

## Book review on:

### ***Germany's Economic Performance. From Unification to Euroization, Jens Holscher (editor)***<sup>1</sup>

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In the 1990-2005 period the German economy experienced dramatic changes, partly associated to the German reunification process.

The main interest of the book, which comprises the papers presented at a 2005 Anglo-German international conference, consists in the contribution of several distinguished German and British economists to the critical debate on the consequences of reunification.

There is an almost general consensus that the slow and sluggish growth performance of the German economy in the 1993-2005 period is not only due to the difficulties of reunification, but also to bad or inadequate economic policies pursued by the German government and by the EU institutions.

The late economist and banker Norbert Klotten is particularly harsh “... I intend to show that ..the German disaster has to be judged principally as political lapses and ignorance, and not to be linked directly to reunification..” (p. 15).

Stephen Frowen in his key- note address is more balanced. He maintains that the task of integrating an economically ruined country as the German Democratic Republic with the flourishing West Germany was difficult. Reunification entailed some short-term advantages, but severe difficulties afterwards. The currency and financial crisis of September 1992 was a crucial moment. The British decision not to devalue, but to leave the ERM, was unfortunate, since it contributed to preclude an early entry of the United Kingdom in the eurozone, where the UK “ might have exercised its influence to introduce a greater degree of flexibility in setting ECB’s monetary policy..” (p. 10). Moreover, Frowen, who in February 1998 was one of the 155 German - speaking economists advocating a postponement of the German entry in the EMU, sustains that in retrospect his position was correct. With the heavy financial burden of reunification Germany was unable to continue to entirely fulfil the Maastricht requirements. In particular in November 2003 France and Germany determined the crisis of the Growth and stability Pact, thus revised in 2005, blocking the sanctions against their excessive public deficits. Finally, he sustains that although the German stagnation was mainly due to structural factors, it was greatly worsened by two shocks: the persistent high level of oil prices and the strong appreciation of the euro.

After an elegant and concise summary given by Holscher in his introduction, two introductory papers by Frowen and Klotten and an obituary on the latter written by Frowen, the book presents four parts. The first part is on monetary issues, the second one focuses on macroeconomic performance, the third on structural developments and the fourth on East Germany: A stimulating paper by Norbert Walter on investment in Germany concludes the book.

The essays cover a wide range of topics.

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In part one they are: monetary transparency (Biefang-Frisancho Mariscal and Howells), a severe critical assessment of ECB's record (Bibow), monetary targeting by the German Bundesbank (Heering) and a comment on part 1 by Soufani.

Part 2 comprises two papers with almost opposite views and a comment by Waltraud Schelkle. The first paper, by Horst Feldmann, maintains that the breach and dilution of the Growth and Stability Pact was mainly due "to lack of political will" by Germany, France and Italy, not to the slow rate of growth of the German economy. In fact also on cyclical adjusted terms there would have been a worsening of the public deficit. The paper thus advocates more rigorous fiscal policies. On the contrary the second paper (by Hein and Truger), following a neo-keynesian approach, attributes to the excessively deflationary monetary policy and to the insufficient increase of wages and internal demand much of the responsibility of Germany economic poor growth performance of the 1995-2005 period.

In her comment on the two papers Waltraud Schelkle takes a balanced position, arguing that Germany is not "the sick man of Europe", but suffers a mid- life crisis" to be overcome by prudent and gradual measures.

Part III comprises a paper by Lothar Funk (Current structural changes: challenges for the German labour market and collective bargaining) and a comment by Eric Owen Smith. Lothar Funk maintains that some mega- trends such as globalization, the move towards a service society, the greater use of information technology and the ageing of society, have changed both the composition of labour demand and supply and the industrial relations system. There has been an increase in the demand for skilled labour and a relative decline in the demand of unskilled labour. The labour market and the collective bargaining system have only partially adjusted to the changed situation and this has contributed, together with the employment difficulties due to the reunification, to maintain high levels of unemployment in the country. A wider relaxation of sectoral collective bargaining, and more "opening clauses" might have substantially reduced the problem. In his comment Eric Owen Smith underlines that the German labour market has already substantially changed (through increasing flexibility of hours worked and of money wages rates, a great rise in the number and proportion of part-time jobs, etc.) and that perhaps too much attention has been given to the inefficiency of the labour market as an explanation for high unemployment, while also several other factors such as the inflexibility of the capital market, problems associated to corporate governance, the macro-economic shocks due to unification etc., have had consistent adverse effects on employment.

Part IV consists in two papers, by Johannes Stephan and Michael Kaser, dedicated to East Germany.

Johannes Stephan analyses the differences in labour productivity between East and West Germany. While in 1991 the average level of productivity in manufacturing, was in the East about 17,8% of the western level, the gap was reduced to about one third in 2002, but has remained almost stagnant since the end of the 90s. On the basis of a firm specific data-set in four sectors (machinery, cosmetics, electro-technical firms, furniture), Stephan has tried to capture the importance of some managerial differences in order to explain the East -West gap in productivity. He discovered that such managerial aspects as the intensity of use of modern communication technologies, strategic planning, networking etc., were indeed relevant.

Michael Kaser's paper tries to compare East Germany economic transition with three other former communist countries: the Czech Republic, Hungary and Poland. He

notices that, despite the enormous net transfer from West Germany to former East Germany (1200 billions of euros from unification to 2004) the economic performance of East Germany was considerably worse than the performance of the other three former communist countries. In 2004 East Germany's real GDP had not yet completely recovered the 1989 level, while it had increased by almost 25% in Western Länder, by almost 42% in Poland, by over 13 % in Czech Republic and by almost 20% in Hungary. Also the unemployment rate had worsened more in East Germany than in West Germany, Hungary and the Czech Republic.

Michael Kaser maintains that the poor performance of East Germany Länder was partly due to the substantial revaluation of Eastern currency with the one-to-one conversion rate between the Eastern and Western currencies, while other Eastern European countries had at first devalued, to the much higher unit labour cost, to the probably excessive capacity closure in eastern Länder, etc. e finally concludes that "...under conditions of high unemployment in the eastern Länder, and Poland, the question needs to be posed as to whether 'extensive' policies favouring more employment should take precedence over 'intensive' policies promoting labour productivity.." (p. 237).

The concluding section consists in a paper by Norbert Walter on the prospects of foreign direct investment inflows. The author maintains that the negative perception on Germany's economic perspectives prevailing till 2005 overlooked the positive aspects, which he emphasizes. Germany had a good record on human capital, patents and innovation, had a strong financial position for several firms, had a good transport network, had recently introduced important reform policies, had a crucial position in the relations with the new eastern members of the European Union, had low and convenient housing prices, etc. Therefore, Norbert Walter, anticipating some of the 2006-7 events, gave a rather optimistic view of the German economic perspectives and of its capabilities to attract foreign capital.

The book gives on the whole an interesting assessment of the debate on German economy after reunification.

It does not, however, analyze in depth two crucial aspects of its recent trends, namely the impact of globalization on its productive structure and the gradual, but persistent loss in the comparative advantage in human capital which Germany had traditionally held.

In particular too little consideration is given in the book on the outflows of direct investment abroad. In the last two decades Germany has de-localized a growing and substantial part of its production capacity to Eastern Europe and other emerging countries. This has contributed to enhance total profits of German corporations, compensations of managers and of top employees in headquarters, international competitiveness and exports of German firms, but has contributed to reduce the creation of internal medium and low- skilled jobs. This, together with the immigration policy and the mistakes made, from the economic point of view, on the reunification policies, only partly justified by political reasons, had contributed to determine high levels of unemployment and an increase in wage inequalities. The semi-stagnation of total wages has strongly contributed to explain the slow dynamics of aggregate consumption and thus of internal demand and real GDP:

As regards human capital, Germany has kept up to now a relatively good level, but in the last half century has gradually lost many positions, in per capita terms, if compared with some other countries, such as the US, Japan, South Korea, Sweden, Finland, etc

and has lost part of its former advantage vis-a -vis France, Italy, Spain, etc. In absolute terms, moreover, it has less engineers, scientists and researchers than large emerging countries such as China and India. Its dual system in education, with an early choice of a substantial part of the young population towards vocational education, although slightly revised, is good for chemistry and mechanical production, but is not adequate for the more sophisticated high –tech sectors such as microelectronics and telecommunication and for the more advanced tertiary sectors.