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The wrong path to growth

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The debate about higher wage demands in Germany poses a threat to the German economy as it can seriously undermine competitiveness. For a number of years now we have been witnessing a rise in unit labor costs. Stoking expectations that wages can continue to rise unchecked despite stagnating labor productivity and far too low investment will jeopardize the foundation of the economic upswing. It is perilous to overstate the strength of the German economy.

True, in the last decade wage policy played a key role in stabilizing costs and boosting employment, and also responded judiciously and wisely in the 2009 crisis. Wages had indeed tended to lag behind. But in recent years the room for wage increases has been fully exploited. In the period since 2008 labor productivity in Germany has been practically flat. The upshot: the steeper rise in wages – in 2014 contractual wages will rise by an estimated 3 percent – has pushed unit labor costs some 11 percent up on their 2008 level. Due to the introduction of the minimum wage the trend will continue next year with an increase of 2 percent. The impact of this development will take time to feed through, but is to some extent already evident. In 2012 and 2013 German exports increased on average by only 1.6 percent; Germany shines only in comparison with other eurozone countries, in global terms Germany has lost considerable market share over the past ten years. Germany has not been world export champion for a while now, ranking well behind China and now behind the USA in third place. Even graver is the fact that, for years, too little has been invested in Germany itself, and the industrial capital stock, upon which we so depend, is actually shrinking. Capital outflows abroad are high, linked not only with the wage level but also with energy costs, regulations and other location factors. But even higher wage increases are certainly not the right way to generate more investment here at home. But this investment is what is needed to boost domestic demand in the right place. The importance of investment today for the viability of our social welfare system and the future of prosperity is frequently underestimated.

The argument that higher wage increases would help push up the inflation rate of currently 1% is not very convincing. It would not serve companies if they had to pass on cost increases into their prices. Short-term changes in the price level cannot be the objective of central banks either, as they themselves always stress. They were well advised not to counter the rise in inflation seen in 2011/2012 with sharp rate hikes as only temporary factors were at play. Today the argument applies the other way round. The price adjustment process in Europe’s periphery is set to come to a gradual end and, in a growing world economy, it is unlikely that commodity prices will head further south. As a result, unlike last year and in the first half of this year, import prices will not tend further downwards. The current low level of inflation is likely to prove a temporary phenomenon and should not prompt hectic wage or monetary policy responses.

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