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The Debate about Europe and Wages in Germany

1 Debates about Europe?

- Some debates
- ... but not particular to wages
- ... or to Europe

2 Debates about wages and welfare

- *bizarre*: the Bazaar Economy
- *hard workfare*: Hartz IV, etc.
- *more heat than light*: minimum wages

3 The missing debate

- the EMS dilemma
- EMU as cooperative solution
- the EMS dilemma reloaded?

1 German Debates about Europe

... *not* particularly controversial

- various interpretations of Ireland's „No“:
 - misbehaviour of a spoilt child,
 - outlet for general discontent
 - or: a big worry only for (French) legalists...
- general preference for the „muddling through“ approach

1 German Debates about Europe

... *not* particularly related to wages

- some discussion about the future of *Mitbestimmung* in Europe (codetermination by works councils and board-level representation)
- ...but very little debate in which *wages* would be seen as a European issue
- wage-setting perspectives:
 - either national in relation to other sectors and unions,
 - or global in relation to low-wage countries
- wage policy cooperation in Europe not high on the agenda
~ deemed as either utopian or undesirable

1 German Debates about Europe

... *not specifically European*

- high unemployment and slow growth in (parts of) EU:
complaints about Eurosclerosis, vis-à-vis dynamics elsewhere
= cyclical business (or hype) since 1980s, similar patterns elsewhere
- debates about wage & income stagnation, increasing inequality,
relocation and deindustrialization
... run elsewhere, too
- ... but some German specifics of debates about wages
in connection with offshoring, workfare and minimum wages
→ *next section*
- however, one big issue mostly ignored:
the spillovers of German wage trends onto other EU economies
and their feedbacks onto the German economy → *last section*

2 German debates about wages and welfare **the Bazaar Economy hypothesis**

... propagated by Hans-Werner Sinn, head of CESifo Munich

- a warning that Germany will be reduced to a trade platform:
„loss of value added and the industrial base of the economy
due to excessively high wages for low-skilled labour“
- offshoring of jobs in MNE and supply chains to low-wage countries
„German companies remain highly competitive,
but German workers are not“

→ recommendations:

creation of low-wage sector for low-skilled, wage subsidies rather
than minimum wages

← widespread reactions:

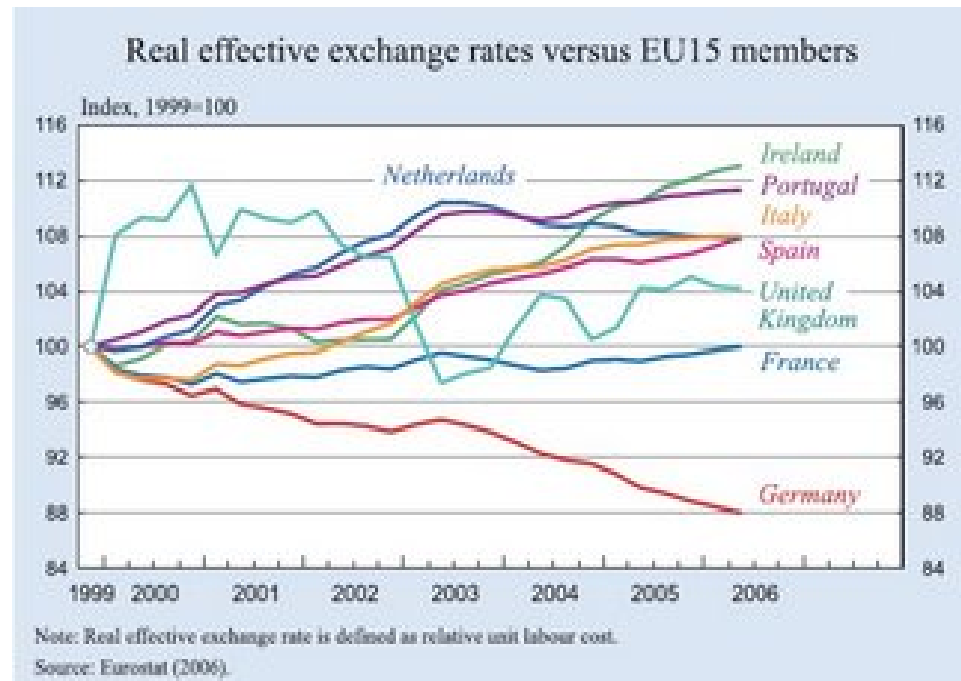
„biased“, „bizarre“, if not „nonsensical“ in view of the facts

2 German debates about wages and welfare the Bazaar hypothesis rejected (I)

- German net exports ratio (NX/GDP) highly positive
total value added in trade on the rise

Year	2000	2001	2002	2003	2004	2005	2006	2007
NX/GDP (%)	0.05	1.7	4.1	3.9	5.0	5.3	5.6	7.1

- relative decline of
unit labour costs
in Germany
wages hardly excessive



2 German debates about wages and welfare **the Bazaar hypothesis rejected (II)**

- small FDI flows & few jobs relocated to Eastern Europe & Asia:
 - only ~ 11% of net acquisitions and FDI lending to CEE, China and India,
 - only ~ 3% of total FDI to CEE, China and India,
 - offshoring: less than equivalent of 1% of total employment (< rest of EU)
 - net creation of jobs through international trade:
export-induced production has added ~ 60,000 jobs p.a. since mid-1990s
 - outsourcing (to domestic service firms) and offshoring (to foreign producers) part of „normal“ structural change:
comparative advantages – increasing tradability of services
- ← arguments (partly updated) from SVR report 2004/05
(SVR, Sachverständigenrat: German Council of Economic Advisors)

2 German debates about wages and welfare **the bizarre twist of the Bazaar debate**

- the split cycle:
 - 2002-05 external demand (NX) strong // internal demand (C,I,G) weak
 - 2006-08 NX still strong, I and G stronger // C still very weak
- *bizarre*: German economy looks *as if* it had pre-emptively „reacted“ to Bazaaristic warnings
 - service sector (in particular logistics) has expanded,
 - thereby strengthening the industrial base in transnational networks (CEE as extended workbenches, under competitive pressure)
 - German low-wage sector increasing from 15% in 1995 to 22% in 2007, close to US value („low wage“: $< 2/3$ of median hourly wage rate)
 - ¿ gains or losses in welfare?
 - ¿ unemployed masses transformed into working poor ?

2 German debates about wages and welfare

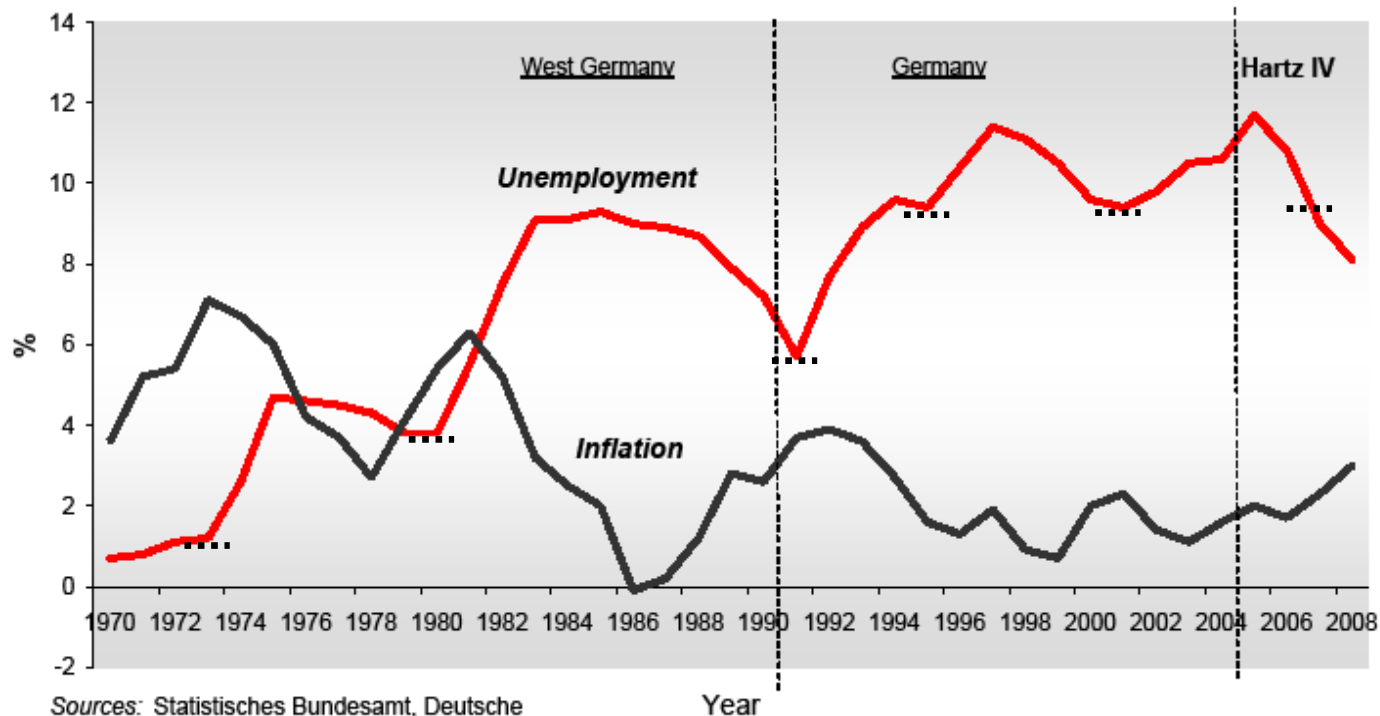
Hartz* IV and hard workfare

- * Peter Hartz, chairman of the commission on labour market reforms
- 2003-05 labour market reforms as part of the Agenda 2010: Schröder government's contribution to Lisbon process
- Hartz IV (starting in 2005):
 - merging administrations of long-term unemployment and basic welfare
 - reducing unemployment benefits for long-term unemployed to level of welfare benefits:
base rate: 351 €/month + costs for „adequate“ housing
 - combining benefits with participation requirements („workfare“) and allowances for low-paid jobs (wage subsidies)
 - applying to ~10 % of population in Germany, ~20% in Berlin

2 German debates about wages and welfare

Hartz IV – employment effects

- suggestions that Hartz IV has strongly contributed to break in upward trend of German unemployment:
 - reduction of reservation wage = increase in effective labour supply
 - reduction of payroll tax wedge = increase in effective labour demand



2 German debates about wages and welfare

Hartz IV – income effects

- critique 1 – incomparability of unemployment data:
 - with introduction of Hartz IV in 2005 statistics were changed
 - previously „hidden reserve“ on welfare benefits now included
 - „workfare“ in 1 €jobs and other minijobs excluded, etc.

¿ break = statistical artefact?
- critique 2 – other factors causing structural break
 - strong export + investment boom + demographic change

→ next cyclical downturn will show
- critique 3 – disastrous income effects of Hartz IV
 - increasing poverty and income inequality
 - not reducing payroll tax wedge (labour cost)
 - keeping down consumer demand and, hence, the economy

2 German debates about wages and welfare

Hartz IV – political effects

- splitting the Social Democrats (SPD), not only in terms of the usual controversies between „modernizers“ and „the left wing“, but having centrifugal consequences:
 - ➔ loss of active members to newly founded „left party“ (in alliance with former „strongly Eastern“ PDS)
 - ➔ losing much voter support
 - ➔ transforming not only the party system at national level (CDU, FDP, SPD, Grüne + Linkspartei), but also options for government: high barriers to forming coalitions of SPD and the left party

2 German debates about wages and welfare

Minimum wages vs. wage subsidies

- situation
 - standard wage setting by unionized bargaining losing ground:
low-wage sector rapidly increasing; 2007: 22% of all employees
 - more and more precarious employment:
1995-2005: -1.5 m in typical employment, + 2.6 m in subcontracted & temp work, mini jobs and other atypical employment
 - stagnation of real wages:
2008: average hourly wage rate in real terms back to 1991 level
- controversial debate about legislation of minimum wages
 - further extension of existing legal restrictions in some sectors?
 - current key figure: 7.50 €/h (~60% of average wage rate)

2 German debates about wages and welfare

Minimum wages vs. wage subsidies

- *Pro* minimum wages
 - efficiency & morale: „work must pay for a living“
 - international comparisons: „it works elsewhere“
 - benchmark for negotiations: „no race to the bottom“
 - *Contra* minimum wages
 - job loss: minimum wages increase (youth) unemployment
 - international comparisons: „it ,works‘ only where it is redundant“
 - efficiency & morale: wage subsidies (combi-wages, negative income tax) help to meet income & employment targets
- ➔ it all depends on the pace and character of technical progress:
- minimum wages may help to achieve high productivity growth at fair income distribution,
 - but in case of labour-saving technical progress wage subsidies may be required to preserve employment.

3 The missing debate

The EMS dilemma

- European repercussions of German wage developments?
hardly discussed, no memories of European Monetary System (1989-98)
- The dynamic instability of EMS
 - 1 D-mark key currency because of low inflation and chronic trade surplus:
German export orientation → higher interest-rate levels in other EMS countries
 - 2 Bundesbank playing inflation-fighter game with German trade unions:
wage bargains in excess of monetary targets punished by interest-rate spikes
 - 3 = 1+2: Bundesbank setting interest rates for all of EMS with regard to
German inflation only:
German policy games could cause recessions elsewhere;
incompetent politicians started blame game, with Bundesbank as scapegoat
- dilemma for trade-deficit countries in EMS:
choice between short-run costs of recession and long-run costs of realignments
- dilemma for German labour market:
job losses through higher tolerated inflation or through realignments?

3 The missing debate

EMU as cooperative solution

- *Soft Line* Hopes about European Monetary Union
 - supranational currency, not anchored to German price level only
 - greater influence of rest of Europe on interest-rate setting
 - shrinking of interest-rate differentials allows for more growth, especially in former „soft currency“ countries
- *Hard Line* Hopes about European Monetary Union
 - supranational currency, removed from arena of national politics
 - independence of European Central Bank guarantees monetary stability
 - fiscal cooperation required (Stability and Growth Pact) to make EMU viable, but much smaller role for wage setters

3 The missing debate

EMU = the EMS dilemma reloaded?

- A potential dynamic instability of EMU ?
 - 1 *nominal* interest-rate convergence gives rise to booms in former soft-currency countries and inflation divergence
 - 2 Germany: under common monetary policy (“one size has to fit all”), low inflation = high real interest rates, stagnation and (further) export orientation:
wage moderation recreates EMS constellation of trade asymmetries
 - 3 other EMU countries: no balancing option of locally high nominal interest rates (for capital imports) or exit option of realignments
trade asymmetries can create crises that feed back to demand in EMU core:
EMU trapped in a stagnation regime!
 - ¿ alternatives to wage moderation in Germany ?
 - ¿ national BoP restrictions in monetary union ?
 - ¿ self-stabilization through German capital exports and losses?
 - ¿ changing actors: game between ECB and financial markets
– more or less destabilizing than old EMS game ?