IMK
Institut für Makroökonomie
und Konjunkturforschung
Macroeconomic Policy Institute
Hans Böckler Stiftung
Fakten für eine faire Arbeitswelt.

How promising is wage restraint for a large economy?

The example of Germany before and during the current crises

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Overview

- Embedding the German growth model: Two types of growth in the euro area.
- Characteristics, performance and sustainability of these models.
- Focus on Germany: wage restraint, exports and labour market institutions
- The German way: part of the solution or part of the problem?

Different growth models in the euro area after EMU

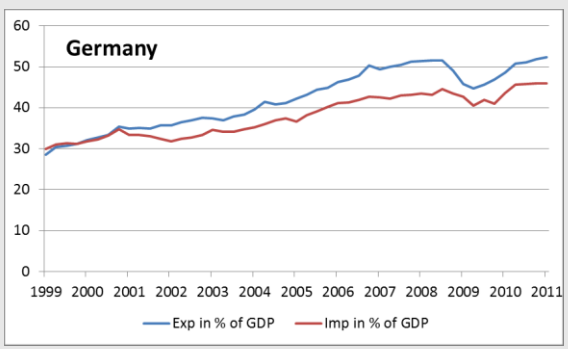
DE, NL, AT, FI, BE | **IT**, FR | **ES**, GR, PT, (IE)

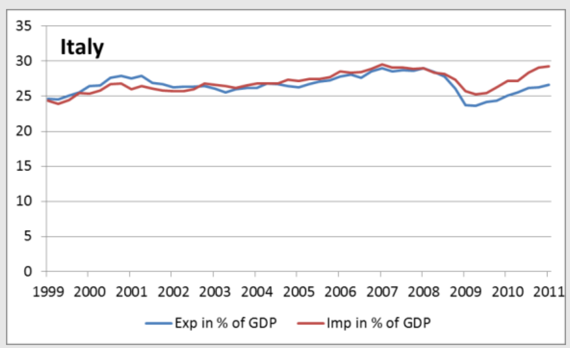
export orientation — *debt-financed consumption*

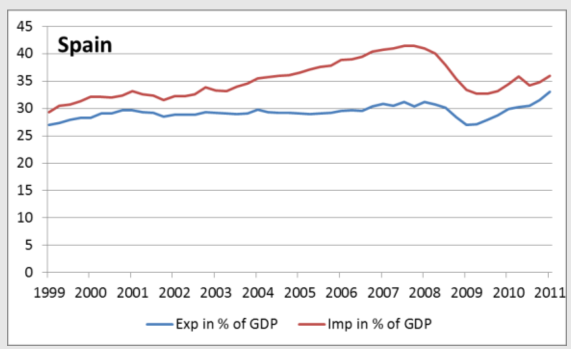
- better market access, no more appreciations in ea
- low priv. consumption
- Exp > IMP

- interest rates similar, no more depreciations in ea
- medium domestic dem.
- Exp = Imp

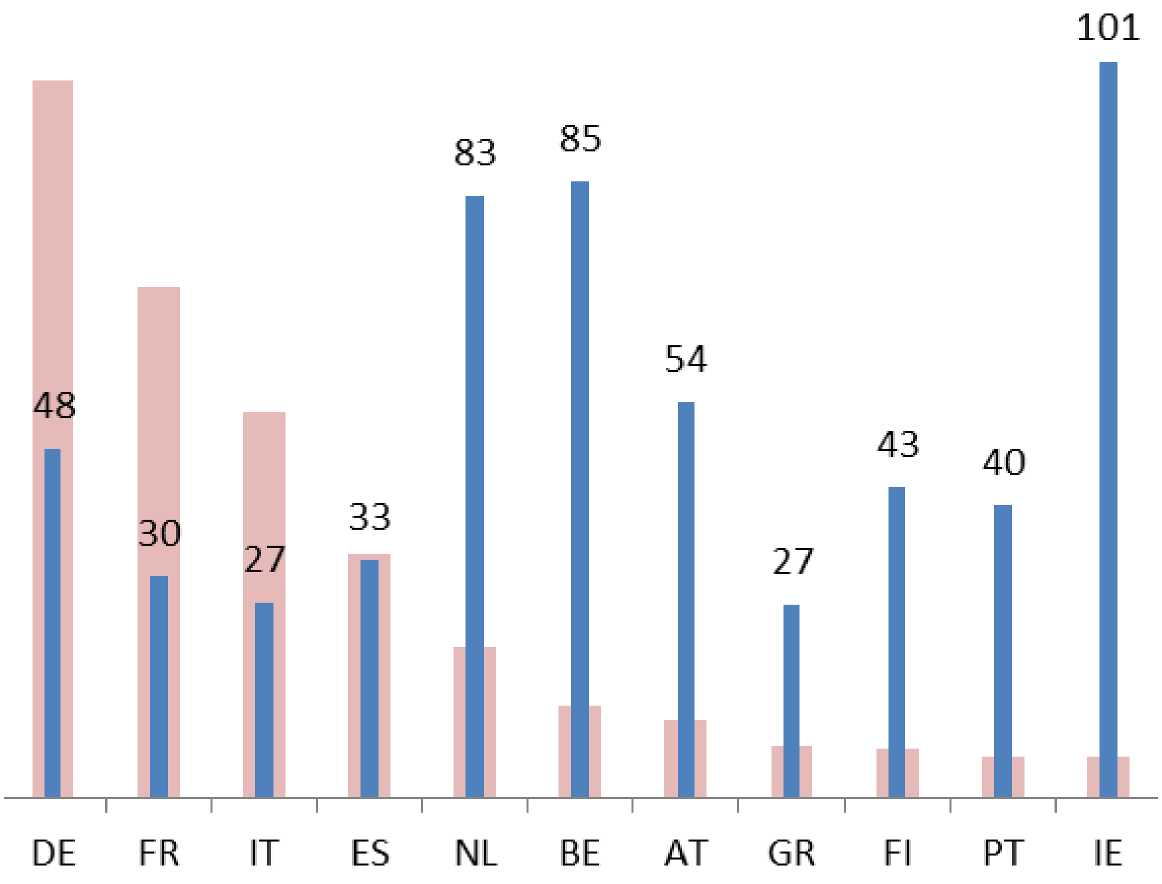
- interest rates ↘, no more depreciations in ea
- very strong domestic demand (housing)
- Exp < Imp







Degree of openness (2010, sorted by GDP)



Source: Eurostat, own calculations

How did the different models perform:

- since start of EMU until 2008;
- since the financial & economic crisis and during the current debt crisis?

Growth composition in export oriented Germany

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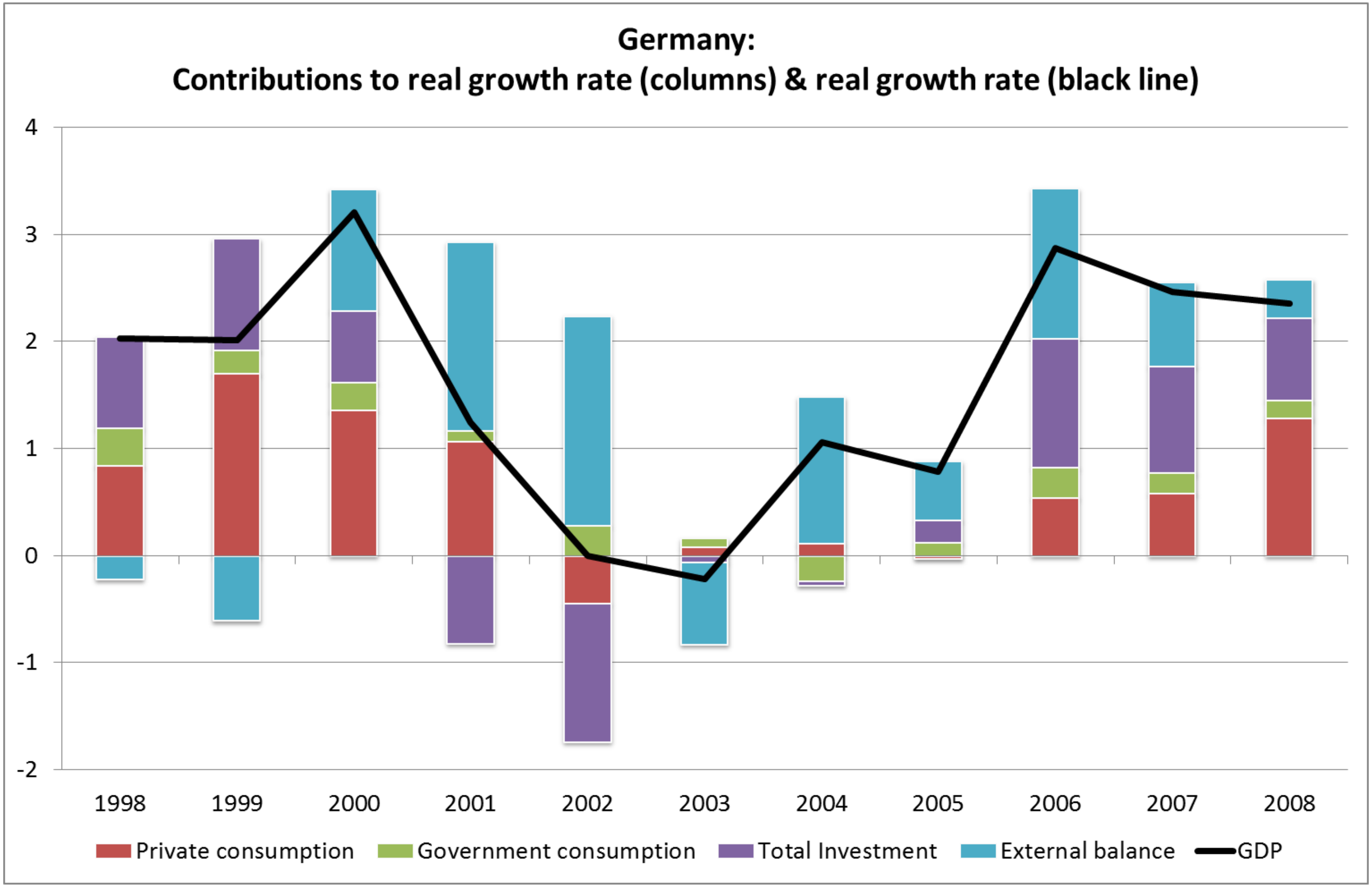
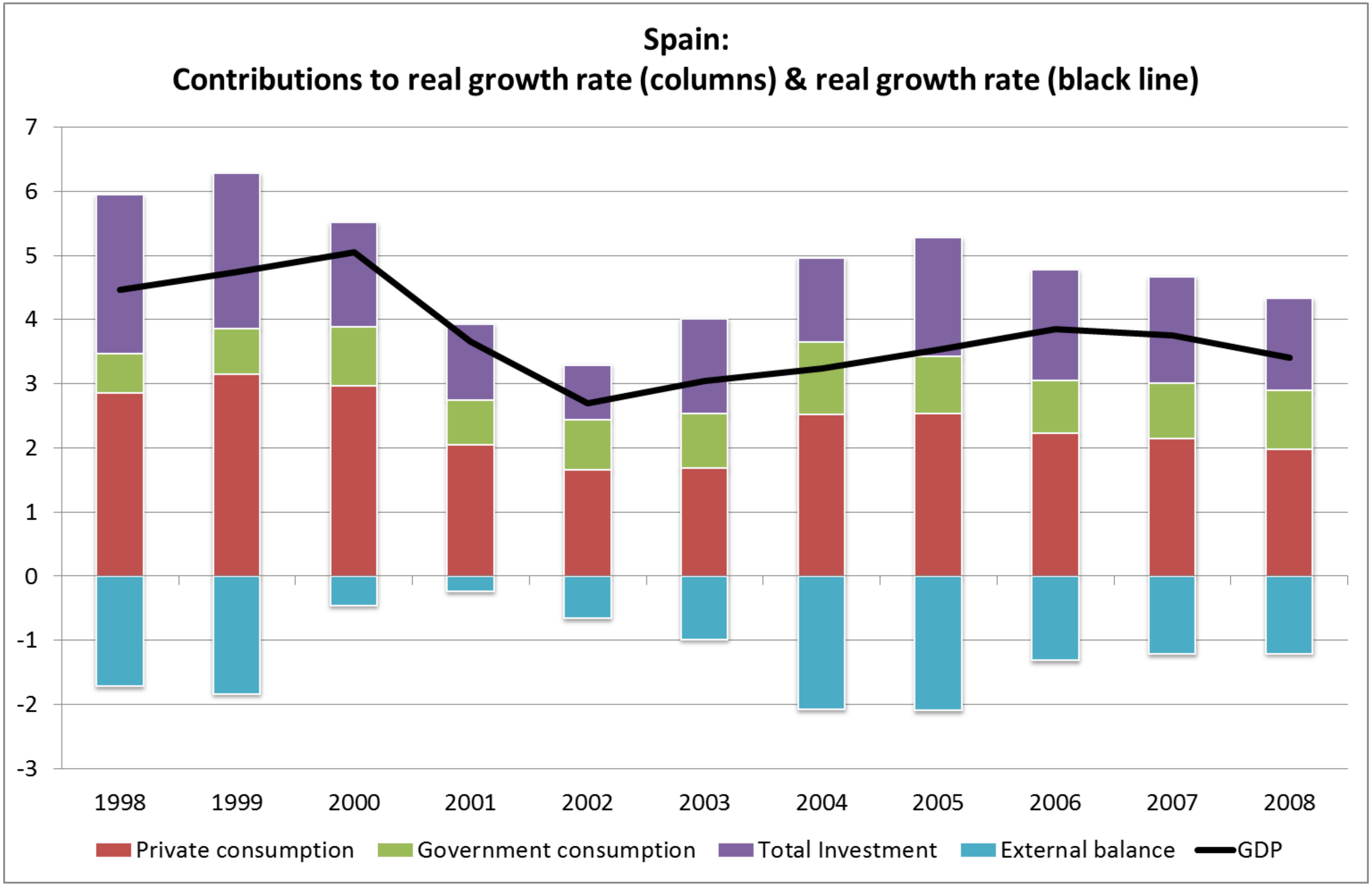
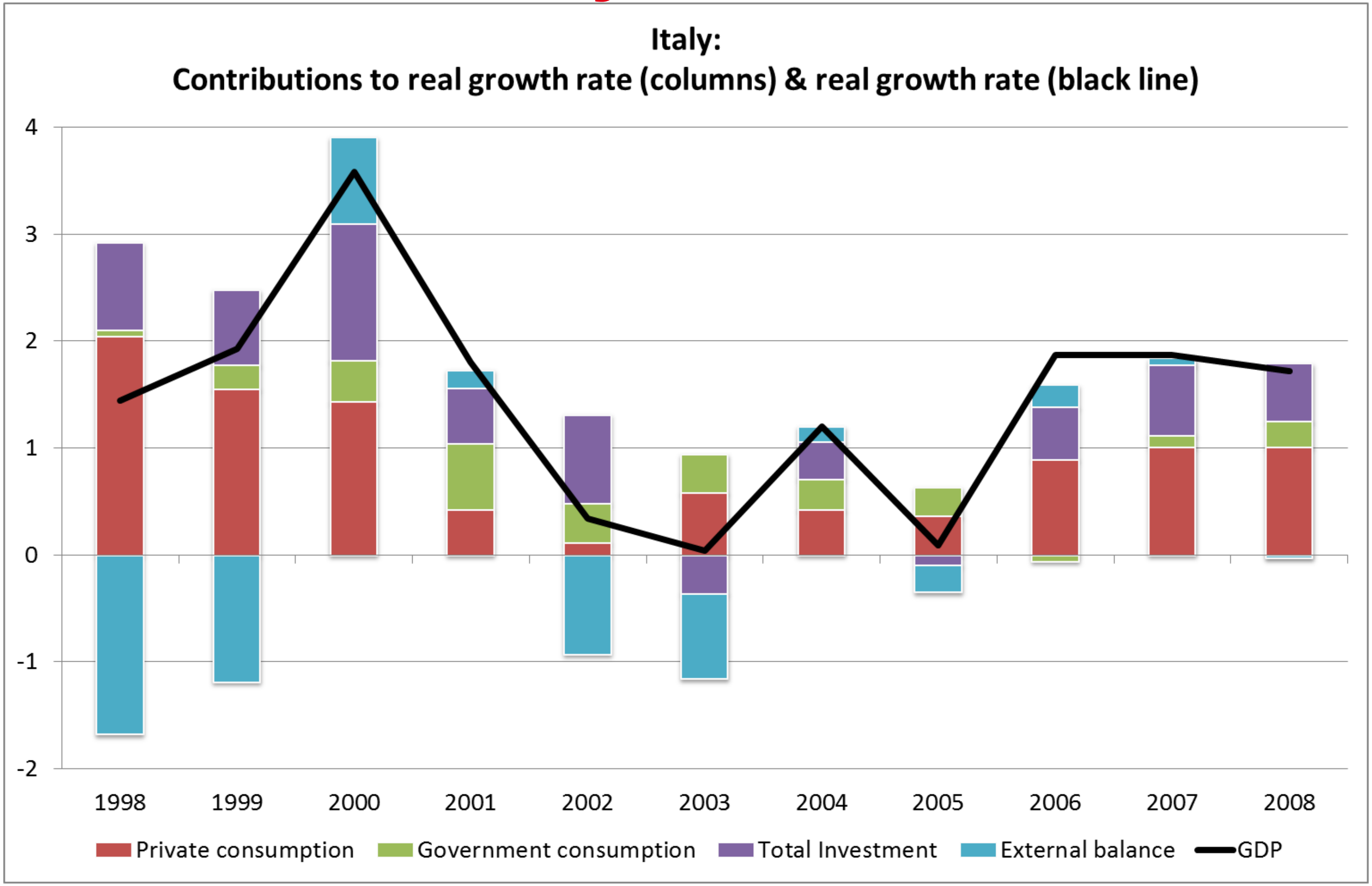


Growth composition in inward-oriented Spain

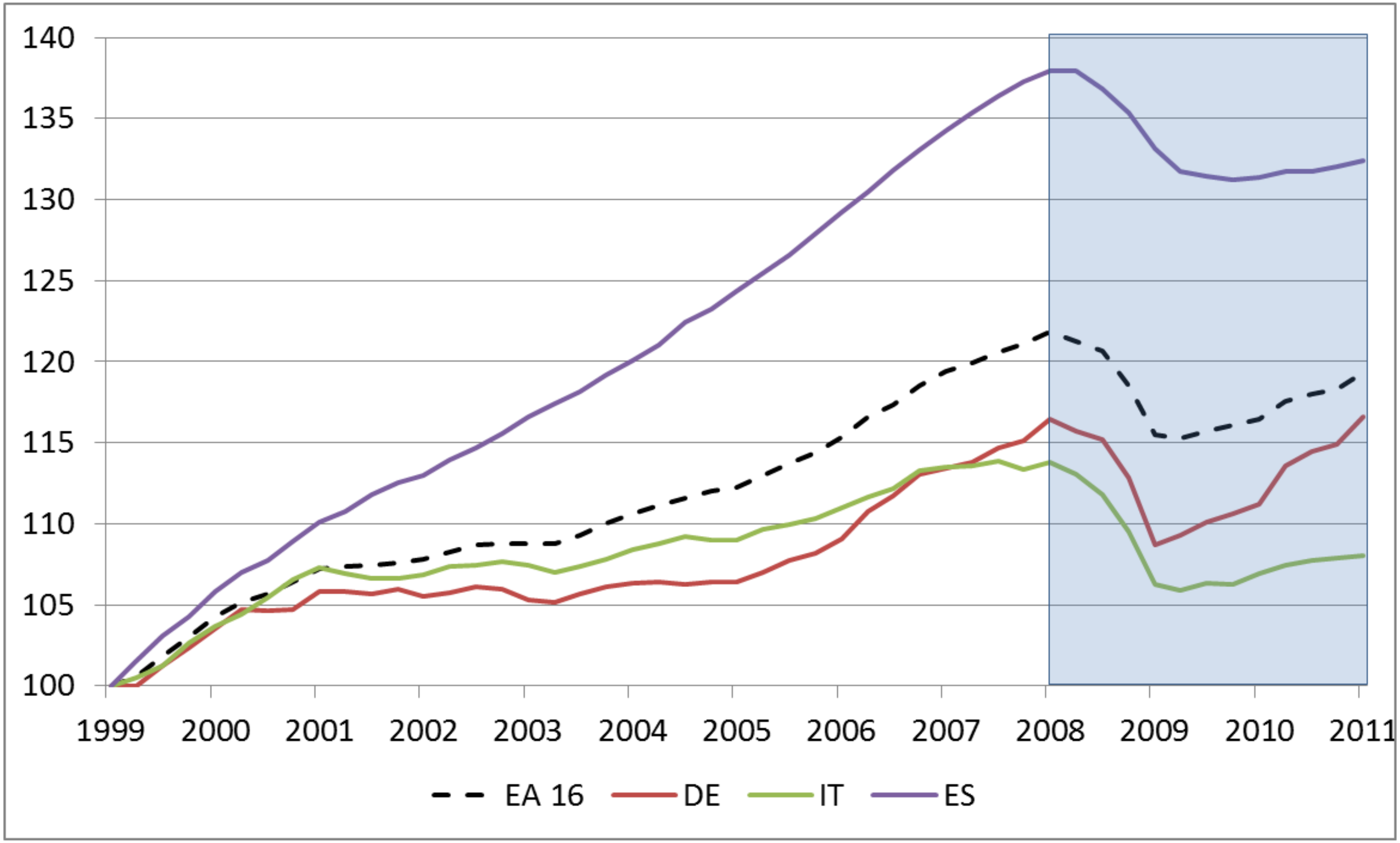


Growth composition in the middle case: Italy



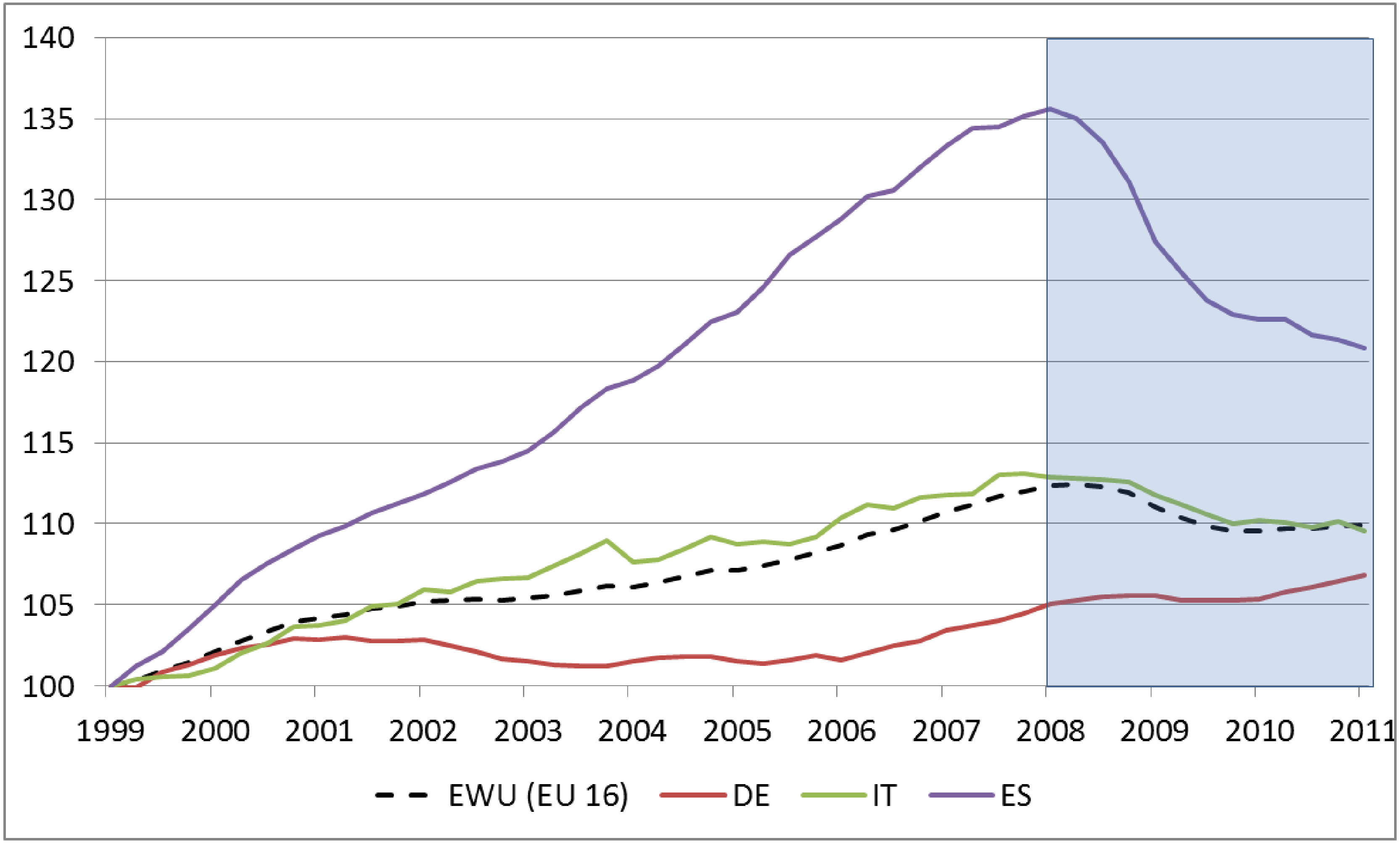
Growth:
large spread, two phases

GDP, in real terms, 1999q1 = 100



Employment before and after the crisis

Employees (in persons), 1999q1 = 100



Performance in comparison

1999-2007: Since start of EMU

a. ES-GR-IE-PT: interest rate induced boom and externally financed private and in part public consumption after EMU start.

b. DE-AT-NL: export-oriented growth fostered by exchange rate and wage restraint below euro average.

c. IT-FR: did not much profit from EMU, no export boost.

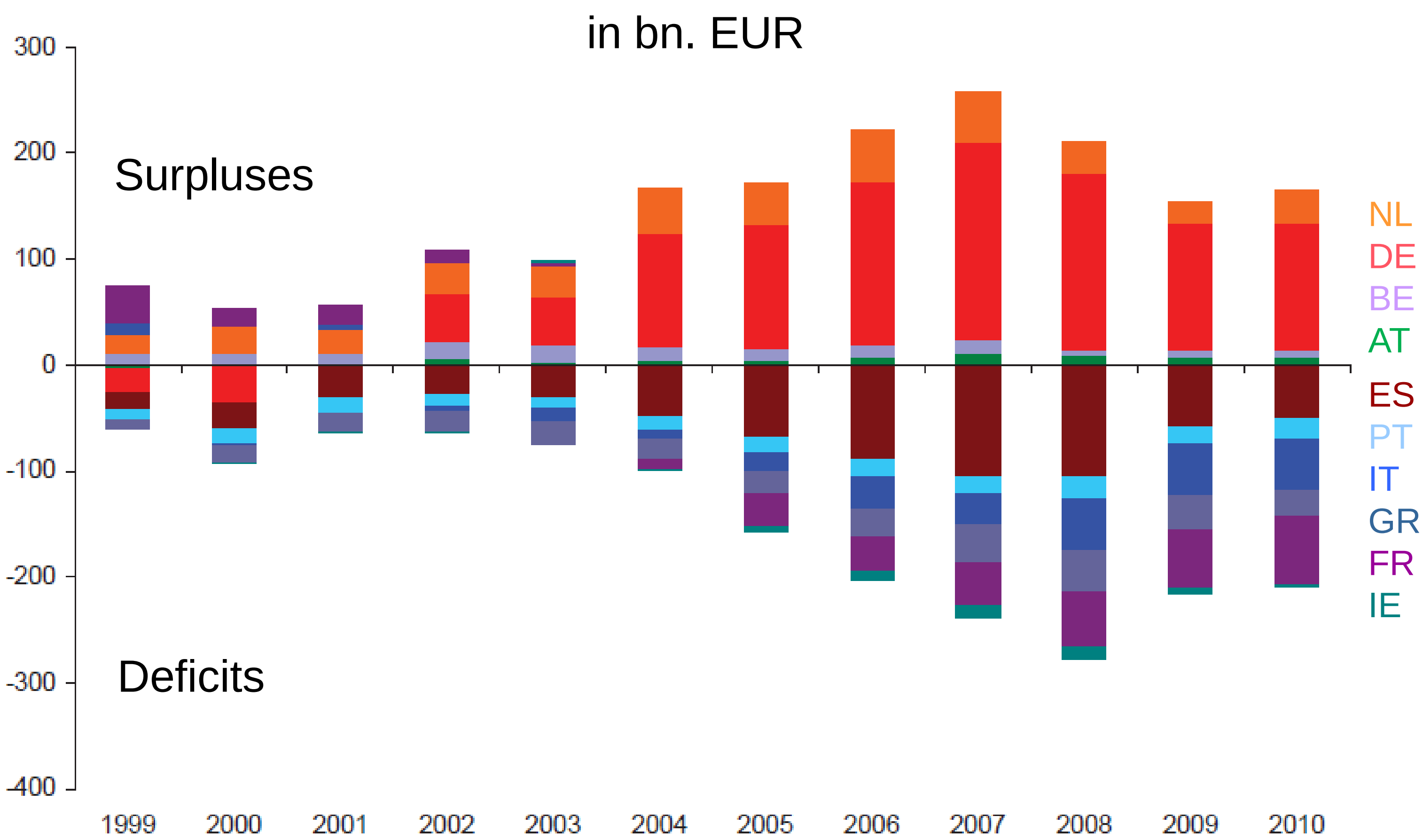
2008q1-now: The crises made clear that *all* models were not immune – but for different reasons and to different degrees:

a. Real estate bust in ES & IE; financial market bubble and profit transfer in IE; manipulation of statistics and poor tax revenues in GR; rapidly rising public debt in PT. End of EMU boom.

b. Export revenues have to be written down, private consumption is low. Due to Asian imports, (fragile) export surge since end of 2010.

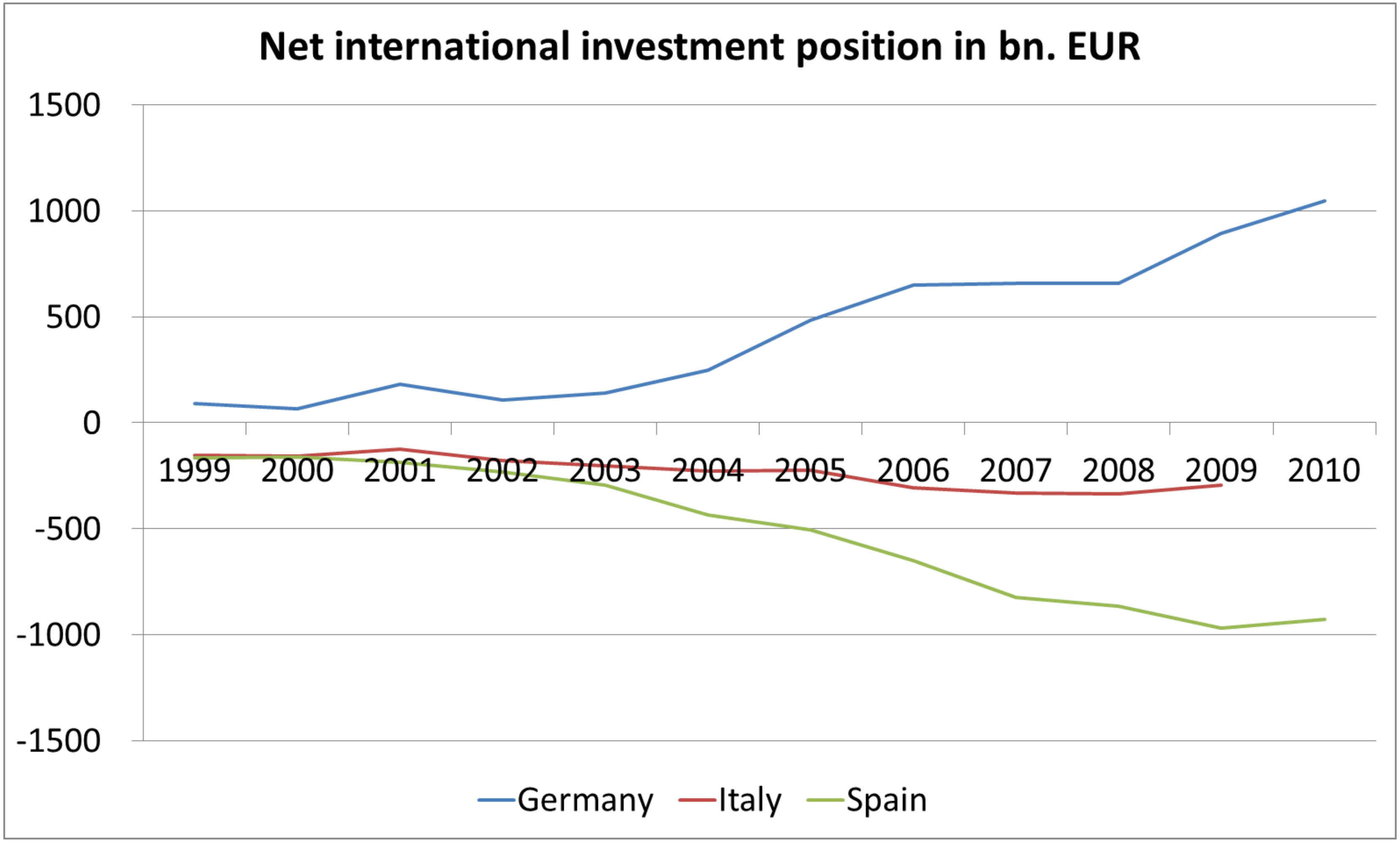
c. Loss in competitiveness.

Persistent current account imbalances as a consequence



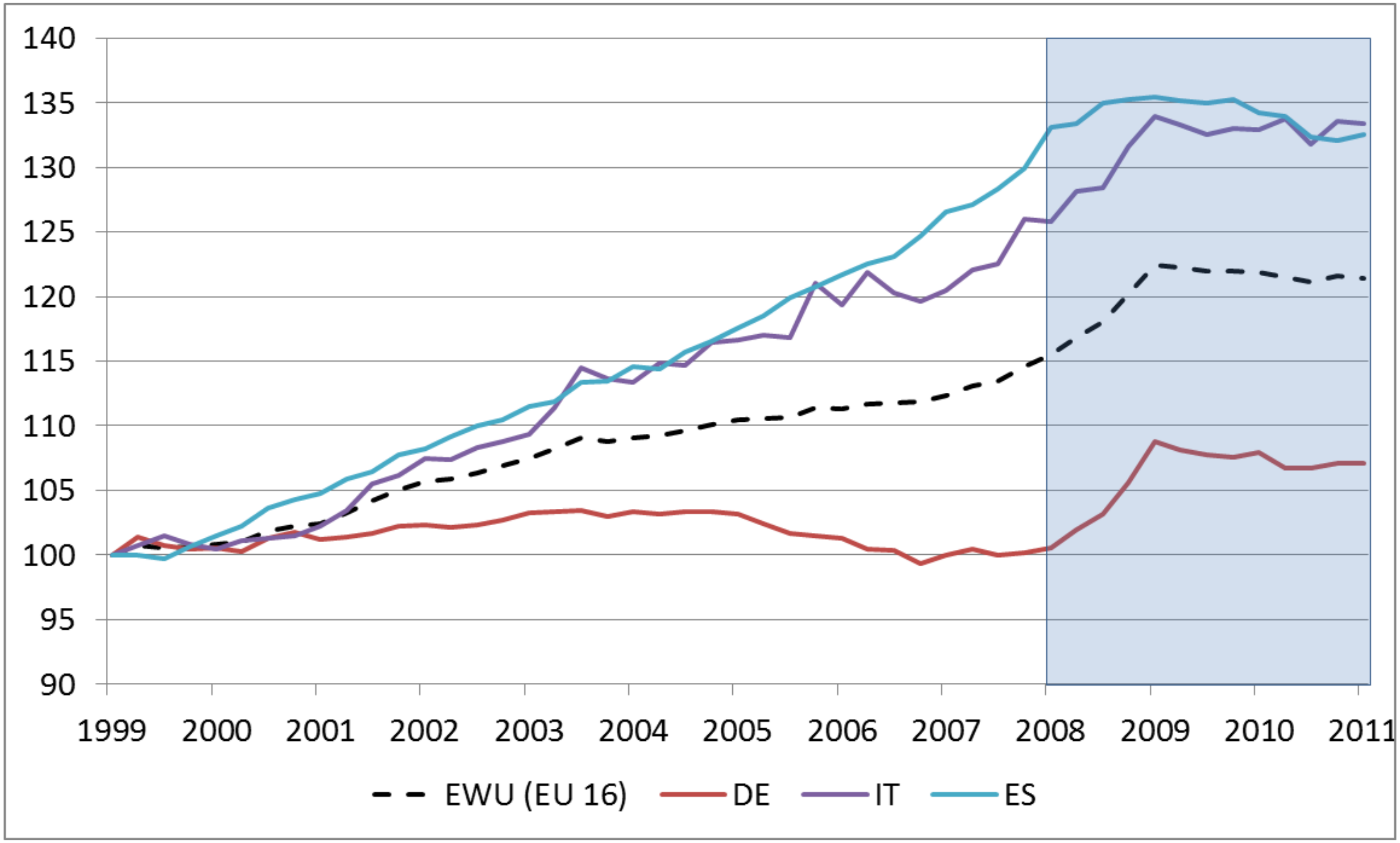
Source: AMECO, own calculations

…which is reflected in the net investment positions



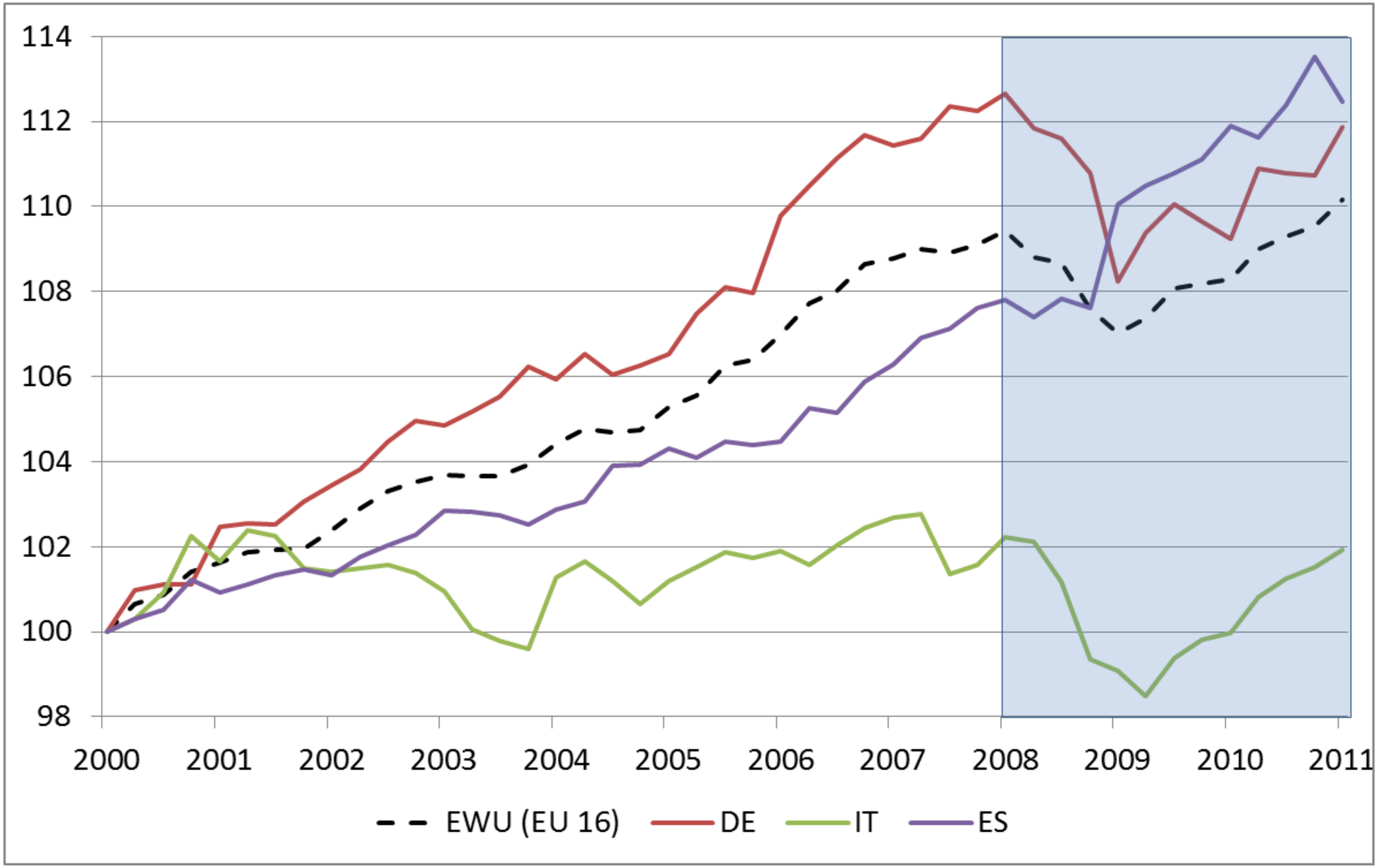
The specific German contribution to this situation -- setting the standard for price competitiveness

Nominal unit labour costs (whole economy), 1999q1 = 100



It’s productivity – a little bit

Labour productivity per in real terms, 2000q1 = 100 (data restrictions)



Primarily, it's compensation of employees (aka wage restraint)

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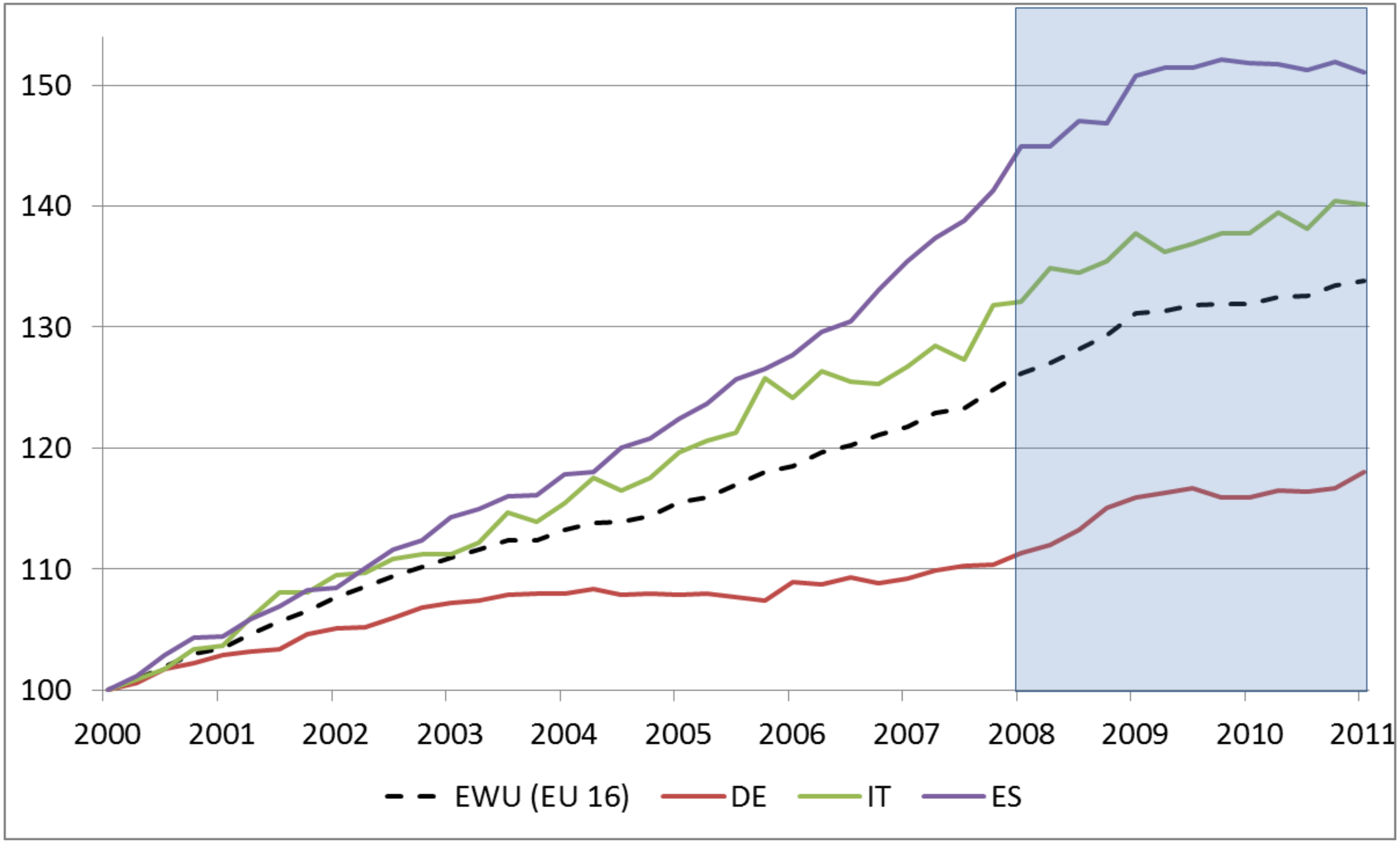
Compensation of employees per hour (in nominal terms), 2000q1=100 (data restrictions)



Consequences of wage restraint for Germany (and Europe)

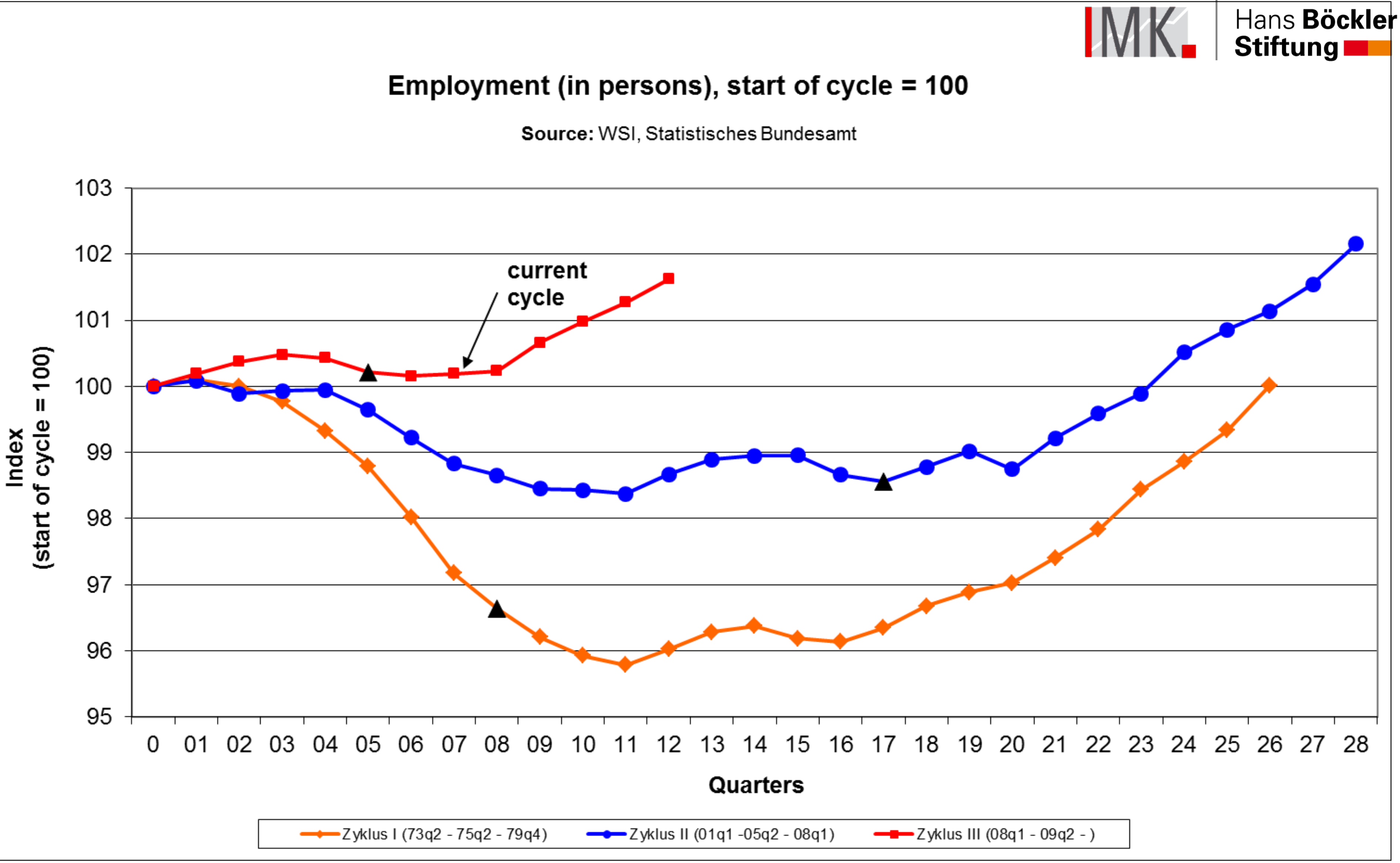
Since EMU:

- DE improved competitiveness significantly, other countries lost.
- Potential causes?
  - ULC surge due to reunification that had to be corrected;
  - Hartz reforms increased external flexibility:
    - liberalisation of forms of employment and employment protection: e.g. agency work, "mini jobs";
    - higher pressure on employees through tightening of unemployment insurance;
- ➲ wage pressure, especially on low wages (no minimum wage in Germany).
- As a large but open economy, this boosted exports and growth but also reduced private consumption -- and growth.
- Some followed the German path, some did not: macroeconomic imbalances.

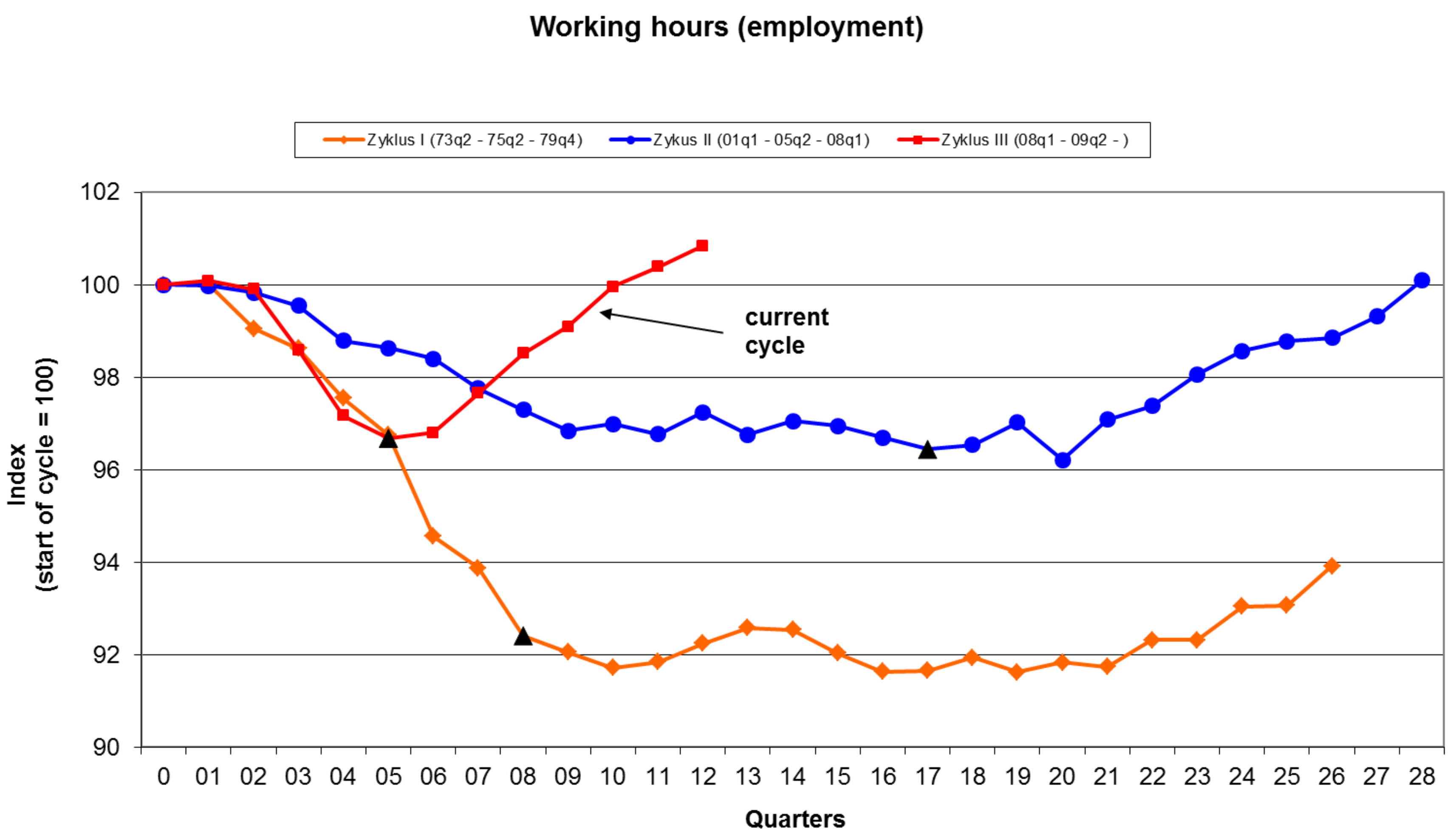
During the crises:

- In the crisis, due to its export orientation Germany was hit hard (GDP: -4.7% in 2009) – but will be on top again (+4% 2011?).
- Surprisingly, employment performed comparatively well in the crisis – why?

Comparing downswings

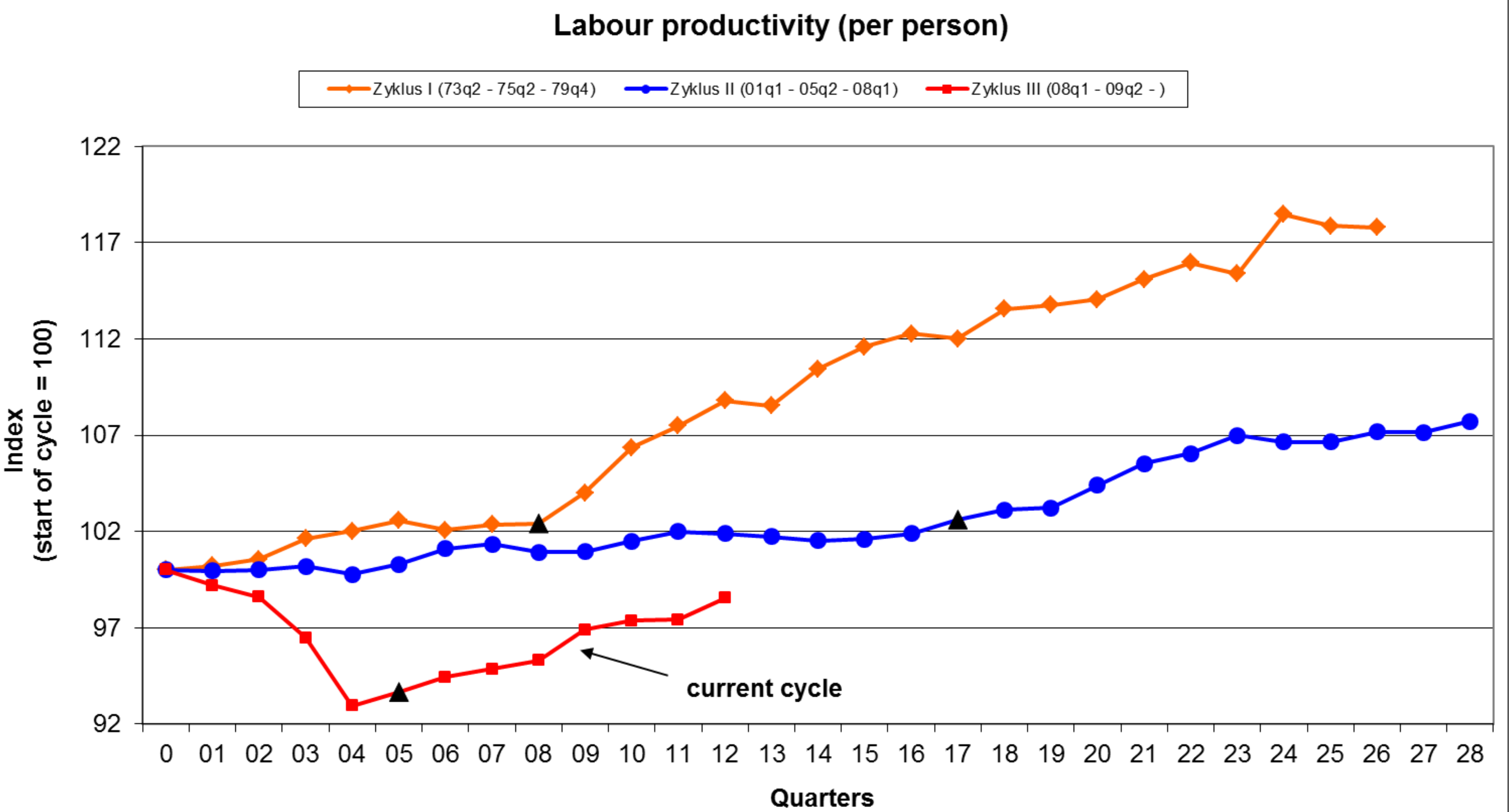


Comparing downswings II



Source: WSI, Statistisches Bundesamt

Comparing downswings III



Source: WSI, Statistisches Bundesamt

Good societal policies + luck = “miracle” (Krugman)

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- Sharp fall in labour hours but not much labour displacement (labour hoarding), why?
- ➥ High *internal* flexibility of the German labour market:
  - adjustment of working time by different instruments:
    - flexible reduction of collectively agreed weekly working time;
    - short-time work;
    - working time accounts were introduced before the crisis by collective agreements
- (Still) based on a corporatist labour market regime (high unemployment insurance, high employment protection, strong trade unions and employer associations).

Good societal policies II

- Due to labour hoarding,
  - skills (and workers) are immediately available if demand increases;
  - private consumption was stable (trust in stable jobs).
- Supported by a specific constellation!
  - in the crisis policies stabilised growth and employment (e.g. car scrapping premium, investment programmes);
  - only a few months after the beginning of the crisis, exports started to increase;
  - (discussion on) demographic situation leads to fear of shortage in labour supply;
  - services are becoming more important.

Conclusions

The success of Germany is Janus-faced, for three reasons:

1. Wage developments improved competitiveness and exports but it did not lead to growth above EMU average.
2. DE is the extreme case of a *large* economy that is strongly dependent on exports.
3. German ULC fostered macroeconomic imbalances.
4. Although external flexibility was increased in Germany, what caused the good labour market performance in the crises was internal flexibility based on corporatism and a specific constellation.

Germany – best practice for Europe?