Wages, Competitiveness and Germany's Export-led Development Model

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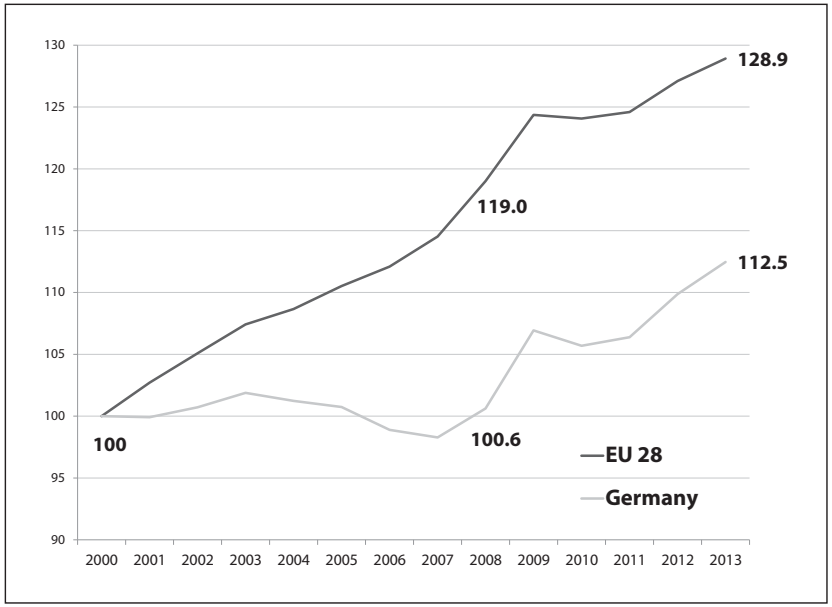
Current European and international perceptions of the German economic development model are rather contradictory. On the one hand Germany is admired for its successful management of the economic crisis, its high degree of international competitiveness and its comparatively good overall economic performance. On the other hand Germany is heavily criticized for its one-sided export-led development which has created a huge account surplus and contributed considerably to the development of large economic imbalances at both European and global levels. While the former view praises Germany as a model for other countries to emulate in order to become more competitive, the latter emphasizes the impossibility of generalizing the success of the German development model, as simply not all countries can have an account surplus.

Considering the current narratives about the German model, wages and other labour costs usually play a major role,

probably *the* major role. The latter refers to the fact that the development of German unit labour costs has been rather unique (*Figure 1*). As the only country in Europe, Germany has seen almost stagnating unit labour cost leading per definition to a strong increase in its price competitiveness.

Figure 1: Nominal unit labour costs in Germany and EU 28 2000-2013, 2000 = 100



Source: AMECO Database

The stagnation of German unit labour costs was mainly the result of extremely moderate wage developments which, against the background of high unemployment, were enforced by a partial erosion and fragmentation of German collective

bargaining (Schulten and Bispinck 2014) as well as by a deregulation of labour market and social security protection – promoted in particular by the notorious 'Hartz Laws' (Knuth 2014). For many observers the changes in collective bargaining and labour market regulation have been a successful policy to transform Germany from what was called the 'sick man of Europe' at the beginning of the 2000s to an 'economic superstar' at the end of the decade (Dustmann et al. 2014). Others criticized the same policy as a strategy of 'wage dumping' whereby Germany has followed a beggar-thy-neighbour approach and achieved its economic success mainly at the expense of other countries (Flassbeck and Lapavitsas 2013). Coming from different economic and political perspectives, both views are based on the same assumption that there is a direct link between wage developments, the increase of price competitiveness and the success of Germany's export industries.

Although the hypothesis of a close 'wage-price-competitiveness-nexus' is very common in many discussions on the German economic development model, more recent studies have fundamentally criticized that view for at least three reasons (Detzer and Hein 2014; Duval 2013; Storm and Naastepad 2014a). First, it is based on a rather narrow concept of competitiveness which mainly draws on prices and largely neglects the broad range of other non-price factors. Secondly and closely related to the first point, it widely disregards the specific sectoral composition of German export industries and Germany's particular integration into the international division of labour. Thirdly, the assumption of a close 'wage-price-competitiveness-nexus' draws only on a supply-side perspective and completely ignores the problem of demand. This holds true for the development of demand in the main

target countries for German export industries as well as for the implication of restrictive wage developments for the domestic markets within Germany. All in all, the debate on the role of wages and competitiveness within the German economic development model needs a much more differentiated analysis, in order to come to a more accurate policy conclusion beyond the simple demand for lower or higher wages.

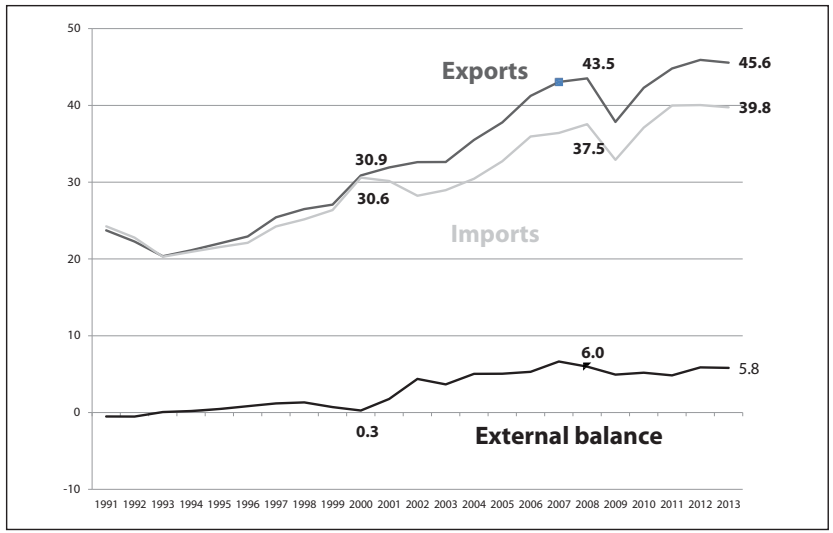
Germany's export-led development

The German economic development model has always been based on a strong export sector. During the 1970s and 1980s export industries accounted for between 20 and 30 percent of GDP, which was already a rather high value for a large economy such as Germany. After decreasing somewhat in the 1990s due to the economic effects of German reunification, the importance of the export sector increased again sharply in the 2000s, growing to more than 45 percent of the country's GDP in the years 2012 and 2013 (*Figure 2*).

Parallel to the growth of exports Germany also saw a strong increase in imports which reached almost 40 percent of the GDP in 2013. The increase in both exports and imports reflects growing integration into the world economy. Many German companies have (re)organized their production and value chains on a European and global basis, so that there is a growing element of intra-firm trade. While exports and imports were almost balanced during the 1990s, at the beginning of the 2000s exports started to grow much faster than imports, leading to a significant trade surplus of around 6 percent of GDP. In absolute terms Germany became the

'the world champion of exports' with a trade surplus of more than 160 billion euro in 2012 and 2013.

Figure 2: Exports, imports and external balance in Germany 1991-2013, in % of GDP



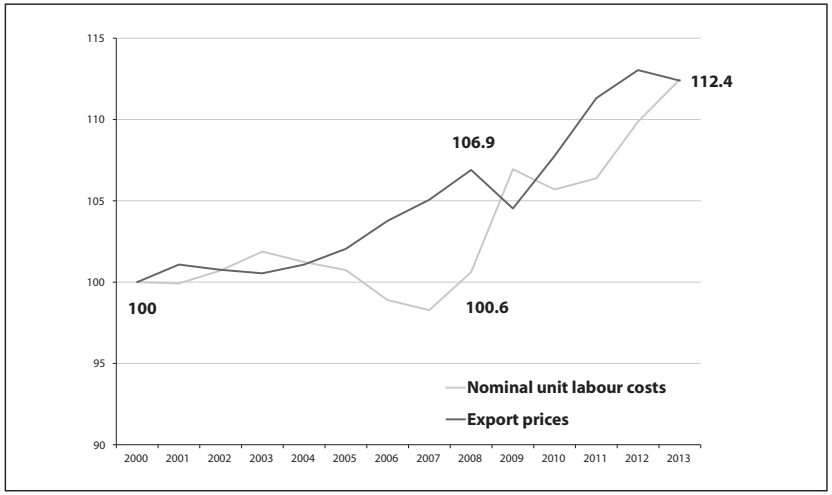
Source: Statistisches Bundesamt (Federal Statistical Office), National Accounts

The role of non-price competitiveness

Many studies suggest that the strong increase of German export industries in the 2000s was not primarily driven by developments in unit labour costs, but was mainly the result of strong economic growth in Germany's main export markets (European Commission 2012). A comparison of the devel-

opment of unit labour costs and export prices (*Figure 3*) is also proof of the minor importance of wages. In the first half of the 2000s both figures showed an almost parallel development. In the second half, however, unit labour cost went down while export prices showed a strong increase. As the second half of the 2000s was also the period of Germany's fastest export growth, many German companies obviously saw no need to transfer the gained price competitiveness resulting from wage restraint into lower export prices (Herzog-Stein et al. 2013a). On the contrary, the companies could directly use moderate wage developments to realize some extra-profits.

Figure 3: Nominal unit labour costs and export prices in Germany
2000-2013, 2000 = 100

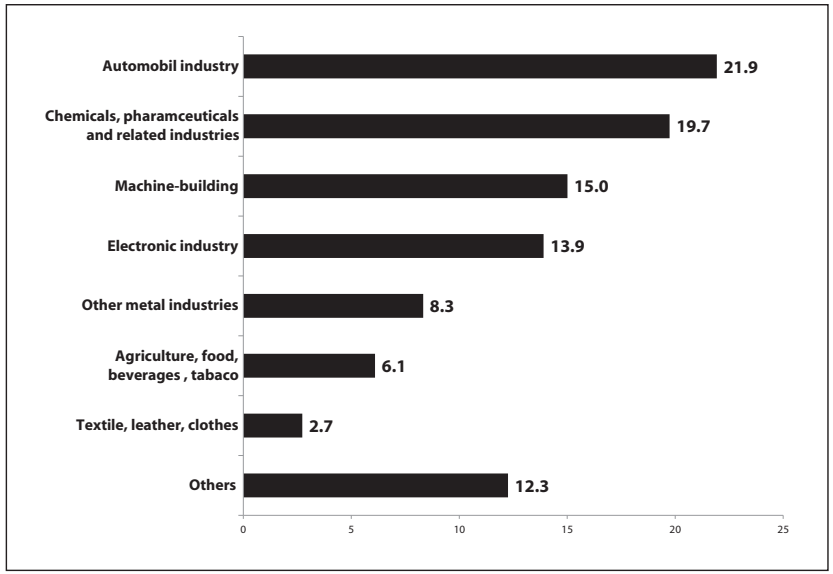


Source: AMECO Database, Statistisches Bundesamt (Federal Statistical Office)

The relatively low price sensitivity of export industries also reflects the specific sectoral composition of the German export sector (*Figure 4*). Of all European countries Germany has by far the largest share of world exports in the list of the 100 most complex goods (Felipe and Kumar 2011). The German export sector is largely dominated by automobiles, chemicals and machine-building which are all knowledge and technology intensive industries in which labour costs play only a minor role. Following calculations made by Storm and Naastepad (2014a: 8f.) unit labour cost made up only between 20-24 percent of the gross output prices in German manufacturing.

To sum up, several studies have found strong evidence that the large increase achieved by German export industries was mainly driven by a high degree of non-price competitiveness (European Commission 2012, 2014, Felipe and Kunar 2011, Storm and Naastepad 2014a, 2014b). Among the core elements of non-price competitiveness are, in particular, the provision of innovative and specialized products, an advanced standard in technology, the quality of goods and services, the accuracy and engagement of business relations. In a broader perspective, non-price competitiveness even includes basic societal framework conditions such as the technological and logistical infrastructure, the systems of skill formation and research and development or the culture of labour relations. Based on such a broader perspective, for example, the World Economic Forum developed a Global Competitiveness Index which recently ranked Germany worldwide in 5th place (World Economic Forum 2014).

Figure 4: Sectoral composition of German exports 2013, in % of all exports



Source: Statistisches Bundesamt (Federal Statistical Office), Statistics on Foreign Trade 2014

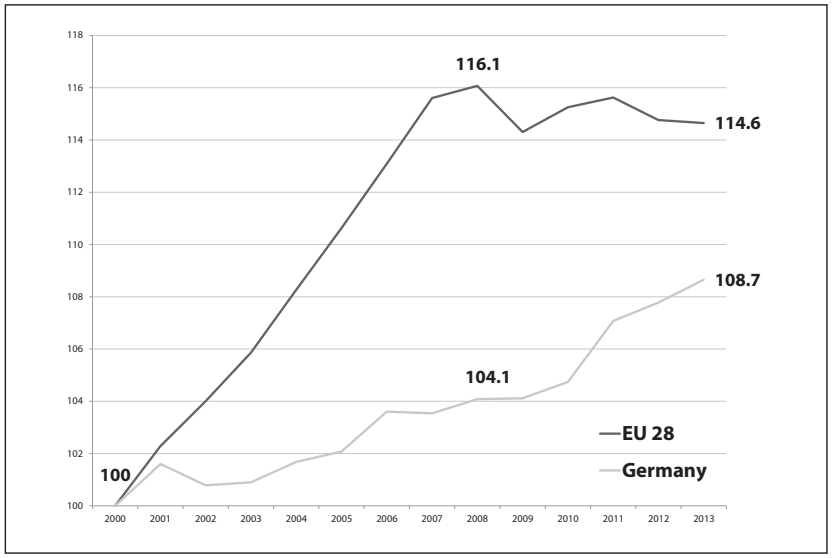
The downside of Germany's export-led development model

While the restrictive wage developments have not been the main drivers behind Germany's flourishing export industries, they nevertheless have strongly contributed to the downside of the German export-led growth model, which is a largely underdeveloped domestic sector. In the 2000s German wage developments were basically characterized by two main trends (Schulten and Bispinck 2014). First, wage increases

remained largely below productivity growth and were often even below the inflation rates which led to a further decline of the wage share and an ongoing redistribution from labour to capital income. Secondly, Germany saw a significant increase in income inequality promoted by growing wage dispersion and a fast expansion of the low wage sector.

Both trends in wage developments had a strong negative effect on the overall development of domestic demand as it significantly dampened private consumption (Sturn and van Treeck 2013). Between 2000 and 2008 the average private final consumption expenditure in the EU grew by 16 percent, which was four times faster than in Germany where it was only 4 percent (*Figure 5*). Only after the crisis in 2009 did a somewhat higher wage growth in Germany contribute to higher growth of private consumption, while wage cuts and wage freezes in many other European countries led to a stagnation of private demand (Schulten 2014).

Figure 5: Private final consumption expenditure in Germany and the EU 2000-2013, 2000 = 100



Source: AMECO Database

Although Germany has obviously gained from its flourishing export industries, the weak development of domestic demand has strongly undermined the economy's ability to realize its growth potential (Herzog-Stein et al. 2013, European Commission 2014). Moreover, the underperformance of the domestic sector was also – at least partially – responsible for the fact that import growth rates were no longer in balance with export growth (Detzer and Hein 2014). Thus, the restrictive wage developments in Germany have indeed contributed to the rise in Germany's account surplus and the increase in growing macroeconomic imbal-

ances. However, this was primarily not due to a strategy of 'wage dumping' but mainly through the dampening of domestic demand.

Conclusion

The discussion of whether certain national economic development models are an example for other countries is often little more than a highly instrumental form of 'cherry-picking' where policymakers single out certain elements to legitimatize their own policies. This is exactly what is currently happening in Europe when references are made to the German model. Relying on the myth that it is the issue of labour costs, which have generated Germany's relative economic success, the German example is frequently used to justify a policy of wage restraint and labour market liberalization, in particular in the account deficit countries of southern Europe. Above all, it has been the German government itself which has strongly promoted such a policy through the institutions of the European Union and thereby has permanently reproduced that myth.

The economic reality in southern Europe shows very clearly that a policy of wage cuts and labour market liberalization might lead on paper to an improvement of price competitiveness. The impact on the export industries, however, has remained rather small as these countries lack many structural preconditions for an export-led development. Moreover, the restrictive wage developments have had – as in Germany – a strongly dampening effect on private demand and have thereby actually hindered an

economic recovery (Schulten 2014). If there is anything to learn from Germany, it is definitively not the labour market policy but more the importance of well-developed industries which are specialized in certain market niches and are therefore able to provide a high degree of non-price competitiveness (Duval 2013).

However, the German export-led development model itself is far from being sustainable as it highly depends on the development of world markets and relies systematically on the existence of an account surplus which makes it necessary for other countries to continue with their deficits. Moreover, even for Germany itself the one-sided export-led growth strategy has become more and more problematic as it goes along with a systematic neglect of domestic sectors such as education, health, public infrastructure etc. (Rietzler 2014).

In the meantime, it has become more or less common place in international economic debates to state that Germany needs to rebalance its economic model through a strengthening of its domestic development (e.g. European Commission 2014). As far as wages are concerned, Germany has the potential for more expansive developments without losing its overall competitiveness. In addition to that, there is a strong need for more public investments to maintain the pre-condition of Germany's high non-price competitiveness. Both more expansive wage developments and more public investments could strongly promote domestic demand, which would be of benefit not only for Germany but also for the European and international economy.

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