

Chapter 5

Internal devaluation and employment trends in Germany

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1. Introduction

Recent trends in employment and unemployment in Germany have been widely hailed as a ‘miracle’ or even a ‘role model’. In the course of the current euro-zone crisis they are being used politically to advertise the need for so-called ‘structural reforms’ of the labour market in order to foster more favourable labour market developments in other EU countries. But what is the substance of this story?

The bottom-line of the present chapter is that these ‘reforms’ have contributed substantially to internal devaluation in Germany which, in contrast to most other euro-zone countries, took place *before* the ‘Great Recession’ of 2008/2009. This development is analysed in Section 2. In Section 3 I describe labour market trends over the past 15 years and discuss the ways in which labour market reforms and internal devaluation have contributed to changes in employment levels and employment structures. In Section 4 I look at the potential links between internal devaluation and international competitiveness, which entails a look at the external effects of the internal devaluation approach within the monetary union until the Great Recession. Section 5 is dedicated to the more recent changes on the German labour market since 2008, which reflect the end – for the time being – of internal devaluation in Germany, while this approach is being imposed on other countries. I conclude that the present – as compared with many other EU countries – positive tendencies in Germany are not to be attributed to ‘Agenda 2010’, but rather to the first attempts at limiting the damage caused by these ‘structural reforms’ on the German labour market.¹

The main message of what follows is that we are facing a paradoxical situation. Paul Krugman (2014) is certainly right when he states that ‘if you try to identify countries whose policies were way out of line before

1. I developed this line of argument earlier in Lehndorff (2015a) and (2015b).

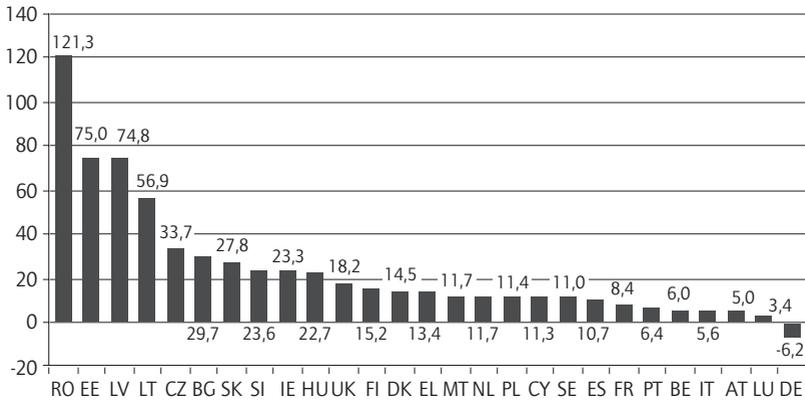
the crisis and have hurt Europe since the crisis, and that refuse to learn from experience, everything points to Germany as the worst actor'. The reason why this policy approach is credible for large parts of the European public, however, has very much to do with the relatively positive labour market trends in Germany since 2008. The bitter irony is – if for the wrong reasons – that this turn of events favours the presentation of Germany both at home and abroad as a model for Europe, which provides a platform for the German government's leading role in imposing the wrong lessons on other countries.

2. The making of internal devaluation

Given the different dynamics in unit labour costs and inflation rates, the European Commission (2010) estimated the level of internal devaluation of the German economy relative to the other euro-zone economies since 2000 at roughly 30 per cent. In fact, the development of wages in Germany in the 2000s was most unusual. Germany was the only country in the EU in which real wages per employee fell on average over the period 2001 to 2009 (Figure 1). Compared with other euro-zone countries – such as Ireland, Greece or the Netherlands, with pay increases above 10 per cent, but also with the second largest EU economy, France, with a pay increase of 8.4 per cent – the decline by 6.2 per cent in Germany reflects what we could call a classic example of internal devaluation within a monetary union. What was behind this outstanding feature of the biggest EU economy during the first decade of the euro?

The usual suspects in this instance would be the trade unions and their collective bargaining approach. In fact, it is a widely shared belief among critical observers in Germany and beyond that so-called 'competitive corporatism' has been at the root of what is called 'wage moderation'. Given the importance of export-oriented manufacturing industry in the German economy, it is far from absurd to assume that both employers and trade unions share the intention of protecting jobs in German manufacturing by keeping wage increases below those in competitor countries. What is more, as analyses of collective bargaining in German metalworking have shown, local derogations from sectoral agreements soared in the early 2000s, giving way to swaps of job protection for pay cuts in many metalworking companies (Haipeter 2013). The fact that these were firm-level derogations from sectoral agreements, however, reflects the fact that the so-called 'wage moderation' was part of a more complex problematic.

Figure 1 Changes in real wages per employee,* EU, 2001–2009



* Nominal compensation deflated by the national HCPI (harmonised index of consumer prices).

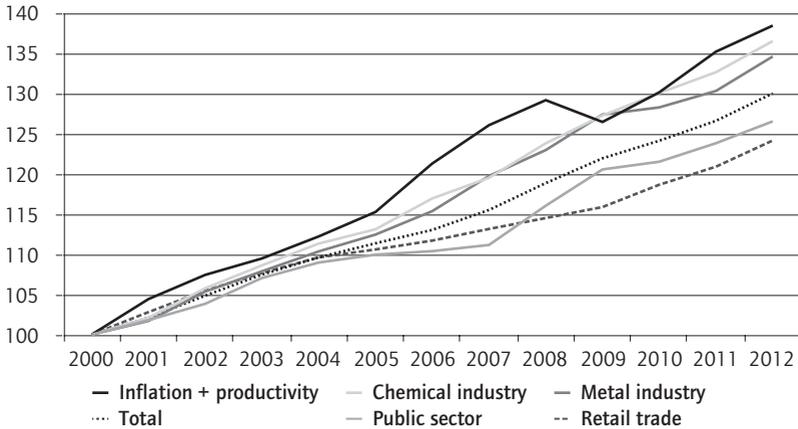
Source: Schulten and Müller (2015).

2.1 The weakening of collective bargaining

A glance at the development of collectively agreed wages from 2000 to 2012 (Figure 2) yields a perhaps surprising realisation. In the metal and chemical industries, of all places – in other words, in the two industries exposed most intensively to international competition – collectively agreed wages and salaries have risen most strongly. It is true that even the comparatively assertive trade unions in these sectors were unable, up to 2008, to take full advantage of the so-called distributionally neutral leeway defined as the sum of price rises and aggregate productivity growth (I shall come back to subsequent years in Section 5). The main reasons for the low average wage rises, however, lay in sectors – such as retail trade and public services – that are not exposed to international competition or only to a small extent.

This widening gap reflects important structural breaks in the German employment system that began to evolve in the 1990s and deepened in the early 2000s (Lehndorff *et al.* 2009). The *first* break was the erosion of the institutional architecture within which the so-called ‘convoy principle’ has traditionally functioned in German collective bargaining. The tacit conditions for the success of the ‘wage formula’ – that is, a guideline for the minimum collectively agreed pay increase across sectors defined as inflation rate plus average productivity growth in the whole of

Figure 2 Development of collectively agreed wages in selected sectors, 2000–2012 (2000=100)



Source: WSI-Tarifarchiv (2015).

the economy, rather than in the respective sector – to which the industrial trade unions continue to orient themselves in their bargaining policy, have been unhinged at the level of both primary distribution (collective bargaining) and secondary distribution (welfare state compensation mechanisms). As a result, trade unions have suffered from a loss (or relinquishment) of political influence over the implicit conditions of a more solidaristic wage policy, including – in particular – tax policy and the cornerstones of labour market regulation (described below). The drifting apart of collectively agreed wages thus conceals both a power-political and an institutional break, which probably can be made good by means of collective bargaining only to a limited extent.

To take the example of public services, what weighed down the United Services Union (*ver.di*) in its collective bargaining approach was the tax reforms of the SPD/Greens government, which resulted in considerable loss of revenues for public finances (in the middle of the previous decade they had amounted to more than 40 billion euros a year; Truger and Teichmann 2010). The massive pressure for spending cuts thus unleashed directly affected the wages – as well as working time – of public service employees. An important side-effect of this pressure was the break-up of the public employers' collective bargaining association as the federal states were hit hardest by declining tax revenues. It was thus no accident that, until 2007, collectively agreed wage rises in public

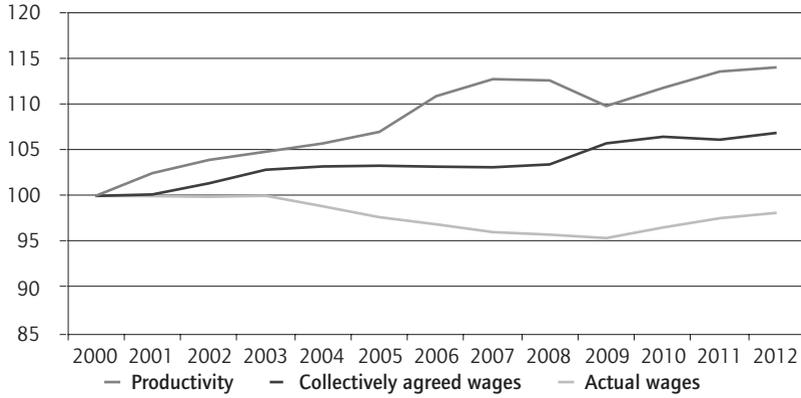
services were among the lowest in the major economic sectors. This was closely linked with a decline in trade unions' structural power as broad swathes of public employees now had to seek wage increases without being able to rely on, for example, the propensity to strike of the refuse collectors. The changes in the institutional framework and the political balance of power are inextricably linked.

Another example is the retail trade, the largest private service industry, which experienced the weakest pay rise in collective bargaining of all major sectors. One important reason here was the systematic dismantling of the Federal Government policy to declare sectoral collective agreements generally binding, following strong pressure from the employers' umbrella organisation since the mid-1990s (Schulten and Bispinck 2013). This turnaround substantially weakened both the employers' propensity to join bargaining associations and ver.di's leverage in these negotiations.

This leads us to the *second* structural break reflected in a 'negative wage drift' between collectively agreed and actual wages. In the first decade of the euro up to 2009, the rise in *actual* nominal wages per employee was little more than half the rise in nominal wages agreed in collective bargaining (Unger *et al.* 2013). In real terms, the latter rose only modestly, while the former fell (Figure 3). That is, most of what is unusual about the decline in real wages per employee, as shown earlier in Figure 1, was attributable to a weaker *impact* of collective bargaining on actual wages, rather than the outcomes of collective bargaining as such.

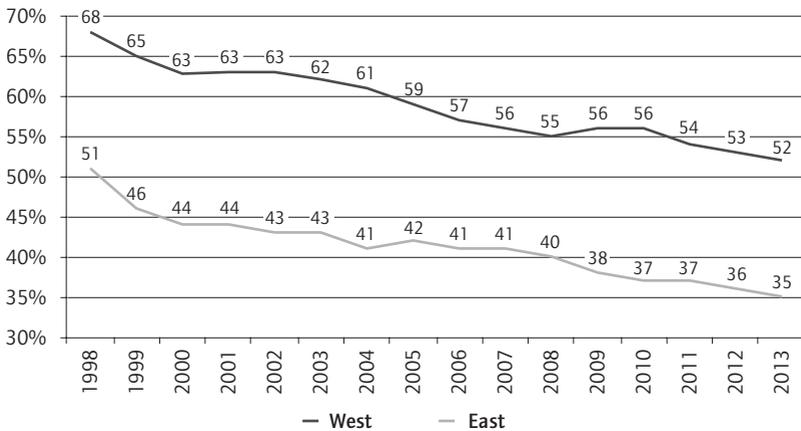
The single most important driver of this decline in collective bargaining *impact* was the drop in collective bargaining *coverage*. This trend has been particularly marked in sectoral agreements. From 1998 to 2013 the share of workers covered by sectoral agreements dropped by 16 percentage points in both parts of Germany (Figure 4). If we include firm-level agreements (whose importance has grown over time when counted by firms but not by workers covered), in 2013, 60 per cent of western German and 47 per cent of eastern German workers were covered by some form of collective agreement, which adds up to an average of 49 per cent coverage by sectoral agreements, plus 9 per cent by firm agreements, in Germany as a whole (WSI-Tarifarchiv 2015).

Figure 3 Collectively agreed and actual real wages per employee, 2000–2012 (2000=100)



Source: WSI-Tarifarchiv (2015).

Figure 4 Share of workers covered by sectoral collective agreements (1998–2013)



Source: WSI-Tarifarchiv (2015) based on IAB-Betriebspanel.

Compared with the late 1990s and the early 2000s this decline appears to have slowed down over the past few years, at least in the western part of the country, but it would be premature to claim that it is about to come to a halt. The single most important reason behind the mid-term trend is the weakening of trade unions: net trade union density fell from around 30 per cent in the mid-1990s to around 19 per cent in 2013 (Visser 2013).

It is obvious that weaker unions provide less incentive for employers to join an employers' collective bargaining association. While it is true that, as demonstrated by the examples of France and various other EU countries, weak trade union density can be outweighed by an established practice of statutory extensions of collective agreements, this practice (as mentioned earlier) has been blocked for strategic reasons by the employers' umbrella organisation since the 1990s. Hence the overall weakening of the collective bargaining architecture.

Against this background, the overall drive towards privatisation of public services and the increasing importance of outsourcing strategies in manufacturing has gained an additional negative impact on collective bargaining. Ever broader segments of industry and services have been made subject to poorer working conditions and wage standards. By way of example, massive low wage competition became a feature of postal services in line with the EU services directive. Obviously neither outsourcing nor privatisations are particular to Germany. However, in connection with the abovementioned institutional upheavals – especially the widening gap between wages in manufacturing and in services, as well as the widespread lack of generally binding collective agreements – they reinforced the dampening effect on labour incomes.

Last but not least, the abovementioned local derogations from collective agreements since the late 1990s developed a particularly problematic dynamic. In the metal industry in particular the drive towards locally agreed wage cuts and working time extensions began to threaten the whole system of collective agreements. Eventually, from 2003 on, IG Metall counteracted by establishing a system of a centralised internal coordination in combination with greater involvement of the local membership base, which step by step helped to regain control over this process and to prevent collective agreements from being hollowed out further (Haipeter 2013). Nevertheless, depending on the economic situation, in large parts of manufacturing the demand by employers at firm level to deviate from sectoral agreements remains a permanent challenge for works councils and local trade union organisations.

While the process of weakening of collective bargaining which started in the 1990s has proved to be a mid- to long-term trend, the so-called 'labour market reforms' of the mid-2000s worked as shock therapy. This move marked the *third* structural break in the employment system and gave a particularly powerful boost to internal devaluation.

2.2 'Agenda 2010'

The so-called labour market reforms from 2003 onwards were intended to bring about – and indeed caused – a structural break in the German employment system. They led to massive additional pressure on both collectively agreed and actual wages (on the following see, if not indicated otherwise, Bäcker *et al.* 2011; Bosch 2014; and Knuth 2014). These were the main elements relevant to the present issue whose effects I will spell out in what follows:

- The partial replacement of unemployment insurance by a means-tested benefit system that requires that offers even of low quality jobs must be accepted has had an intimidating ripple effect in broad segments of the labour market. This gave a strong impetus for the short-term unemployed to try and avoid being trapped in the means-tested 'Hartz IV' scheme by accepting job offers on low pay. What was labelled by the Federal Labour Agency as an 'increasing unemployment dynamic' (BA 2011) caused substantial knock-on effects in the whole pay structure (I will come back to this later).
- Many previous restrictions on temporary employment were abolished, while the European equal pay principle for agency labour was hollowed out by an opt-out in the case of collective agreements. This paved the way for a wave of dumping 'agreements' well below equal pay standards. The number of temporary agency employees rose from 300,000 in 2003 to around 900,000 in 2011, which amounted to almost 3 per cent of all employees liable to pay social security contributions. Temporary workers on average earned around half as much an hour as standard employees in 2006, which has been increasingly perceived as a threat to pay standards among core workers, too.
- Additional strong impetus for the extension of atypical employment was given, on the one hand, by public subsidies for low wages within the framework of Hartz IV and, on the other hand – and frequently in combination with it – by the promotion of 'mini-jobs' with pay of up to 450 euros without any reference to hours worked. The number of 'mini-jobbers' (as their first job) rose from around 4.2 million at the beginning of the 2000s to roughly 5 million persons. By 2012 around 14 per cent of all dependent

employees – most of them women – were exclusively in marginal employment (that is, without obligatory social security contributions for workers). Even if schoolchildren, students and pensioners are not included the figure is around 9 per cent; 84 per cent of ‘mini-jobbers’ were on low wages (Weinkopf 2012).

- Several pension reforms abolished previously existing pathways to early retirement; furthermore, stepwise from 2012 to 2029, the statutory retirement age is being gradually increased from 65 years of age to 67.

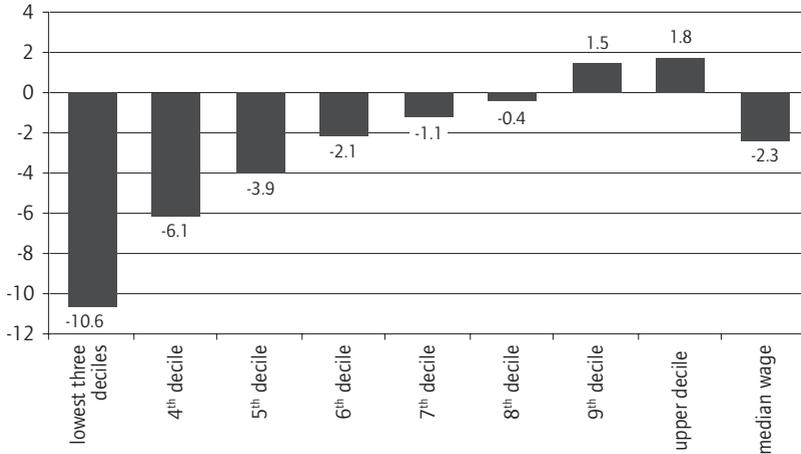
I will return to the employment effects of these reforms in Section 3. As to their effects on wages, which are the focus of the present section, Bäcker *et al.* (2011: 48) have given a blunt summary: ‘Since the introduction of the “Hartz reforms” pressure has increased to accept employment even under the poorest conditions as regards low wages, temporary work, fixed term employment, part-time work or mini-jobs’. Lowering unemployed people’s ‘level of expectation’ based on ‘intimidation’ (Knuth 2014: 6) was one of the express aims of Hartz IV right from the start – and it was achieved. As Herzog-Stein *et al.* (2013: 9) have shown, by comparing succeeding growth cycles, this dubious success is reflected in the unusual stagnation of average real wages after the reforms from 2005 to 2008 during a period of economic growth.

As a consequence of the structural breaks in the German employment system since the mid-1990s a large low wage sector emerged; in 2012 roughly 24 per cent of employees earned less than two-thirds of the median wage, compared with 19 per cent in 1995 and 21 per cent in 2000 (Kalina and Weinkopf 2014). Particularly noteworthy is the fact that only a minority of them – around a fifth – had no occupational or academic qualifications. The justification of low wages often presented – that they offer low qualified people a chance to enter the labour market – is even more dubious if one takes into account that 46 per cent of all registered unemployed persons in 2013 had no occupational qualifications (BA 2014).

The rise of the low wage sector is also reflected in the medium-term changes in overall pay structures: the lowest three deciles in the wage grid suffered from substantial losses over the 2000s, while hourly pay rose only in the two top deciles (Figure 5). These data support the view that the growing low wage sector has also produced a negative pull effect on

median, rather than just average, wages. Hence the fall even in median *hourly* pay, which was less marked than the fall in actual wages per person in employment depicted earlier.

Figure 5 Real hourly wages, by decile, 2000–2010 (%)



Source: Brenke and Gabra (2011).

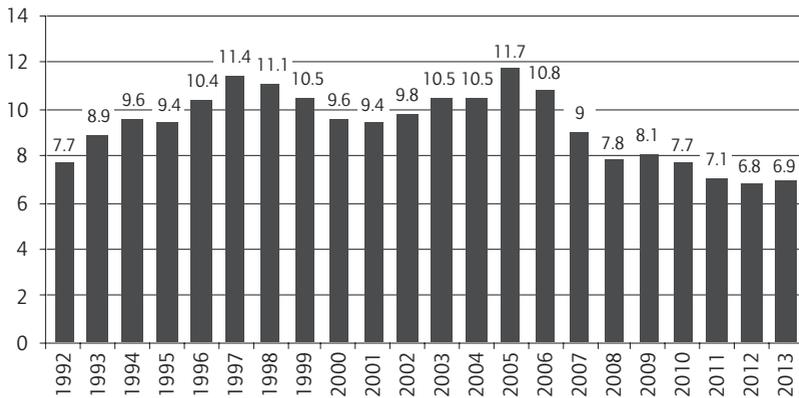
This change in wage *structures* behind the *average* pay decline over the 2000s gave way to a peculiar feature: up to the Great Recession, the share of households at risk of poverty (defined by an income of less than 60 per cent of median household income) increased because poverty rose both among jobless households and non-jobless households, while employment was on the rise at the same time (Gábos *et al.* 2015). That is, in Germany poverty increased along with job growth. It is to this ‘paradox of employment and poverty’ (Arbeitsgruppe Alternative Wirtschaftspolitik 2013: 20) to which I now turn.

3. Internal devaluation and the labour market

Looked at in a long-term perspective the German labour market has experienced a remarkable change over the past decade (on what follows cf., if not stated otherwise, Knuth 2014 and Bosch 2014). In the past, unemployment would usually fall in phases of economic growth and rise in recessions. From the 1970s, as in many other countries, the ups tended to be much more important than the downs. This, in turn, gave way to a

step-by-step increase in unemployment across business cycles. In contrast to this long-term trend, from the mid-2000s registered unemployment fell, briefly interrupted by a minimal rise in 2009, and continued to do so at a slower pace after the Great Recession (Figure 6). As already mentioned, most of this new feature was attributable to the important influx from short-term unemployment into employment after the 'labour market reforms'. While this influx was most marked up to 2008 it has remained relevant to a lesser extent since 2009 (Herzog-Stein *et al.* 2013).

Figure 6 Registered unemployment, Germany, 1992–2013 (%)



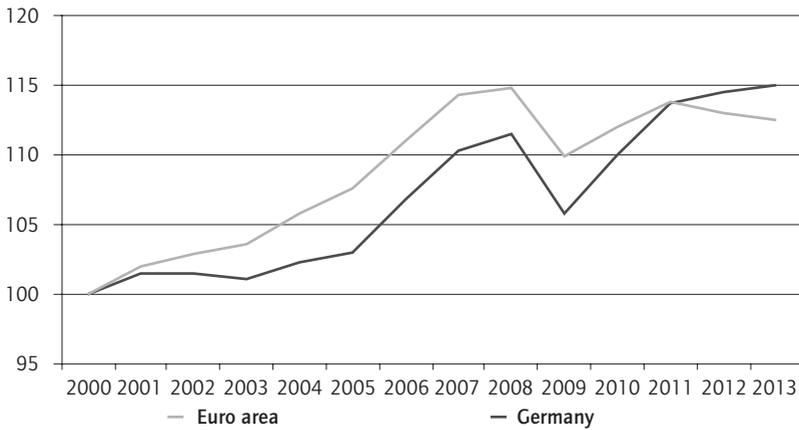
Source: BA (2014).

Interestingly, employment grew faster than unemployment declined: The employment rate rose from 65.6 per cent in 2000 to 73.5 per cent in 2013 (Eurostat database). Demographic change plays an important part in this. From around 2000, labour supply in Germany began to suffer from an ageing population. At the same time, the changes in the pension system built high barriers to early retirement. This led to a boost to the employment rate among workers aged 60 and over (Knuth 2014).

What is more, it should be noted that both the employment *rate* and the overall *number* of persons employed have been on the rise. In general one would expect a strong GDP growth to be the main driver of employment growth. Average GDP growth in Germany, however, has been far from outstanding by EU standards. As depicted in Figure 7, German GDP in the early 2000s suffered from a longer stagnation period and subsequently grew at a much slower pace than the euro-zone average, kept pace at a lower level until the Great Recession, dropped sharply in

2009 but recovered much more strongly than the euro-zone average and, different from most euro-zone countries, continued to rise after 2011. As Herzog-Stein *et al.* (2013) have shown by comparing the changes in GDP and employment during the business cycles 1999–2005, 2005–2009 and 2009–2013, the employment intensity of growth remained by and large the same over this period of time. This means that *most of what is being hailed as the German ‘jobs miracle’ is attributable to the stability of employment during the Great Recession and the stronger than average GDP growth from 2009*. I will come back to this in Section 5.

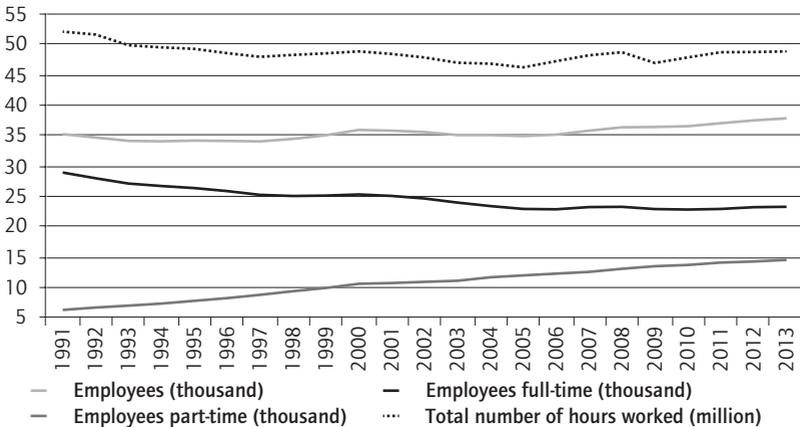
Figure 7 Level of real GDP, euro area and Germany (2000=100)



Source: Eurostat database (own portrayal).

Thus, if we want to understand the drivers behind the rise in employment *beyond* GDP growth we have to look at structural changes in the labour market. The arguably most pertinent source of the almost continuous rise in employment, in terms of both persons employed and percentage of the working age population, is the rise in female labour market participation. This long-term trend, in turn, is closely linked to soaring part-time employment, giving rise to a disconnection (at least until very recently) between the number of persons in employment and the total number of hours worked: the total number of hours worked dropped from the early 1990s until the mid-2000s and kept fluctuating over the following years (Wanger 2015). That is, roughly, more and more people shared a falling (up to 2005) and since then more or less stagnating labour volume, due to a continuous drop in the number of full-time workers (until 2006) and an ever growing number of mostly female part-time workers (Figure 8).

Figure 8 Employment and total hours worked, 1991–2013



Source: IAB (author's figure).

This change in average hours worked reflects an increasing dispersion of working hours between men and women, intertwined with an increase in precarious work, notably so-called mini-jobs (Kümmerling *et al.* 2015).² This went hand in hand with an increase in other forms of precarious employment fostered by the labour market reforms of the early 2000s, as summarised in the previous section.

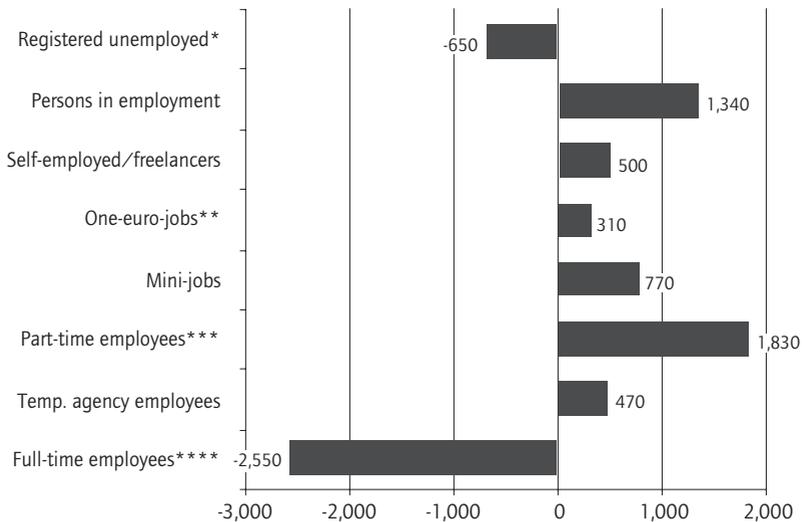
Thus, while recent employment growth in Germany is attributable mainly to the stronger than average GDP growth since 2009, it has been, in the longer run, closely connected to a substantial structural change in the German labour market. This structural change has been fostered, though

2. The significance of the mini-job regulation, which has contributed substantially to the growth of the low wage sector, is closely related to the maintenance of the so-called 'conservative welfare state' which partly compels and partly promotes limited participation by women in working life. The inadequate levels of child care facilities, which still have not been overcome, makes it difficult for many women with young children to resume work fairly quickly, while the tax and social contribution system makes unequal distribution of employment income between married couples financially attractive. Even though this system – which is still stuck in the 1950s – is increasingly coming under criticism and some modernisation has taken place (such as the introduction of a parental allowance on the Swedish model) its stability stands in marked contrast to the neoliberal-inspired reforming zeal in other areas. The extent of this stability is reflected in the retention of a benefit for parents not using child care, as well as in the stubborn defence of tax splitting for married couples. Hence the reinforcement of precarious work due to an interaction between neoliberal labour market reforms and a conservative gender model in Germany (Bosch/Jansen 2010).

not exclusively, by the labour market reforms of ‘Agenda 2010’ and must be regarded, next to the fall in collective bargaining coverage, as the main path to internal devaluation in the German economy up to the Great Recession.

Given the widely shared belief that ‘Agenda 2010’ is the reason behind German job growth it is important to keep in mind that, as already mentioned, these labour market reforms had a discernible effect neither on GDP growth nor on the employment intensity of growth. They influenced the sources of additional labour input, that is, short-term unemployed persons in close interaction with the rise in precarious and low paid work. This dynamic also reflected the greater emphasis on external flexibility in company human resources policy based on fixed-term contracts and temporary work (Bosch 2014). The importance of these structural changes for the overall ‘employment miracle’ is depicted in Figure 9.

Figure 9 Changes in employment structure, Germany, 2000–2010 (‘000 persons)



Notes: * By German Labour Agency definition (-210,000 by ILO definition).
 ** Subsidised active labour market policy scheme. *** With social security contributions, i.e. without mini-jobs.
 **** Excluding temporary agency jobs. All numbers rounded off.
 Source: Bundesagentur für Arbeit (author’s figure).

Both temporary agency workers and mini-jobs are overwhelmingly poorly paid. Among workers in mini-jobs, the share of low-wage workers was 86 per cent in 2010 and among temporary agency workers around two-thirds. The relevance of the labour market reforms for wage developments is not controversial: even most mainstream economists cheering on the Hartz reforms share the view that ‘wage moderation’ has been the single most important effect of ‘Agenda 2010’. By way of example, ZEW (Centre for Economic Research, Mannheim) economist Bonin (2013: 150) has come to the conclusion that ‘the structural improvements brought about by the reorientation of labour market policy alone’ could not explain the rise in employment since 2005: ‘Presumably the strongest support came from the restoration of international competitiveness due to many years of wage moderation ... Furthermore, the emergence of a low-wage sector resulting from the greater employment pressure imposed on the low qualified unemployed subdued the growth of average unit wage costs.’

It is these competitiveness-related effects of internal devaluation to which I now turn.

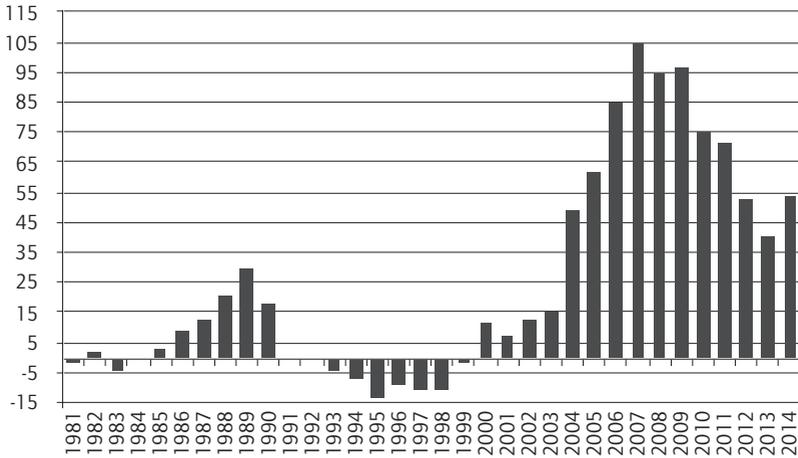
4. Internal devaluation and competitiveness

The German economy has been one of the most manufacturing-based and export-oriented economies in Europe for a long time. The export industry’s performance and success is based primarily on high specialisation and product quality, especially of capital goods; the strong orientation towards customer service; the flexibility and qualifications of employees as a basis of incremental product and process innovation; all factors embedded – at least hitherto – in comparatively strong medium-sized (*Mittelstand*) ownership structures and a broad system of institutions ranging from occupational training to codetermination, as well as in a culture in which manual and technical work is appreciated (for references, see Lehndorff *et al.* 2009). Nevertheless, looking at the 2000s up to the financial crisis, compared with earlier decades, the soaring current account surplus with the euro-zone countries is striking (Figure 10).

It would be difficult to explain this turn of events primarily by a sudden regaining of product and process innovation capacities allegedly lost over the preceding decade. As a look at the 1980s reveals, there must have been much more than this. In fact, as noted by Bonin (2013) and many

others, there can be no doubt about the importance of declining average wages for this extraordinary surplus boom in foreign trade with the euro-zone countries. In previous decades the exchange rate adjustment mechanism would have made it possible for economies with rising labour unit costs and higher inflation rates to react to falling unit labour costs and a modest inflation rate in Europe’s strongest economy. From the founding of the monetary union two-fifths of Germany’s foreign trade no longer had to fear such action. This is what internal devaluation was all about, as reflected in the impressive rise in current account surpluses with the countries of the euro zone in particular during the short growth period 2004–2008.

Figure 10 Germany’s current account balances with the countries of the euro zone (billion euros)



Source: Deutsche Bundesbank (author’s figure).

Internal devaluation meant in practice that from the early 2000s the product- and process-based strengths of German manufacturing industry were *supplemented* by the decline of unit labour costs in comparison with other EU countries. Average real wages in Germany fell, while labour productivity rose in relation to the EU average, which gave way to a particularly low inflation rate far below the euro-zone average, as well as the ECB’s target inflation rate. Even in industry unit labour costs in Germany fell up to 2008 much more than in any other country in the euro zone, with the exception of Finland (on what follows see Herzog-Stein *et al.* 2014). On top of this comes the fact that wages in the private services

sector in Germany are, on average, 20 per cent lower than in industry (unprecedented in the EU), which means that many pre-services for industry are extremely cheap. The Bundesbank (2011: 17) was thus certainly right to claim that German export success also gained ‘impetus from improvements in price competitiveness’. The European Central Bank (ECB 2011) estimated the improvement in Germany’s price competitiveness compared with the major global trading countries in the period 1999 to the beginning of 2011 at 16 per cent (basis: GDP deflator).

How does this relate to the widely shared observation that demand for many German export products does not depend primarily on price? While it is true that this does not apply by any means to all export industries,³ there is no doubt that in particular in the motor and the machine-building industries – which account for around one-third of German goods exports – the price elasticity of demand is relatively low. Thus it must be assumed that the drop in nominal unit labour costs is reflected to varying degrees in export price levels across industries. On average, export prices rose from 2003 to 2008, while at the same time (until 2007) nominal unit labour costs fell (Schulten 2015). As shown by the example of the metal industry, where unit wage cost advantages were not reflected in falling prices subsequent to 2000, profits of German firms increased as competitors in other euro-zone countries raised their export prices at a faster pace (IG Metall 2010). The Bundesbank (2011: 33), too, pointed out that part of the relevant cost benefits ‘were apparently used to increase profit margins’.

Before coming back to this important aspect, the other side of the same coin must be highlighted. Wage developments impact on the demand-side of the economy. From the end of the 1990s the key issue of all public ‘debates’ was the level of labour costs, which allegedly had to be brought down in order to boost the competitiveness of the German economy. The supposed imperative of lowering labour costs was never questioned, whether in relation to pension reform, decentralisation of collective bargaining or tax policy. As indicated earlier, in contrast to what had been prophesied by the neoliberally inclined main actors in the economy and politics no impetus was discernible from falling wages and labour costs

3. One particularly crass example is social and wage dumping in German slaughterhouses, taking advantage of loopholes in the statutory regulation of agency labour. The external effects include jobs put at serious risk, especially in the Danish, but also in the French meat industry (Czommer/Worthmann 2005; Refslund 2012).

for either investment or growth. What happened instead was almost a stagnation of the domestic market. The weak wage development hindered both a transfer of the growth impetus from the export boom to the domestic market and also a boost to imports, which would have enabled Germany's trading partners abroad to benefit from its export-induced growth impetus (Joebges *et al.* 2010: 10). Herzog-Stein *et al.* (2013: 17) show, on the basis of alternative model calculations, that higher wages would not have adversely affected either employment or economic growth despite a predicted lower growth in exports: 'The stronger domestic dynamic would have compensated for the weaker foreign demand and growth and employment would have been higher'.

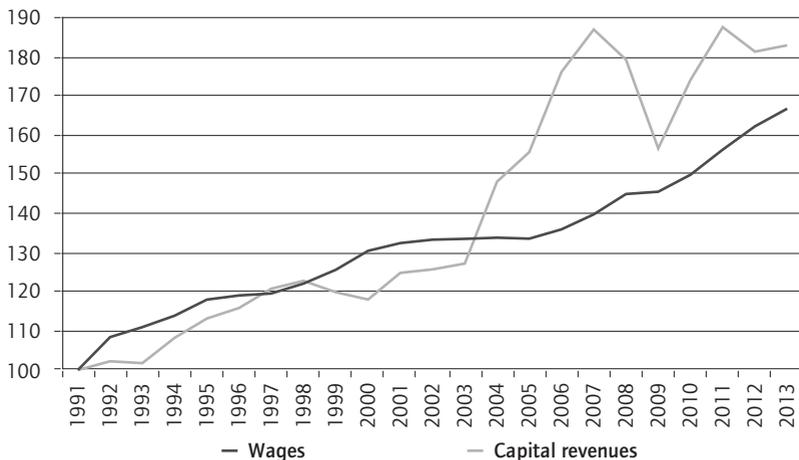
Therefore, the criticism formulated by many observers that Germany exports too much tends to divert attention from the core problem. It makes more sense to emphasise the other side of the coin: Germany imports too little. The key outcome of the prevailing economic and social policy approach of internal devaluation in the first decade of the euro zone was the '*import deficit*' of the largest EU economy. The relative and temporary success of this approach was possible only because the other EU economies did not choose the same route. The domestic imbalances in Europe's largest economy were the main source of the external imbalances that paved the way to the crisis in the euro zone. Thus, the common denominator that sums up the German business model in the monetary union can be described as '*making profits without investing*'.

And they did make profits. In contrast to falling average wages per employee and to the stagnation or minimal growth of overall labour income, profits rose significantly (Figure 11). The share of profits in GDP rose by 9 percentage points from the beginning of the 2000s to the eve of the crisis. The dynamic of rising inequality was among the strongest in the EU (Schäfer 2012; ILO 2010). The contrast to the pre-euro era was striking. On top of this, due to the tax reforms in the early 2000s secondary distribution did less than had previously been the case to attenuate the changes in primary distribution.

Due to weak economic growth, however, only a small part of rising profits was used for domestic investment. An analysis by the Bank for International Settlements (Ma and McCauley 2013: 8, 13) comes to the conclusion in relation to Germany that '[t]he fruits of wage moderation and labour market reforms were not invested domestically but instead funded the accumulation of net foreign assets', which on this account did

not involve an increase in direct investment, but a massive boom in lending abroad. Thus, German profits participated actively in the booming global financial market bubble and in particular the financing of strong growth driven by partly private, partly public debt in Europe's deficit countries. German investors were among the largest foreign creditors of the indebted US private sector, and German banks were the largest creditors of partly public, but primarily private debtors in Greece, Ireland, Portugal and Spain (Bofinger 2010; Lindner 2013). It was thus only a minor journalistic exaggeration when a commentator in the British *Guardian* newspaper declared: 'Germany blew the bubbles that popped up in the rest of Europe' (Chakraborty 2011). It stands to reason that the bursting of this bubble resulted in considerable losses among German investors and banks, too (Herzog-Stein *et al.* 2013).

Figure 11 Labour income and capital revenue, 1991–2013 (1991=100)



Source: Destatis (VGR), calculation by Unger *et al.* (2013).

To sum up, the economic policy approach of internal devaluation in Germany before the crisis had three major effects: first, it held down imports due to the extraordinarily weak growth of the domestic market; second, it helped to increase exports further, by adding (on average!) price-based to product-based competitiveness; and third, it gave an extra boost to profits as export prices (again: on average!) did not reflect the drop in nominal unit labour costs. As a consequence, internal devaluation in Germany was crucial for the soaring economic imbalances within the euro zone both on the side of trade imbalances and on the side of capital

exports into deficit-driven economies. Thus, the German economy was heavily complicit in preparing the ground for both the global financial and the euro-zone crises. But when the bubble burst in 2008 and the euro house of cards almost collapsed in 2010 the German economy and its labour market turned out to be an island of (relative) stability. How could this be possible?

5. The gradual renunciation of internal devaluation

The fact that Germany is currently being held up as a model can be traced back to the much lauded ‘German employment miracle’ since 2008/2009 (on what follows, cf. Bosch 2011). The truly astonishing stability on the labour market during the financial crisis was the main condition of the rapid economic recovery from the third quarter of 2009 and the ensuing growth in employment in the following years. On the one hand, for the first time in many years stronger economic impetus came from the domestic market, primarily due to higher collectively agreed pay increases; on the other hand, on this basis industrial companies were able to react most quickly to the initial global economic recovery. Furthermore, in combination these developments were such a balm for crisis-hit state budgets that Germany was able to avoid what other – sometimes even less indebted – countries felt forced to do: introduce drastic austerity programmes.

Almost overnight, counter to the relentless mantras that had previously prevailed, extensive economic stimulus programmes were implemented. While in the years before the crisis economic growth was hindered by cuts in public spending, which matched lower tax revenues due to tax reforms, the temporary change of course in financial policy in 2008 and, especially, 2009 was a considerable impetus to growth (IMK Arbeitskreis Konjunktur 2011). The biggest direct effect of this recovery was the prevention of a massive fall in employment in crisis-ridden manufacturing. A similar turnaround happened with respect to external vs. internal flexibility. Only a few years beforehand, during the preceding phase of recession and stagnation, many companies had thinned out their workforces to such an extent that they struggled with staff shortages when the economy revived. This was still fresh in the memory and now even considerable productivity losses were accepted in the short term in order to retain skilled staff. Thus, the emphasis was now put on *internal* flexibility.⁴ The contrast was as stunning as with regard to fiscal policy.

Since the mid-1990s increasing *external* flexibility had been one of the core neoliberal dogmas of employment policy; this was thus also one of the guiding principles of the labour market reforms. What rescued the German labour market in the crisis, however, was precisely the opposite: the reactivation of *internal* flexibility based on cooperation between employers and trade unions at eye-level.

Key to the revival of internal flexibility was short-time working, at levels not seen since the mid-1970s (Herzog-Stein *et al.* 2010). But other working-time measures contributed as much if not more to reducing the volume of work: the reduction of positive balances on working-time accounts, which in previous years had sometimes grown considerably; the reduction of overtime; and the use of collective agreements to ensure employment (Bogedan *et al.* 2011). Above all, the various forms of cuts in individual working time had even more of a massive effect on total volume of work than (collective) short-time working (Fuchs *et al.* 2010; Groß 2013; for an overview cf. Kümmerling and Lehndorff 2014).

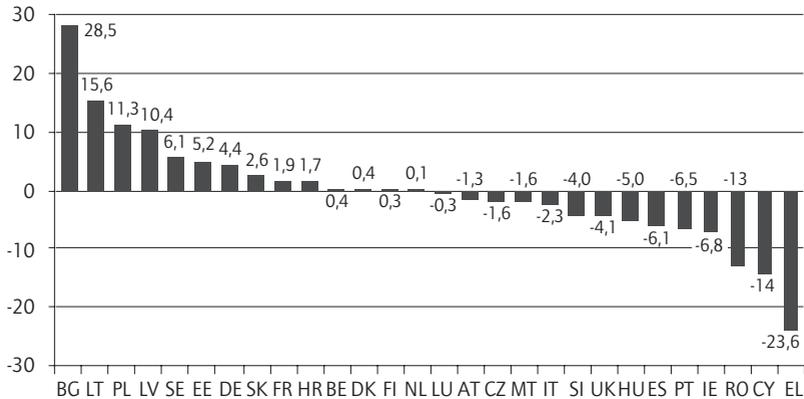
The overall positive experience of safeguarding employment by reactivating precisely those elements of the German social model that had survived the neoliberally inspired zeal for demolition triggered a fresh political dynamic – guided by Merkelian adaptability – that could not easily be dismantled again as economic recovery set in from the second half of 2009. The policies of internal devaluation could not be carried on as easily as in the years before the crisis. This gave rise to a paradoxical situation which continues to dominate the European scene: the relatively positive employment trend in Germany has served as a political platform for the German government to push for a policy approach of internal devaluation in other countries, while the drivers behind this relatively positive development at home have been exactly those which are being forbidden to other countries.

The turn of events is reflected in the new trends in wage developments in Europe since 2010 (Figure 12). If we compare this pattern with the one before the Great Recession (Figure 1), the contrast is striking not just due to the dramatic wage cuts in the most crisis-ridden countries, but also due to the overall more favourable development of wages in Germany.

4. It is true that considerable numbers of temporary workers in manufacturing were made redundant, but in the labour market overall this fall in employment was more than offset by employment gains in other sectors.

Apart from the Baltic states Germany had the highest wage increases of all euro-zone countries since 2010. This shift is largely attributable to the experience of 2008/2009 and the broad public criticism of the increasing social inequality which gave tailwind to a more active wage policy on the part of trade unions. Furthermore, the public debate inside Germany triggered new labour market regulations (most importantly the introduction of a statutory minimum wage and a facilitation of the extension procedure of collective agreements) which could support these more positive wage trends in the future, but may have contributed at least to contain the further downward wage drift. As was already discernible in Figure 3, this shift in emphasis is reflected in both collectively agreed and actual wage developments from 2008.

Figure 12 Changes in real wages per employee,* EU, 2010–2013 (%)



* Nominal compensation deflated by the national HCPI (harmonised index of consumer prices).
 Figures for 2014: Forecast of the European Commission (Spring 2014).
 Source: Schulten and Müller (2015).

True, if balanced economic development is to be achieved in Germany and Europe this shift is still much too weak and the import deficit remains high. Nevertheless, the stabilising influence of consumer demand on the domestic market should not be underestimated. During the heyday of internal devaluation – between 2001 and 2008 – almost three-quarters of the relatively slow growth of around 1.2 per cent a year, on average, was triggered by export growth, while the average contribution of domestic demand to GDP growth amounted to 0.3 percentage points (Priewe and Rietzler 2010). In four out of the five years after 2009, by contrast, domestic demand contributed more to growth than the export surplus (Table 1).

Table 1 **Development of GDP and the growth contributions of its components, Germany, 2009–2014**

	2009	2010	2011	2012	2013	2014
Real GDP change (%)	-4.7	3.7	3.3	0.7	0.1	1.6
Growth contributions of structural components (in ppt)						
Exports	-2.9	1.5	0.7	0.9	-0.5	0.4
Domestic demand	-1.8	2.3	2.6	-0.3	0.6	1.2
Private households	-0.1	0.4	1.3	0.4	0.5	0.7
State	0.5	0.3	0.2	0.2	0.1	0.2
Capital investments	-1.9	1.0	1.2	-0.4	-0.1	0.7

Source: IMK, various reports.

As a consequence, for the first time since the turn of the century, the main driver of continuous employment growth – albeit under the condition of roughly unchanged total hours worked due to the ongoing rise in female part-time workers – was domestic demand based on (still modest) pay rises.

Nevertheless, ‘the long shadow of the 2000s’ (Bispinck 2012) still lay on the labour market. The proportion of employees and households on low incomes was still at the pre-crisis level in 2011. The significance of precarious employment had not diminished but the number and share of full-time workers with open-ended contracts increased for the first time in more than ten years. All in all, Germany’s economic and social development since 2009 can best be described as zigzagging and the shifts in emphasis are still too tentative to enable the German economy to give a powerful impetus to help overcome the euro-zone crisis.

But even if the impetus were more powerful it could hardly overcome the negative effects of austerity and internal devaluation imposed on other countries. The export world champion cannot remain unscathed by this. As can be seen in Figure 10, the current account surplus in relation to the euro countries, first with the global financial crisis and then once more with the outbreak of the euro-zone crisis, fell significantly (on what follows see IMK-Arbeitskreis Wirtschaftspolitik 2013; IMK/OFCE/WIFO 2013; Deutsche Bundesbank 2013). While initially it was possible to make up for this loss by means of export growth to Asia and the Americas, it should not be forgotten that the euro zone, with its share of still roughly 37 per cent, continued to be by far the largest export market for the

German economy. It should therefore come as no surprise that, after the rapid upturn in 2010/2011, growth rates fell again in Germany, too. Thus, the boomerang of internal devaluation returned to the economy of its origin.

6. Conclusion

The paradox of recent developments in Germany and Europe can be summed up as follows: the comparatively positive economic and labour market development in Germany is not to be attributed to the internal devaluation entailed by 'Agenda 2010' before the financial crisis, but rather to the first attempts at limiting the damage caused by these reforms. Nevertheless, the 'jobs miracle' is used as a justification of the predominant EU policy approach geared to imposing internal devaluation on other countries. Some may be reminded of the old AC/DC lyrics: 'I'm on my way to the Promised Land, I'm on the highway to hell.'

It should be kept in mind that the logic of internal devaluation in Germany up until the financial crisis could work, in terms of improved price competitiveness, only because policy approaches in other countries did *not* follow the same logic. If all economies take the same route there will be a race to the bottom. If this had happened earlier, the euro zone would have experienced its first recession already some years before the financial crisis. What is more, and most importantly, the shortcomings in product-based competitiveness existing in many EU countries will not be overcome by internal devaluation. Rather, the opposite will be the case: falling wages, mass unemployment and poverty will reinforce the devaluation of what is ultimately the most crucial productive resource of any national economy, namely human labour.

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