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Crisis and recovery in the German economy: The real lessons

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ABSTRACT

Owing to its strong dependence on exports, Germany was among the economies hit hardest by the financial crisis. But unlike almost all other countries, Germany emerged from the crisis quickly and stronger than before. What lies behind this success story, if at all it is one? The commonplace – neoliberal – answer is that Germany's success is the hard-won reward for strict economic management, combining fiscal conservatism and structural reforms of welfare and the labour market. The latter, by reducing labour costs, fostered competitiveness, boosted growth, and increased employment. "Progressive" economists arguing that Germany beggared its Eurozone neighbours by squeezing workers' wages, share a similar view. However, this particular explanation of Germany's resilience is wrong and unhelpful. Germany's export success cannot be explained in terms of its (labour) cost competitiveness, but is caused by strong *non-price* competitiveness. This, in turn, is due – much more than is normally recognized – by the remaining distinctly *non-neoliberal* dimensions of Germany's economic model (including a Keynesian crisis response). German and European policymakers preaching austerity and structural labour-market changes as the model for other Eurozone countries, misunderstand Germany's rebound from crisis, with serious costs to Eurozone populations.

1. Präludium

The Eurozone entered a recession in the first quarter of 2008, and quarterly growth rates collapsed in the first quarter of 2009, when, as Fig. 1 illustrates, the financial crisis hit Europe full-force. Export-dependent Germany was hit hard: its GDP fell by a cumulative 6.6 percentage points over five successive quarters (2008Q1 = 100), but then recovery set in – and Germany's GDP bounced back to its 2008Q1 level in the first quarter of 2011. France, which did better than Germany initially, recovered more languidly. While it took German GDP 12 quarters to recover, French real GDP rebounded to the 2008Q1 level after 5 full years, in 2013Q4. Italy and Spain are even doing worse – their real GDP has been on a downward trend since 2008Q1 with no strong turnaround as yet in sight. Italy suffered a cumulative decline in real GDP of 9 percentage points, while Spain's GDP fell by 7.4 percentage points over these 5 years. In 2013Q4, the GDP of the Eurozone as a whole is still 2.6 percentage points below its level in 2008Q1. Hence, whereas other European economies are still struggling if not failing, Germany bounced back quickly – with revitalized export industries, low borrowing costs, an inflow of investors' cash, a huge external surplus and a balanced budget. Whereas in 2008 Germany's rate of registered unemployment was roughly the same as the Eurozone, at 7.5% and 7.6% respectively, there has been a remarkable divergence since then, with the Eurozone rate rising to 12.1% in 2013, while Germany's unemployment rate has declined to 5.3% (according to Ameco-database figures). As head of the Eurozone's strongest economic power, Chancellor Merkel is in a position to dictate the terms under

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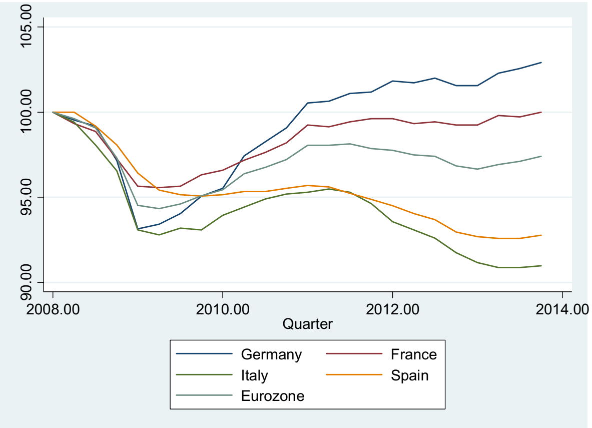

Fig. 1. Germany's recovery (2008Q1–2011Q1) *Note*: The index of real GDP for 2008Q1 = 100.
Source: Quarterly real GDP data are from the Eurostat Database.

which struggling Eurozone nations can apply for further credit. It led German sociologist Ulrich Beck (2013) to argue that the Eurozone crisis has given birth to a political monster: a German Europe rather a European Germany, based on creditor–debtor relationships where Germany is the main creditor and the debtors have trouble meeting their obligations.

German performance is the more remarkable, because just two decades ago, its economy after reunification was stagnating with five million workers unemployed. For years, the German "sclerotic" economic model was ridiculed, *The Economist*[1] calling Germany "the sick man of Europe", when comparing it to the more rapidly growing and supposedly more innovative Anglo-Saxon capitalism, dominated by financial markets coordination and shareholder value maximization (see Siebert, 1997). But the tables were turned by the financial crisis, which set the U.S. and most other economies on a path of "secular stagnation" while jumpstarting a German resurgence. The result has been an obsession, most prominently perhaps in France and Britain, with "the German model" – the benchmark against which to judge national economic performance.

The essence of this model, so the dominant narrative goes, goes back to Chancellor Gerhard Schröder's drastic labour market reforms (the Hartz reforms), which created strong price or cost competitiveness of Germany's export-oriented manufacturing sector (Dadush et al., 2010; OECD, 2012; Ma and McCauley, 2013). Mainstream commentators praise Germany as the only EMU country that got it all right and they set it up as the example to be followed by the crisis-ridden Eurozone members. This view has become codified in policy in the *Euro Plus Pact* (adopted by the European Council in March 2011), the core aim of which is to foster Eurozone (unit labour cost) competitiveness and net exports via labour market deregulation and welfare state reform, in conjunction with fiscal austerity (Gros, 2011; Gabrisch and Staehr, 2014).

[1] This happened in 1999. See: http://www.economist.com/node/209559.

More progressive observers are buying into the same narrative centred around relative unit labour costs (RULC) by problematizing Germany's "mercantilistic" wage and trade policies (Priewe, 2011). "Germany has pursued a policy of aggressive wage restraint resulting in large current account surpluses," writes Stockhammer (2011), and "German gains in competitiveness (since the introduction of the Euro) have not been founded on superior technological performance, but on more effective wage suppression." Bibow (2012) argues the same, claiming that "not German engineering ingenuity, but wage restraint gave German exporters an extra boost." Lapavitsas et al. (2011, p. 2) in a fairly typical statement, write: "Germany has gained [cost] competitiveness within the Eurozone for the sole reason that it has been able to squeeze its workers harder [than the rest of the Eurozone]." Germany's growing trade surpluses with Southern Europe are proof of Germany's success in "beggaring" its Mediterranean neighbours. "With German unit labour costs undercutting those in other countries by an increasing margin, its exports flourished and its imports slowed down", write Flassbeck and Lapavitsas (2013). These heterodox observers of course strongly reject the neoliberal reforms propagated by the *Euro Plus Pact*, but – following the same logic – argue instead for strong (relative) German wage increases to reduce Germany's external surplus and help rebalance the Eurozone (see also Darvas, 2012; De Grauwe, 2012; Sinn, 2012).

To us, all this is flawed economics. Germany's resilience cannot be explained in terms of its (superior) international cost competitiveness, nor can one attribute the Eurozone imbalances to differences in relative unit labour costs. Germany's rebound is not due to the Hartz reforms and "effective wage suppression". Far from it. We argue that Germany's remarkable rebound must be explained in terms of the country's superior technological performance giving rise to strong *non-price* competitiveness. Germany's technological prowess, in turn, is founded on economic coordination and strongly market-guiding industrial policies – not cost competition. We begin by questioning the conventional wisdom and argue that changes in RULC do not explain Germany's superior export performance. We proceed to providing evidence on Germany's technological competitiveness – and its determinants. We further consider how "wage suppression" has actually been damaging to Germany's aggregate performance. The *Euro Plus Pact* has wrongly reinforced the belief that crisis countries are crisis countries because of weak unit labour cost competitiveness and Germany is strong because of strong cost competitiveness. The wrong lessons have been learned from Germany's rapid rebound from crisis and this is leading to large avoidable economic costs.

2. Unit labour cost competitiveness: does it matter for Germany?

Competitiveness indicators are known to be weak predictors of future export performance (Gros, 2011; Gaulier and Vicard, 2012) – we need only to refer to the well-known "Kaldor paradox" (Kaldor, 1978) which holds that the effects of growing relative (labour) costs or prices on exports or market shares are rather weak and often