

Andreas Dombret: The European labour market during the crisis

Welcoming address by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the reception given by the Deutsche Bundesbank at the Annual Congress of the Verein für Socialpolitik, Göttingen, 12 September 2012.

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1. Welcome

Ladies and gentlemen, members of the association,

On behalf of the Deutsche Bundesbank, I would like to warmly welcome you to this reception.

The Bundesbank is a true friend and supporter of the Verein für Socialpolitik – and not without a certain degree of self-interest. Scholarship and research form an indispensable foundation for the work of central banks – this holds true now more than ever. Conversely, central banking issues time and again provide impetus to new research. Thus, the relationship between central banking and scholarship can be suitably described as symbiotic.

But central banks are not the only parties with a strong interest in the Verein für Socialpolitik's research findings that are presented and discussed here and elsewhere. In the course of the crisis, the need to present and categorise information in a scientific and well-founded manner, yet at the same time in a way that is understandable for the general public, has increased enormously.

Providing explanations and, even more, overcoming the crisis undeniably raise fundamental questions in many areas of our field. You are probably familiar with the old joke that economics is the only field in which two researchers can receive the Nobel Prize for saying the exact opposite thing. So it is not surprising that various approaches to solving the crisis are the subject of contentious debate, indeed not just at symposia and research seminars, but also among the general public. Such debates are also raging among economists, most recently with regard to the need for a banking union.

This has a positive spin-off effect as this type of friction can unleash the energy needed for promoting new insights. The Annual Congress provides the ideal forum for such productive contention. Such congresses facilitate the direct exchange and debate of ideas, both as a public event and in private.

2. Labour market reforms as an important part of adjustment processes

The subject of this year's congress – the labour market – is important and has practical significance for central banks. This is relevant, of course, for the role that the labour market plays in the monetary transmission mechanism as well as its impact on prices. Well-functioning labour markets can make it that much easier to conduct a stability-oriented monetary policy.

Additionally, the topic of this congress, "New Approaches and Challenges for Labour Markets of the 21st Century" is highly topical with regard to the euro area crisis, which is overarching everything else right now.

The crisis can also be seen as a balance of payments crisis of the affected countries, brought about by excessive public and private debt, combined with a lack of competitiveness.

As we know now, the existing regulatory framework for monetary union, the "rules" of the European economic and monetary union, did not prevent these undesirable developments – the fiscal framework was not implemented consistently, and was watered down, and the macroeconomic imbalances in individual member states, which are reflected

in the high level of private sector debt, were not treated with due attention or were completely ignored.

And even if there is some disagreement within the profession about the correct pace and timing: I have the impression that there is still a broad consensus that the crisis can only be resolved if these causes are eliminated and avoided in the future.

Fiscal rules have been tightened at the European level; a new process to monitor economic imbalances has been created along with mechanisms for crisis prevention. Major changes in European banking supervision are also imminent; the European Commission will submit proposals in this regard tomorrow.

Individual member states in particular are also called upon to take action. They must rein in their public finances and create the necessary conditions in which their economies can become more competitive again and enjoy sustained growth.

The structure of national labour markets and their possible reform play a crucial role here. Such measures will not only make an important contribution towards increasing growth potential, but also represent the most direct way of reducing the, in some instances, dramatically high unemployment. This is borne out by events in Germany. Whilst one in four of the labour force is seeking work in Spain and Greece, German unemployment was 5.5% in July according to the Eurostat's estimate. The labour market economists amongst you know how arduous it can be to trace the path of how certain institutional changes influence the situation on the labour market. However, several studies, including those by some Bundesbank researchers, indicate that the labour market reforms of recent years played a crucial role in contributing to the turnaround on the labour market and to its resilience during the crisis.¹

However, the German example also shows that labour market reforms need time to take their full effect. The measures introduced in particular in Spain, Italy and Greece will not lead to full employment overnight, especially as the devil is often in the detail. It is therefore not certain whether the changes adopted so far are enough to increase the flexibility and performance of the labour markets there sufficiently.

However, the reforms must lead in the medium term to "light at the end of the tunnel" on the labour market. Pessimists who deny the possibility of a turnaround in the crisis countries are currently having a field-day. However, if we remember the state of the German labour market as recently as the middle of the last decade, few would have dared to hope for the development emerging in subsequent years. The external environment was naturally favourable at that time and the starting point was not as serious as that currently faced by other countries. I believe that the crucial lesson is that with appropriate measures the functioning of the labour market can be changed so that this per se, in a very broad economic framework, allows more opportunities and thus also a more favourable employment trend.

3. Germany's contribution to reducing imbalances

The aim must be for Europe as a whole to emerge stronger from the crisis. But in the discussion on macroeconomic imbalances, there are often calls to force the core countries to actively reduce their current account surpluses – through interventions in the wage discovery process, for instance, or by way of additional fiscal stimuli – so as to bring relief for the deficit countries. I won't beat around the bush here: besides the fact that narrowing the problem down to an analysis of current account balances is, in itself, unfortunate, to say the least, this

¹ Michael Krause and Harald Uhlig (2011), "Transitions in the German labor market: structure and crisis." Deutsche Bundesbank Discussion Paper Series 1: Economic Studies No 34/2011.

path would do a disservice to Europe. After all, the euro area is not an island but a region competing with the USA, Japan or China.

What is more, fixing one's sights on a greater contribution by Germany overlooks the reality of the situation. Firstly, Germany's trade surplus with the euro area is less than 2%,² and secondly, boosting demand in Germany would trigger only negligible spillover effects in the periphery countries. This is also confirmed by IMF research. On top of this, without the rescue packages to which Germany has made a decisive contribution, the adjustment process would inevitably be even more arduous and abrupt.

The crucial factor is that this adjustment process is already underway: unit labour costs in the deficit countries are on the decline, considerably so in some cases, and Germany's current account surplus with the rest of the euro area at the end of 2011 was only just around one-half of the just over EUR 100 billion back in the year 2007.

Structural reforms, including labour market measures, are a major underpin of this process. As the reforms usually affect large sections of the population, they initially often come at a high political and social cost. However, the answer to this problem cannot be to drip-feed the adjustments over time; on the contrary – making a quick, clean break is better for swiftly reaping rewards and opening up prospects for the future.

4. Conclusion

Efficient labour markets are a key factor in overcoming the crisis. Decisive action must therefore be taken to tackle the prevailing deficits so as to enhance the growth potential of Europe as a whole.

By contrast, calls from various quarters for an artificially induced deterioration of competitiveness in the surplus countries, macroeconomic fine-tuning or a simple redistribution of burdens would be of no help to Europe; in fact, quite the opposite.

Policymakers are thus called upon to do their bit at European level and in the member states. And monetary policy is called upon – not to alleviate the failures of policymakers in resolving problems, but to continually reiterate that ensuring price stability is the primary and most important contribution of monetary policy to the stability of the monetary union. It must continually reiterate that this contribution can only be made by central banks that are institutionally and de facto independent and have a clearly defined mandate.

With this brief and – some will certainly think – obligatory warning against the misappropriation of central banks, I shall leave the matter there – as a Bundesbank official, I hope you will forgive me for this “ceterum censeo”, or mantra.

Thank you very much for your attention. I now wish you a pleasant and stimulating evening at the Deutsche Bundesbank's reception.

² Darvas, Zsolt (2012): “Intra-euro rebalancing is inevitable, but insufficient.” Bruegel Policy Contribution 2012/15, August.