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Does the German social model support the convergence of living conditions in the EU?

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1.1 Convergence in the EU

- Two types of convergence in the EU:
  - Beta-convergence: catch-up process of poorer countries
  - Sigma-convergence: Reduction of social inequality within member states and the EU

- EU not conceived as merely economic union in which convergence is reached through factor mobility and market forces

- Convergence will not happen spontaneously; there must be a political will to achieve it and it has to be actively managed

- EU developed instruments to reach convergence (structural funds, EU directives ...)
1.2 Convergence in the EU

- Convergence cannot be reached only through EU policy and convergence debate cannot be conducted on a country by country basis
- Common economic area – and even more so in a monetary union – a policy adopted by one country can have both positive and negative effects on the convergence processes in other countries
- Many examples of negative effects of national policy in tax, fiscal, social policy and other areas
- My research question: Is the German social model setting model supporting convergence in the EU?
- This question became important because of extremely high trade surpluses of Germany
- Very different answers to this question in and outside of Germany
2.1 Germany trade surpluses - are their roots in the German social model?

- German surplus in balance of payments in recent years around 8.5% of German GDP – mainly due to export surpluses

- Surpluses exceeding the upper limit of 6% set by the EU – but no sanctions – sanctions easier when countries have to ask for credits

- Main stream view of trade surpluses and deficits: price competitiveness and wages is the driver

- Recipe: If unit costs go down in South Europa and up in Germany everything is fine: wage setting therefore crucial - productivity neglected
2.2 Balance of payments of Euro-countries in billion €

2.3 Development of hourly gross wages in selected countries - 2000q1=100 (1)

Source: Albu et al. (2017) IMK Report 128
2.4 Unit labor costs in the Euro zone 2000q1=100 (1)

2.4 Unit labor costs in the euro zone 2000q1=100 (2)

Source: Albu et al. (2017). IMK Report 128
3.1 German wage setting system

German trade unions under suspicion to enforce wage restraint in order to encourage job growth in Germany at the expense of other EU member states.

Some authors speak of *producer coalitions* in big companies in which unions and works councillors tolerate less favourable working conditions of peripheral workforces or suppliers and have campaigned against the introduction of the MW (Carlin/Soskice 2009; Palier/Thelen 2010; Hassel 2014).

There are producer coalitions, but main reason for wage moderation declining coverage by collective agreements because of the deregulation of product and labour markets and new employer strategies.
3.2 Evolution of coverage by collective agreement in Germany 1998 - 2016

Source: WSI Tarifarchiv (based on IAB Establishment Panel data)
3.3 Collectively agreed wages grew faster than actual wages - negative wage drift

3.4 German wage setting system

Where unions are strong high wage increases and short working hours (example engineering industry)

German wage setting system – vulnerable to outsider competition - most CA’s not declared as generally binding

**Main reasons for negative wage drift:**

- Employer’s leave of do not join the employer’s association
- Fragmentation of companies / delocation of jobs to uncovered companies
- Deregulation of product market and privatization
- Deregulation of the Labour market through the Hartz-Acts
3.5 Result beside low average wage increases - increasing income inequality

Hourly gross wage of employees by deciles 1995-2015

Source: Bundesregierung, Armuts- und Reichtumsbericht 2017 (SOEP v32)
4.1 Would higher wage increases in Germany help?

Most non-German economists would agree

But different views

- **EU-Commission**: “Overall there is no evidence that wage developments are at the root of the development”  
  (European Economy 9/2012: 91) – Why then the dictates of the institutions in South European countries?

- **German government**: Low price elasticity of German exports, ageing society needs savings for the future...

- **IMK**: Low price elasticity – but German wage restraint reduced domestic demand and therefore imports – a combination of wage increases and investments programs would help
4.2 Public investments in % of GDP 2016

Source: Eurostat
4.4 Development of domestic demand 2000q1=100 (2)

5. Conclusions

Low wage increases and growing income inequality in DE led to high trade imbalances in the EU – **negative impact on**

- **beta-convergence**: austerity policy in deficit countries stopped catch-up processes

- **sigma-convergence in EU**: increase of inequality in DE and EU

**Driving force not producer coalitions** – unions do not have the power anymore to negotiate higher wage increases across the economy

**Higher wage increases and more investment in Germany needed to reduce trade imbalances**

**But no political will in DE to do so!**