bonn variety.

The third attempt was to absorb various smaller unions of different ideological standings - notably the more conservative Christian and the tiny liberal ones - as well as the union of white collar-workers in the mainstream of the DGB. In the end, after painful deliberations, this attempt failed mainly because the large DGB quickly developed an identity of blue collar-worker representation with strong political sympathies for reformist socialism, i.e., in the range of the German party system, for social democracy.¹⁴ Hence, just like in the Weimar republic, the union movement did remain split although it is fair to say that the relative weight of the dominating blue collar-umbrella organization, the DGB, was becoming even more decisive than it used to be in Weimar times with respect to the ADGB. In any case, it is unclear whether and to what extent all this had substantial influence on bargaining, because neither the DGB nor the ADGB concluded collective agreements; most likely, it did have some influence on the political voice of the unions which may have been somewhat more homogenous in the last four decades than it used to be in the Weimar republic.

¹² See Olson (1982), p. 49.

¹³ For details, see Hartwich (1967), pp. 70-72.

¹⁴ After a brief period of merger with the DGB, the christian unions split off in the early 1950s as they did not recognize their more conservative stance sufficiently represented in the official union position. As to white collar-workers, a separate nation-wide union (the DAG) was founded in 1949 after unsuccessful negotiations with the DGB.

To sum up, there were certainly trends towards a more encompassing union organization in the early post-war period, but it is hard to see anything revolutionary in them. They appear to be more like the final conclusion of developments that had been well under way in the Weimar republic. In any case, there was no sharp 'Olsonian' discontinuity that may explain a dramatic shift from aggressive wage demand based on narrow group interests towards moderation in the interest of the whole economy.

Note that there was in fact one institutional change in the legal framework of collective bargaining from Weimar to Bonn which, in our view, was much more important than the more marginal shifts of union organization: the end of compulsory arbitration.¹⁵ Whereas, in the Weimar framework, an industrial dispute could be settled by a rather complicated procedure which culminated in a compulsory arbitration under the auspices of the Federal Minister of Labour, the new law on collective bargaining of 1949 did not contain any such provisions of state intervention in industrial disputes. Again, the explicitly wide interpretation of private bargaining autonomy was a consequence of the bad Weimar experience with this system, which uprooted the whole bargaining framework: instead of being used as an instrument of last resort, it actually removed the pressure for agreement from the parties and thus induced them to carry on with maximalist positions and to speculate on the arbitration's likely bias. In all major industries, at least half of the 'agreements' in the later years of the Weimar republic were implemented via compulsory arbitration.¹⁶ Nevertheless, industrial relations remained bad, not least because most compulsory agreements were explicitly disapproved by one party, in the majority of cases the employers' side, sometimes even by both parties. The employers' associations regularly claimed that the arbitrations had a bias towards labour interests, which was in fact plausible because the labour ministry was always headed by union members with a strong affiliation to either the Christian or the social democrat labour movement.

¹⁵ In all other respects including, e.g., special provisions concerning the possibility of declaring a collective agreement generally binding under specific circumstances - the legal frameworks for collective bargaining of the Weimar and the Bonn republic are remarkably similar. See Paqué (1993a).

¹⁶ See Hartwich, pp. 418-420; for a detailed account of the Weimar experience with compulsory arbitration, see Bähr (1989).

It is important to realize that this institutional change and its likely consequences is out of the scope of Olson's theory. If anything, his theory would predict the removal of compulsory arbitration to have a negative impact on growth because it dissolves a link of the behaviour of distributional coalitions to the public interest via government intervention. Sure enough, however, this matter is very complex and certainly not at the core of Olson's theory.

(c) *Worsening distributional sklerosis over time?*

If it is difficult to defend the view that there was a wholesale demise of distributional coalitions after World War II, it is equally difficult to identify an Olsonian process of sklerosis thereafter: once established, interest groups were able to lobby for their purposes just as well in the early 1950s as in later decades. This is particularly obvious for unions because the framework of collective bargaining remained remarkably constant over time, with only a very few labour law extensions and court decisions specifying the conditions of strikes and lockouts that changed over time due to technical progress and the ever more perfect logistics of firms. At any rate, these changes cannot remotely explain the vast variations in wage behaviour between the 1950s and the 1980s on one side - with a persistent decline of real unit labour costs, but different unemployment records - and the first half of the 1970s when labour costs rose sharply and aggravated the labour market plight and the growth slack.

Note that rejecting an Olsonian process of sklerosis as an explanation does not imply rejecting any explanation of the relatively poor growth record of later decades on basis of some sort of sklerosis. In fact, the German economy was gradually subjected to an intricate network of regulations and administrative red tapè that was apt to leave traces in the growth of productivity - though it is of course very difficult to quantify any such effects econometrically due to the extremely complex channels of causality through which a process of sklerosis works. However, it is to mean that such a sklerosis was not Olsonian in the sense that it grew *pari passu* with the clout of distributional coalitions; rather it reflected for a large part a general trend towards bureaucratization, which was present in other western countries as well independent of their immediate post-war destiny, and which calls for a more general theory in terms of the 'bureaucratic translation' of certain consumer preferences (e.g. for a clean environment) into actual policy practice.

3. *An Alternative View*

In part 2, we made clear that we do not interpret the German post-war experience as 'caused' by weak distributional coalitions in the Olsonian sense. However, this does not mean that we regard the behavior of interest groups as irrelevant. We rather think that the driving forces of the miracle have to be located in a non-trivial sense on the supply side of the economy and the particular pattern of specialization of German industry, with interest groups simply being overrun by a long series of unanticipated positive shocks, which had positive persistence effects¹⁷ - just as the successive shrinkage of industry in the mid-1970s, the early 1980s and the early 1990s had or will have negative persistence effects. Hence, even in a roughly stable institutional setting, there may be vastly different growth performances and vastly different experiences of unemployment persistence and employment growth.

To clarify the major line of our reasoning, let us briefly retell the story of the German economic miracle in our own terms¹⁸ and then draw some more general conclusions.

(a) *Interpreting the miracle*

In our story of the German post-war revival, it is convenient to distinguish between three periods, namely the 'post-war misery' (mid-1945 - mid-1948), the 'early reconstruction' (mid-1948 - mid-1950) and the 'miraculous growth' (mid-1950 - ca. 1957).

Mid-1945 - mid-1948

These three years were closest to an Olsonian institutional void. However, contrary to Olson's interpretation, we take it that this void was filled rapidly and decisively under the auspices of the Allied forces. With a grain of salt, one may even speak of a wholesale institutional reconstruction, with a few deliberate changes, notably some more encompassing political parties, a bit more

¹⁷ In the sense of Lindbeck, Snower (1986) and Blanchard, Summers (1986).

¹⁸ This will be an extremely condensed version of the extensive account in Giersch, Paqué, Schmieding (1992), pp. 45-87.

centralization in unionism, some significant moves towards a more balanced federalism, and - a few months later - the introduction of a less interventionist collective bargaining system than the one in the Weimar republic. These changes were certainly facilitated by the presence of the Allies and their final say in all de facto-constitutional matters; to a large extent, however, they were also genuinely German lessons drawn from the surviving political élite of the Weimar republic. In one important respect, the Allied occupation is likely to have made a big difference: the timing and the radical shape of the currency reform, including the establishing of an independent central bank. While there was a strong German ordoliberal lobby in favour of full-scale liberalization of prices and for a sharp cut in the money supply, the political struggle about these matters would probably have been much more protracted in the absence of an Allied 'superpower'.

It is remarkable that, in their liberalization parts, the reforms of mid-1948 were in effect a reconstruction of the Weimar *market* economy, not the creation of something new. Of course, for the people in the midst of post-war misery, it was a huge step forward - and the ordoliberal literature coined the catchy name social market economy, thus nurturing the general feeling that a completely new system was founded. At base, however, the reforms did no more than remove the economic heritage - monetary overhang, price controls - of the Nazi-dictatorship. The skeleton of the welfare state remained basically the same as in Weimar - of course, supplemented by a host of special provisions to deal with specific post-war problems such as the reintegration of refugees.

Mid-1948 - mid-1950

These two years - roughly from the currency reform in 1948 up to the beginning of the Korea boom in early summer 1950 - were the time of rapid economic reconstruction and rapid economic structural change in response to the new liberalized price system, which brought a thorough reshuffling of the economy's resources to more efficient uses. In many respects, it was comparable to the post-socialist reallocation of resources in eastern Europe going on right now in countries like Poland, the Czech Republic or Hungary, but of course the task was much simpler because the destruction (in the broad sense) and the distortions had been much less severe in the first place. The war-time destruction turned out to be relatively harmless in economic terms, because, with appropriate economic incentives and the more or less undestroyed skill of the workforce, a large part of the physical equipment could be put to use again rather easily. In addition, the capital equipment was modern by all standards because the Nazi wartime effort

did, if anything, spur technological progress despite the manifold allocative distortions involved. Thus, economically speaking, the marginal productivity of repair investments turned out to be extremely high, much higher than the public and many specialists at the time anticipated.¹⁹ Note the crucial difference to today's post-socialism, where repair investments are on average much less profitable, because the capital equipment is technically old-fashioned and to a significant part economically obsolete. Hence the productivity head start that was given to Germany after the currency reform, is simply out of reach for Eastern Europe today. In the same vein, the distortions of the production structure were substantial in post-war Germany - notably due to an overcrowded agriculture which was flooded by refugees from the former eastern German provinces - but certainly not comparable to the deep traces of misallocation incurred by four decades of command economy.

It is important to realize that, by the term reconstruction, we do not mean anything like a deterministically natural process going on more or less independent of the major reform steps taken as the term has sometimes been used in the literature to question the importance of the liberalization measures in 1948.²⁰ We rather regard reconstruction as the immediate consequence of the reform package, which thus really obtained its ex-post justification, just as the dramatic liberalization measures in eastern Europe today are justified precisely on the grounds of the following adjustment process, how ever protracted it turns out to be. This is not to say, that any single point of the reform was absolutely necessary; it is to say, however, that a major step towards liberalization was required to unleash the forces for reconstruction and market-bound structural change.²¹

Unions acted very cautiously in this period which, from early 1949 on, was a time of cyclical consolidation, not of boom. As a consequence, business profits soared and created the leeway for the necessary self-financing in the absence of well-developed capital markets. At the same time, however, real wages grew quite fast - by almost 16 per cent in 1949 and roughly 8 per cent in the first half of 1950 - thus giving a quite satisfactory balance to union membership. As we argued above, however, the unions' weakness was more practically based on the lack of strike funds than on any organizational deficiencies in the Olsonian sense.

¹⁹ For details on the sharp productivity growth in this period, see Giersch, Paqué, Schmieding (1992), pp. 50-51, and Table 4.

²⁰ In this sense, Abelshauser (1975, 1979).

²¹ See Giersch, Paqué, Schmieding (1992), pp. 39-41 for a more detailed critique of the original Abelshauser hypothesis concerning the relevance of the 1948-reforms.

Mid-1950s - ca. 1957

Beginning with the Korea boom, the West German economy embarked on a growth journey that went clearly beyond mere reconstruction in the sense above. From a bird's eye view, it can be interpreted as a sequence of unexpected positive productivity and terms-of-trade shocks emanating most of all from West Germany's integration into the world economy. In fact, it was a process of re-industrialization that drove unemployment to virtually zero within a few year's time.

What were the driving forces of this process? As usual, there is a hen/egg-problem in identifying the ultimate causes of what appears to be something like a cumulative virtuous circle. Sure enough, it was not an internally engineered demand expansion by whatever Keynesian means since the government and the central bank took consistently a stability-oriented, non-activist stance in fiscal and monetary matters. Beyond that, however, a number of different causes appear to be relevant.

- (i) Germany was simply lucky enough to have a traditional pattern of specialization with a strong manufacturing industry that produced goods with a relatively high income elasticity in world markets., notably investment goods. This made the country the ideal supplier to export markets in times of worldwide investment booms. Thus, whenever times were to be 'good' in the world market in the first post-war decade, they would turn out to be even better for West German producers.
- (ii) Export demand met a very high supply elasticity, mainly because the German economy had a large labour supply of skilled and highly mobile workers - mainly refugees. In modern language, there was a large supply of first-rate outsiders, and despite the existence of a rather generous welfare state and unemployment benefits very similar to today's system, these outsiders were not 'trapped' in a low search intensity of long-term unemployment simply because, relative to their low reservation wage, the emerging industrial jobs were well-paid and highly productive.
- (iii) Unions remained relatively moderate in their wage demands, but not because they were organizationally weak. Other reasons appear to be more important to rationalize union behaviour. Firstly, until 1952, unions still pursued old syndicalist aims of co-determination that went back to the Weimar republic. These aims required much political lobby activity promising a rosy anti-capitalist future that made short-run sacrifices in terms of wage demands

did, if anything, spur technological progress despite the manifold allocative distortions involved. Thus, economically speaking, the marginal productivity of repair investments turned out to be extremely high, much higher than the public and many specialists at the time anticipated.¹⁹ Note the crucial difference to today's post-socialism, where repair investments are on average much less profitable, because the capital equipment is technically old-fashioned and to a significant part economically obsolete. Hence the productivity head start that was given to Germany after the currency reform, is simply out of reach for Eastern Europe today. In the same vein, the distortions of the production structure were substantial in post-war Germany - notably due to an overcrowded agriculture which was flooded by refugees from the former eastern German provinces - but certainly not comparable to the deep traces of misallocation incurred by four decades of command economy.

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look bearable.²² In this sense, it was precisely the old-style socialist radicalism of unions that prevented them from playing a more aggressive part in the capitalist play of collective bargaining for higher wages. Secondly, again in the early years, there was still a danger that the unemployment among refugees might politically lead to a right-wing backlash, which would have been counterproductive for unions' general aims and their prospective role in society. Thus there might have been a certain element of social responsibility due to the specific post-war problem setting. Thirdly - and in our view most importantly - unions were (as everybody else) repeatedly surprised by the waves of productivity growth and terms-of-trade improvements hitting the German economy. Again and again in cyclical upswings, there was a widespread belief that, now finally, the German miracle was running out of steam and that the expansion would dissipate in much more inflation and less real growth than last time. Not before the end of the 1950s did this belief become reality. In other words, the supply elasticity of the economy in view of unanticipated shocks was persistently underestimated so that wage increases, which looked not so moderate *ex ante* and which were demanded by unions with quite a bit of radical rhetorics, turned out well bearable *ex post*. Once the real expansion had taken place, however, the rationale for further wage increases had been reduced as well because more outsiders had become insiders and 'voted' for cautiousness within the unions. To be sure, the average wage increase of 8 per cent in nominal and 6 per cent in real terms *p.a.* in the 1950s was anyway so good by historical standards that it would have been very difficult for union leaders to activate the membership with academic notions such as a higher wage share in national income. In fact, some such attempts in the early 50s badly failed.

(b) *The role of institutions and distributional coalitions*

Let us be very courageous for the moment and simply draw some general conclusions from the German experience on the relevance of Olsonian and non-Olsonian factors in and after large-scale liberalization experiments - of course, at the full risk of over interpreting just one empirical example. Briefly summarized, the conclusions would then be the following ones:

²² See Wallich (1955), pp. 307-310.

- (i) Radical reform steps from a command system or a fully administrated economy to a market order are greatly facilitated if the power of interest groups can be checked by whatever mechanism, in the post-war West German case by foreign occupation. In this respect, central and eastern European countries have a much more difficult task to solve because their economic reforms are closely linked to the introduction of full-scale democracy with the concomitant reawakening of private distributional coalitions. To keep these interests at bay, these countries need a strong 'constitutional consensus' on the economic liberalization measures, which may be reached in some countries - notably those with a tradition of a market economy in the interwar period - but not in others. In this sense, Olsonian factors are very important for the extent and the speed of implementation of the reforms.
- (ii) Similarly, in the immediate aftermath of the reform, it is very advantageous if the thorough reallocation of resources that invariably follows the reform can proceed without powerful distributional coalitions hindering or distorting the process by enforcing an all too early profit squeeze on the fledgling market economy. Again, West Germany was lucky in this respect if only for the not really Olsonian reason that unions lacked the necessary strike funds to back up a more militant stance in collective bargaining. At present in central and eastern Europe, union influence is rather moderate as well, but there are other distributional coalitions such as, e.g., the powerful farmers' lobby in Poland that threaten to grind at least part of the reform process to a halt.
- (iii) Once the main brunt of the transformation or reallocation crisis is over and those resources of the economy that are employed, are so in an efficient way by the standards of a market economy - a state reached in post-war West Germany at 10-12 per cent unemployment in early 1950 - the further growth prospects depend above all on the economy's elasticity of goods supply and the possibly accidental income elasticity of demand that prevails for its product mix in world markets. In these respects, again, West Germany was lucky in the 1950s, with a very high quality and mobility of its surplus labour and a traditional strength in investment goods industries. A growth theory aimed at explaining the German success would then primarily have to focus on those long-term factors that brought about these favourable circumstances, namely the decent technical education of the industrial workforce in Germany (which is presumed to be on average much better than, e.g., in Britain), the specific knowledge incorporated in the fast-

growing export industries, and, ironically, the loss of the eastern provinces and their relatively backward agriculture, which released a large, then highly motivated and mobile labour force to find work in the industrial heartlands of the West. These are precisely the factors that the new growth theories tend to focus on,²³ and in this respect, they appear to be on the right track.

- (iv) It is important to realize that, in a rapidly changing international division of labour, factors that drive an economic success story in one period may become the cause of decline in another, if only - for whatever reason - the competitive edge of the country is eroded faster than that of other countries. What brought hefty terms-of-trade gains in an earlier period need not do the same in all subsequent ones so that economic growth may contain a significant element of 'specialization luck'. In fact, recent empirical research on growth²⁴ has shown that growth rates are highly unstable over time - much more so than country characteristics - which points to strong elements of terms-of-trade luck in the growth process. Presently, one may interpret the quite dramatic crises of traditionally export-oriented investment goods industries in countries like Sweden, Germany or Switzerland as a fundamental erosion of their competitive position in world markets.
- (v) Distributional coalitions may influence this process in a variety of ways, the most important of which is the effect of unionism on the path of unemployment. In this respect, the last four decades in West Germany provide a particularly nice example: unionism added a strong element of inertia to the adjustment of real wages, which thus transformed productivity and terms-of-trade shocks into persistent changes of employment and unemployment. In times of repeated unanticipated positive shocks like in the 1950s, this may lead into a genuine 'employment miracle'. In turn, in times of powerful negative shocks to industrial employment as in the mid-1970s, the early 1980s and probably also the early 1990s, it may induce a basically irreversible rise of equilibrium unemployment - provided there is an unemployment benefit system (as the German one) that links the benefit level to the terminal wage and pays a rather generous share of this wage for a very long period of time (in Germany indefinitely). By simply cutting off a low wage employment segment, which exists and rapidly expanded in countries like the United States that do have less union influence and much less generous benefit systems, unemployment of formerly well-paid

²³ See, e.g., Mankiw (1993), Paqué (1993).

²⁴ See Easterly et al. (1993).

industrial workers is perpetuated: alimented by the benefit system, more people are kept in subsidized search for the relatively small chunk of well-paid industrial jobs. In the future, the most extreme example for this queuing for high-paid jobs will probably become the eastern German economy where a rather large part of formerly employed industrial workers will queue at the gates of an industrial sector that will be much too small at the prevailing locational conditions and the collectively negotiated wage to push unemployment down to anything close to the western level.

- (vi) Apart from its effect on employment, distributional coalitions may have manifold detrimental consequences for economic growth to the extent that, through their lobbying activity in favour of regulation of the economy, they close options for the future. For the case of Germany, it would require an immensely detailed empirical analysis to find out whether and to what extent the marginal extension of regulatory rules and the welfare state became a hindrance to growth or not. There are good reasons to suspect that it did²⁵ although, by the very nature of the question, one should not expect anything like a conclusive empirical answer. But, to repeat, any such process of institutional sklerosis appears to be much less the consequence of an Olsonian resurgence of interest group power than of a change of interests themselves.

²⁵ See, e.g., the different articles in Giersch (1983).

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