From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy

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From “Sick Man of Europe” …

- In the late 1990s and into the early 2000 Germany was “the sick man of Europe”:
  - Germany’s economic growth averaged only about 1.2 percent per year from 1998 to 2005
  - Unemployment rates rose from 9.2 percent in 1998 to 11.1 percent in 2005

… to “Economic Superstar”

Today, and after the Great Recession, Germany is often described as “Economic Superstar”

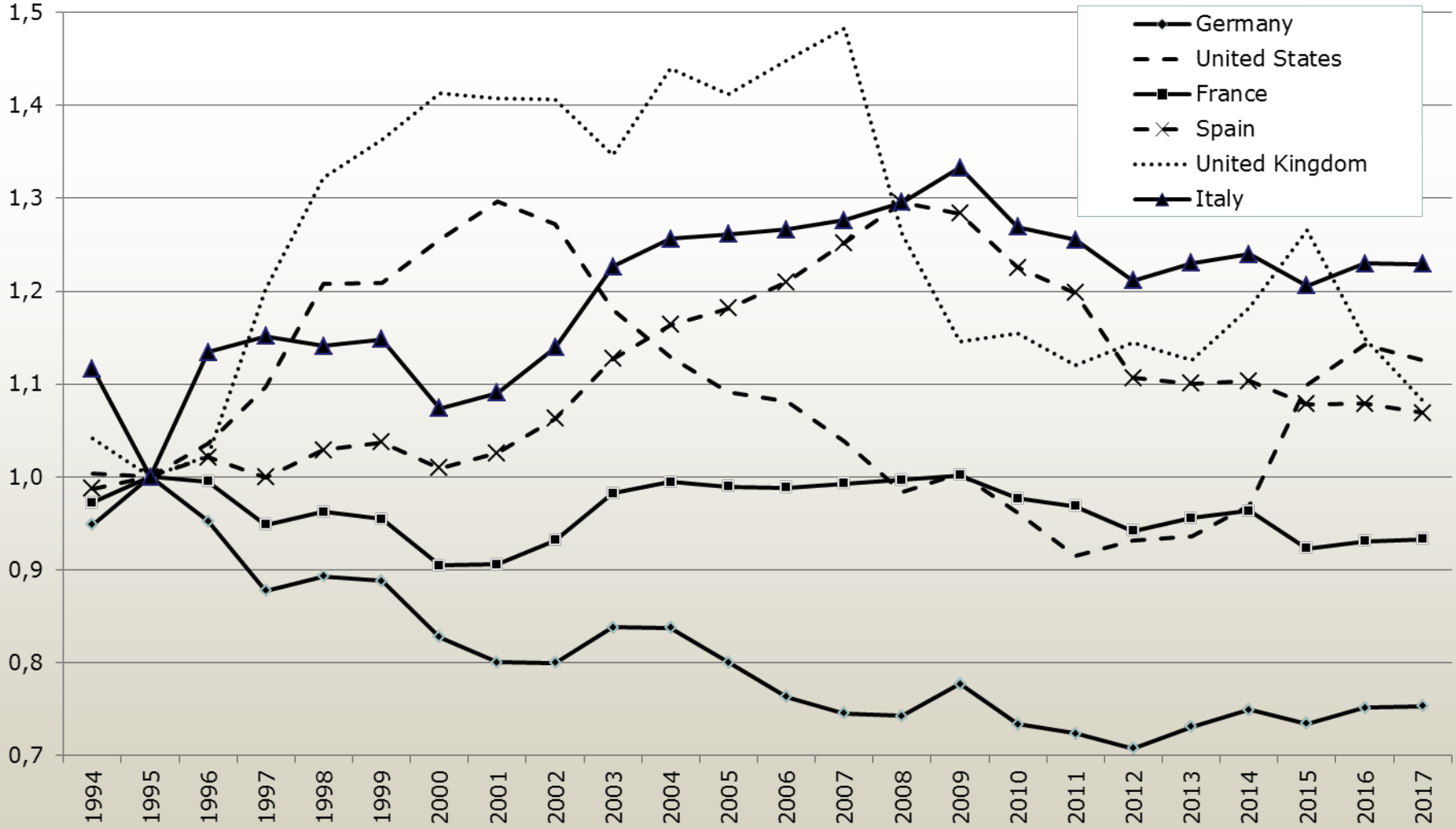
- number of total unemployed fell from 5 million in 2005 to about 3 million in 2008, and about 2.5 million beginning-2018
- unemployment rate declined to 7.7 percent in 2010, today it is about 5.7 percent
- almost no increase in unemployment during the Great Recession, despite a sharp decline in GDP in 2008 and 2009
- exports reaching all-time records

  (about 50 percent of GDP / 8 percent of world exports)

What has happened?

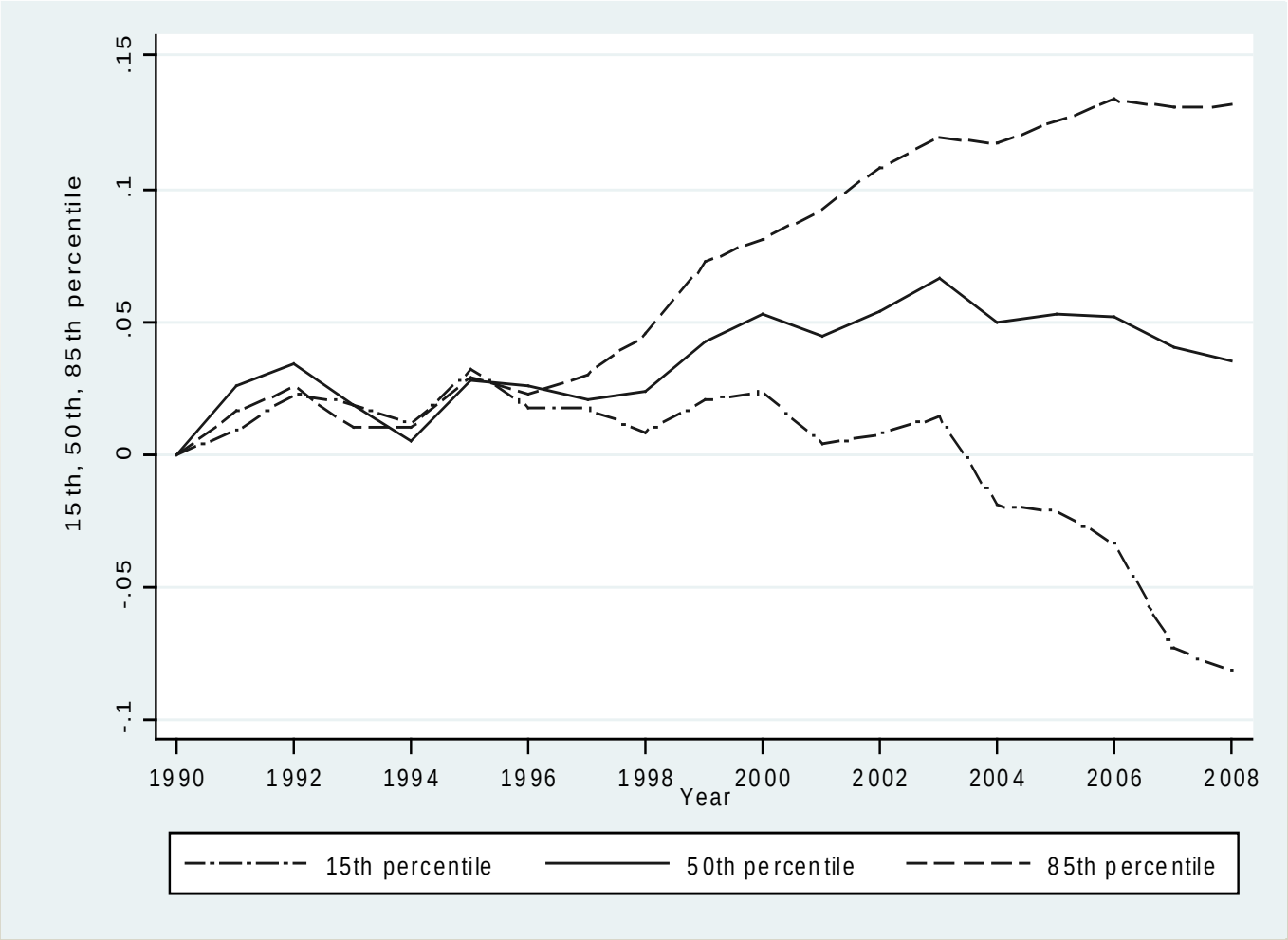
How is it related to the labor market?

Unit Labor Costs, 1994-2017

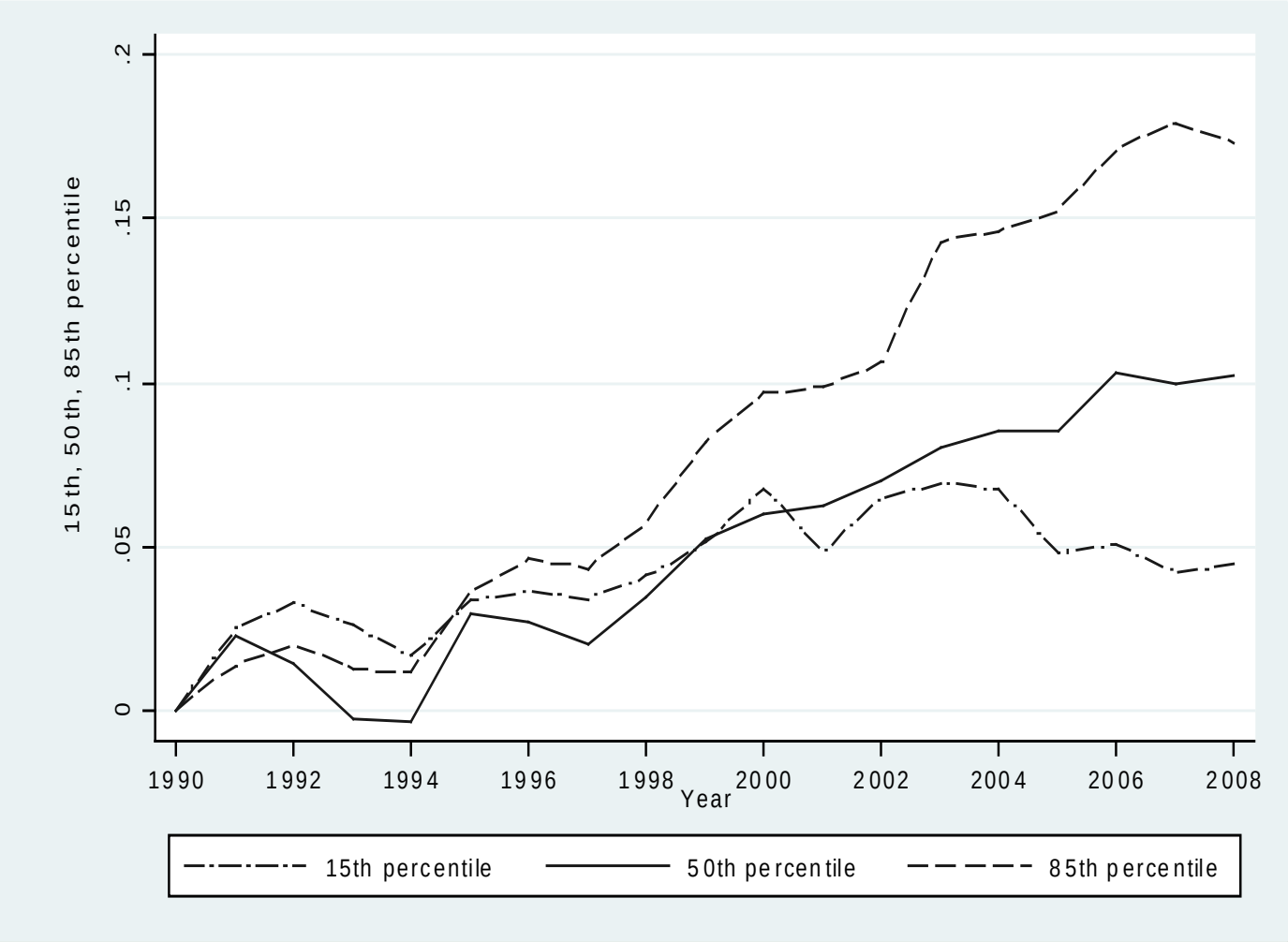


Source: OECD Economic Indicators

Indexed Real Wage Growth of the 15th, 50th, 85th Percentiles West Germany, 1990-2008



Tradable Manufacturing



Indexed Real Wage Growth of the 15th, 50th, 85th Percentiles, West Germany, 1990-2008

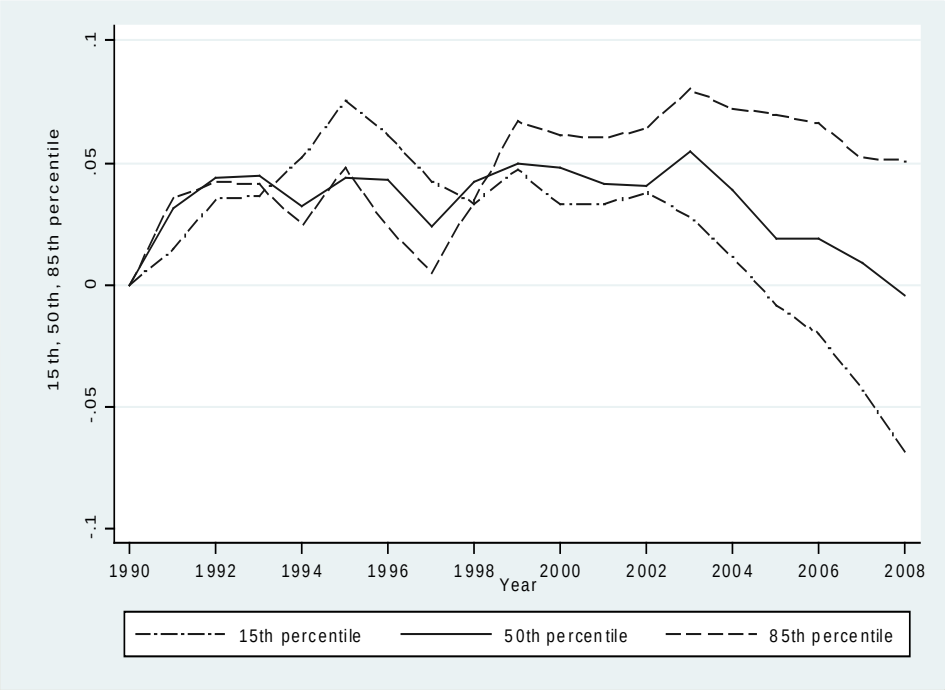
Puzzle:
How did competitiveness in tradable manufacturing increase with wages increasing more in those sectors than in rest of the economy?

- Value added in manufacturing is only roughly one-third of the value of end product

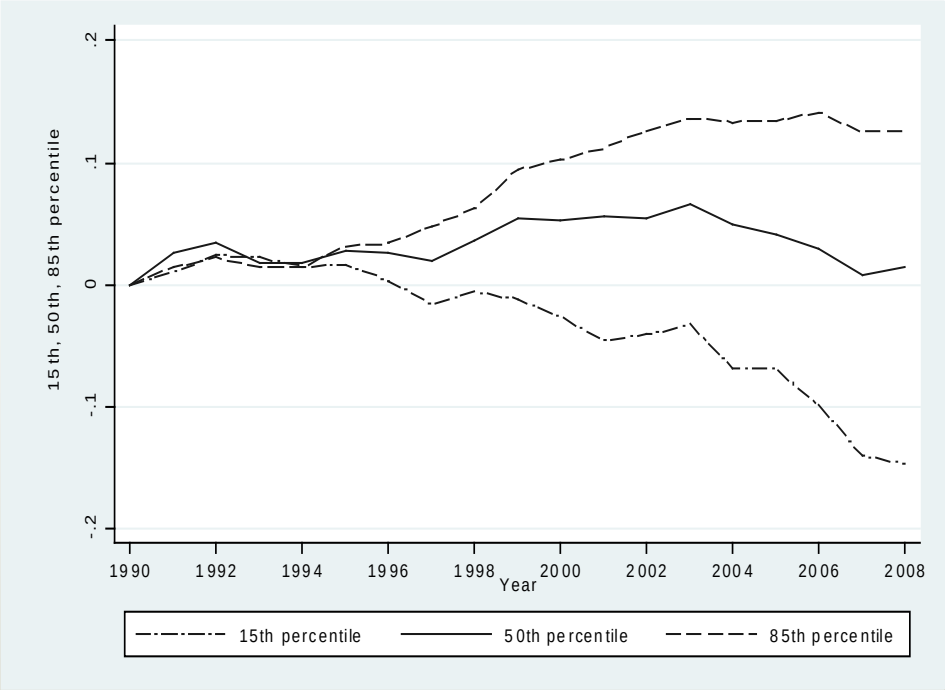
- Remainder of value added contributed through inputs from other industries, either domestically or from abroad

- Tradable Manufacturing: large productivity increases
  - 22 percent of all jobs in 1995, 18 percent in 2008; value added: unchanged at 22 percent

Nontradable Sectors



Tradable Services



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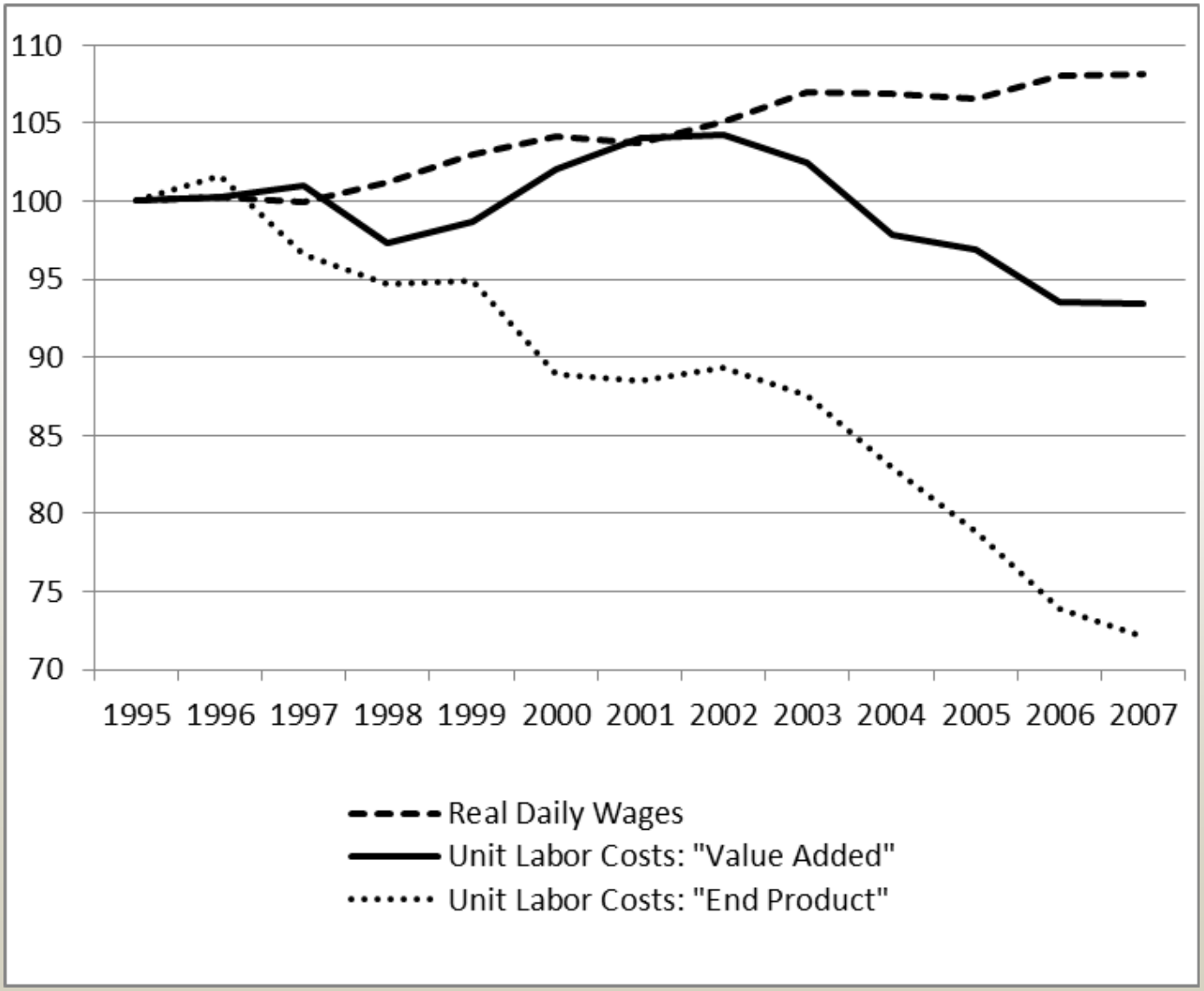
Tradable Manufacturing: Real Wages and Unit Labor Costs



Sources of Increased Competitiveness

- Drawing on inputs from domestically provided nontradables and tradable services, where real wages are lower and additionally fell since mid-1990s

- Productivity increases have outpaced real wage increases in this sector

- Increased use of trade integration with Eastern European countries through inputs imported from abroad (about 8.5 percent of inputs in Germany in 2000; France 1.9 percent, Italy 2.5 percent)

Competitiveness and Germany‘s Labor Market Institutions

- Institutions allowed for unprecedented decentralization of wage setting process, hours, and other aspects of working conditions, from industry-region-wide level to the level of the single firm

- Specific feature: the governance structure of the German system of industrial relations not rooted in legislation and not governed by the political process, but laid out in contracts and mutual agreements between the three main labor market parties: trade unions, employer associations, and works councils

What Led to Greater Flexibility in the German Labor Market?

- Extraordinary cost of German unification burdened German economy in unprecedented way, partly responsible for Germany's dismal performance throughout the 1990s and early 2000s.

- Opening of central and eastern European countries constituted a unique opportunity for German industry to move production abroad

- German labor market institutions have many components that make them inherently flexible in times of extraordinary economic circumstances!

- Since the mid-1990s, German economy has used those flexibility margins to transform itself into highly competitive economy.

Role of Hartz-Reforms

- Labor market and welfare reforms introduced between 2003 and 2005.

- 3 main objectives:
  - Activation of the unemployed (reforms of unemployment assistance and social assistance, intensify job search efforts, start-up subsidy, One-Euro jobs, wage subsidies)
  - Reforming unemployment services (reorganization of Federal and Local Employment Agencies, Job Centers, fostering market forces through placement and training vouchers)
  - Fostering employment demand (deregulation of temporary agency work and employment protection for certain demographic groups, fostering employment in low wage sector: Mini-/Midi-Jobs)

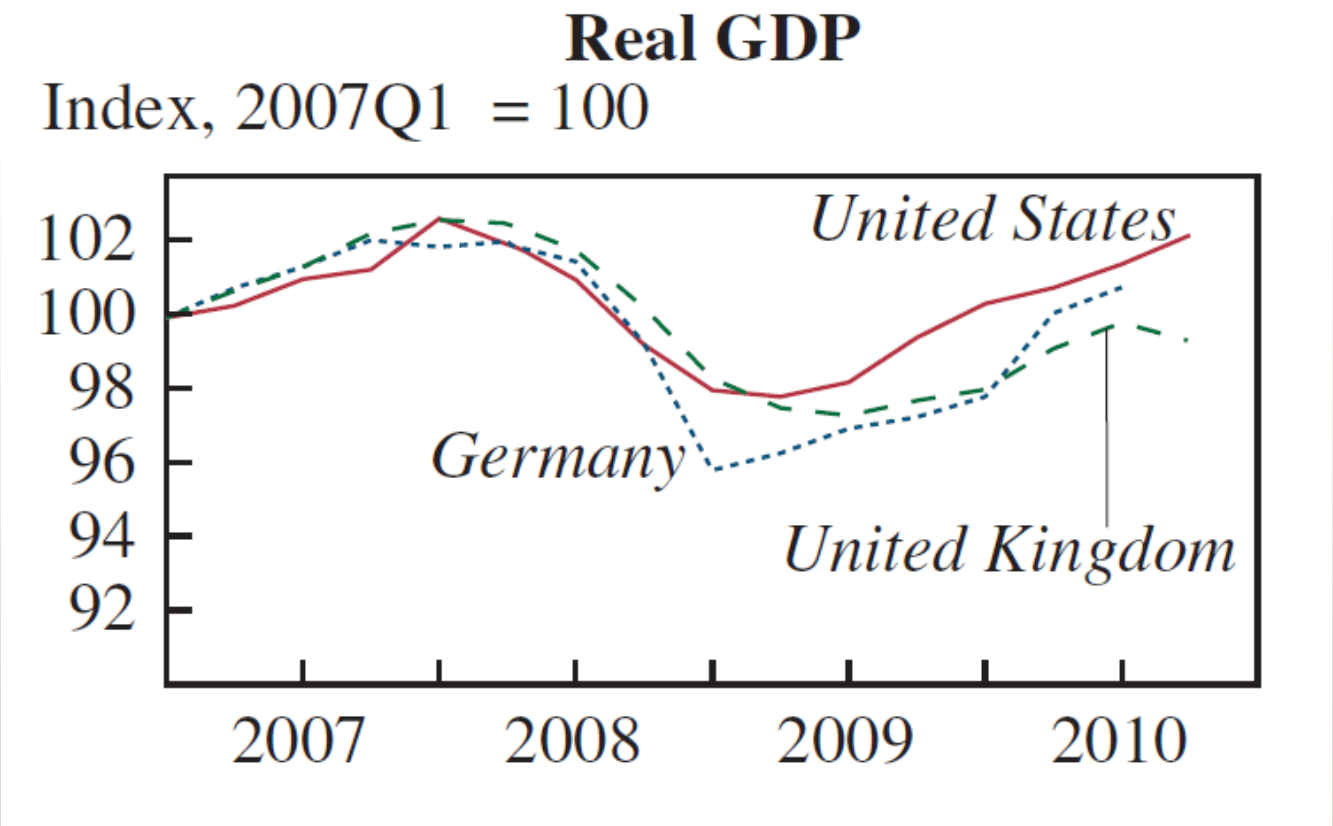
- Implementation of Germany's Hartz-Reforms started in 2003, 10 years after the economy has started to improve its competitiveness.

- Mostly supply side measures that activated unemployed by cutting generosity of system.

- How would assessment of Hartz-Reforms look like had competitiveness of German economy not improved beforehand?

Magnitude of the Crisis

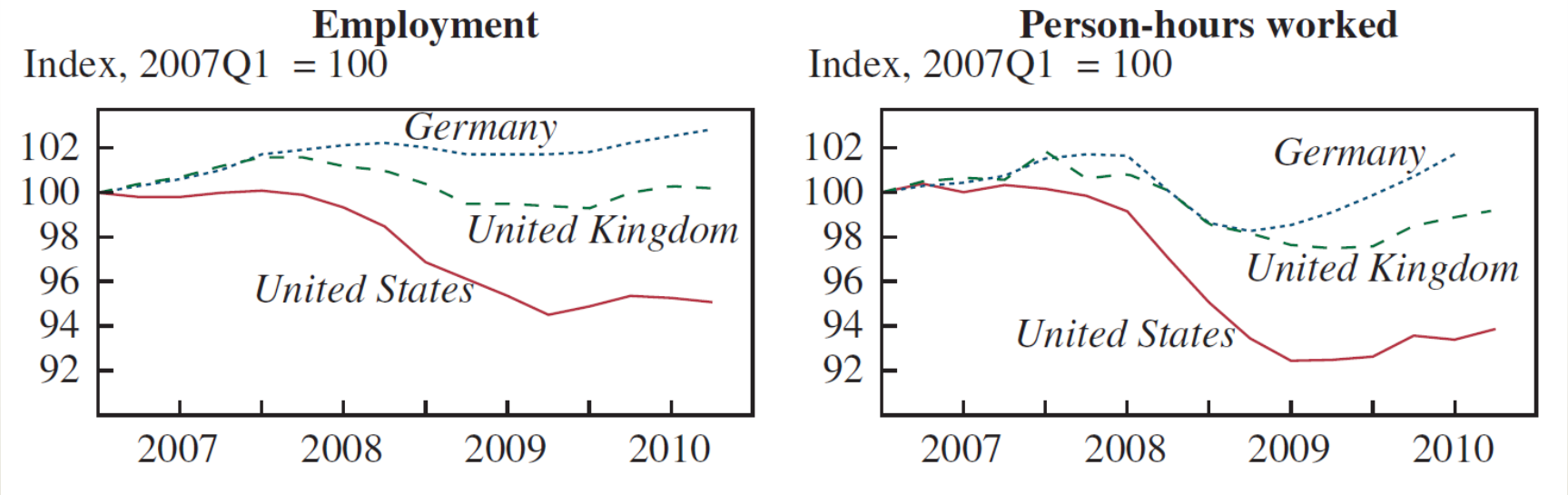
Germany, the United States and the United Kingdom

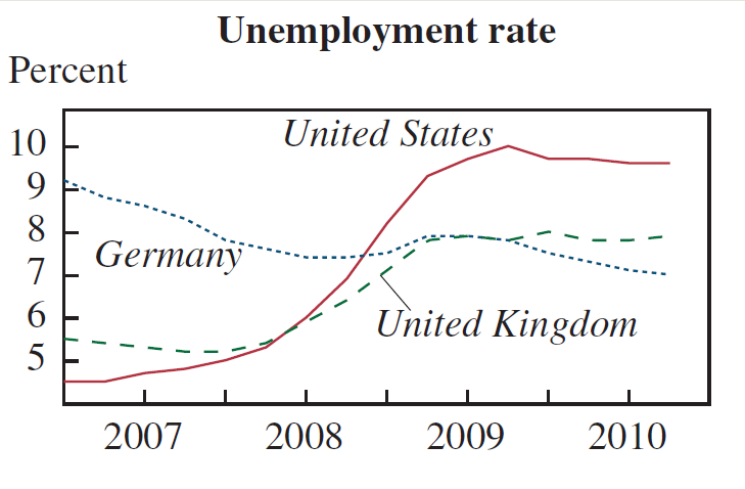


Source: Burda and Hunt, 2011, Figure 1.

Labor Market Experience

Germany, the United States and the United Kingdom





Source: Burda and Hunt, 2011, Figure 1.

What has this to do with Germany‘s Economic Fate during the Crisis?

- Germany’s exporting industries – the industries most hit by the Great recession – were highly competitive at the onset of the crisis and Germany’s exports were in high demand
  - Firms suffered recruitment problems/shortage of trained labor at the onset of the crisis (Möller, 2010)
  - Labor hoarding (Möller, 2010; Burda and Hunt, 2011)

The Role of Institutions

- Before the Crisis: restore competitiveness by allowing unprecedented decentralization of wage setting process (Dustmann, Fitzenberger, Schönberg, Spitz-Oener, 2014)

- During the Crisis: enhancement of firms' buffering capacity (Möller, 2010)

Why did Germany get off fairly lightly, this time?

- Nature of crisis was such that it hit those German industries that at the onset of the crisis were highly internationally competitive
  - o GDP decline was driven by the collapse of world trade
  - o No housing bubble, no decline in domestic demand
  - o Many key export markets did recover fast
- German labor market institutions have many components that make them inherently flexible in times of extraordinary economic circumstances!

References:

Dustmann, C., B. Fitzenberger, U. Schönberg, A. Spitz-Oener: 'From Sick Man of Europe to Economic Superstar': Germany's Resurgent Economy, *Journal of Economic Perspectives*, Vol. 28(1), 2014.

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