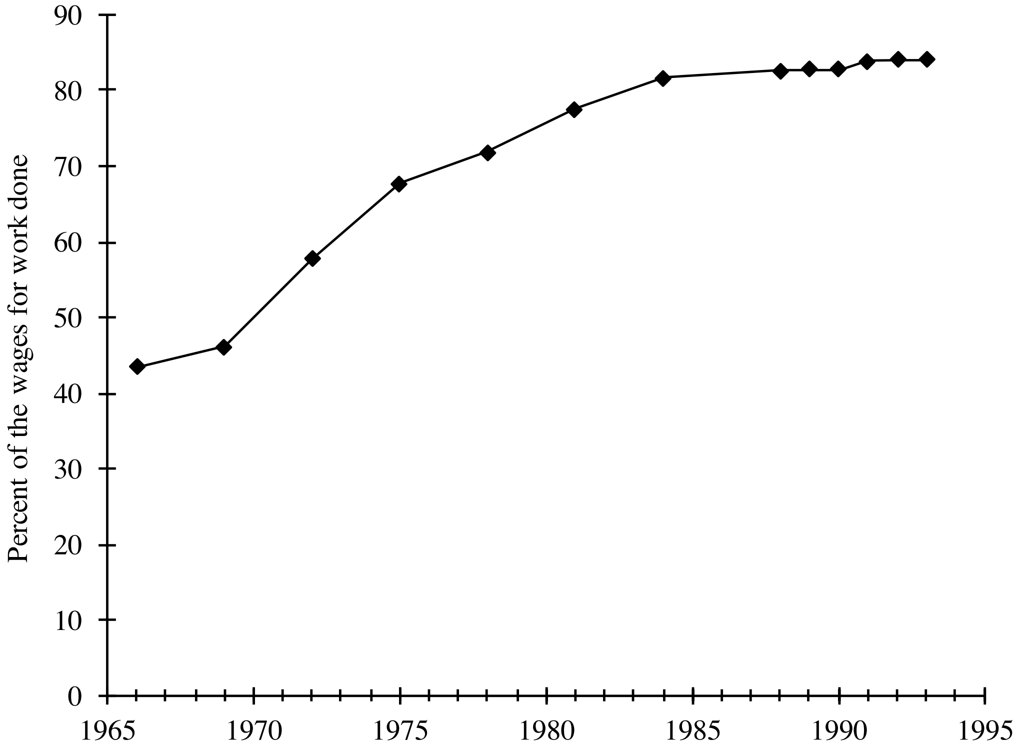
Wolfgang Scherf

Additional labour costs and its Problem in International Competition

1. Additional labour costs as a location factor

In part times the additional labour costs (indirect labour costs) increased strongly. According to the Institute of the German Economy (Institut der deutschen Wirtschaft) there was an increase in the ratio of additional labour costs to wages for work done from 43.4% in 1966 to 84% in 1993 in the manufacturing industry (Figure 1). Especially the representatives of the industry always demand to counter the dynamics of increase in indirect labour costs. They justify this position by pointing out the danger to the competitiveness of German companies due to extremely high labour costs.

Figure 1: Additional labour costs in the manufacturing industry



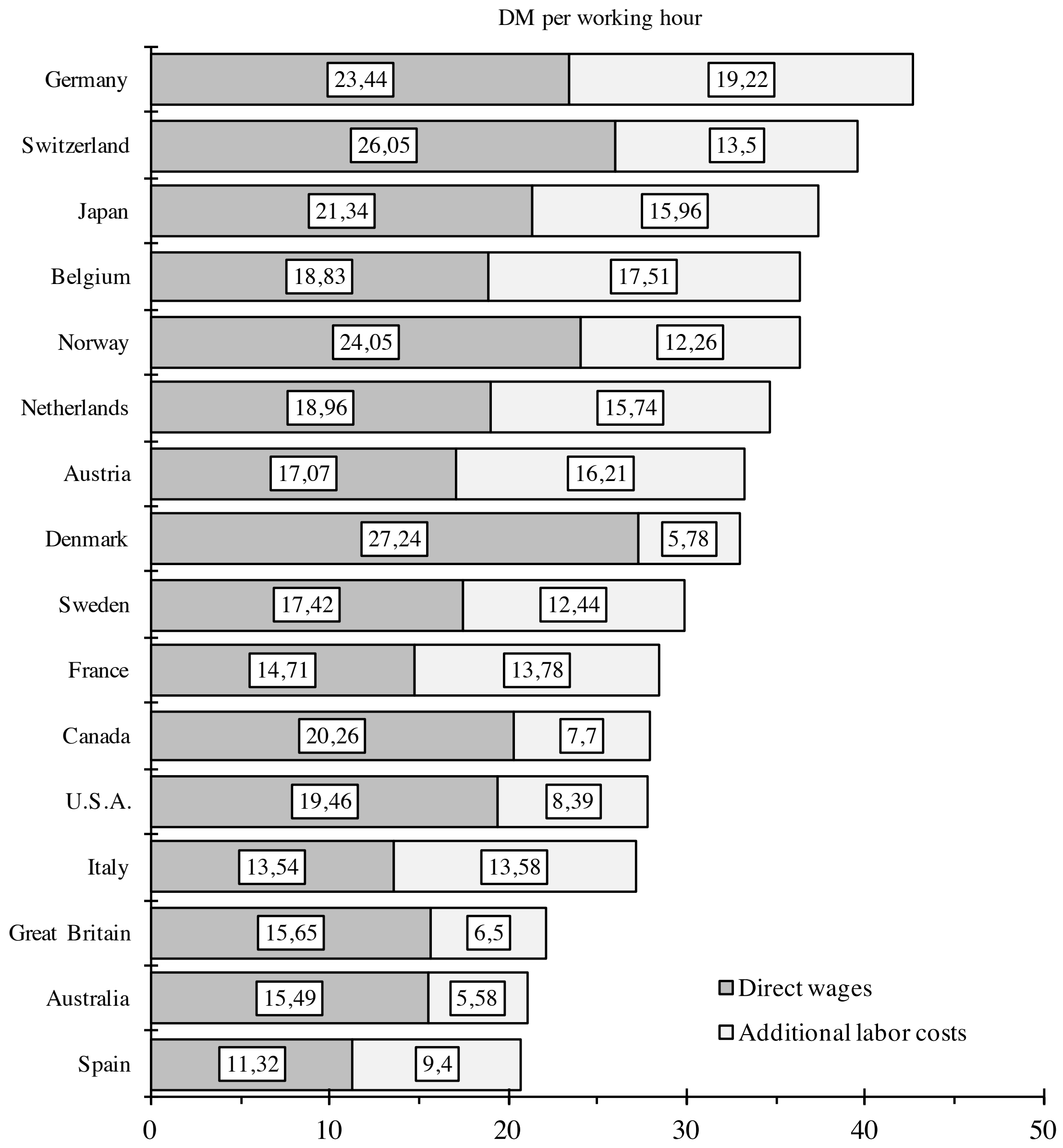
The additional labour costs play an important role in the recent discussions about the „location Germany“[1] (Standort Deutschland). According to polls of business enterprises

[1] For the current debate about the „location Germany“ see for example M. Heise, Die deutsche Wirtschaft im internationalen Standortwettbewerb, Wirtschaftsdienst 1993/VII, 348-355; E. Kantzenbach, Der Wirtschaftsstandort Deutschland im internationalen Wettbewerb, Wirtschaftsdienst 1993/XII, 625-632; A.

Erschienen in: T. Matsugi, A. Oberhauser, F. Schober (Hrsg.), Integration and Adjustment of Global Economies, Berlin 1996, 189-204.

additional labour costs, especially the employers social security contributions, are considered a negative location factor: First the companies would like to have a lower tax burden (24% of total company answers). Secondly they prefer a reduction of social security contributions (21%)[2]. The wages, however, are supposed to be a minor problem, since only 11% of all answers consider the high wages as top priority.

Figure 2: Labour costs in the manufacturing industry 1993



Heise, Haben wir ein Wechselkursproblem?, Wirtschaftsdienst 1994/I, 30-34; Sachverständigenrat zur Begutachtung der gesamtwirtschafltichen Entwicklung, Jahresgutachten 1993/94, 163-177.

[2] See G. Nerb, Der Standort Westdeutschland im Urteil der Unternehmen, Ifo Schnelldienst 8/92.

The international comparison of labour costs in DM for the manufacturing industry[3] documents the special problems of additional labour costs in Germany (Figure 2). In 1993 West Germany had the highest labour costs in total of all industrialized countries; mostly because of the by far highest indirect labour costs. High-wage countries like Switzerland and Norway exceed even the direct wages of West Germany. In contrary the indirect labour costs of these countries are way below the German level. Denmark, which has the highest wages, ranges only eighth since the social security is mainly financed by taxes. International comparisons of labour costs cannot be easily interpreted since even a tax financed social security system can increase costs of the companies; their competitive position need not to be better.

During the last years Japan caught up to the European industrialized countries. Because of fast rising labour costs and a strong currency appreciation Japan can be considered a high wage country. The Japanese wage system proved to be a stabilizing factor in the latest recession as well as a competitive advantage because of its profit-related bonus payments[4].

In interpreting the labour cost statistics, one has to consider the changes of direct wages and additional labour costs due to appreciation or depreciation of the currencies. In local currency the West German dynamics of labour costs during the 80s was in the middle of the industrialized countries. However, the appreciation of the DM was stronger than the advantage in labour costs would have justified[5]. Hence, the competitiveness of the German economy depends to a high degree on the development of the exchange rate which in turn cannot be explained solely by the relative developments of costs and prices. In past years the monetary policy of the German „Bundesbank“ led to a comparatively high level of interest rates, i.e. changes in the competitive position are also monetary-related. In the discussion about the direct labour costs and its significance as a location factor in Germany, it must always be considered, that it is only one of many factors in determining relative international competitiveness.

The basic problem of additional labour costs is that they increase the costs of the factor „labour“ and therefore worsen the cost-earnings ratio of the companies. In the following this paper will focus on the question whether this primary effect has negative consequences for the major economic goals: full employment and price stability. Since the German economy is highly internationally integrated aspects of foreign trade have to be especially considered. The influence of additional wage costs will be discussed against the background of an open economy oriented mainly towards world markets. But first, the different kinds of additional labour costs will be defined.

---

[3] See C. Schröder, Industrielle Arbeitskosten im internationalen Vergleich 1970-1993, iW-trends 2/94, 57-66. For the development of the per unit wage costs see H. Fröhlich et al., Lohnpolitik in der Europäischen Währungsunion, Köln 1994, 24-36.

[4] In figure 2 the bonus payments are included in the additional labour costs.

[5] See C. Schröder, Industrielle Arbeitskosten im internationalen Vergleich 1970-1993, iW-trends 2/94, 59.

2. Different kinds of additional labour costs

The total labour costs consist of wages for work done and indirect labour costs. The latter is not a uniform cost category but consist of very different elements which are classified according to the „accountability principle“ in the scientific literature. Hence three groups of indirect labour costs can be differentiated[6]: (1) statutory, (2) contractual and (3) managerial indirect labour costs.

Table 1: Additional labour costs in the manufacturing industry 1993

	Percent of the additional labour costs	Percent of the wages for work done
Statutory additional labour costs	44.5	37.4
• Employers social security contributions	29.0	24.4
• Paid holidays and other time off	6.4	5.4
• Sick pay	6.1	5.1
• Other statutory additional labor costs	3.0	2.5
Contractional and managerial additional labour costs	55.5	46.6
• Vacation and vacation payments	24.5	20.6
• Bonus payments (13. monthly salary)	11.7	9.8
• Company pension plan	10.5	8.8
• Capital accumulation plan	1.5	1.3
• Other additional labor costs	7.3	6.1
Total additional labour costs	100.0	84.0

Source: Institut der deutschen Wirtschaft Köln. Own calculations.

Statutory indirect labour costs are enforced by governmental regulation. In the manufacturing industry the ratio of legal to total indirect labour costs was 44.5% in 1993. The Institute of the German Economy classifies these costs in:

- ❑ employers social security contributions share 65.2%
- ❑ paid holidays and other time off share 14.4%
- ❑ sick pay share 13.6%
- ❑ other statutory additional labour costs share 6.7%

The respective shares show the structure of the statutory indirect labour costs and, hence, refer to their total volume.

The social security system should insure economic risks of employees and their families in case of illness, accident, old age and unemployment. In 1993 the employers social se-

[6] See for the following E. Hamer/W. Schierbaum, Personalzusatzkosten – der unsichtbare Lohn, Bonn 1991.

curity contributions had by far the largest share with 65.2% of the statutory indirect labour costs. According to the law on continued wage payments the employees are entitled to their wages if the work is interrupted due to official holidays (about 12 days per year) or sickness (wage will be paid for up to 6 weeks). Other continued wage payments are stipulated by collective wage agreements for about 60% of the work-force. Other statutory indirect labour costs are maternity protection, paid time off, job safety, industrial constitution rights, and disabled benefits rights.

The additional costs due to shifting bureaucracy from the public to the private sector can also be considered indirect labour costs. Thereby the government hands over obligations of personal inventories which exceed the direct costs due to social provisions (e.g. statistics, returns for control purposes). Furthermore the statutory minimum vacation of currently 18 working days which must be paid out in full can be considered as statutory additional labour costs.

The contractual indirect labour costs consist of total expenses, which even accrue if no work is done depending on the provisions in the collective wage agreement. For example: collectively agreed vacation exceeding the statutory minimum, vacation payment, Christmas allowance and employer's contribution to capital accumulation benefit. Managerial additional labour costs are fringe benefits which depend on the personal relationship between employer and his employees.

The Institute of the German Economy adds the contractual and managerial indirect costs together. Their share of the total indirect labour costs in 1993 was 55%. In detail the following categories – and their share of the sum of contractual and managerial additional costs – can be distinguished:

- ❑ holidays including vacation payments share 44.2%
- ❑ bonus payments: gratifications, 13th monthly salary share 21.0%
- ❑ company pension plan share 18.9%
- ❑ capital accumulation plan share 2.8%
- ❑ other additional labour costs share 13.1%

Since there is a wide variety of indirect labour costs it is almost impossible to consider all the kinds in a theoretical analysis. Furthermore the definitions used are not suited for such a purpose. For analyzing economic consequences it is recommendable, however, to use a different categorization for indirect labour costs:

- ❑ In the first group are the additional labour costs which are in the broader sense payments for work done. The employees consider these as they do their wages or salaries. In this way, they are part of the wages or salaries and are used as such by the employees. In any case the paid official holidays, vacation payments and special payments belong to this first group. These costs sum up to 42.6% in 1993 of the total indirect wage costs in the manufacturing industry.

- The second group consists of additional wage costs which are attributable to the individual employees but do not affect their disposable income. The employers social security contributions belong to this group as well as the companies pension plans, continued wage payments in case of sickness and capital accumulation benefits. Altogether they add up to 45.6% of the indirect wage costs in the manufacturing industry in 1993.

Both groups together in the above mentioned definition make up about 90% of indirect labour costs. Since the other indirect labour costs consist of comparable elements the two groups cover nearly all relevant indirect labour costs.

Thereby it is possible to narrow the subject. Additional labour costs in the narrow sense can only be found in the second group, whilst the first group consists of positions which cannot be distinguished from wages and salaries. If the unions and the employers agree in a reduction of working hours it is of minor importance whether this is implemented as a cut of weekly working hours or a prolonged vacation. A cut in weekly working hours results in a rise of hourly wage for „work done“ if the monthly wage is maintained. Prolonged holidays, however, increase the wage for „work not done“ and therefore indirect labour costs – obviously an arbitrary definition. A second example; the differentiation of normal wages and the 13th monthly salary is also of minor importance.

Additional labour costs which are in the broader sense wage for work done will be excluded in the following. This does not mean that they do not cause economic problems, however, they should be seen in combination with direct wages and not with additional labour costs. Furthermore, if one considers that 2/3 of the additional labour costs consists of social security contributions it can be justified to focus specifically on them, i.e. an increase in employers social security contributions serves as an example for analyzing the problems of additional labour costs. The employers social security contributions have been the main cause of the growth of additional labour costs since the early eighties[7]: During that time the contribution increased from 16.2% to 19.95% in January 1994.

3. Economic effects of additional labour costs

It may be generally agreed that an increase in additional wage costs will have a negative effect towards the major economical goals of stability only if this increase is not compensated by a comparable growth in production. Therefore the additional labour costs compete directly with wages: without affecting price-stability and the level of employment nominal and real wages can rise according to the increase in productivity if we as-

[7] See E. Hemmer, Personalzusatzkosten in der westdeutschen Wirtschaft, iW-trends 1/94, 56/57.

sume a constant share of additional labour costs[8]. The labour costs per unit will rise, if the share of indirect labour costs increases and the direct wages move according to the productivity.

Theoretically this effect could be compensated by a lower growth rate of nominal wages compared to the increase of productivity. This would be a wage policy which does not affect the cost level (kostenniveauneutrale Lohnpolitik) as the „Sachverständigenrat" (council of economic experts for the assessment of the economic development) has always recommended[9]. In reality, however, the unions rule out such a practice. Hence, the effects of indirect labour costs will be analyzed under the assumption that they increase the labour costs per unit.

The companies have different possibilities to adjust to an increase in additional labour costs:

- Increasing the costs of the production factor „labour" leads to capital investments to increase efficiency. The resulting displacement of labour might cause unemployment (pressure-to-rationalize argument).
- The companies might shift national production plants abroad where the burden of indirect labour costs is lower. This would also result in an undesired displacement of national workforce.
- Ultimately they have the possibility to avoid further cost pressure by passing on the costs. If price increases can be pushed through on the consumer, production and employment might not have to decrease.

The transition to a more capital-intensive production method according to the argument of pressure-to-rationalize is as time consuming as the shifting of production to foreign countries. The predominant form of adjustment in the short run may be the increase in sale prices as a result of cost increases. Therefore the labour-cost-related shifting processes are the basis of the analysis of economic effects as a result of the increase in additional labour costs.

a. Macroeconomic shifting processes[10]

From the employer's view, all indirect wage costs are definitely labour costs since these costs are part of the price calculation and also determine the competitiveness of the company. An increase of the employers social security contributions which are calculated on the basis of gross-income can serve as an example of the problem and will be dis-

[8] Strictly speaking this only applies if the utilisation structure of the social product and savings habits remain constant. For the sake of simplicity these modifications will not be considered.
[9] See Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Jahresgutachten, Stabiles Geld – Stetiges Wachstum, Bonn 1964, Z. 248.
[10] See W. Scherf, Beschäftigungspolitische Aspekte einer Reform der Arbeitgeberbeiträge zur Rentenversicherung, Finanzarchiv, N.F., Vol. 45, No. 2, 1987, 284-301. The results of passing on employers contributions is about equal to the general case of rising labour costs.

cussed in the following. The proximate consequence is an increase in the labour costs per unit which the companies will try to compensate by increasing the sale prices. The precondition for passing on the entire cost increases is a parallel increase in aggregate total demand. Then inflation will not result in a decline in volume. Such a development might not be impossible if one looks at the different elements in demand. But some prerequisites have to be met:

- The additional premium earnings of the social security system should not be allowed to eventually be used for the existing deficits in the budget. Moreover these earnings need to finance additional benefits.
- The price increases must be financed by an elastic money supply. This also implies a tendency towards a constant level of interest rates.
- The possibility of passing on the costs have to be safeguarded against external influences. This danger can be reduced by establishing a system of free-floating exchange rates.

The first postulate results in a greater demand due to raised contributions, either cash or non-cash. Increasing transfer payments, for example, will increase the consumption of the transferee. Even on the assumption that the consumption rate of transferees relates to the consumption rate of the employed the consumption of non-entrepreneurs would rise proportional to labour costs. This case in reference to cost and demand effects is comparable to a nominal wage increase which exceeds the increase in productivity. If the consumption rate of the transferees increases more than average, the non-entrepreneurial consumption will grow disproportionately, i.e. it would prove to be more advantageous to pass on the costs than to raise wages.

The entrepreneurs might orient their consumption plans more toward a mid-term income average (permanent income hypothesis) than toward the actual income. Hence, despite the cost increase they will maintain their consumption expenditures. Altogether it can be assumed that there would be a roughly comparable growth-rate of nominal demand for consumer goods and labour costs.

If private consumption is increasing proportional to labour costs it could be ruled out that the companies will not reduce their real demand for capital goods. A reduction in investments could at the utmost be the result of increasing interest rates. Hence, the second precondition is brought into play: The money supply, meaning the volume of money times velocity of circulation, must be flexible in order to finance the inflationary development of costs and demand without increasing interest rates. If this precondition is met, the passing on of employers social security contributions might not be abortive due to a lag of domestic demand.

The domestic price increase, however, will ceteris paribus deteriorate the competitiveness of domestic products on world markets. High inflation and fixed exchange rates will impair exports and promote imports. In case of a normal reaction the balance of current accounts will deteriorate, i.e. the shifting potential decreases because of a decline in net foreign demand. Then, the companies either have to lower their selling prices and reduce their profit margins or accept reduced sales volumes which lead to losses in employment and output.

One reason is now found for possibly negative consequences of high indirect labour costs on the „location Germany". The reasoning, however, depends mainly on the assumption about fixed exchange rates. Free-floating exchange rates could compensate differences in domestic inflation by adverse adjustments of exchange rates. In the case of an accelerating domestic inflation the above mentioned export and import effects will result in an increasing foreign currency demand and, hence, a depreciation of local currency which overall will scarcely affect the competitiveness of domestic companies.

From these considerations follows that the establishment of a European Currency Union would intensify the problem of internationally different indirect labour costs. As long as the currency union is not complemented by an economic and social union, countries intending to improve their social security system will lose competitiveness by establishing financial instruments which are cost effective. However, this can also have the desired effect to reduce excessive and ill-financed social benefits. In future the Federal Republic of Germany must, due to the foreseeable worsening of the age-structure, inevitably increase social security contributions – an obvious location disadvantage in a European Currency Union.

A flexible exchange rate cannot always protect the domestic economy from the consequences of a contribution and cost related inflation for production and employment. A limited elasticity of money supply can on the one hand cause a crowding out of private investments due to an increase in interest rates which may prevent a full passing on of employers social security premiums. On the other hand a higher level of interest rates tends to increase net-capital imports and the demand for domestic currency which results in an appreciation. Once more the international competitiveness is negatively affected. Despite flexible exchange rates a worsening of the balance of current accounts is probable. This along with a declining demand for capital goods will result in reduced domestic production and employment.

One could counter that a tight monetary policy can be ruled out if the „inevitable" price increase is low. Adjustments of the employers social security contributions have been below one percent annually, therefore, they might have only a minor influence on the price level. Increasing the premium, however, might lead to higher wage-increase and, hence, to a rise of premium-related inflation. In general, the unions try to negotiate higher nominal wages because of increased productivity and to compensate realized and expected inflation. As a result, the small price effect of an increase in social-security contributions might support or even put a wage-price-spiral into action which makes a tight monetary policy probable.

All in all, the possibility of passing on indirect labour costs decides whether they become a location disadvantage or not. In case of a demand-effective use of funds, a flexible money supply, and free-floating exchange-rates, a competitive disadvantage is not very likely. If these preconditions are not met, losses of production and employment can be expected. Hereby an increase in indirect labour costs is not followed by a rise in demand. The undesired tendency towards stagflation is the result, i.e. indirect labour costs might not only be problematic in view of price effects but also in view of effects on employment.

The above mentioned considerations about passing on indirect labour costs refer to a representative company. There can be quite substantial differences in the level of indirect labour costs between companies or sectors[11]. Even if on average a full passing on of cost increases might be possible, companies with a below-average share of indirect labour costs might improve their competitiveness, et vice versa.

b. Further adjustment processes

At the beginning, it was already mentioned that companies who face increasing indirect labour costs might shift production abroad or increase their rationalization efforts. As long as the additional costs can be passed on, both alternatives are rather improbable. Consequently, the two alternatives cannot be seen as the primary form of adjustment but rather as a result of a vain attempt to pass on the increasing costs. Hence, the question arises: Will the undesired effects of rising indirect labour costs be supported by the substitution of expensive domestic workers with either capital or cheap foreign labour?

Let us consider first the „pressure-to-rationalize argument“ whose economic importance is in general overestimated. According to this, the companies respond to a change in the ratio of factor prices by substituting the expensive production factor with a cheaper one. This substitution lasts until a new minimum cost combination is achieved. This criteria of decision might be convincing in the microeconomy, however, it is doubtful from the macroeconomic point of view. Rising labour costs make additional capital investments for rationalization purposes more attractive only if prices of investment goods which can be used alternatively are not affected by labour cost changes.

This precondition cannot be assumed in case of general labour cost increases. The costs of additional capital which are spread over the operating time are determined by the

[11] According to the Institute of the German Economy the indirect labour costs within the e.g. service sector vary between 69.9 % for the wholesaler and 102.7 % for insurance companies – compared to an average of 83.7 %.

price-level of investment goods and the interest rate[12]. Both variables also depend on the average labour costs:

- Companies producing investment goods will – like other companies, too – try to increase selling prices due to rising indirect labour costs. Since, in general and especially in the investment goods industry, prices are mainly cost related13, the increase in prices of investment goods will be comparable to the average inflation. If we assume a flexible money supply and a constant interest rate, the increase in demand will allow the rise of the price level. In this case, the ratio of factor prices remains mainly constant since the increase in labour costs will be approximately compensated by a parallel increase in capital costs.
- If a tight monetary policy fights the cost-induced price increase the capital investment will become more expensive. In case of an increase in prices of investment goods which are proportional to the increase in labour costs a monetary-related increase in interest rates will shift the ratio of factor prices by burdening the production factor capital – exactly the opposite of what is claimed in the „pressure-to-rationalize argument“.

Consequently, if indirect labour costs can be passed on there is no relevant incentive for factor substitution because the ratio of factor prices remain approximately constant. If it is not at all or only partly possible to pass on indirect labour costs, the propensity to invest will be reduced. However, the rationalization efforts will not increase since increasing interest rates make capital investments less advantageous. The „pressure-to-rationalize“ argument is not convincing due to the economic interdependencies of factor prices[14]. Hence, from this point of view, we cannot raise an additional employment related objection against indirect labour costs.

Of greater importance might be the existence of multinational companies and the increasing integration of the world economies. This might lead to a displacement of domestic workforce which is expensive in favour of cheap production in foreign countries. Fixed exchange rates in a (European) Currency Union in combination with extreme indirect labour costs makes foreign investments more attractive and discourages local investments[15]. Strictly speaking, this applies only to increasing indirect labour costs in the

[12] See J. Kromphardt, Kosten- und Preisanpassungsverhalten der Unternehmer und Einkommensverteilung, Zeitschrift für die gesamte Staatswissenschaft, Vol. 124, 1968, 537.
[13] This applies for the calculation of new products as well as for the recalculation of existing products. See S. Wied-Nebbeling, Das Preisverhalten der Industrie, Tübingen 1985, 46ff and 76ff.
[14] This statement is supported by an empirical study of H.-P. Basler who could not find any correlation between the pressure due to high labour costs and rationalization. Hence, it might be recommendable to look at the emergence of new technologies as a cause of increasing rationalization efforts. See H.-P. Basler, Lohnentwicklung und Lohnpolitik als Bestimmungsgründe konjunktureller Verläufe und struktureller Verschiebungen, Berlin, 1981, 102.
[15] The German system of social security has positive economic effects, e.g., in international comparison there are less strikes but this advantage must be „reasonably” priced.

future because the current level is already taken into account in current exchange rates. With respect to the European Currency Union and due to the fact that flexible exchange rates do not safeguard perfectly against external influences, the question remains, how can we counter the negative influences of increasing indirect labour costs on international competitiveness.

4. Possibilities of restricting additional labour costs

In the Federal Republic of Germany the additional labour costs may also rise in the future. Due to the demographic development, especially the statutory pension plan will have to increase its premium income. Furthermore, the worsened employment situation will result in an additional burden for the federal labour office (Bundesanstalt für Arbeit). In addition, the insurance to cover the risk of needing permanent nursing care will cause additional costs although the employers should get a compensation[16].

The permanent increase of social security contributions can be interpreted as a structural defect of the social security system. To counter these dynamics there are basically two alternatives:

- One can try to fight the immediate cause, i.e. in the future the growth of expenditures for social security must not exceed the growth of economic capacity.
- Complementary, there is the possibility to finance a necessary expenditure increase differently from the past, e.g. by (partially) giving up the indirect and labour cost effective financing through the employers contributions.

The German social policy follows, at least in part, the first alternative. The reform of the statutory health insurance which is not yet completed results in a limitation of benefits and improved economic incentives by establishing excess policies. As the launching of the insurance to cover the risk of needing permanent nursing care showed there is a more intense discussion about alternative financial arrangements than about the necessary and appropriate design of the benefits.

The statutory pension plan which might have major financial problems in the future serves as an example how cost increases could be limited. The prior goal is to leave the insured person his net-income position. The pensions should only be expanded by an inevitable amount. A step in the right direction was the orientation of the pension increases to the average net-wage increases[17]. Now the changes of taxes and employee contributions are to be considered completely. Furthermore, there could be a real ceiling

---

[16] See H. Salowsky, Industrielle Arbeitskosten im internationalen Vergleich 1970-1992, iW-trends 2/93, 72.

[17] In addition, after a revenue-neutral reorganisation of the system, pensions should be taxed but the pension premiums should be tax-free. The pension structure would then be comparable to the net-income-structure. Today the pension assessment base is gross-income-related and therefore does not pursue the system's goals.

for the pensions because the goal of social security need not be attributed to a steadily increasing income level.

A substantial part of the financial problems of the social security system was caused by political decision-makers who burden basically working systems with non-insurance obligations. The statutory pension insurance has to cover many non-insurance benefits which do not correspond to the principle of equivalence. In the future, the federal government should respect the autonomy of the pension insurance plan more and, hence, reduce certain pension benefits or finance them completely with government grants, i.e. from tax revenues. Furthermore, the pension funds must not be used as a working fund to finance other divisions of the social security system in need. This happened after the German unification when the additional burden of the unemployment insurance was partly financed by the pension plan.

There are also possibilities to adjust the method of financing. The employers social security premiums could be transferred to employees contributions by simultaneously increasing their gross-wages[18]. The employees will not carry an additional burden but they will realize the total costs of social security. Demands to improve social benefits will be demarcated since the employees will be under no illusion that employers have to pay half of the contributions. The decisive advantage concerning the developments of additional labour costs is that necessary premium increases do not directly affect labour costs in the future.

However, this effect can also be achieved differently by the already mentioned consideration of contributions development on the nominal wage increase. It has the identical consequence for the employees if they finance the contributions from increased nominal wages or whether they relinquish parts of the wage-increase if the employers pay part of the contributions. The willingness to accept the fact that, in the end, the employees have to finance the social benefits out of a real wage cut or non-consumption is not very widespread. Hence, shifting the pension contributions to employees might be more successful than the political wage compensation for changes in employers contributions which the council of economic advisors (Sachverständigenrat) proposed already 30 years ago – without success.

To secure the international competitiveness, a stabilization of additional labour costs is surely favourable. The economic policy should prevent a further increase of social security contributions. This can only be done by limiting the growth-rate of social expenditures. However, one must not forget that the international competitiveness of Germany does not solely depend on the development of additional labour costs. Product quality,

[18] W. Schreiber proposed this already in the early 60s. See W. Schreiber, Schein und Wirklichkeit in der Sozialversicherung, Soziale Sicherheit 12/1962, 353-356. Recently the Schreiber-plan was brought again by H. Hax, the president of the Sachverständigenrat. See J. Eckhoff, Die Bedeutung der Personalzusatzkosten, Wirtschaftsdienst 1993/VIII, 408.

service, punctuality, and not least, innovative power and flexibility are decisive points, too. The wage policy and exchange rate developments are like monetary policy definitely crucial factors.

However, there is no need to be pessimistic: In the beginning of the 90's the German economy experienced a distinct deterioration of its competitive situation. Since last year, however, the situation improved. The development in wage policy as well as the stabilization of the inflation rate and exchange rates within the European Union contributed greatly[19]. Whether these positive developments will be maintained is doubtful. A major problem will be the European Currency Union. Hereby the exchange rate mechanism would be abolished which compensated in part the differences in domestic inflation rates and so took on an outlet function[20].

[19] See Deutsche Bundesbank, Reale Wechselkurse als Indikatoren der internationalen Wettbewerbsfähigkeit, Monatsbericht, Mai 1994, 59.
[20] P. Bofinger has a more optimistic view: In the European Union excessive wage agreements would lead to regional unemployment. Hence, according to Bofinger, moderate wage agreements will be the result. Experiences with the German unification do not support this view. See P. Bofinger, Europäische Zentralbank versus Europäisches Währungssystem, Wirtschaftsdienst 1992/IX, 461.