

# Financialization of the German housing market

Explaining the recent rise of housing prices in Germany

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## **Abstract**

While many housing markets across the European Union have seen large housing price fluctuations since the 1980s, Germany has until recently remained a beacon of housing market stability. Since 2010, Germany however suddenly witnessed substantial housing price and rent increases. This thesis seeks to understand this price increase in light of a combination of short and long-term economic and institutional developments within Germany. Starting at the end of the Second World War, this thesis illustrates the rise of financialization in Germany as an effect of the breakdown of the Fordist accumulation regime. This breakdown of the Fordist regime also manifests itself in the policy regarding the housing and credit sector, which has increasingly become in favour of marketization, privatization and liberalization. It is this liberalization of housing in combination with the inflow of capital that is switched into housing that have led to the rise of property prices and rents in Germany. To confirm this, quantitative measurements of financialization, overaccumulation and capital switching are presented. Whereas most existing studies on financialization do not address the relation between agency and structures, this thesis illustrates that agency is crucial for understanding structural developments. Based on this analysis it is concluded that the developments of financialization and the liberalization of the housing and financial markets are the result of government regulation that seeks to reconcile and mediate the conflict of interests between different societal groups and fractions of capital.

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## **Introduction**

In the past years housing prices have been rising at breath-taking rates across Europe (CBS, 2019; Sweney, 2021; Eurostat, 2020). In the large cities, the rise in prices is most severe. European metropolises like Amsterdam, Munich and Paris are among a larger selection of cities who currently have highly speculative housing bubbles (UBS, 2020). The rise in housing prices has been so strong that even in the middle of the Covid-19 pandemic, most of the 27 European Union (EU) member states experienced substantial housing market appreciations, with the EU average being almost five percent (CBS, 2020; CBS, 2021A). This percentage is however somewhat misleading. The differences between EU members are substantial with some countries experiencing almost no housing inflation, while others are affected by price increases of over ten percent per year. Among the countries that are strongly affected by the recent rise in housing prices is Germany (CBS, 2020; CBS, 2021A; Bundesbank, 2021).

When looking at the recent history of the German housing market, this current development becomes very surprising. Until 2010, the German housing market experienced barely any inflation, while many other European housing markets were already seeing steep housing price increases (Bundesbank, 2021; Wijburg & Aalbers, 2017A, 972). The UK and the Netherlands, for example, experienced close to 300 percent real residential property price inflation between 1985 and 2007, compared to a 15 percent real price decrease in Germany (Hilbers et al., 2008, 13). Even in the direct aftermath of the GFC when most housing markets in Europe were in financial turmoil, Germany remained a beacon of stability (Kofner, 2014). This image of a stable German housing market however is incompatible with the price surge that has struck since 2010. Whereas between 1995 and 2010, the German housing market experienced barely any inflation, since 2010, Germany became a highly inflationary housing market with property price increases that surpass those of the UK and the Netherlands during the same period (Wijburg & Aalbers, 2017A, 972; Office for National Statistics, 2020; CBS, 2021B; Bundesbank, 2021). Since 2010, German property prices have on average increased by almost 80 percent while rents have gone up by almost 50 percent (for visualization see Bundesbank, 2021). The development is however not equally distributed as towns and cities have seen larger price increases than the rural regions. Particularly the largest seven cities have been hit hard with property price increases of almost 130 percent while rents increased by 55 percent (ibid.). For comparison, in the same period the consumer price index (CPI) rose by ten percent, while

the nominal average wage grew by fifteen percent (Bundesbank, 2021; OECD, N.D. A). These figures thereby place Germany among the fastest inflating housing markets in the EU.

Understanding why this trend has recently occurred in Germany is of great societal and economic importance. In the first place, this is because property price inflation exacerbates income and wealth inequality (Goda, Stewart & Torres García, 2020). The development might be beneficial for property owners, but those who are looking to purchase a house or must rent their home are suffering the burden. In Berlin for example, the average rent of a 60 m<sup>2</sup> apartment has increased from € 360 per month to € 648 in a mere ten years (Van de Hulsbeek & Zwart, 2019). This increases the cost of living for Berlin's inhabitants significantly and even forces some residents to relocate. People looking to purchase a home similarly struggle, as they must take on ever increasing amounts of private debt to afford the house. On a macroeconomic level, this increased private indebtedness leads to growing financial instability. The Global Financial Crisis (GFC) of 2008 has clearly demonstrated this risk, as the subprime mortgage crisis developed into a large international financial crisis (Gotham, 2009). Thus, from both a micro and macro perspective there are potentially severe consequences of rapid property inflation.

Despite the importance of the topic, the academic understanding of the topic is insufficient. Housing markets are an important part of the macroeconomic arrangements within countries and have played an important part in triggering the GFC. Despite this, conventional macroeconomic theory has largely disregarded the housing market with few works covering the topic (for a discussion see Aalbers & Christophers, 2014; Piazzesi & Schneider, 2016). Microeconomic studies do cover the housing market but do so in terms of demand and supply disequilibria, which disregards the social and political contexts and instead sees the economy as a separate, self-interested realm governed by its own laws. Studies by mainstream economists therefore lack the comparative depth needed to understand the developmental differences between national housing markets.

Noticing this gap in the literature, political economists and institutional economists have looked at institutional differences to explain the different developments in housing markets. These studies in the literatures on the Varieties of Residential Capitalism (Schwartz & Seabrooke, 2009) and Comparative Housing Systems (Allen et al., 2004; Kemeny & Lowe, 1998; Kemeny, 2006; Hilbers et al., 2008) stress the importance of institutions in mediating the housing market.

Their analyses often rely on ideal typical categorizations, like the distinction between liberal market economies and coordinated market economies (Hall & Soskice, 2001), or the distinction between the Rhineland model and the Neo-American model (Albert in Peck & Theodore, 2007, 734). This perspective was until recently the most popular for analysing the German housing market.

In the study of the German housing market, Institutionalists scholars proposed the idea of a fundamental German stability (among others Blackwell & Kohl, 2018; Voigtländer, 2014; Kohl, 2014; Kofner, 2014; Kemeny, 2006). This stability was associated with a unique set of institutional characteristics of the German housing market. Particularly the role of the government and the conservative, risk-averse nature of the financial sector received substantial scholarly attention. According to the Institutionalist understanding of the German housing market, the German housing market should because of these characteristics have been stable since 2010. This was however clearly not the case. The fact that Institutionalist scholarship was unable to predict this change is hardly surprising as the theory is overly structural and static. Although Institutionalism has rightly stressed the importance of national institutions on the housing market, its lack of deeper analysis of driving and contesting agents and their structural ties in the economic system makes the theory simplistic. This also leads to the inability to explain institutional changes, leaving the theory limited to merely describing the status quo. Notably, The Varieties of Capitalism analysis merely offers a heuristic descriptive device that can neither explain how particular institutions came about or whether they are about to change. In addition to this, the ideal typical models often draw on a rather functionalist understanding of institutional complementarity. Overall, the Institutionalist understanding of the German housing market has thus proven to be insufficient.

This thesis will instead analyse the developments on housing markets following insights from the critical political economy (CPE) approach. Like the Institutionalist theory, the CPE approach argues that the social and political contexts are important for understanding developments within markets. Unlike the Institutionalist theory however, the CPE approach provides a much more dynamic perspective on institutions. According to CPE, institutions can change because of structural economic changes, agency or the interaction between both. This approach has recently gained in popularity, particularly with authors from political science, sociology and urban geography (among others Soederberg, 2020; Adkins et al., 2019; Fields,

2018, Wijburg & Aalbers, 2017A; Foster, 2007; Epstein, 2002).<sup>1</sup> When studying housing market developments, CPE has mostly focussed on the structural economic changes, like the global rise of financialization. Authors analysing financialization contend that over the last decades financial capital has become increasingly dominant compared to productive capital. Rather than financial capital serving the real economy, the focus has shifted on increasing accumulation via finance itself (Aalbers, 2008, 148). In many countries, this development has also led to debt-fuelled housing markets as finance increasingly uses the housing market as an outlet for overaccumulated capital (Wigger, 2020, 4).

Although the CPE approach improves on the previously criticized approaches, there are also several shortcomings in this literature that this thesis seeks to address. Although over the last few years the literature on the relation between financialization and housing has developed significantly, the topic is still undertheorized. This is especially true for the different relations between financialization and housing across countries (ibid., 546-549; Fernandez & Aalbers, 2016, 75). Much is written about financialization via mortgage debt in countries like Spain, the UK and the Netherlands. This however leads to the disregard of other mechanisms of financialization in countries not dominated by homeownership, like Germany (Wijburg & Aalbers, 2017A, 969). Moreover, the focus in the literature has often been on countries that already have highly financialized housing markets, thereby disregarding cases where financialization did (until recently) not occur. Germany provides a great case to address these shortcomings. Germany is namely not dominated by a culture of homeownership, has until recently not seen significant price increases in residential housing and is not often studied. As such, Germany provides an interesting and theoretically very relevant case. For this reason, the following question will be central to this thesis: *Which economic and institutional developments have caused German property prices and rents to increase so significantly since 2010?*

This thesis is not the first study this question as several papers have recently been written on financialization in Germany from a critical geography perspective (Wijburg & Aalbers, 2017A; Wijburg & Aalbers, 2017B; Wijburg, Aalbers & Heeg, 2018). While this literature provides important empirical insights, the cause of this financialization is not sufficiently explained or

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<sup>1</sup> Although there are substantial differences within the literature of critical political economy, this discussion is beyond the scope of this thesis. For an overview of the different debates and analytical foci of authors that study financialization see (Wigger, 2020).

theorized. Like much of the financialization literature, these works focus on describing the effects and mechanisms of the development of financialization without analysing the underlying causes supporting the trend. Moreover, the relation between agency and structure remains below the theoretical radar and is unaddressed. Although the work by these critical geographers is less structuralist than the Institutional work, the relative importance and interaction between structural developments and agency in relation to financialization remains blurred.

To address these limitations and develop insights on the relatively understudied case of Germany, this thesis employs a critical realist ontology and philosophy of science. Central to critical approaches is the belief that economics, politics and social relations are inherently strongly connected with one another and cannot be studied in isolation (Van Apeldoorn & Horn, 2018, 6). Critical scholarship is critical of existing power relations and seeks to promote the emancipation of disadvantaged groups.<sup>2</sup> This critical attitude is not limited to social relations but is also applied to the philosophy of science (Wigger & Horn, 2016, 43). The critical philosophy of science that this thesis uses is the critical realist approach, as was originally proposed by Bhaskar ((1975) [2013]). Critical realism prioritizes ontology over epistemology, thereby departing from positivist logics. To apply the meta-theoretical insights from critical realism this thesis utilizes the theoretical framework of the Regulation School. Most Regulation scholars implicitly follow a critical realist ontology and epistemology, making the combination logical (Jessop & Sum, 2006, 3 & 16-17).

The structure of the remainder of this thesis is the following. The first chapter begins with a brief discussion of the relation between housing and capital (1.1). This relation is of fundamental importance for understanding the Regulation theory (1.2) and its main concepts of the accumulation regime (1.3) and mode of regulation (1.4). In this discussion on the Regulation theory the relation with critical realism is also briefly discussed. As the approach of the Regulation theory as outlined in sections 1.2 to 1.4 is still rather structuralist, it is complemented by insights from the Gramscian Regulation school (1.5). This section focuses on the role of agency and how this leads to institutional changes. After a summary of the theory is presented (1.6), in the next chapter we turn to the discussion on the epistemology and

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<sup>2</sup> This societal criticism is not the goal of this thesis, rather the critical perspective is employed for its scientific critique. Although no research can be totally value free, the main goal of this research is not to promote a certain political view.

ontology of critical realism (2.1), the operationalization of the key concepts (2.2) and the methodology of this thesis (2.3). Chapter 3 will contain the empirical analysis, while chapter 4 concludes and discusses the results. More information on the structure of the empirical analysis will follow in chapter 2.

# **Chapter 1: Housing and Regulation Theory**

## **1.1 Housing and capital**

For people to live a healthy and prosperous life, suitable housing is almost always a necessity. Housing provides a safe space and a location for one's family, thereby fulfilling a crucial role in any human life. Housing is however also of crucial importance for the functioning of economic systems, as it provides workers with a location that is usually relatively close to the workplace. As such, the provision and distribution of housing plays a crucial biological, social and economic function. In capitalist societies, housing additionally functions as an investment product for storing and accumulating capital. This role can be clarified by positioning housing as a form of fictitious capital.

In essence, all capital originates as a surplus of production that is saved for use in either future production or future consumption. Ideally, capital in the meantime increases its value. For capital to do this, it needs to be circulated and reinvested into an asset that is worth more than its original value, thus creating surplus value (Harvey, 2014, 72-74). The classical way to achieve surplus on capital is by investing accumulated capital into real production, a form of capital investment Marx called 'real capital' in *Das Kapital* (Vol III, Ch. 30-32). Money capital is used to buy production tools that help create finished goods that are bought by consumers. The surplus value from capital in this case arises from the circulation between different forms. Marx however also noted that capital can be invested in assets that are themselves not productive, something he referred to as fictitious capital (Vol III, ch. 25). This fictitious capital is a legal ownership that makes profit by bearing interest on expected future production. Fictitious capital does not produce anything itself and is therefore always dependent on the real production economy. In addition to this rentier surplus value extraction, fictitious capital can also be circulated and exchanged, and thus, it can serve for speculative activities. The faster fictitious capital circulates, the more speculative behaviour is attached to it (Harvey, 2014, 72-74). The market value of fictitious assets can thus be artificially inflated due to speculation, and create 'wealth' for the owners, without anything changing in the real production economy. Understanding housing as a form of fictitious capital means that to understand the development of housing prices, we also must understand the developments in the production economy. The

Regulation Theory is perfectly suited for such a comprehensive analysis of housing as will become clear in the following sections.

## **1.2 Regulation theory: The ontological foundations**

Regulation Theory is founded on the belief of the inherent instability of capitalism and draws on Marxists, Keynesian and Institutionalist insights to explain both the long-term instability of capitalism and the possibility for a temporal stabilization based on regulations (Jessop & Sum, 2006, 15-16). The inherent crisis-tendency of capitalism is assigned to the recurring phenomenon of overaccumulation, understood as the absence of opportunities to reinvest surplus capital profitably within the confines of a given market (ibid., 21-22). This overaccumulation often manifest itself because of a combination of supply and demand side developments. For the supply side, a surplus of capital might originate from growing corporate profits or the inflow of foreign capital (see Hung, 2008). This increased capital needs to find suitable investment opportunities. The demand side for capital might however not provide such an outlet as intense competition or lack of aggregate demand growth reduce the profit margins on investments in this market (see Wigger, 2017). Regardless of the specific combination of factors that lead to overaccumulation, they all share the same outcome: investment in production is not possible with all surplus capital. For this reason, overaccumulation is also called the capital surplus absorption problem. Resultantly, capital must either find new markets to expand into or when this is no longer possible a general crisis follows in which capital can no longer accumulate (Harvey, 2014, 14; Christophers, 2011, 1347-1348).

Even though many authors have predicted capitalism to fall because of its contradictions and tendencies towards crisis, capitalism has managed to survive (For a discussion on these contradictions see Harvey, 2014). According to Regulation scholars, it is important to look at the stabilizing role institutions play for the continued accumulation of capital (Jessop & Sum, 2006, 14-15). Regulation scholars argue that capitalist accumulation regimes can be stabilized by social and (extra-)economic institutional arrangements for a limited period (Jessop & Sum, 2006, 15; Becker et al., 2010, 226). These institutions ‘regulate’ and temporarily remedy the contradictions of capitalism, hence the name Regulation. It is important to note here that the concept of Regulation covers more than what is typically meant by regulation in the English language. Although government regulation is part of the analysis, regulation also covers other formal institutions (ibid.).

### *Ontology and the Regulation theory*

Although many differences exist between the varieties of Regulation schools, there are also a range of fundamentally shared principles. At the most abstract level, we can summarize these similarities by stating that most authors implicitly follow the philosophy of science of critical realism (Jessop & Sum, 2006, 3, 16-17). Although critical realism will be covered more extensively in the next chapter, a brief introduction on the ontological perspective on reality and the agency-structure will be given here as it is necessary for understanding the Regulation theory. Ontologically, critical realism is 'realist' as it believes that there is an objective, stratified reality. This reality exists of visible events and experiences but also of underlying structures and tendencies (Patomäki and Wight, 2000, 223). These underlying structures exist regardless of whether we can observe them in our current events and experiences. The idea of a stratified, objective reality has important implications for the analytical focus of theories that follow a critical realist ontology. These namely focus on mechanisms rather than events. A second important point for theories following the critical realist ontology is the relation between agency and structures. Critical realism offers an understanding of reality in which structures and agency are equally important. The outcome of their interaction is decided by material and ideational determinants (ibid.). In this perspective structures might constrain or enable certain behaviours from agents within the system, but that does not equate to functionalism. The future is considered open-ended and agents can contest or reinforce existing structures.

Regulation theory allows for an agency-based approach as it is a weak systems theory, meaning that actors have substantial autonomy to alter economic and institutional structures, particularly in transitional periods between stable regimes (Van der Pijl, 2009, 27 & 150-151). The Parisian school, advanced primarily by Aglietta (1979), Lipietz (1985) and Boyer (1990) amongst others, focusses on explaining the stability of an economic system from a macroeconomic and institutional perspective. They however do not focus much on transitional periods between economic systems, nor on the agency involved in these developments. As this thesis is interested in describing structural economic changes and the role of agency, the Gramscian West German and the Amsterdam schools of Regulation are used as a complement to the

perspective of the Parisian school (Jessop & Sum, 2006, 26-27 & 101-102).<sup>3</sup> This way, both the ideational and material realms are covered.

At the heart of Regulation theory are three concepts: the mode of development, the accumulation regime and the mode of regulation (Jessop & Sum, 2006, 41-42). These concepts relate to one another in terms of abstraction. The mode of development is the most abstract concept and denotes an economic paradigm. This mode is a combination of a specific accumulation regime with a mode of regulation. Lower on the ladder of abstraction, regimes of accumulation can be defined as regularities in capital accumulation that postpone economic distortions and disequilibria (Boyer & Saillard, 2002, 334). Alternatively, we can define an accumulation regime as ‘a complementary pattern of production and consumption that is reproducible over a long period’ (Jessop & Sum, 2006, 41-42). These regimes of accumulation are supported by a mode of regulation. A mode of regulation is a collection of norms, behaviours, organizational forms and networks that can temporarily stabilize regimes of accumulation (ibid.; Becker et al., 2010, 226). The combination of accumulation regimes with a complementary mode of regulation allows capital to stably accumulate over a period of time but are not indefinite and can fall prey to their own contradictions. In that case a transitional period occurs until a new temporarily stable form of accumulation is found. Modes of regulation are typically understood rather functionalist by Parisian scholars, as they only react to changes in the regime of accumulation. As mentioned, this thesis departs from this perspective. Instead, it is argued that agency from political and societal actors is particularly important for understanding changes in the mode of regulation, as well as to a lesser extent for changes in the regime of accumulation. To account for this, Gramscian insights will be included at the end of the theory to complement the Parisian school. Before this is done however the aforementioned key Regulation concepts will be theorized more extensively.

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<sup>3</sup> Jessop & Sum consistently call the group of Amsterdam Regulation scholars, the Amsterdam School. The authors in this tradition state themselves that they are not a school, with followers that contribute to the school building, but merely a project (Van Apeldoorn, 2004). To prevent confusion, it is chosen to use the name Amsterdam School in this thesis.

### 1.3 Accumulation regimes

An accumulation regime comprises a combination of sub modes on three different axes of accumulation: 1) extensive or intensive accumulation 2) introverted or extraverted accumulation and 3) productive or financialized accumulation (Becker et al., 2010, 227). Extensive accumulation is concerned with expanding capitalism into areas that were previously not governed by market logics, either at home or abroad (Jessop & Sum, 2006, 24). In intensive accumulation regimes, accumulation is increased by intensifying exploitation of workers in existing markets. A second distinction of accumulation concerns the orientation of accumulation towards either domestic or foreign markets (Becker et al., 2010, 227). Introverted accumulation is focussed on domestic markets, while extraverted accumulation has an outward focus in terms of both trade and capital. Note here, that an outward focus can both entail export-oriented accumulation or import dependence (ibid.). The last form of accumulation is the most fundamental and involves the difference between accumulation primarily via production or financial/fictitious capital. As this distinction is the most important for the present purpose, it is useful to discuss this more extensively.

#### *Financialization and capital switching*

The shift from a mode of accumulation based on production towards one that is primarily based is called financialization. Krippner (2005, 174-175) defines financialization as a pattern of accumulation in which profits accumulate primarily through financial markets rather than trade and commodity markets. Many authors have noted that accumulation regimes based on the accumulation of financial capital have become dominant over the last decades across many western countries. This shift in accumulation regime must be understood in relation to blocked productive accumulation (Becker et al., 2010, 227; Harvey, 1985, 3-13; Aalbers, 2007, 175; Arrighi, 1994, 220-222). Recall, that capital can either be invested in productive or financial capital. The choice to invest in either one depends on the calculation of the risk relative to the rate of accumulation of either form of capital. This insight is at the core of the theory of capital switching by Harvey (1985, 3-13). Although Harvey himself is not a Regulation scholar, his theory on capital switching fits in well within the general framework of Regulation theory. Harvey describes the economy as three circuits in which capital can be invested, borrowing the conceptualization of circuits from Lefebvre (1970). The primary circuit is made up of investments in real production and services. The secondary circuit is concerned with

investments in fixed assets that store value, like housing (ibid., 6-7). The third circuit is concerned with investments in technology and labour that indirectly influence the production of goods and services (ibid., 7-8). Harvey's main insight into the relation between these sectors is that capital can be switched between sectors to the circuit in which capital is most profitable, a process called capital switching.

Capital switching occurs due to a combination of overaccumulation and inherent contradictions in investment of primary circuit capital (Christophers, 2011, 1347-1348). As mentioned before, investment of surplus capital into production leads to further production and thereby increases total profits. As more wealth is invested in production however, the supply of the product is also increased. To simultaneously allow capital to be reinvested while preventing this from undermining profits, demand thus must grow substantially. Under the Fordist accumulation regime in the era of embedded liberalism (1950-1970) this was achieved by the regulation structure of Keynesian macroeconomic and social policies that promoted wage growth and expanding consumption (Buch-Hansen & Wigger, 2010, 26; Ruggie, 1982). Since the 1980s, incomes in the Western industrialized world have however generally stagnated, undermining the profitability of investments in production (Crouch, 2009, 392-393). As a result of increased corporate profits, the amount of surplus capital that needs to be reinvested has meanwhile only grown (Christophers, 2011; Crotty, 2005; Alvarez, 2015; Dobbs et al., 2015). This combination means that the production sphere suffers from a tendency to overaccumulate. Resultantly, capital therefore instead seeks profitable investments in the secondary circuit (and to a lesser extent in the third circuit). Harvey calls this a spatial-temporal fix of overaccumulation, as this temporarily stabilizes accumulation by moving overaccumulated capital into a different market. We might therefore think of housing and the secondary circuit more generally as a sponge for the overaccumulated capital of the primary circuit.

The original theory of capital switching by Harvey (1982 & 1985) strongly emphasizes the relation between primary and secondary circuit capital as one of dependence of the latter: when the primary circuit is saturated with capital and close to an economic crisis, then capital moves to the secondary circuit (Aalbers, 2007, 175). Harvey (1985, 20) even describes the second circuit as a 'last-ditch hope' to invest overaccumulated capital in. Authors following Harvey criticized this view and highlighted that housing can be an interesting investment opportunity regardless of developments in the primary circuit (Beauregard, 1994, 716; Haila, 1991, 346; Aalbers, 2007, 177). These critical authors contend that financial actors move their capital to

the sector in which it is most profitable, regardless of overaccumulation in the primary circuit and risk of crisis.

#### *Fourth circuit of capital*

Expanding on criticism of Harvey's theory of capital switching, we can discuss the addition of a fourth circuit of capital which was theorized by Aalbers (2007, 149-150). He called this circuit 'financial capital for its own good' and related it to the process of financialization. Aalbers views this as a new stage of capital switching in which capital in the financial sector has become so decoupled from the real economy, that investments in financial markets are independent of developments in the other circuits. Whereas the secondary circuit expands because of capital switching from other circuits, the fourth circuit of capital can grow regardless of developments in other spheres (ibid.). In essence, this is the growth of speculation on financial markets that functions independently of processes in the real economy. Building on this, Aalbers (ibid., 149-151) argues that capital switching from the first to the secondary circuit still occurs but that the secondary circuit is increasingly dependent on the switching of capital that was originally accumulated via the expansion of the fourth circuit of financial capital. This means that as financialization develops further in the fourth circuit, more capital will move into housing. In other words, the development and expansion of financial markets themselves increasingly stimulate housing market developments (ibid., 153-155). To summarize, Harvey understands capital switching into the secondary circuit as a result of overaccumulation in production, while Aalbers argues that the largest cause of capital switching into the secondary circuit is overaccumulation in the fourth circuit via the expansion of financial markets.

### **1.4 Mode of regulation**

Supporting the different regimes of accumulation is the mode of regulation. Here, Regulation authors typically distinguish five sub dimensions of the mode of regulation: The wage relation, monetary/financial regime, the competition form, the state and international regimes (Jessop & Sum, 2006, 42; Jäger & Raza, 2001, 2). Regulation scholars distinguish institutions for the different regional, national and supranational levels (Peck & Tickell, 1992, 347-353; Jäger & Raza, 2001, 2). Scholars have most often focussed on the national level, but depending on the specific case, supranational (international organizations) and regional (federal states) levels can equally be an important part of the analysis. It must be noted that, although the five sub

dimensions are described independently, they are by no means operating independently from one another. Rather, they are heuristic categories to structure the analysis of institutional changes. In extension of this, it must be mentioned that not all sub dimensions are equally important. Certain subdimensions can be more important than others. Several authors have stated that the liberalisation of financial markets, that is pushed by several international institutions and states, is for example most crucial for enabling financialization (Jessop & Sum, 2006, 229-230; Harvey in Christophers, 2011, 1349). Having said that, we will now discuss the five different subdimension, paying particular attention to the role of these institutions with regards to supporting a financialized regime of accumulation.

#### *The five dimensions of the mode of regulation*

The wage relation was originally of most importance in Regulation theory (Jessop & Sum, 2006, 19). The concept denotes how the capital-labour relation in a country is institutionalized, particularly with regards to labour markets, wage determination and the organization of production (Bieling et al., 2015, 56; Jessop & Sum, 2006, 42). We however must also note the importance of social wages, denoting wages or benefits that are granted outside of the labour contract, like pensions, social security and allowances (ibid.). The wage relation is important for housing markets as it provides a crucial element in the profitability of the production realm, as sustained profitability in production requires mass consumption. Alternatively, Crouch (2009) has suggested that stagnated wages have played an important role in financialization as policy makers have tried to compensate stagnating incomes, by simultaneously increasing both homeownership and housing prices to keep the general consumer confidence large.

The sub dimension of the monetary/financial regime is concerned with the forms and emission of money, the organization of credit systems, the relation of currencies and the monetary regime that exists in a country (Jessop & Sum, 2006, 42). The monetary regime is important for the accumulation structure, as accumulation via production generally prefers inflationary policies while financial capital needs lower levels of inflation to be profitable (Becker et al., 2010, 227-228). Besides inflation policies of central banks, we can also describe the relation between capital and production under this subdimension. Particularly the increasing liberalization of financial capital that increasingly promotes the role of speculation for accumulation (Jessop & Sum, 2006, 229-230). The liberalization and development of financial markets is crucial for the development of financialization as without such innovations switching capital from production to other circuits becomes very difficult, disincentivizing such a switch (Harvey in

Christophers, 2011, 1349). Moreover, besides allowing switching of capital, financial markets are able to promote financialization directly by expanding the total amount of capital that is available as credit, thanks to innovations such as securitization (Wijburg & Aalbers, 2017B, 311).

The competition form has increasingly become important as the focus of many Western policy makers has moved from demand- to supply-side economics (Jessop & Sum, 2006, 228-230). The classical analysis on competition institutions is concerned with the form of competition between firms regarding (financial) services and goods markets (ibid.). The different forms that are discerned are often the ideal types of oligopolies, monopolies and a market of perfect competition. More fundamentally, we can however also discuss whether something is allowed for competition on markets in the first place. We can discern a mode of competition in which there is a lack of private competition on a market as the market is controlled by non-profit actors like government agencies. Inversely, privatization and the public listing of government agencies alter the distribution and production of (public) goods by introducing market logics of competition, individualization and marketization (Soederberg, 2020, 19-21). This logic of competition can even extend itself towards public owned agencies who incorporate much of the same management principles of privatized firms. Moreover, we can discuss competition that is either more regional/national in character or more transnational (Becker et al, 2010, 228). This also includes competition between financial actors in different countries.

The final two subdimensions are the state and international regimes. Early Parisian work did not focus much on theorizing the position of both institutions and it remains a weak spot in the Regulation theory (Jessop & Sum, 2006, 230-232). The state is generally ascribed the role of guaranteeing economic preconditions for the national functioning of both labour and capital in the economy and coordinating flows of capital globally. The international regime is conceptualized as stabilizing economic relations between nations. Vidal (2002, 108-115) describes three levels of international regimes: namely patterns of international commodity and capital movements, international political agreements and international adaptation processes. The operationalization of the state and international regimes is simplistic and misses the point that states, also when they act internationally, are political agents that are influenced by the society they are situated in. Menz & Soederberg (2006, 19) have argued that for financialization to be successfully integrated into national policy it depends on politicians who are able to

convince others and build coalitions across society to gain political legitimacy. Gramscian Regulation scholarships help to explain how such coalitions are formed.

## **1.5 Gramscian perspectives: Theorizing the state, international regimes and agency**

### *Ontology of the Gramscian perspectives*

Parisian Regulation scholars see changes in the mode of regulation as an attempt to stabilize changes in the mode of accumulation. This perspective is rather functionalist and disregards the social and political agency involved in influencing the mode of regulation, particularly surrounding government policy (Buch-Hansen and Wigger, 2010, 26). The regulation structure therefore does not exist to make the accumulation structure work but is instead often an outcome of political interest struggles and compromises. For example, the labour-capital compromise that made the Fordist accumulation structure stable was the outcome of decades of labour conflicts (ibid.). To understand why the mode of regulation changes, we therefore need to embed agency in our theory, as was done by the Amsterdam and West German Regulation schools.

The Amsterdam school has mainly been advanced by Bode (1979), Van Apeldoorn (2004), Overbeek (2004) and Van der Pijl (1984), while the West German School was advanced by Hirsch (1986), Junne (1984) and Esser (1986).<sup>4</sup> Both schools are very similar as they share the same Gramscian perspective on the role of classes, compromise and hegemony. Their ontological focus is however somewhat different as the Amsterdam school focuses mainly on international regimes, while the German school focuses on the state. However, the commonalities are larger than the differences and as such they will be treated as a common Gramscian Regulation school. The Gramscian Regulation school uses the same main concepts and structuralist thinking as the Parisian school, but add agency and a better conceptualization of the state and international regimes.

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<sup>4</sup> Van der Pijl has become heavily criticized over the last few years for supporting conspiracy theories surrounding 9/11, the Covid-19 pandemic and the disaster with MH17 among others. It is for this reason that it was considered to leave his name out of this thesis entirely. Since Van der Pijl has contributed substantially to the Amsterdam school it was decided to nevertheless mention and cite him. It must however be made clear that this in no way should be seen as supporting any of the statements by Van der Pijl, from which this thesis distances itself.

### *Theorizing the state and interest configuration*

Central to the Gramscian perspective is that we cannot separate the social, political and economic realms, thereby removing the economic reductionism of the Parisian school (Jessop & Sum, 2006, 26-27). Both schools therefore focus on political and societal conflicts of interests, either as capitalist competition or class conflict (ibid., 44). Crucial in this system, according to the German school, is the state as it is able to influence the various other modes of regulation substantially via legislation and the formation of class compromises on the national level (ibid., 46). Borrowing from Gramsci and Poulantzas, they argue that the formation of a hegemonic bloc will be founded based on the alliance of different classes under a dominant class (ibid., 46-47). Concretely, we can therefore see the ideological and legislative position of the state as a result of a political compromise between different classes (ibid., 93). This state as a result is not a coherent, closed system that acts as a unitary actor, but is rather a contested system that changes based on inputs from the broader societal and political system. The state seeks to promote the 'societal interest', but it can never promote everyone's interest equally, especially when interests are directly conflicting. As a result, the state always must privilege some interests.

In the struggle over which interests are prioritized the political parties, labour unions, social movements and other collective actors that can organize classes and their interests are particularly important. Political parties can mediate societal interests and the state via electoral competition and interaction with a plurality of societal actors like enterprises and interest groups (Jessop & Sum, 2006, 101-103). Changes in the composition of government coalitions or in party programmes can reflect societal changes in ideology or voting behaviour and often result in transformations of the mode of regulation. One can think here of the rise of the social democratic Third Way or the decline of social democratic parties across Europe more generally as important political shifts (Menz & Soederberg, 2006, 24). Changes in the mode of regulation can also arise due to the influence of bureaucrats who are able to influence norms and beliefs, modes of calculation. Alternatively, social movements can play an important role in changes in the mode of regulation as they address topics often that were left unincorporated by traditional political parties (Steinmetz, 1994, 194). Lastly, we should mention the importance of labour unions as key actors in the wage relation in society, whose historic strength has played an important role in the Fordist mode of regulation in which productive capital and labour formed an alliance to preserve high wages (Menz & Soederberg, 2009, 24; Steinmetz, 1994, 188-189; Hirsch & Roth, 1986, 37). Their general decline across Europe, together with that of

social democratic parties might undermine the strength of this coalition, thereby allowing new coalitions to arise that do not prioritize productive capital and wage growth. This in turn has important implications for the regime of accumulation.

### *Fractions of capital and the formation of hegemonic coalitions*

The Amsterdam school tackles the issue of agency from the concept of fractions of capital. Fractions of capital can be discussed in three levels of abstraction: 1) the capital-labour relation, 2) the circulation of capital and 3) the distribution of profits (Jessop & Sum, 2006, 25). For the present purpose, the second level of circulation of capital is most interesting as it distinguishes between the ideal types of productive (industrial capital) and unproductive capital (commercial & banking capital) (Van der Pijl, 1984, 3-6). These forms of capital often have contrasting interests, in the first place regarding inflation as discussed in the previous section. Furthermore, fictitious capital seeks maximum transnational mobility and safe, profitable investment opportunities in financial markets while productive capital seeks to enhance consumer demand and maximize sales.

Similarly to the German school, the Amsterdam school believes that the formation of a hegemonic coalition is necessary for stability in the mode of regulation (Jessop & Sum, 2006, 7-8). They call this the comprehensive concept of control (CCC), a term that originated from Bode (1979, 20). A CCC is a hegemonic project in which the conflicting tendencies between capital groups and/or labour are overcome by finding a compromise that is able to receive general societal acceptance (Jessop & Sum, 2006, 25-26; Overbeek, 2004, 118). The concept of control can become hegemonic when it is able to both find a balance between the interests of labour and different fractions of capital (Van der Pijl, 2014, 31). Fordism was able to unite the interests of different capital fractions as investment banks were able to combine finance and productive capital interests, while increasing wages and the Keynesian welfare state satisfied the labour interest (Overbeek, 2004, 118). For financialization via housing a similar compromise between the (imagined) interest of capital fractions and the general population seems necessary to gain political support. This political compromise can occur within the nation-state, but the Amsterdam school has also highlighted the importance of transnational actors, like international organizations such as the EU and the World Bank. Capital is not limited to national borders, nor are the political compromises that occur between fractional interest groups (Overbeek, 2004, 124-125).

Although the idea of capital fractions provides a useful heuristic tool, it has not been without criticism. The groupings of different fractions of capital can sometimes be arbitrary and generalizing. Ruigrok and van Tulder (1995, 20) for example argue that the interest of productive capital is not homogenous, but rather made up of many sub interests that can also be conflicting. This can for example be caused by pressure from competing firms, that make it hard to form a united capital fraction. Another point of criticism is that besides substantial differences between subgroups there also exists considerable similarities between the commercial and banking capital fractions, as was noted by Clarke (1978). In sum, categorizing ‘fractions of capital’ is rather complex and in practice difficult. To overcome this problem, it is useful to limit the Amsterdam school to its core idea: that the interests of subgroups of capital are often opposing. The identification of different fractions of capital should then be done empirically and case specifically. Furthermore, we should use the concept of fractions of capital more as a tool rather than as a universally applicable category, something that is applicable to most concepts in Regulation scholarship.

## **1.6 Summary**

To explain the increasing housing prices, Regulation theory predicts that a shift towards a financialized regime of accumulation has occurred. In this process capital is switched from production capital towards financial or fictitious capital like housing. Two distinct interpretations of why this process occurs exist. Harvey argues that capital is switched because of overaccumulation in the production sphere, while Aalbers stresses that we must understand capital switching to the second circuit as a result of the general expansion of financial markets and financialization. For both interpretations, capital switching is however dependent on institutional structures that enable or limit the process. Particularly the state’s legislative ability to liberalize financial and housing markets is important in this regard. To understand change in the mode of regulation the ideas of the German and Amsterdam schools are used. Using a Gramscian perspective, these schools discuss how different societal actors can form political compromises on the national and international level. It is theorized that such a political alignment of interests between different social groups and capital fractions is the reason that states alter their policy favourably for financialization in the housing market.

## **Chapter 2: Critical realist epistemology, methodology and operationalization**

### **2.1 Critical realism**

#### *Ontology and epistemology*

Before discussing the methods applied in this thesis, it is important to delve deeper into critical realism's perspective on epistemology. This epistemology is namely the basis for the methodological choices in the subsequent section. This epistemology however cannot be discussed separately from ontology. To understand the position of critical realism, it is useful to contrast it with the two extremes which it seeks to reconcile. In the first-place critical realism is opposed to the extremes of positivism. Positivist science believes that there is a reality that we can study objectively. To understand and gain knowledge on this reality, empiricism is deemed the best epistemology (Danermark et al., 2001, 7-8). This effectively combines our perception of reality (ontology) with the way we acquire knowledge (epistemology), something Bhaskar calls the epistemic fallacy (Bhaskar in (Patomäki and Wight, 2000, 217-218)). In effect, this positivist logic entails that 'there can be no experience without someone to experience' (ibid.). As Patomäki and Wight (2000, 218) rightly note, this move towards 'objectivity' is a logical fallacy as the only objective way to understand reality, would be through the subjective human experience. In reaction to this positivist outlook on science, post-positivism centres the human subjective experience in the form of discourses as the focal point of its ontology (ibid.). In extension of this, it denies that we can ever be sure that there exists anything like a reality. This would mean that we can never compare between competing truth claims and as a result making theories becomes pointless (ibid., 217). This is ontological and epistemological relativism taken to the extreme.

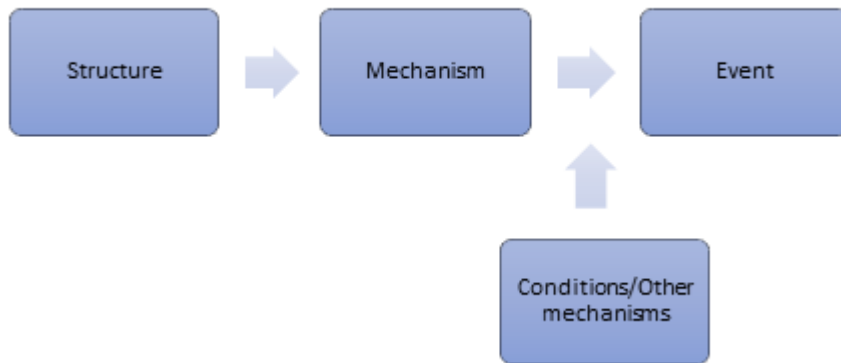
Critical realism is opposed to both extremes and seeks to find a middle ground by combining ontological realism, epistemological relativism and judgmental rationality (Archer et al., 2013, xi). Ontologically, critical realism asserts that there is an objective reality, and this reality is layered into observable events but also of unobservable intransitive mechanisms (Sayer, 1992, 5-6). This layered reality exists regardless of our perception of it, making the theory 'realist'. Epistemologically, critical realists argue that our knowledge of this objective reality is not neutral but rather value laden and falsifiable (ibid.; Wigger & Horn, 2016, 41). Although

critical realists therefore subscribe to epistemological relativism, it does not equate that each claim about the nature of reality is equally valid. Instead, critical realism argues that certain elements of knowledge and theories may be more adequate for comparing truth claims, something in which using the right methods can help (Sayer, 1992, 5-6; Danermark et al., 2001, 10).

Critical realism approaches truth claims by arguing that observing empirical regularities is insufficient for scientific progress (Jessop & Sum, 2006, 303-304). The primary goal of research is not to merely observe that X causes Y, but to understand *why* X causes Y (Sayer, 1992, 106-107). To understand such causal mechanisms, critical realists utilize a retroductive logic of inference (Easton, 2010, 121-123). Retroduction can be conceived of as ‘a mode of inference in which events are explained by postulating (and identifying) mechanisms which are capable of producing them’ (Sayer, 1992, 107). Like induction, retroduction begins at the empirical level, but then it moves to a deeper level in order to develop a causal mechanism that might be responsible for explaining the empirical phenomenon (Lawson in Wigger & Horn, 2016, 46). Jessop & Sum (2006, 17) describe this deeper level as asking, ‘what the world must be like for certain stylized facts and/or specific observations to be possible.’ Knowledge as such is therefore created through a constant interaction between theory and empirical evidence (Jessop in Wigger & Horn, 2016, 46). This means that working with rigid pre-written hypotheses is void.

The final important point to touch upon regarding epistemology is the nature of causal relationships in critical realism. Causation in critical realism is opposed to the empiricist logic that sequential regularities between X and Y are enough to discern causal relations (Sayer, 2000, 13-14). Instead, critical realism understands causality as the ability of structures to allow for certain events via mechanisms (ibid.). Whether this outcome occurs depends however on conditions, like agency and alternative mechanisms. Structures therefore always have causal power, but whether a certain outcome occurs depends on specific other conditions (Figure 1).

**Figure 1.** Critical realist causality



Source: Sayer (2000, 15)

### *Critical realism and the Regulation School*

The facets of critical realism also find their reflections in Regulation scholarship. The most striking reflection of critical realism in the regulation is found in their ontological similarities, as discussed in the previous chapter. Epistemologically, like critical realists, Regulation scholars reject the belief in universal principles. Instead, they stipulate that knowledge exists only within a local and historical context (Danermark et al., 2001, 8). Critical realism and the Regulation school respect the uniqueness of each case and do not seek to find universal laws but rather study power, structures and tendencies (Patomäki and Wight, 2000, 223). To understand these power structures, Regulation scholars employ the method of retrodution and move between more abstract and concrete conceptions of reality, a method that is called articulation (Jessop & Sum, 2006, 303-304). Overall, we therefore see many similarities between critical realism and Regulation scholarship, something that is also found in the upcoming discussion on methodology. This does not equate that all principles of critical realism are applied in Regulation theory. There are some differences between both groups of scholars, particularly on the ontology of structures (for more on this see Jessop & Sum, 2006, 299-321). Despite such differences however, the critical realist philosophy of science and the Regulation School are very compatible and provide a solid theoretical base for discussing the developments on the German housing market.

## 2.2 Methodology

### Critical realist methodology

Having covered the ontology and epistemology, we arrive at the methodological position of critical realism and the Regulation School. This methodological stance can be characterized as ‘anything goes’, or stated more formally, as critical methodological pluralism (Patomäki & Wight, 2000, 227; Danermark et al., 2001, 152; Wigger & Horn, 2016, 47-48). This does not equate to methodological relativism but is rather a position that states that although not each method is equally viable for every research, in principle there are no objections to the use of any method. This holds as long as the method is properly motivated and it is line with the epistemological foundations of critical realism. As critical realists believe in the primacy of the ontology, the ontology must necessarily decide which methods are most useful. Often this is a combination of different methods (Danermark et al., 2001, 2). Rather than create a strict dichotomy between qualitative and quantitative research, it is instead acknowledged that each method has its own function in research and that both can function as complementary. This thesis adopts a similar approach by combining qualitative and quantitative sources with a study of existing literature on the topic to study the topic from a wide range of sources and perspectives. This triangulation is useful as different sources can remedy the risk of unreliable measurements in any individual measurement (Beach & Pedersen, 128-129). Put differently, it is very unlikely that truly independent sources and measurements create the same outcome, unless this outcome is true. Moreover, different sources can highlight different elements of reality and might therefore be complementary. Which specific sources this entails will be discussed more extensively in the operationalization (2.3).

### Research method and periodization

This thesis uses a method that can be best described as a less-strict version of process-tracing. The often rather rigorous, monocausal and sequential interpretation of causality in this method is very limiting and will thus not be used. Still, like process-tracing, the focus of this thesis is on understanding the causal mechanisms and processes that have led to the rise of prices on the German housing market in a largely, but not completely chronological fashion. In terms of periodization the focus is on the period since the Second World War. Although the main focus is on the period since the 1980s, a discussion on the post-war period is included. The reader might be surprised by this rather long time for explaining the rise of housing price since 2010. Wijburg & Aalbers (2017A) for example, start their analysis only in the mid 1980s. Yet, in order to fully understand the rise of financialization in Germany and its relation to the housing

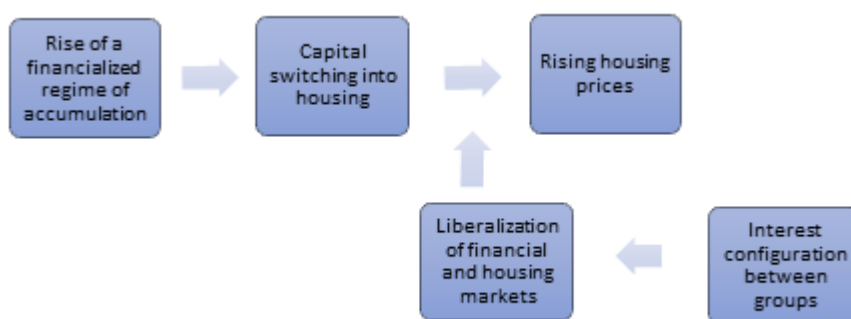
market we must understand how the financial sector and housing was organized before the 1980s. The gradual breakdown of the old Fordist regime is namely of crucial importance for understanding both the rise of financialization and the new role of housing in Germany. This long-term orientation does pose the issue of German reunification. As the reunification of the East German Deutsche Demokratische Republik (DDR) with the West German Bundesrepublik Deutschland (BRD) can more adequately described as a friendly take over rather than a merger, it is chosen to only study West-Germany before 1991.

The empirical analysis of this thesis analyses both macroeconomic/financial as well as major regulatory and institutional changes with regards to the housing and credit sector. This way, developments in both the regime of accumulation and mode of regulation are covered. The discussion on the developments in both of these categories alternate one another in a largely chronological fashion. To structure the discussion, it is broken down into different periods which correspond to the differs sections of the empirical analysis chapter. These periods are: the Fordist regime of accumulation (1945-1980), the rise of a financialized regime of accumulation (1980-2000), the stagnation and revitalization of Financialization (2000-), the breakdown of the Fordist housing system (1990-) and finally the rise of financialization via rental housing (2010-). The choice for this periodization will become apparent and justified during the empirical analysis. In this historical overview, the focus is on illustrating the switch from a Fordist production-oriented regime of accumulation towards a financialized regime of accumulation and its consequences. This breakdown namely did not only entail a new form of accumulation but also meant the gradual breakdown of many Fordist institutions. Most important of these are the changing role of financial actors relative to the production economy and the decline of collective social security, including (social) housing. It is this breakdown, that allows the rise of financialization via rental housing and the increase in housing prices in Germany since 2010.

## 2.3 Operationalization

Although including a hypothesis is not coherent with the critical realist perspective this thesis follows, there are certain expectations before the research is conducted. In this thesis the expectation is that a change in accumulation structure has occurred in Germany. The original Fordist regime of accumulation, based on mass consumption and production, is increasingly being replaced by a financialized form of accumulation due to a trend of overaccumulation. The result of this rise of financialization is that capital is increasingly switched into housing, which in turn explains the rising housing prices. Changes in the mode of regulation, particularly the deregulation of financial and housing markets, have facilitated this mechanism. The state plays a particularly important role in the gradual liberalization as it seeks to form a compromise between the different interests of labour, productive capital and (international) financial capital among others. For a compromise to function, a large enough group of ordinary civilians however also must gain something in this shift. Their support can be explained by the benefits for homeowners of increasing housing prices and the high level of private landlords in Germany. Visually, this causal mechanism is presented in figure 2. Note, for the sake of clarity feedback loops are left out, but rising housing prices and the liberalization of financial and housing markets most likely also reinforce the financialized regime of accumulation.

**Figure 2.** Hypothesized causal mechanism



Note: both capital switching and the rise of financialization are (in)directly caused by overaccumulation and in turn also reinforce overaccumulation. Therefore, overaccumulation is not presented separately, but rather as an element of both processes.

As mentioned before, the analysis alternates between two different sections. Visually this corresponds to the upper and lower areas of Figure 2. For the upper area, the analysis relies mostly on quantitative proxies for the theoretical concepts of financialization, capital switching and overaccumulation. Although these concepts are quantitative, data that specifically measures these exactly measures these concepts directly does not exist. As a result, we must resort to using proxies to measure these various concepts. None of the individual proxies measure the concepts perfect, but by using a lot of them, we can still get relatively confident empirical results. This is in line with the discussion on the method of triangulation. These proxies originate from the databanks of the OECD, World Bank and Statistisches Bundesamt. Moreover, a previous study on the financialization of Germany by Detzer et al. (2013) was used extensively, as it compiled an enormous collection of (historical) data on the development of financialization in Germany until 2013.

#### *Financialized regime of accumulation*

To measure if a financialized regime of accumulation has developed in Germany, several quantitative proxies are used. We can distinguish two types of measurements for financialization in this thesis. Firstly, there are measurements that measure the relative importance of the financial sector. The first in this category is the value added by the financial sector relative to GDP. This value assesses whether the sector has grown in relative importance in Germany. Additionally, the relative employment in the financial sector will be discussed. Secondly, as financialization can also expand to households and non-financial corporations, measurements are also included that measure financialization in the broader sense, which is more in line with the definition of Krippner (2005). The expansion of the total financial assets in the economy provides one such general estimate of the growth of financialization in the whole economy. Financial assets comprise all non-physical liquid assets including cash, bank deposits, bonds, shares and investment in equity. This means that all physical assets ranging from land, machines and equipment are excluded. In Germany, the vast majority of financial assets is part of what theoretically is discussed as the fourth circuit of capital: bonds, shares, securities and derivatives (Statistisches Bundesamt, 2020). Another substantial amount of financial assets (around 25 percent) is however held as currency, deposits and cash (ibid). These are not fictitious assets, but as they still indirectly contribute to the expansion of fourth circuit of capital and only form a fraction of the total, it is decided to not subtract this from the measurement of financial assets. It must be noted however, that the measurement of financial assets is therefore not equal to the amount of fictitious capital in the economy, although it does

illustrate a general development. As financialization often coincides with a growth of total private (mortgage) indebtedness, this will be used as an additional measurement. Finally, to measure if financialization expands into non-financial corporations, an analysis of the relative importance of financial profits on total profits is used.

### Capital switching

Similarly, to the measurement of financialization, the measurement of capital switching is conducted via proxies. For capital switching this is however much more difficult than for financialization as was exemplified by King (1989) and Beauregard (1994). In the first place this is due to data problems. Most existing data that is available to proxy capital switching, like fixed capital investment, does not accurately cover what Harvey understands as the secondary circuit of capital, as it also involves investments in fixed production tools like machinery. Moreover, Beauregard (1994, 724) and Harvey (1985, 22) both concluded that there are so many agents, types of investments, sites of investments and interactions involved in capital switching that any analysis trying to accurately cover capital switching is incredibly complex. Christophers (2011) illustrates however, that capital switching can be measured successfully. To do this, Christophers (2011, 1353) compares the corporate and public investments in buildings with investments in the factors of production, labour and fixed capital (subtracting building expenditure). Secondly, he analyses the investment portfolios of institutional investors to analyse trends in investments. These actors are well suited to switching capital into the most profitable sectors and therefore can indicate larger patterns. By combining both measurements, we can be confident whether or not capital switching has occurred.

This thesis will apply these proxies to Germany. Following Christophers (2011, 1353), the productive capital investment on the national level is calculated by combining the total compensation of labour and the total gross fixed capital within Germany, minus dwellings. This is then compared to the total investments in buildings, which is the last remaining element of gross fixed capital. As suitable data for Germany is available on investments in housing by *all* institutional investors, this will be used instead of an analysis on specific portfolios.<sup>5</sup> Both data sets combined also give a rough estimate on the source of the switched capital, from either the primary or fourth circuits of capital. There are however several limitations here. Firstly, there is no data on investment patterns from private households, who make up a large share of

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<sup>5</sup> More information on these two measurements will follow in the empirical analysis.

total landlords in Germany. Secondly, much of the investment in housing is done via funds. This means that the investments by private firms, financial institutions and individuals who invest in these funds, cannot accurately be measured. These indirect investments are measured, but as financial assets and not direct investments into housing. Similarly, the expansion of mortgage lending in housing counts as an increase of financial assets rather than direct investment in housing. Theoretically however, both cases are capital switching into the second circuit, not the fourth. The data as such is not always perfect. By combining different measurements however, most of these limitations however are overcome.

### Overaccumulation

The final concept that is measured quantitatively is overaccumulation. It is hypothesized that the root cause of both the rise of a financialized regime and capital switching is overaccumulation. The expansion of financial markets is however both a cause and an effect of a process of overaccumulation. This means that the effect and cause of overaccumulation is already being measured, at least partially, by the rise of financialization. Similarly, the measurement of capital switching also already measure a process of overaccumulation. To further reinforce that the source of these processes is overaccumulation the relative importance of finance for the total non-financial corporate profits is also measured. Additionally, the current account and inflow and outflow of capital are used as measurements to cover the possibility of overaccumulation occurring thanks to the inflow of foreign capital. Hung (2008) argues that this was a primary cause of overaccumulation in the export-oriented accumulation strategy of China.

### Regulatory changes in the housing and credit sector

The analysis of the lower area of Figure 2 is based on an analysis of major regulatory changes in the housing and the financial sectors. Determining the major regulatory changes is in large part based on existing analyses, which are then reinterpreted in light of the Gramscian Regulation theory. To understand these major regulatory changes, the interest configuration that has supported this change is process-traced. The discussion on this interest configuration includes a variety of domestic and international actors and their organization in larger contesting political coalitions. Agency plays an important part in these regulatory changes. Although agency strictly speaking entails a direct action, *potential* action will also be interpreted as a form of agency. The risk of a backlash or criticism is namely equally a factor

that influences policy decisions. Key theoretical concepts that are central in this reinterpretation are the formation of coalitions, the role of opposing fractions of capital and the mediative role of the state in forming a comprehensive concept of control (CCC).

## Chapter 3: Empirical analysis

Before discussing the developments that have led to the recent surge in housing prices, it is useful to first become acquainted with the structure of the German housing market. The German housing market is namely quite different from those of other advanced economies. Two elements in this regard are particularly unique about the German housing market: the tenant culture and the organization of the financial/mortgage credit sector. Understanding these differences will help the reader understand why Germany does not follow a model of financialization via mortgage debt, but rather a model of financialization via rental housing units as was first pointed out by Wijburg & Aalbers (2017A). After this general introduction to the German housing market, we turn to the main body of the empirical analysis. This consists of a largely chronological analysis of changes in the regime of accumulation and mode of regulation since the Second World War. Here, particular attention is devoted to the role of agency and its interaction with changes in the economic structure.

### 3.1 The current German housing market: an overview

#### *The German tenant culture*

Germany has one of the lowest homeownership rates in Europe, at just over 40 percent (Kofner, 2014, 264). This is in the first place caused by government policy. Since the end of the second world war the German government has actively intervened on the housing market to make housing more affordable (Wijburg & Aalbers, 2017A, 971). The post-war German housing situation, like that of many other countries that suffered from the second world war, was disastrous (Wertheimer, 1958, 338). To achieve sufficient affordable housing, the German government heavily invested in developing the social and private renting markets by subsidizing renting and the construction of rental housing (Kofner, 2014, 264). This focus on maintaining a strong rental sector has since remained a constant in government policy on the housing market. Although the government has also attempted to make homeownership accessible, particularly to underprivileged groups in society, it never became a top priority of governments to increase homeownership rates (Busch-Geertsema, 2000, 1). This can partially be explained by the fact that homeownership never became as closely associated with status as in other countries (Helbrecht, 2012, 445). Although the causation is debatable, as one might also argue that this a collective coping to deal with the lack of opportunities for

homeownership, it is still a notable distinction from other countries. Either way, Germany has a very strong private rental sector that comprises about half of the total German dwellings (ibid.). For comparison, many other countries have a private rental sector that makes up about ten to twenty percent of the total housing stock. Finally, it is important to mention that Germany has a particularly strong private landlord culture. Sixty percent of all rental housing is privately owned, that is by couples, individuals or estates (ibid.). This means that in comparison to other countries, Germany has a much larger private landlord group. This is of particular importance for understanding the policy choices that are discussed later in this chapter.

#### *A diverse financial and mortgage credit sector*

Germany is also unique in terms of the organization of the credit sector. Germany's financial sector is centred around a diverse array of banks (Behr & Schmidt, 2015, 4). Although several non-bank financial institutions (notably pension funds, insurers and investment funds) have played an increasingly important role in the German financial sector over the last decades, still the largest share of German finance is directly or indirectly controlled by banks (Detzer et al., 2013, 73-74). Although banks are the most prominent financial institution in the German financial sector, there is no subgroup of banks that dominates the financial system. Whereas in many countries, the pillarization of banking has eroded in favour of private commercial bank dominance, Germany still has three distinct types of banks: private, savings and cooperative (Behr & Schmidt, 2015, 5; Bülbül, Schmidt & Schüwer, 2013, 1-2). These pillars are however by no means coherent, homogeneous categories. Instead, even within pillars Germany is characterized by a very heterogeneous banking sector (Detzer et al., 2013, 75). This heterogeneity is reinforced by the fact that many banks are locally organized, either by solely operating in particular regions or by operating via local branches. Although Germany no longer has the 4000 banks it had before the turn of the millennium, its total of around 1800 banks today is still substantial (Story, 1996, 373; EBF, 2020).

The fragmentation and pillarization of German banks becomes even clearer when we look in more detail at the three different pillars and their business strategy. Private banks are the main banking type and control about forty percent of banking assets in Germany (Behr & Schmidt, 2015, 5-6). Generally speaking, private banks are oriented on international financial services, financial markets and operate on a for profit basis (ibid.; Detzer et al., 2013, 73). Savings banks control about as many banking assets as private banks. They share a focus on savings and regional banking services (Bülbül, Schmidt & Schüwer, 2013, 2). Traditionally, these banks

were owned by local governments and supported local sustainable businesses without the goal of profit maximization. As a result of this heritage, they are also often called public banks. Although currently, many savings banks are no longer owned by the public, their main purpose has not changed (ibid.). Thirdly, there are the cooperative banks. They are only half the size of the former bank types. Like savings banks, cooperative banks often have a local orientation (Behr & Schmidt, 2015, 6; Bülbül, Schmidt & Schüwer, 2013, 3). Cooperative banks are a special type of bank as their clients are often also the members of the cooperation. Central to cooperative banking is that they are democratic self-help organizations (Bülbül, Schmidt & Schüwer, 2013, 3). The cooperative nature of these banks in practice means that like with savings banks their main orientation is not profit. This means that besides a large variety of banks, Germany also is characterized by a relatively small share of banks that operate on a for profit basis.

Like the financial sector more generally, the German mortgage market is dominated by a diversity of banks. The dominance of banks is even stronger in the mortgage market, where banks own a market share of 96 percent. This is the result of policy that the only banks and life insurance companies are allowed to give out mortgages (EMF, 2020, 79). Like in the banking sector more generally, the market share of mortgages is for a large extent controlled by banks that are not oriented towards significant profit making. More than half of all mortgages are provided by cooperative savings organisations, savings banks and specialized mortgage banks, while commercial banks only give out a quarter of all mortgages (Helbrecht & Geilenkeuser, 2012, 2). Instead of profit maximization, German mortgage lenders prefer to lend only to financially stable households, housing associations and investors who seek to build private rental buildings (Wijburg & Aalbers, 2017A, 971). By requiring high down payments, offering fixed interest rates and fixing the mortgage loan value (usually 80 percent) to the foreclosure value, the German mortgage providers have made it relatively difficult for citizens to get a mortgage (Voigtländer, 2014). Moreover, the German financial sector has experimented comparatively little with financial innovations like securitization. Instead, most banks finance their mortgages via covered bonds (*Pfandbriefe*) or alternative financial assets, which stay on the balance sheet of banks (Wijburg & Aalbers, 2017A, 971; Kofner, 2014, 270-272). This means that moral hazard with regards to mortgages is relatively limited. In sum, the German mortgage sector therefore can generally be characterized as conservative compared to the more profit-oriented and risk-seeking mortgage sectors in other countries.

The combination of strict borrowing conditions in the financial sector and a public and government preference for renting have made housing-centred financialization via mortgage debt difficult to impossible. Instead, Germany has followed a model of financialization via the rental market (Wijburg & Aalbers, 2017A, 977-978). To understand how this is possible, we first have to go back in time and start at the end of the Second World War.

### **3.2 The Fordist regime of post-war Germany (1945-1980)**

The German post-war economy was devastated and in shambles. After half a decade of total war, much of Germany's pre-war production, population and capital had evaporated. Moreover, the allied victors demanded severe economic punishment and reparations of Germany. This meant that what little was left of Germany's productive capital was reduced even further. Germany's housing was in a similarly disastrous situation as millions of refugees poured into Germany, while a substantial part of the housing stock was either destroyed or damaged. Despite all the initial setbacks, Germany would recover remarkably strong in the following decades. During the 1950s, the era of the so-called German economic miracle (*Wirtschaftswunder*), GDP would grow by eight percent per year (Carlin, 1994, 4). From 1960 to the oil crisis of 1973, West German GDP would increase by a further four percent per year. A similar wonder occurred in the production of housing, where the housing shortage of 5 million dwellings in 1950 was counteracted with a completion rate of 500.000 houses annually during the 1950s (Wertheimer, 1958, 338). Germany thus recovered remarkably rapidly from its post-war malaise.

The incredible post-war economic miracle was built on the Fordist regime of accumulation. Central to this Fordist accumulation regime was the development and expansion of mass-production (Jessop, 1989, 263). In Germany, unlike Britain, the production was mostly based on high-skill production, particularly in automobiles and electronics (ibid., 270-271). The steady expansion of this mass-production was provided by growing domestic consumption and a relatively strong export position (ibid.; Carlin, 1994, 14 & 29). The stable mass-consumption of goods that this regime of accumulation required, was supported by the mode of regulation of the social market economy, also called Rhineland capitalism. This social market economy was a combination of free markets with a strong, but limited state that would guarantee a system

of low inflation, social security and equal competition (Wrobel, 2011, 4-5).<sup>6</sup> The provision of social security was not limited to guaranteeing workers rights and unemployment benefits but was also extended to housing. Here, the state provided affordable housing via rent subsidies, stimulated the investment of private funds into the construction of housing and financed the building of almost 300.000 social housing units a year (Wertheimer, 1958, 340-341). A similarly important role in providing the stability of this system, was played by the strong labour unions and employer organizations, who were responsible for collective bargaining (Carlin, 1994, 11; Eichengreen & Ritschl, 2008, 30 & 34-35). Although the interest of productive capital and labour did not always align, there was still a substantial degree cooperation between labour and capital, as the predictability and stability of consumption growth was in the interest of both parties. The result of this cooperation was that wages would generally follow the growth of productivity during the post-war era (Jessop, 1989, 272). This combination of aggregate demand growth from domestic and foreign consumption meant that the risk of overaccumulation in this system was rather limited as surplus capital could be absorbed by the expansion of production.

#### *Finance during the era of Fordism*

The financial sector played an equally important role in the expansion of mass-production under the Fordist accumulation structure. Like today, Germanys financial system was dominated by three distinct banking pillars. On the national level, the big private banks (*Großbanken*) were the most important (Detzer et al., 2013, 39-41). Although after the war, many of Germany's largest private banks were broken up into regional offices to prevent the concentration of power, ten years after the second world war the previously disassembled private banks were allowed to reunify (Eichengreen & Ritschl, 2008, 25). This was needed as the large German non-financial companies, preserved by weak competition policy, needed banks with large capital assets that could provide a stable influx of capital for expanding production. As a result, loans to these large non-financial companies accounted for sixty percent of the total loans of the big private banks between the 1950s and 1970s (ibid.). This

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<sup>6</sup> Although the German government succeeded in providing the first two elements, equal competition was never pushed as hard in practice as on paper. The German government purposefully left many loopholes in its competition policy that allowed the pre-war corporate and financial culture to largely persevere, despite the fierce American pressures to establish the right to compete and hence, the right to create free market access for American and other competitors (Carlin, 1994, 54; Eichengreen & Ritschl, 2008, 27-28).

intimate connection between big banks and big industries was not only financial, as big private banks also significantly affected the decision making within the non-financial corporations they lend money to (Carlin, 1994, 61-65). Via a combination of direct shares (5%) and delegated voting rights (50%), big private banks were able to effectively control the shareholders vote (Detzer et al., 2013, 39-41). Big private banks and large industries as such operated in a close network, both financially as well as personally. Small and medium-sized businesses operated in similarly close networks with their local banks (Carlin, 1994, 64-65). These banks, including savings banks, cooperative banks and regional (private) banks, would provide capital to the rest of Germany's businesses. This meant that the banking system in Germany was segregated, with each having their 'own sphere', both in terms of customers and region. This also meant that each faced only limited exposure to competition.

This uncompetitive banking system was however not to last. Stimulated by the lifting of restrictions on cooperative banking as well as decades of successful business with local businesses, cooperative banks began to expand their business into the traditional domain of the big private banks (Detzer et al., 2013, 40). To compensate for the loss of customers, the big private banks started to look for new ways of expanding their business. First, they attempted to expand into small and medium-sized enterprise loans (Detzer et al., 2013, 41). This however largely failed as the regional, cooperative and savings banks were far more experienced in this market and thus had long standing, intimate connections with the small and medium-sized enterprises (ibid.). Meanwhile, the pressure on big private banks was increased even further by the slump of the German export growth during the 1970s and early 1980s (Jessop, 1989, 271-272). The Fordist mode of accumulation that had served Germany well in the prior decades, had by this time slowed down significantly. Productivity was growing slowly, while high wages were making German products increasingly uncompetitive (ibid.). The international oil crisis of 1973 only added additional fuel to this fire (Detzer et al., 2013, 41). As a result, exports were no longer expanding as fast which pressured the profits of businesses (Jessop, 1989, 271-272). Although, attempts were made in the 1970s to turn the tide via the austerity and modernization policies of *Modell Deutschland*, this did not prove to be effective enough to turn the tide for German industry in the short-term. The massive economic growth spurt under the Fordist accumulation structure was thus over by the 1980s (World Bank, N.D. A).

As a result of lacking growth in the real economy and increased competitiveness by other banks, big private banks were significantly reduced in size. Their share of total banking assets

was halved from 19 percent in 1950 to 9.8 percent by 1980 (Detzer et al., 2013, 40 & 75). It was this competition, in combination with the decreasing profitability of investments in real production that made large private banks dissatisfied with their restricted role as the providers of credit for large German firms (Streeck, 2009, 78-79). Banks, particularly the big private banks, were unable to invest their capital profitably in industries and were thus seeking new markets to invest their capital into. Although their share of assets was significantly reduced, they thus still suffered from overaccumulation, although semantically the term capital absorption problem seems more appropriate considering the decline of banking assets. Inspired by the larger profits that British and American banks were able to make by operating in international markets, Germany's big private banks increasingly strove for a combination of internationalization, liberalization and expansion of financial markets (Deeg, 1999, 87; Story, 1996, 377-378). This led to them promoting the development of the so called *Finanzplatz Deutschland* (English: *Financial Centre Germany*) in the 1980s and 1990s. On this platform, numerous proposals were made for innovations to the financial system. In the following decades, big private banks, with support of numerous international financial actors and large firms, would increasingly push for the replacement of the 'old' national banking system in favour of a more 'modern' internationally oriented market-based system (ibid).

The shift in orientation by private banks from supporting the production sector to accumulation via the expansion of financial assets is an important turning point for the German financial sector. Most smaller cooperative and savings banks would until today remain legally bounded to administer loans to borrowers in their district. Meanwhile, commercial banks, international banks and to a lesser degree the larger savings and cooperative banks, would increasingly move to a model of total finance (*Allfinanz*), providing a diversity of financial services both in Germany and internationally (Behr & Schmidt, 2015, 1-2). Rather than commercial finance being tied to the interest of productive capital, commercial finance would increasingly dictate its development as its own independent sphere of accumulation. The interests of the different subgroups of productive capital and financial capital resultantly were slowly but surely diverging. This development however did not occur in a vacuum. Instead, the future role of finance in Germany was heavily contested. The compromise that resulted from this political struggle would have lasting effects on the development of German finance as it paved the way for the subsequent expansion of finance into the mortgage, real estate, securities and equity markets during the 1980s and 1990s (Detzer et al., 2013, 41; Wijburg & Aalbers, 2017A, 976-978).

### 3.3 The rise of a financialized regime of accumulation (1980-2000)

#### *A changing mode of regulation: The politics of financialization*

The discussion whether the German financial sector should develop into a (more) market-based system was the fiercest surrounding the possible development of securities and equity markets.<sup>7</sup> Initially, opposition to the suggestions by German private banks and other financial actors in the platform of *Finanzplatz Deutschland* was very strong. This opposition was formed by a coalition of a large segment of the general public, small and medium-sized businesses, organized labour, many smaller banks and the Bundesbank. The historical experience of stock market cartels and hyperinflation played an important part in this opposition as many Germans were weary of owning volatile assets, instead preferring to securely store their wealth in bank deposits (Story, 1996, 374-375). The opposition of many family-owned small and medium-sized companies in Germany was caused by the suggestion that these companies should finance via equity rather than bank loans. Financing via equity means sharing corporate control with outsiders, something many of these family businesses were not interested in (ibid.). Employees and labour organizations, who historically had substantial influence in German corporate decision-making, supported this position as they similarly feared losing control of corporate policy (ibid.). Local savings and cooperative banks who did most of their business with local firms were similarly opposed, as alternative means of corporate financing would undermine their business model of bank loans. Representing this position in the German government was the board of the Bundesbank who heavily opposed financing via equity as it would internationalize German corporate ownership (ibid., 377).

The opposition in much of the German society against the internationalization of corporate ownership is caused by a combination of factors. Besides the above-mentioned material motivations for opposition against the development of equity and securities markets, there was also a strong ideological component involved (Story, 1996, 377). The post-war Fordist economy was namely built upon the belief in the power of exporting medium-sized family businesses (ibid., 373). In this system, labour and the different fractions capital worked in relative harmony. Although this Fordist accumulation regime had by this time declined significantly, as outlined in the previous chapter, its ideational legacy remained strongly

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<sup>7</sup> Equity financing involves selling shares of the company to raise funds from investors. These investors therefore do not provide loans but become shareholders. Their share of the company can be traded on stock markets to other investors, thus further stimulating the development of financial markets.

present in Germany. As a result, it was deemed unacceptable by trade unions, politicians, local banks and medium business owners alike that German companies would be run on an Anglo-Saxon financialized model.

The opposition to financial liberalization and financialization in Germany would not last as the Bundesbank and German government became increasingly lenient towards the development of financial markets by the early 1990s (Deeg, 1999, 91-92). A combination of factors was decisive in this regard. Firstly, as already mentioned there was a strong lobby from large German private banks and firms. This lobby was reinforced by foreign banks that operated in Germany (Story, 1996, 379 & 385). The Association of Foreign Banks for example petitioned for the liberalization of financial markets to make Germany, in their words, keep up with international trends. Secondly, there was also international pressure from other states and the European Union to liberalize financial markets (Deeg, 1999, 91-92). An example of such pressures comes from the Security and Exchange Commission of the American government (Story, 1996, 379-380). As German banks were increasingly venturing into the US financial markets, the American financial institutions demanded that they would be given similar access to the German financial market. Deutsche Bank was only given access to New York's bond market after Germany had changed its accounting standards, shareholder voting rights and had given access to international institutions to trade in German bonds (*ibid.*). Such voices for allowing foreign competition on the German market were also voiced by France, the UK and the EU (Deeg, 1999, 91-93; Story, 1996, 384 & 388). Thirdly, German banks were already venturing abroad despite German governmental and Bundesbank attempts to limit this. Most concerningly for the Bundesbank was that many banks were engaged in risky international business, by operating off balance and breaching lending limits to subsidiaries (Story, 1996, 378 & 382). As a result, The Bundesbank opted that it would be better to regulate international financial activities on the European level, rather than limit it altogether. Fourthly, there was a large need for foreign capital. The government needed capital as a result of the large investments it wanted to make following the reunification of Germany (*ibid.*, 381). Capital was similarly needed by the large German firms who were restricted to finance from their own coffers or bank loans (*ibid.*, 385). Finally, the Bundesbank feared that Germany's financial markets would lose out to other financial markets, notably London and Paris (*ibid.*, 385-387; Jessop, 1989, 281; Deeg, 1999, 91-92). As such, it feared that it would metaphorically miss the boat for a strong German financial market.

Due to this combination of international developments and political pressure from a variety of actors, the German government would begin to turn more favourably to the development of Finanzplatz Deutschland. The appointment of Finance Minister Waigel (1992) symbolically confirmed this shift, as he and Kohl began actively campaigning for the Finanzplatz Deutschland (Story, 1996, 387). This position can clearly be seen in a speech by then high-ranking civil servant Jürgen Stark in Frankfurt in 1995 (Bundesregierung, 1995). Here, he declared his support for Finanzplatz Deutschland and his goal for reducing the burdens on capital and the further development of German finance. Germany, the Kohl government believed, should be a leading financial power in the newly formed EU. They particularly envisioned a role for German finance in developing Central and Eastern Europe. Resultantly, The Kohl government liberalized its financial market restrictions and harmonized its legislation with other European countries during the 1990s (for an overview see Vitols, 2004, 6-8). This position was continued by the government of Schröder, who in 1998 enacted the most far-reaching liberalization of financial markets (Detzer et al., 2013, 83). Developments supporting financialization also occurred on the European level. Here, the German government has supported the European financial integration since the late 1980s (Detzer et al., 2013, 105-106). Notable developments here are the Single European Act that allowed for the free movement of capital (1986), plans for a common currency (1992), and the Financial Services Action Plan (1999) that sought to create a common financial market in Europe (ibid.). In just two decades, Germany had thus shifted its position from opposing the liberalization of financial markets to supporting it.

The position of the German government regarding financial policy clearly shifted during the 1980s and 1990s. The extent towards this support has to be nuanced however. Although the German government was generally in favour of European financial integration, it also had to account for domestic support of the different relevant sectors and capital fractions (Story, 1996, 390). Despite the German financial sector pushing for financial integration and liquid financial markets, labour unions and corporations would remain concerned about the consequences for the German social market economy (ibid., 388). Putting their money where their mouth is, many German corporations refused to finance via (foreign) equity and remained committed to domestic bank loans. As a result, while the British financial sector during the 1980s had already become focussed on providing international financial services, West German banks were still heavily oriented towards supporting domestic industries (Jessop, 1989, 281). This was also reinforced by the Kohl government, that sought to continue the export-oriented accumulation

regime of the Fordist era (Story, 1996, 391). The current account surplus that was created via this policy would additionally guarantee the autonomy of the German financial system from foreign credit.

The conclusion that arises from the discussion on the financial liberalization of the German financial sector is that the policy that Germany supported domestically and in Europe was in effect a compromise. This was a compromise between the wish for internationalization and liberalization of the large German financial and non-financial corporations and the desire to remain financially autonomous by organized labour and smaller financial and non-financial corporations. Thus, the concept of control became a combination of moderate financial internationalization and liberalization, with a distinctly nationalist banking-centred element. Resultantly, we see that banking activities between the pillars become segregated once again. Local banks would remain committed towards granting finance to small and medium-sized enterprises on the basis of long-standing relationships, while the big private banks would become the main driving force behind internationalization and the development of financialization during the 1990s (Herr & Nettekoven, 2018, 11-12).

*Changes in the regime of accumulation: The financialization of the German economy*

The European and domestic changes in financial policy had large consequences for the financialization of Germany, which during the 1990s would develop rapidly. Although a production and export-oriented regime of accumulation would remain in Germany, we see also a gradual shift towards a financialized regime of accumulation. To illustrate this development, it is useful to look at several indicators of financialization and contrast these with the pre-1980 period.

The broadest indicator of financialization is the expansion of financial assets. The growth of financial assets was at first relatively slow: the annual growth of financial assets relative to GDP was just 2.9 percent during the 1960 and 1970s and during the 1980s even slowed down to 1.6 percent (Detzer et al., 2013, 46). During the 1990s however, the expansion of financial assets was explosive, with yearly growth rates of six percent on average (ibid.). Several years, financial assets even increased by over ten percent. Due to this rapid growth, the total financial assets held by the domestic sectors relative to GDP grew from around 350 percent in 1983 to close to 675 percent by 2000 (ibid.).

Looking in more detail at these figures, it becomes apparent that the growth of financial assets was the largest for financial institutions. Banks, insurers and other financial institutions all significantly increased their financial assets (Detzer et al., 2013, 47). Of these, banks held the largest share of financial assets. Between 1979 and 2000 the total balance sheet size of banks increased two-and-a-half fold (to 260 percent of GDP), total bank loans doubled (to 130 percent of GDP) and securities held by banks increased fourfold (to 65 percent of GDP) (Detzer et al., 2013, 47-55). This expansion of banking activities has in part been fuelled by a doubling of deposits at banks during the same period (to 120 percent of GDP). Clearly, banks expanded significantly during this period. The growth in other financial institutions is however notable too. The relative growth was especially large in the category of ‘other financial institutions’, comprising mostly institutional investors. This category witnessed a fivefold increase in financial assets to GDP from 1991 to 2000 (ibid., 47). Moreover, there is an increase in internationalization of finance as financial assets owned by foreign nationals increased from 50 to 150 percent during the same period. Additional evidence for financialization is provided by the growth in size of the financial sector within Germany in terms of relative value added as a percentage of GDP as well as employment. The financial sector’s added value to GDP has slowly increased from around 2.5 to a peak of 4 percent by 2000 (Detzer et al., 2013, 56). Employment in the sector meanwhile rose from 1.5 percent to a peak of 2.5 percent in 1991, only to decline to 2 percent by 2000 again. This however is more than likely in part caused by digitalization. Clearly, the German financial sector expanded heavily during this period as a result of domestic and international policy changes.

Although domestic banks still were the most important German financial actors, there were also several noticeable shifts during this period. Firstly, German finance was increasingly internationalizing. German financial institutions increasingly ventured abroad, while oppositely foreign financial institutions increasingly owned German assets (Detzer et al., 2013, 47-48). These financial linkages would only increase in the following decades. Secondly, although banks continued to dominate the German financial system, particularly private banks were increasingly focussed on the financial markets for securities and bonds (Detzer et al., 2013, 55). German private banks also started expanding in investment banking by purchasing foreign investment banks, thereby further extending their market share abroad (ibid., 77). The effects of this on the German banking sector are significant. Private banks and international commercial banks would from 1980 on increase their share of total banking assets drastically. Private banks would grow from 23.5 percent in 1980, to 27.1 percent by 2000, to 38.3 in 2012

(Detzer et al., 2013, 75). This growth has in large part been fuelled by the big private banks, who increased their share of total assets from 9.8 percent in 1980 to 15.4 by 2000 and finally to 25.3 percent in 2012. Finally, foreign commercial banks would increase significantly in size, going from negligible amounts in 1980, to 4.1 percent by 2000 and to 12.1 in 2012. As such, the major winners of these reforms were international and commercial banks. Yet, thanks to the loyal support from small and medium-sized enterprises, regional, savings and cooperative banks have managed to hold on to a sizeable share of the market.

#### *The expansion of finance in real estate*

The search for new markets during the 1980s and 1990s would also affect the real estate market. This expansion already started to pick up pace during the 1980s and coincided with the replacement of SPD chancellor Helmut Schmidt with the new CDU Chancellor Helmut Kohl (Rohmert, 2013, 12-13). During the mid 1980s Germany's GDP would grow significantly again and resultantly demand for real estate increased, particularly in commercial real estate. As part of the spirit of total finance, German commercial banks jumped at this opportunity and increased their activities on the real estate market (Rohmert, 2013, 13). These banks invested significantly in commercial real estate and were speculating in the market for office space in large cities (ibid.). A limiting factor for this expansion into commercial real estate however, was the relatively high interest rates during the economic boom of the 1980s, hovering at around nine to ten percent. The British financial sector by contrast, was able to expand much more freely into real estate as they had much lower interest rates (ibid.). Overall, although during the 1980s banks expanded somewhat into (commercial) real estate, the growth was limited.

This limited growth would however be replaced by rapid real estate activity expansion during the 1990s. Several opportunities presented themselves during this period that stimulated this process. The German reunification allowed western financial actors, who were eagerly looking for new markets, to delve into almost untouched real estate markets in East Germany (Wijburg & Aalbers, 2017A, 976-977). This process was further stimulated by the Kohl government, which was looking to integrate the economies of east and west, while simultaneously upgrading and replacing the existing housing stock to meet West German standards of living (Glock & Hausserman, 2004, 921). To achieve this, the Kohl government introduced several housing policies like subsidies, tax reduction and low interest loans to increase construction and modernization in East Germany. This policy was initially successful in achieving the goal of

upgrading the housing in East Germany (ibid.). As a result, real estate developers and banks expanded their business significantly.

The effects of the reunification on the German housing market financialization were significant. Germany's homeownership expanded from 36 percent in 1994 to 41 percent by 2004 (Andrews & Sanchez, 2011). As a result, Germany's mortgage loans to households increased from 30 percent in 1990 to 45 percent of the total GDP by 2000 (Detzer et al., 2013, 63). Total mortgage debt to GDP would increase from 40 to over 50 percent (Wijburg & Aalbers, 2017A, 977). These figures gave Germany one of the largest mortgage debt levels in Europe, despite it still having a relatively low homeownership rate (ibid., 973). Although the expansion of financialization was faster in other markets, by the beginning of the 1990s financialization in the housing market was quickly developing. This however did not prove to be lasting.

### **3.4 The stagnation and revitalization of Financialization since the reunification (2000-)**

#### *Stagnation of domestic financial markets*

The growth of financial markets and housing financialization would grind to a sudden halt at the end of the 1990s and into the early 2000s. This lack of growth was the result of the 1997 recession that followed the German reunification. At first, the reunification was perceived by many in Germany rather optimistically (Wijburg & Aalbers, 2017A, 977). A quick economic catchup of East Germany was expected that would stimulate the German economy to new heights. Yet, the reunification of the former socialist state had proven harder than anticipated. The reunification had meant the simultaneous and sudden abolishment of the East German currency, political and economic organization (Burda, 2013, 195-196). For several decades, the socialist economy of East Germany had functioned on the basis of large manufacturing industries and publicly owned enterprises (Glock & Haussmann, 2004, 921). With the reunification of Germany, a simultaneous wave of privatization and deindustrialization was set in motion by the German government trust agency. This deindustrialization was so extreme that East Germany went from one of the most industrialized economies in Europe before the reunification, towards having the lowest number of industrial jobs per inhabitant of the EU in 1994 (ibid.). Unemployment subsequently rose towards a staggering 17.5 percent by 2002.

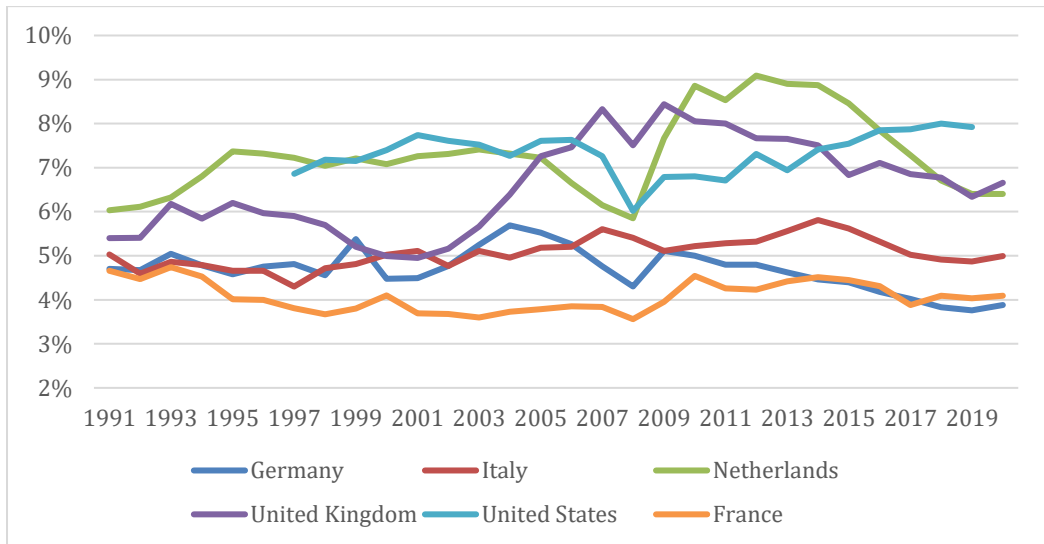
Although during this time, the West German economy also suffered from higher unemployment, this 7.4 percent figure pales in comparison to the situation in East Germany. Unsurprisingly, many East Germans moved to the west, causing a large depopulation that led to a housing market crash in East Germany (Wijburg & Aalbers, 2017A, 977).

The economic malaise slumped the German economic growth, financial markets and housing markets alike. Whereas before 2000, return on equity and investment was comparable to other advanced economies, by the 2000s Germany would have one of the lowest returns on investment (Detzer et al., 151-162). Moreover, Germany's financial institutions were consistently 'underperforming' in terms of cutting costs compared to their international counterparts (ibid., 151). With investment in German equity, bonds and mortgages generating little yield, German financial institutions increasingly started moving their capital abroad. They particularly moved to the emerging markets in Southern and Eastern Europe, where returns were much higher (ibid.). Although capital inflows and outflows before 2000 were relatively similar, after 2000 the relative outflow of capital would constantly be larger than capital inflows (ibid., 95-96). Resultantly, the net international investment position of Germany improved to over 800 billion by 2008 (ibid., 98). This explains why the capital flows that went into Germany because of a consistent and substantial current account surplus (between four and eight percent since 2000), have not led to a large expansion of financial assets or issues of overaccumulation in Germany (OECD, N.D. B). The problem of overaccumulated capital that was unable to be absorbed by German industry or financial investments, was namely spatially fixed into other countries.

Following the recession and the withdrawal of capital, we see a general stagnation in the growth in the German financial sector that has lasted until today. The relative value added of finance has remained relatively similar between 1991 and 2010 (Figure 3). Since 2010, the sector has even decreased in value added. Similarly, during this period we see a decline in employment in the sector (Figure 4), thereby continuing the trend set in since 1991 (Detzer et al., 2013, 56). Although the in Figure 3 and 4 presented statistics covers the developments for *both* finance and insurance, it does indicate that both the employment and value added of finance have decreased since 2010. Although accurate numbers are not available for finance specifically, we can estimate that financial services alone currently employ around two percent of the

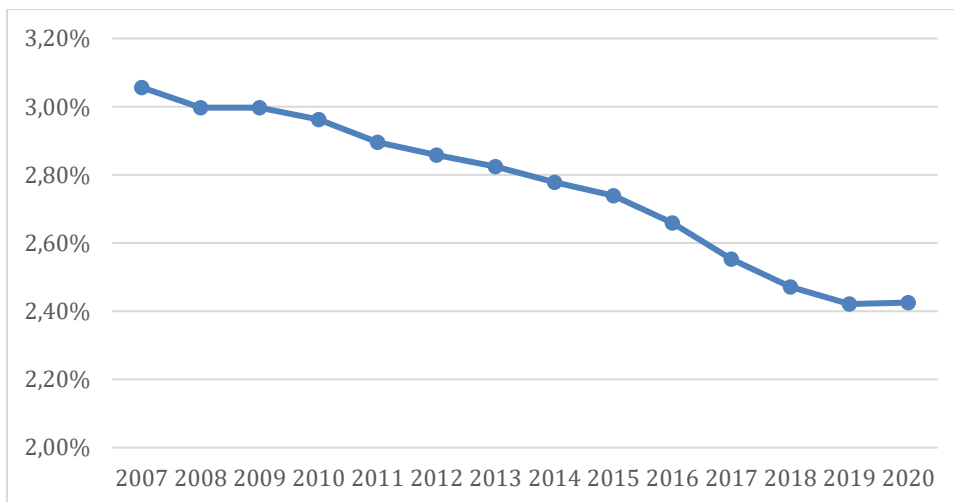
workforce, while contributing around three percent of the value added to GDP.<sup>8</sup> Overall, the conclusion therefore is that the total increase in size of the domestic financial sector in Germany since the 1970s, despite a peak during the 1990s, has been relatively low.

**Figure 3.** Value added by finance and insurance in Germany and selected countries (1991-2020)



Source: OECD (N.D. C)

**Figure 4.** Employment in finance and insurance in Germany (2007-2020)



Source: OECD (N.D. D)

<sup>8</sup> The historical trend from Detzer et al. (2013, 56) indicates that the share of insurance is consistently around half a percent of employment and one percent of value added. Subtracting these numbers gives the results for finance as presented here.

The image of a slowly growing and relatively small German financial sector becomes reinforced when we look at the development and relative size of financial sectors in other Western advanced economies. Although the value-added rates of the financial sector have also decreased in other countries since the GFC, none of the advanced economies listed in Figure 3 have such a low percentage of value added by finance besides France. Even the traditionally weakly developed financial sectors of Italy and Spain surpass Germany in relative size of the financial sector (OECD, N.D. C). The dominance of banks within the financial system in Germany plays an important role in this underdevelopment of the rest of the financial sector. While other advanced market-based economies like the United States, The United Kingdom and the Netherlands have developed significant stock markets, Germany's stock market remains relatively underdeveloped as financing for many companies is still controlled mostly by banks (Demirgüç-Kunt & Levine, 1999, 54). This is in large part caused by the resistance from companies to finance via equity that was discussed earlier.

The comparative stagnation of finance in Germany is also reflected in the private indebtedness of Germany. Since 2000, the growth of private debt has stabilized at around 150 percent of GDP (OECD, N.D. E). This is remarkable as almost all OECD countries have greatly increased their private indebtedness over the last 20 years. Even in spite of the continuing decline labour share in Germany and the breakdown of the Fordist social security under several German governments since the 1980s, Germany still did not see a rise in private indebtedness (ILO & OECD, 2015).<sup>9</sup> Whereas Crouch (2009) argued that a decline in wages and social security following the breakdown of the Fordist regime of accumulation would be compensated by the expansion of credit, in Germany this is not the case. Regarding the growth of mortgage indebtedness, Germany is similarly an outlier. Since 2000, all selected EU member states saw a significant increase of mortgage indebtedness (Fernandez & Aalbers, 2017, 38; Wijburg & Aalbers, 2017A, 973). All European countries thereby followed a common trajectory of rising mortgage debt, regardless of prior level of indebtedness or overall size of the financial sector. Germany however proved to be the only exception to this rule as it has seen a decrease in its level of mortgage debt until 2010 (ibid.). Since 2010, total outstanding mortgages loans have again increased because of rising housing prices in Germany. Still, this increase was marginal

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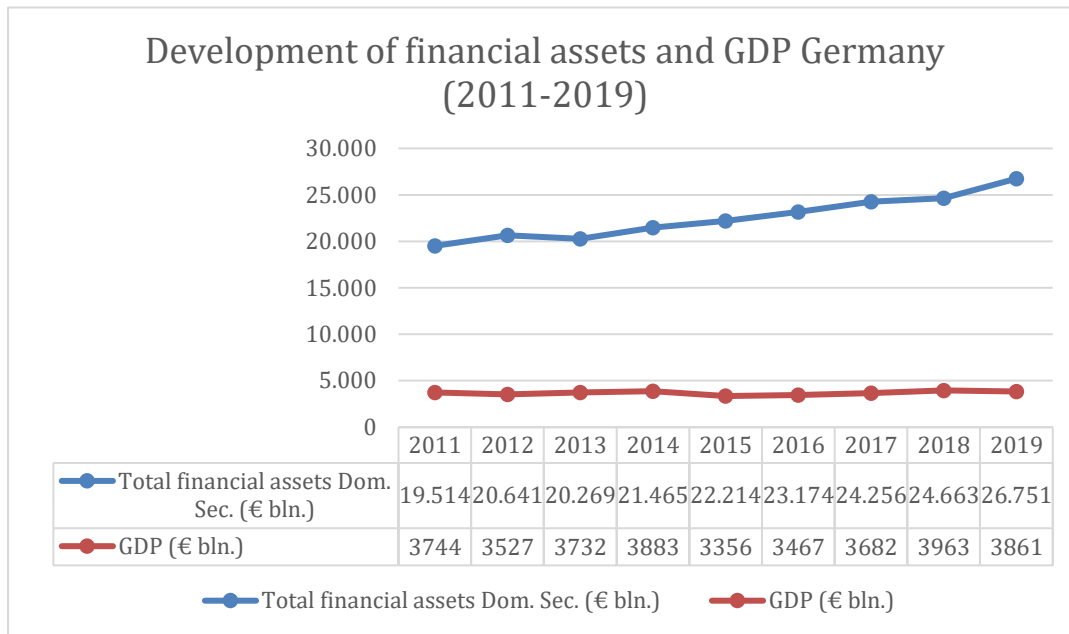
<sup>9</sup> The Schmidt and Kohl governments were the first to push for the reduction of labour costs to make the export-oriented regime of accumulation more competitive (See Jessop, 1989, 271-2). The Schröder government has further expanded this policy as was exemplified in the Agenda 2010 and the Hartz reforms.

with total outstanding mortgage loans still sitting at well below the EU average (EMF, 2014; EMF, 2019).

### *The growth of financialization since the Global Financial Crisis*

Looking at the development of indebtedness and the size of the financial sector one would be inclined to state that financialization in Germany has been limited. There has however been a clear growth in financial assets, particularly over the last ten years. Between 2011 and 2019, total financial assets have increased from €19.500 to close to €27.000 billion euro, netting a total growth of 38 percent (Figure 5). For comparison, real GDP has seen an increase of just three percent during this timespan. Of this total amount of financial assets, only around €1500 billion euro is accounted for by an increase currency and deposits. This means that the other €6 trillion euro are fictitious assets (Statistisches Bundesamt, 2020). Unsurprisingly, the largest share of financial asset growth is accounted for by financial institutions, both domestic and foreign, who expanded their financial assets by €3.000 billion euro to reach a total of almost €15.000 billion (26%) (ibid.). Also noteworthy is that non-financial corporations significantly increased their financial assets by €1700 billion to almost €4.000 billion euro (70%). Households similarly expanded their financial assets significantly by more than 2000 billion to 6700 billion euro (46%). This is an interesting observation as it suggests that financialization in Germany is increasingly occurring outside of the realm of domestic financial corporations. Instead, much of the growth in financial assets can be attributed to the expansion of fictitious assets by foreign financial institutions, households and non-financial corporations. This would explain why despite the fact that the growth in the German financial sector itself has been rather weak, we still see a development of financialization in Germany.

**Figure 5.** Development of financial assets and GDP in Germany (2011-2019)



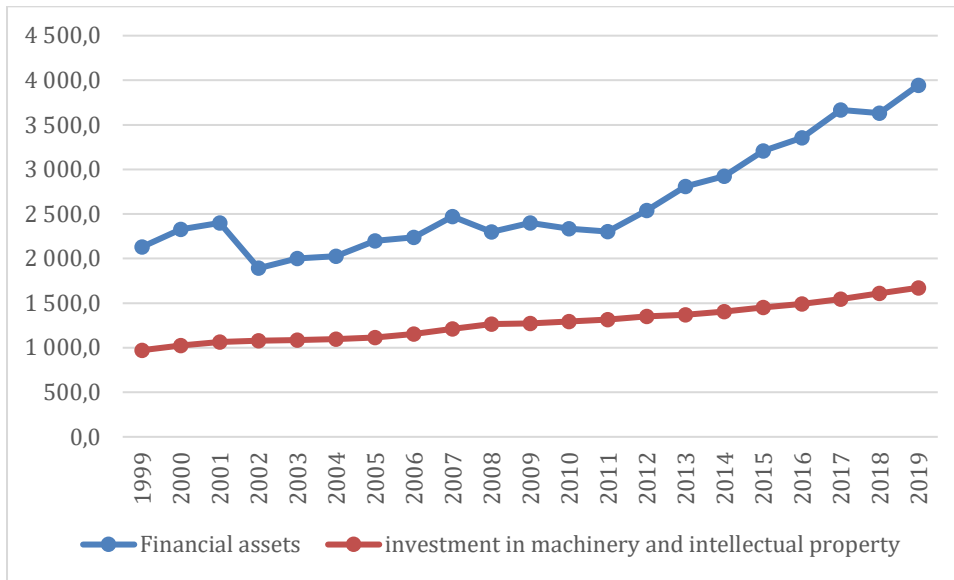
Source: World Bank, N.D. B; Statistisches Bundesamt, 2020

Note: GDP measured in current US dollars.

*Capital switching into the fourth circuit: fuelled by overaccumulation?*

What is striking in both periods of rapid expansion of financial assets in the 1990s and 2010 is that this expansion occurred during a period of stagnation in GDP. The growth of financial assets to GDP in Germany was the fastest when real GDP growth was slowing down between 1995 and 2000 to around 1 or 2 percent per year (World Bank, N.D. A & B). Although this can partially be explained by the measurement relative to GDP, still the rise of financial assets is much larger than in years of significant GDP growth even when accounting for this. Similarly in the period after 2011, a slump in real economic growth was met by a large increase in financial assets. This suggests that as the real economic growth is dwindling, many corporations choose to switch their capital into non-productive assets like stocks and bonds to supplement their lack of growth by investment in production. Such capital switching from productive to financial capital by corporations was also observed by Christophers (2011) for the United Kingdom and the United States (2000-2007), Crotty (2005) for the United States (1980-1990) and Alvarez (2015) for France (2004-2013). Their studies illustrate that the lack of profitability of investments in commercial and industrial activities prompted firms invest more in financial assets. Financial assets thereby increasingly account for a larger share of corporate profits.

**Figure 6.** Investment in financial and productive assets by non-financial corporations (1999-2019)



Source: Statistisches Bundesamt (2020).

Note: Statistisches Bundesamt uses a different categorization for fixed assets than OECD.

In Germany, we see a similar trend as non-financial corporations increased their financial assets relative to fixed assets from 37 to 42 percent between 2011 and 2019 (Statistisches Bundesamt, 2020). One must note here that non-financial assets also comprise investment in land and dwellings. These investments are formally not recognized as financial assets, but often still have a large speculative element. If we exclude these assets from non-financial assets but limit ourselves to the productive assets in investments in machinery, equipment and intellectual property the difference in development becomes much clearer. While financial assets grew by 70 percent between 2011 and 2019, investments in machinery, equipment and intellectual property grew by just 20 percent (Figure 6). Clearly, capital is being switched from productive to financial use, indicating a process of overaccumulation.

Although capital switching into non-productive assets has intensified over the last decade, the process of financialization in non-financial corporations has already developing over the span of three decades. Increasingly, non-financial corporations have preferred short-term profits via financial assets over long-term productive investments (Detzer et al., 2013, 193-194). Property income, comprising interest, dividend and rent, has increased from 15 to 25 percent of total operating surplus between 1991 and 2011. The growing importance of financial accumulation for non-financial companies however becomes most clear when looking at their profits. The

total amount of profits that are derived from financial asset portfolios increased significantly since 2000 from 15 to 40 percent of total profits (ibid., 58). As the operating surplus of non-financial corporations has increased significantly, from 20 to 30 percent between 1991 and 2010, this means that increasingly a process of overaccumulation is developing in non-financial corporations: capital has accumulated so much that it is unable to flow into productive investments and thus is switched into the fourth circuit of capital (ibid., 160).

The expansion of the fourth circuit as stated above should, according to Aalbers (2007, 149-151), coincide and be followed by an inflow of capital into the secondary circuit. Before we can delve into this however it is important to understand how it is even possible that housing has become an attractive investment asset in Germany in the first place. As Harvey (in Christophers, 2011, 1349) had rightly argued, capital switching into an asset is only possible if financial markets and government policy allow it. The financialization of the housing market as such is not only an effect of the regime of accumulation, but equally by changes in government policy with regards to housing. Therefore, we will first go back in time and look at the development of privatization and deregulation of housing from the 1990s until the present day, before moving on with the discussion on capital switching into the second circuit. This will explain how housing in Germany was able to become an investment asset.

### **3.5 The breakdown of the Fordist housing system (1990-)**

Like many other countries that followed a Fordist mode of Regulation, Germany had a sizeable social housing stock. Since 1950, ten million social housing units have been built, a quarter of the total 40 million dwellings in Germany (Kofner, 2017, 63). Social housing is a type of housing that is (partly) subsidized by the government. In return for this subsidy, there are specific goals attached to social housing for a fixed period. After this period is over, a house no longer qualifies as social housing. This means that a large outflow of social housing into regular private housing occurs regularly (ibid.). Although the outflow of social housing as such has always been substantial, by 1987 social housing still totalled 4 million dwellings or 15.3 percent of the total West German housing stock (ibid.). A substantial part of this stock was also directly owned by the federal government, provinces, municipalities and semi-public companies. They however decided to sell a large part of their share of social housing in the

early 2000s. Between 1999 and 2006 this amounted to close to 500.000 social housing units. These were mostly sold to private investors in large transactions. Even more substantial for the breakdown of social housing were the shortening of the protection period and the limited availability of subsidies for the construction of new social housing (Kofner, 2014, 263). With the continuous outflow of social housing, this meant that the social housing stock was reduced to just 1.7 million by 2018 (ibid.). In total, over 3 million social housing units have moved into the private rental sector (Unger, 2016, 1). This reduction was particularly heartfelt in the large cities of Germany, that previously were home to large social housing stocks (Wijburg & Aalbers, 2017A, 978). The once strong social housing system of the Fordist mode of Regulation had thereby thoroughly been torn down.

#### *Motivation for privatization: debts or ideology?*

To explain the massive reduction in social housing, several authors argue that the primary motivation was to reduce public debts at both the federal and municipal levels (Wijburg & Aalbers, 2017A, 978; Voigtländer, 2007, 748; Uffer, 2011, 98). These had namely risen significantly in the preceding decades due to a combination of factors. The first of these was that the independently operating Bundesbank decided that it would no longer allow for inflationary policies to stimulate employment in 1974 (Streeck, 2009, 57). This however also meant that to reach the goal of full employment, the social-liberal government of Schmidt had to rely solely on fiscal policy. This increased public debts significantly. These public debts were already increasing because of a general increase in the costs of social policy. This was in part caused by the habit of using the welfare state as a tool to get rid of abundant labour supply during times of crisis or industrial reorganization. This was in the short-term interest of both labour unions and the employers as wages would be kept high, while abundant or elderly employees could be laid off to reduce costs for employers (Streeck, 2009, 56-58). This strategy however came at severe long-term costs. The increased social security contributions increased the labour price of Germany. During a period when the export-oriented growth model was already becoming increasingly threatened by rising labour costs, this only added fuel to the fire. Besides hindering economic competitiveness, the prevention of conflict between labour and employers meant that ever increasing amounts of public spending were going to social security (ibid., 60). Although the Schmidt government attempted to tackle this problem via austerity of social security in the early 1980s, this had hardly proven successful (Jessop, 1989, 273). When the costs of social security continued to increase during the 1990s, the Kohl government decided that it was necessary to enact even stricter budget cuts on social security

(ibid., 60). This breakdown of the Fordist mode of regulation would also affect the social housing sector, where social housing would be privatized and marketized in order to reduce costs (Soederberg, 2020, 18-19).

Although cutting down on government debt and spending might in part have motivated and legitimized the privatization of social housing, it was the neoliberal ideology of the governments after Schmidt, namely those of Kohl, Schröder and Merkel, that seems the most plausible cause of the privatization (Unger, 2016, 1). The abolishment of the *Wohnungsgemeinnützigkeit* (1989), a tax reduction for non-profit housing sector, was for example legitimized by the government as an austerity measure. Already during the debate, the government however had to admit that the increased revenue from this policy would be limited, as this policy meant that costs for housing support would also go up (ibid.). Moreover, many other expensive fiscal policies in the housing market remained. Policies aimed at boosting homeownership, like the deductibility of mortgage interest for landlords or the capital gains taxation exemption, were never abolished (Martin, Hulse & Pawson, 84). Between 1996 and 2006 the German government even had a subsidy for beginning homeowners, the *Eigenheimzulage*. This policy alone costed the state upwards of €8 billion euro yearly (Die Welt, 2002). This was introduced alongside the longstanding *Wohnungsbauprämie* (1952) that stimulated the access to homeownership for poorer families. Although the *Eigenheimzulage* was abolished in 2006, after facing criticism in the European Parliament for conflicting with European legislation, a similar scheme was reintroduced in 2018 under the name *Baukindergeld* (Tans, 2018). These programmes do not make much sense in the perspective of a retracting government that is attempting to cut debts.

Instead of seeing the privatization of housing solely as a reaction towards increased fiscal deficits, we must also see it as an attempt to free the regulated housing sector for marketization by the commercial sector. This was done via the abolishment of the *Wohnungsgemeinnützigkeit* and by the release of three million previously social housing units in the private sector, that lost their protected status (Unger, 2016, 1). Proponents of this marketization of the housing market argue that liberalized markets are better suited to create an equilibrium of supply and demand (Soederberg, 2020, 18). Markets are deemed efficient, innovative and rational, unlike state interventions that only disrupt the ‘natural’ price that the market equilibrium produces. As it is believed that state intervention makes housing only more expensive, the responsibility for constructing and managing housing should be left to large,

specialized financial institutions. The limited social housing units that remained would be run on a quasi-market model (ibid., 19). This meant that in most cases rents for remaining social housing would increase significantly. The recently privatized housing units saw similar rent increases, as they were no longer protected by social housing legislation (Unger, 2016, 7). Thus, the policy led to increases in housing prices.

### *The politics of the deregulation and privatization of housing*

Like the liberalization of the financial sector during the 1980s and 1990s, the marketization of the housing sector was advanced by a coalition of actors. The first proponents of marketization were (international) financial corporations. They were lobbying heavily in favour of market deregulation and the introduction of a legal framework for real estate investment (Unger, 2016, 4). International organizations played a similarly important role, particularly the EU and the World Bank. The European Commission has for decades pushed member states to liberalize their housing markets and stimulate the private rented sector (Soederberg, 2020, 19). This was done in the name of stimulating economic growth, competitiveness and internationalization within the EU. Meanwhile, the World Bank advanced a similar perspective in its influential 1993 publication 'Housing: enabling markets to work'. They listed three policy goals regarding the social housing market: privatization, marketization and the individualization of responsibility (ibid.).

The neoliberal thinking on housing markets pushed by international organizations was adopted in large part by the subsequent German governments. The Kohl governments (1982-1998) were most active in deregulating the housing market as they had with the financial market. With regards to housing, the Kohl government announced that it would limit state regulation on the housing market and make it increasingly market oriented (Kofner, 2014, 267). Schröder, as outlined in his paper with Blair ('Europe: the Third Way'), also believed that Germany should let go of its Fordist part. Or to put in the words of Blair and Schröder: '*The essential function of markets must be complemented and improved by political action, not hampered by it*'. As such, Schröder continued and to some extent even intensified the breakdown of the Fordist mode of Regulation that was started by Kohl (see also Agenda 2010). Part of this breakdown was the large privatization of social housing in the early 2000s. The subsequent Merkel governments (2005-2021) have continued this course but have not introduced any large, impactful legislative changes towards either the financial or housing markets (for an overview see Detzer et al., 2013, 126-133). Instead, the German governments since 2000 have introduced

several minor laws aimed at further promoting the internationalization and liberalization of housing and financial markets that were set in motion in the 1990s. Notable examples are the Investment Modernization law (2003) that allowed hedge funds to enter Germany and the relatively unimpactful G-REIT law (2007) that allowed German property funds to attract foreign capital (Vitols, 2014, 7; Wijburg & Aalbers, 2017B, 312). The broad support for the marketization by the different political parties that made up these governments illustrates that privatization is not only supported by right-wing governments. Instead, we must understand the housing market developments as a paradigm shift that has affected the major political parties (CDU, FDP, Greens and SPD). It is thus not competition between ideologies, but rather a general agreement on marketization that has characterized the policy of many German parties towards the housing market.

The effects of this policy shift in Germany were significant, but not fully in the positive sense. The policies that international organization had advised, namely also introduced several negative consequences. Privatization was stimulated as it would help increase affordable housing supply. By 2019 however, the affordable housing shortage in Germany's ten largest cities was 880.000 (ibid.). Although it is unfair to blame this totally on privatization, as urbanization and migration also are important factors in this regard, it is also clear that markets do not deliver as was generally believed. Marketization in many cases has led to price increases, while individualization of responsibility for housing has led to a substantial investment gap in affordable housing as it was no longer deemed a collective problem (ibid., 20-21). This effect can partially be explained by the fact that German social housing was mostly sold to investors rather than tenants like in many other countries. The investors that were initially attracted to German privatized social housing were a variety of private equity and hedge funds (Unger, 2016, 7; Wijburg & Aalbers, 2017A, 979). These private equity funds raise capital from other investors (private or institutional) and invest this capital for a set period (usually three to seven years) after which their assets are sold again, aiming for a substantial profit. This means that these funds are actively trying to increase the market value of their property, either by increasing rents or decreasing service to cut costs (ibid., 9). New constructions in this model are avoided as these funds are oriented mostly towards creating short-term profits. Often such funds work with high leverages and purchase property in bulk at prices of over €200 million (Heeg & Dörry in Wijburg & Aalbers 2017B, 311). It is thus also the agency and strategy of the particular landlord that can have large consequences for the status of housing.

*Tenant friendly legislation: incongruous with liberalization?*

It ought to be mentioned that despite decades of marketization, subsequent German governments have also upheld tenant friendly legislation like the eviction protection, rent subsidies and local reference rent (Kofner, 2014, 261-263). These laws however are more effective at controlling prices for existing tenants than new ones, who still face significant price increases (ibid.). Capital accumulation via renting resultantly was not significantly hindered by these policies. When these rent increases were becoming increasingly high in 2015, the FDP and CDU coalition however decided to act and enact a rent freeze (Van de Hulsbeek, 2021). This so-called *Mietpreisbremse* allowed state governments to cap rent increases at ten percent for new contracts. Although the true motivations for this rent cap are impossible to pinpoint, we could hypothesize that it is an attempt to reconcile the conflict of interests between different fractions. On the one hand political parties have to reckon with the large share of tenants in Germany, while they simultaneously have to account for the substantial share of Germans that are private landlords and the large financial interest in renting. The final outcome, the hegemonic coalition in the words of the Gramscian Regulation school, should be acceptable to both groups. In this case, such a compromise entails that the state generally allows significant rent increases, but that this gets regulated when things go out of hand.

This perspective of a compromise between landlords and tenants also helps explain why the FDP and CDU opposed the total rent increase freeze that was enacted by the Berlin city council (Van de Hulsbeek, 2021). Instead, they impose a middle ground, as also was the case with the liberalization of financial markets. Marketization and increased rents are allowed and even indirectly stimulated, but the excessive negative effects for tenants are limited via subsidies for tenants and rent caps when prices increase too fast. As such the financial accumulation via rental housing is stabilized for investors and property owners, while the direct effects for tenants remain limited. This makes housing an attractive investment for investors, who because of the large privatization of social housing also have additional property to invest in. The effects of the decades of housing market liberalization are particularly visible after 2010, something we turn our attention to in the next and final chapter.

### **3.6 The rise of financialization via rental housing, capital switching into the second circuit (2010-)**

The build-up of financial capital, often referred to ‘as the wall of money searching for yield’, is increasingly moving from the fourth circuit into the second circuit of capital, that is from financial markets into housing (Wigger, 2020, 4-5). Thanks to the privatization and marketization of real estate during the 1990s and 2000s, capital has increasingly been able to use housing as an alternative investment asset. The effects of this are particularly becoming clear since 2010. On the one hand ‘the global wall of money’ has increased, while simultaneously the options for profitable investment have decreased. This combination makes investors increasingly desperate to find new assets to invest in to continue the accumulation of capital (ibid.). Investors searching for new investments to store their capital in, are thus investing into real estate, both commercial and residential. This process, as will be discussed in the following chapter, is also visible in Germany.

#### *The wall of money searching for yield*

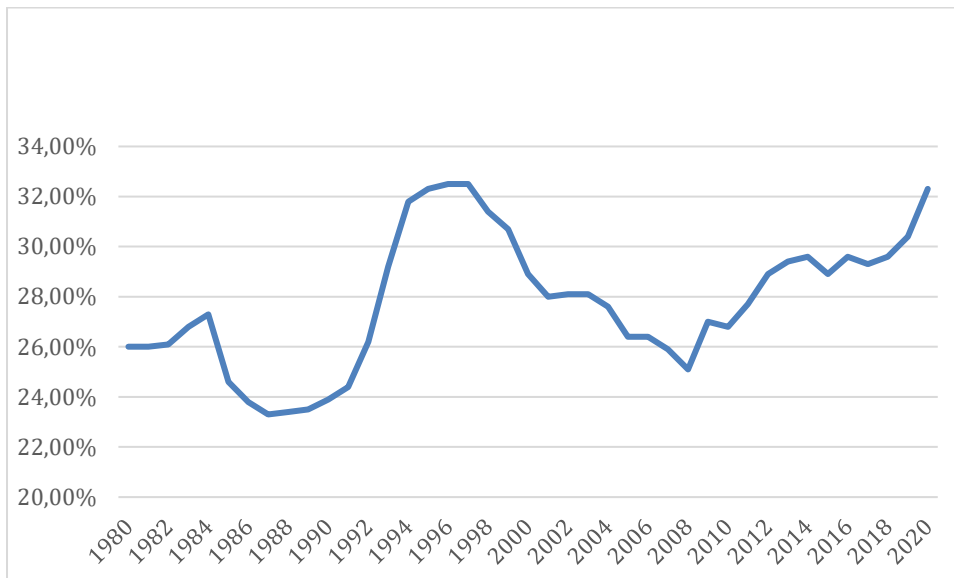
The figurative wall of money originates from the combination of the expansion of the fourth circuit of capital and the increase of overaccumulation in the primary circuit over the last decades, both within and outside of Germany. The increase in size of financial markets, stimulated by an international process of deregulation, have led global financial markets to grow much faster than the real economy (Wigger, 2020, 4). The fourth circuit as such has expanded significantly, not only in Germany but across the globe. Meanwhile, in the primary circuit a process of global overaccumulation has developed. Global corporate profits have expanded, but this overaccumulated capital is increasingly invested in financial rather than productive capital (Dobbs et al., 2015). The monetary expansion of central banks across the advanced economies over the last decade has added oil to this fire by simultaneously increasing financial liquidity and lowering interest rates. This meant that while profitable investments have decreased, the capital available for investments has increased. As a result, investors increasingly flock to alternative investments like German housing, where the yield is around four to five percent (Wijburg & Aalbers, 2017A, 981). This way the expansion of the fourth circuit fuels the second circuit.

The desperation for yield is clear in these investments as the risks associated with investments have increased significantly, both in investments in financial assets as well as in real estate (PWC, 2019, 13; Hoang, Silbereis & Stengel, 2021). Thanks to the lack of alternative, secure investments, German real estate had suddenly become highly interesting to invest in, despite its relatively low yield. Resultantly, many investors started investing their capital into German real estate (Wijburg & Aalbers, 2017A, 979). This was particularly true for the big cities, where urban growth had already started pushing housing demand and rents up (ibid.). This scarcity and potential for higher rents however made investing into German property even more interesting, thus enticing even more private investors to speculate on housing. The result of this is that the demand for housing and housing prices increased significantly over the last decade. The high demand is clearly visible in the price that investors pay for rental housing. Since 2010, this has increased by almost 200 percent (Deutsche Bundesbank, 2021). This is far more than the increase in price for residential property (80%) or rents (50%) (ibid.). Clearly, a large part of the ‘destabilization’ of the German housing market is therefore caused by an investment boom.

#### *Capital switching into housing: macroeconomic trends*

To confirm that the rise of housing prices in Germany is indeed caused by the influx of investments, we now turn to the analysis of capital switching. This will additionally help us find the source of the overaccumulated capital. First, we look at capital switching from the primary into the secondary circuit, as was theorized by Harvey (1985). To do this we use a method adopted from Christophers (2011) that analyses primary circuit capital switching via three macroeconomic measurements. The first measurement that Christophers used is employment compensation (1991-2020), which measures the gross wage costs and the social contribution provided by the employer. The second and third measurements are based on the Gross Fixed Capital Formation (GFCF) (1980-2020). This measures the total produced production assets, excluding land and resources, minus the disposables. The GFCF is subdivided into six different forms of assets; dwellings, other buildings and structures, information and communication technology, transport equipment, cultivated biological resources and intellectual property products (OECD, N.D. F).

**Figure 7.** Investment in dwellings as a percentage of GFCF



Source: OECD (N.D. F).

The annual expenditure on dwellings on average hovers around 25 to 30 percent, but we can see clear peaks in the spending on housing by firms and the public sector between 1991-1998 and 2010-2020 (Figure 7). This corresponds almost perfectly to the expansion of financial markets and financial assets which were discussed earlier, illustrating the close linkage between both. The growth of investment in dwellings is 6.5 percent per year between 1991 and 1998. During this same period, investment in other fixed assets grew by just 0.4 percent per year, while employee compensation grew by 3.2 percent per year. The combined growth of investment in productive capital (both labour and productive assets) is thereby outpaced by investments in housing, lending support to Harvey's capital switching thesis (OECD, N.D. F; OECD N.D. H). Between 2010 and 2020, investment in dwelling grew even faster at a yearly rate of 10 percent. Although employee compensation and investments in other fixed assets also grew during this period, by 4.7 and 5 percent respectively, the investment in housing is again larger than in productive assets. Although capital is therefore increasingly oriented towards the secondary circuit, it is not the case that the primary circuit during these periods is so oversaturated with capital that investments here totally dry up. Still, a large part of capital is absorbed by housing, illustrating that this is indeed a case of overaccumulation in the realm of production. This thus supports the theory by Harvey (1985) that capital is switched into housing when capital can't be fully absorbed by the primary circuit.

*Capital switching into housing: The rise of institutional investors*

Although the rise in investment in dwellings suggests a process of capital switching, one could also conclude that the rise in investment in dwellings is an effect of rising property prices. To reinforce that this is not the case, we also look at the development of the total real estate investments by institutional investors. Here, we see additional support that capital from the primary and fourth circuits are invested into housing. Investment in residential property has seen several significant changes since the 1990s. For several decades, the German residential property market was controlled nearly exclusively by domestic institutional investors (Wijburg & Aalbers, 2017B, 311). Their total investment in the seven biggest cities of Germany was around €20 billion euro in the 1990s, a figure that remained unchanged until 2004. During this time foreign investments in German residential property were already occurring but were largely negligible. Between 2004 and 2007, a major shift happened in the residential property market as institutional investments boomed from 20 billion in 2004 to more than 60 billion by 2007 (ibid.). This was caused almost exclusively by the influx of foreign capital from investment funds. The investment capacity of these international investment funds grew significantly during the 2000s because of access to cheaper credit and financial innovations like securitization (ibid.). Initially, this capital was invested mostly in the property markets of Southern Europe. As these markets became saturated with capital however, investors were looking for new, unsaturated and cheap property markets. Germany provided just such a market as the prices of German property had decreased to its lowest point in 2003 (ibid.). As fast as foreign capital moved into the German it would however also leave. By 2009 investments had dried up to just a sixth of the 2007 level. This highlights the volatility of international capital flows into Germany.

Investment data for the period after the GFC is more problematic. The residential market has namely seen such a large increase in demand for property that the supply is unable to keep up. This means that total investment volumes have decreased, despite a growing demand (PWC, 2019, 23-24). Moreover, detailed information on which institutions have invested in real estate is unavailable for the residential market. For commercial real estate, this information is available, making it a useful proxy for developments of the residential real estate market. The fact that this is a good proxy for the residential market is reinforced by the fact that developments in both real estate markets have historically been almost identical, both in terms of internationalization and total investment value, something that will become apparent in the next sections. The main difference between both markets is that the commercial real estate

market does not include a substantial private landlord share, something that accounts for 40 percent of the private rental market (RentCal, N.D.). This means that a large share of private investments is missed and thus the conclusion of the commercial property market cannot be fully extrapolated to the residential market. Yet, for reasons stated above it is the best source that is available.

Investment in German commercial property by institutional investors in the 1990s and early 2000s was relatively modest at a total investment of around €20 billion euro (Bulwiengesa, 2016, 4). This investment was mostly done by domestic open and closed property funds together with pension funds and insurance companies. After the GFC, investment in commercial property saw a drastic decrease from almost €75 billion in 2007 to just over €15 billion in 2009 (Bulwiengesa, 2016, 4). Since then, investments in commercial real estate have picked up significantly to over €60 billion in 2018 (PWC, 2019, 12). The total investments of pension funds and insurance funds moved from negligible amounts in 2009 to €2.8 billion by 2014 and over €5 billion by 2017. A similar growth of investment has occurred for the different (real estate) investment funds. The investments by specialised real estate investment funds grew from €4 billion to €10 billion in 8 years, while real estate leasing investment went from €5 to €11 billion in the same period. The largest growth in investment was however not by domestic investors but rather from the umbrella category of international investors. Their share has increased from €7 to €29 billion, thereby accounting for half of total investments in the German market. Although domestic institutional investors have clearly moved their capital into housing, the largest cause of the increased demand for German real estate has come from foreign investors. Their volatile investment behaviour is largely responsible for both the large increases and crashes in investment in Germany. This foreign capital originates mostly from Europe (22%), North America (12%) and Asia (9%) (PWC, 2018, 19). This reinforces that overaccumulation and its effects have to be understood in an international, rather than solely in a domestic context.

To precisely point which circuit the capital originates from that is invested into German housing is very difficult. This is partly caused by the importance of investment funds, who collect their capital from other investors. The origin of these sub-investors as such remains largely unknown. Still, it has been illustrated in the empirical analysis that it is very likely that the capital that is funded into the housing market is increasingly channelled into housing from *both* the primary and fourth circuits of capital. As such, the conclusion from the final chapter of the

empirical analysis is that overaccumulation and the lack of investment possibilities in both the primary and fourth circuits are the main cause of the investment hike in Germany. Additionally, we see that a substantial part of this increase is caused not by German capital, but rather from international investors.

## Chapter 4: Conclusion and discussion

### Conclusion

The central question in thesis was: *Which economic and institutional developments have caused German property prices and rents to increase so significantly since 2010?* Rather than answer the question from a microeconomic perspective, this thesis sought to give an explanation that went beyond looking at demand and supply disequilibria. Although factors such as the migratory movement to cities are important for understanding the development of housing prices, they only form a part of a larger explanation. To understand this larger explanation, a critical realist philosophy of science and the Regulation theory were utilized. Unlike many other Regulation works that centre around sketching the relation between the accumulation regime and mode of regulation, this thesis also explicitly looked at the role of agency in influencing the mode of regulation. As a result, the understanding of the recent housing market developments in Germany presented in this thesis go beyond economic and modernist reductionism. Instead, it sketches a long-term development of how and why housing has become an investment good and source of accumulation in Germany.

To answer the research question, we have to begin at the end of the Second World War. During this period, Germany had a Fordist production-oriented accumulation regime which was supported by a Fordist mode of mode of regulation in the form of the social market economy. In this social market economy, a combination of growing wages and social security provided the foundation for the rise of mass-consumption, which together with the large exports made the productive accumulation regime stable. As part of the social security, the government made sure that all Germans had access to affordable housing. Housing was thus to a large extent a collective, non-marketized responsibility. Finance in this system took a supportive role, as it provided the capital needed for the production of corporations to grow. Thus, the interests of financial capital, productive capital, labour and governments were relatively aligned, as they all profited from production, export and consumption growth. This also meant that there was no need for capital switching into other circuits, like housing.

This stability of the Fordist era would decline as production and export growth slowed down in the 1970s and 1980s. As a result, big banks were no longer content with their role as supporters of the declining productive capital. Instead, they started searching for new markets.

As part of this search for new markets, they pushed for the development of a financialized accumulation regime. Initially, this development could be postponed thanks to strong opposition from smaller banks, family businesses, the government and the Bundesbank to financing via equity. The combination of support of international finance, foreign governments, large corporations and developments in other financial markets however led the Bundesbank and government to alter their opposition to the financialization of the German economy. The Kohl government, like the governments after it, was largely in favour of marketization and liberalization of financial markets. As a result of this political agency, financialization in Germany developed rapidly in the 1990s. In their search for new markets, these financial institutions also expanded into commercial and residential real estate during the 1980s and 1990s. This was again supported by the Kohl government, as it strove to develop the recently reunified East German housing market. This resulted in a large housing boom and the expansion of mortgage debts during the 1990s.

The rise of financialization would however grind to a halt by the late 1990s and early 2000 as the economic reintegration of East Germany proved to be much more difficult than anticipated. Germany suffered from a combined housing market and economic crash, leading to the exodus of much of Germany's domestic and foreign investments to more profitable emerging markets in Southern and Eastern Europe. The growth of domestic financial markets had as a result stagnated, a status that lasts until today. A part of this stagnation is also down to the refusal of many small to medium-sized family business to finance via equity. They often remained loyal to their local savings and cooperative banks. As a result of this loyalty, we also see a clear split between banks in Germany. Smaller, regional savings and cooperative banks who operate by providing loans for a minimal, while many larger cooperative and private banks provide a diversity of financial services (*Allfinanz*) on a for profit basis. This combination of a slowly growing domestic financial market, the operation of many banks on a minimal profit and the lack of a large stimulation of homeownership via government policy also effected the growth of private and mortgage debt. Since 2000, this growth has been marginal. This is surprising since almost all advanced economies in the world have seen vast growth in debt, particularly related to mortgages. Germany however, for the reasons stated above did not develop into a debt-fuelled housing centred form of financialization.

Germany however did experience housing-centred financialization, namely via rental markets. The German governments since the Second World War, have stimulated the growth of the

rental sector via rent regulation, social housing construction subsidies and housing benefits. This policy has created a considerable rental sector that comprises over half of the total dwellings in Germany. The affordability of this rental market was for a long time, as part of the Fordist mode of regulation, guaranteed by the state via subsidies and rental regulation, but also via tax exemptions for non-profit landlords. This role has however slowly eroded since the 1990s. Like in many other countries, the German government has opted to privatize, marketize and liberalize the (social) housing market. This however in turn also puts the government in a tough position. It has to manage the large interests for increased rents by private landlords and financial capital, while not alienating the large group of German that are tenants. The result of this conflict of interest is a compromise. The housing market is made investor-friendly by allowing rent increases, while the negative excesses for tenants are prevented via rent caps and housing benefits. This compromise made German housing an interesting investment, but not necessarily an extremely lucrative one, as the housing markets in Southern and Eastern Europe provided much higher yields. The demand for German housing by investors as a result remained rather low.

This changed by the expansion of capital in the primary and fourth circuits of capital since 2010. As a result of the global rise of corporate profits and financial markets, there has been a build up of overaccumulated capital both within and outside of Germany. Pressured to find yield in this low interest rate environment, this capital was looking for new investments. The German housing market provided just one such opportunity. As a result, capital was increasingly switched away from investments in the fourth and primary circuits of capital and was instead invested in the German housing market. The housing demand that was already rising as a result of urbanization was thus increased even further. This meant that Germany's decades of housing stability were ended by long-term economic, political and institutional developments in combination with short-term searches for yield by investors. These investors are increasingly also foreign, meaning that the German housing market is increasingly influenced by international financial developments.

### Discussion

Besides answering the research question this thesis also had two other goals. The first was to theorize the importance of agency and politics for housing market developments. Rather than understand changes in the mode of regulation as merely reacting to changes in the regime of accumulation, it was theorized that agency plays a key role in shaping the institutional developments. The analysis of this thesis confirms this predicted importance of agency. The importance of agency not only extends to the mode of regulation, as was theorized, but also quite directly the regime of accumulation itself. The resistance of a large segment of German businesses to financing via financial markets is crucial for understanding the relative underdevelopment of financialization in Germany. Likewise, the liberalization and privatization of the housing market was grounded in the actions of policy makers and politicians. Here, the importance of ideologies is additionally highlighted. As such, this thesis has demonstrated the necessity for research of housing market financialization to account for this agency and to make this explicit. We cannot properly understand housing financialization and its different trajectories without acknowledging agency, and in extension culture and ideology.

A second goal of this thesis was to discuss the capital switching theory by Harvey (1985) and measure this empirically, something only few studies have done successfully. Based on the analysis of this thesis it can be concluded that the method for measuring capital switching from Christophers (2011) is well suited to doing this. There was however also an issue with the bridging of the capital switching theory to empirics, namely differentiating between the different circuits of capital and their relative importance. Although these different circuits can be relatively easily distinguished in theory, empirically this is much more difficult. Based on the method by Christophers, primary to secondary circuit capital switching can relatively clearly be identified but for capital switching from the fourth circuit this is much more difficult. This is in large part caused by the dominance of investment funds in housing investments. Moreover, the relative importance of each circuit in this process is hard to measure as the proxies are not precise enough for such conclusions. Although the acknowledgment of different sources of overaccumulated capital and its role in capital switching is theoretically useful, empirically it is incredibly difficult to distinguish the source of capital or to measure the relative importance of each form of capital switching. This means that although we can discern large patterns in investment between different circuits, to precisely point the source of capital that is invested into housing is in many cases impossible. As such, Beaugard (1994, 724) and

Harvey (1985, 22) were right when pointing out that an accurate analysis of capital switching is incredibly complex.

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