Lessons from the German and Dutch job miracles

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The German Model – Seen by its Neighbours

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Lessons from the German and Dutch Job Miracles

Paul de Beer[1]

Two job miracles

During the 1990s, many German experts visited the Netherlands to unravel the secret of the Dutch miracle. It was a period in which the European economy was struggling to overcome a deep recession and the German economy was stuck in a depression after reunification, but the Dutch economy, and the Dutch labour market in particular, was performing remarkably well. The term "polder model" was introduced to characterize the wonderful Dutch tradition of conferring and consensus seeking amongst the trade unions, the employers and the government, which resulted in typical Dutch "inventions" such as wage moderation, part-time work and a strong reduction of social expenditure without a significant increase of income inequality or poverty. As a consequence, within a period of twenty years, the Netherlands progressed from one of the worst-performing European countries, with respect to unemployment and labour participation, to one of the leading countries. In 1997, the German Bertelsmann Foundation awarded the Dutch Foundation of Labour (*Stichting van de Arbeid*) the Carl Bertelsmann Prize as acknowledgment of the performance of the Dutch model.

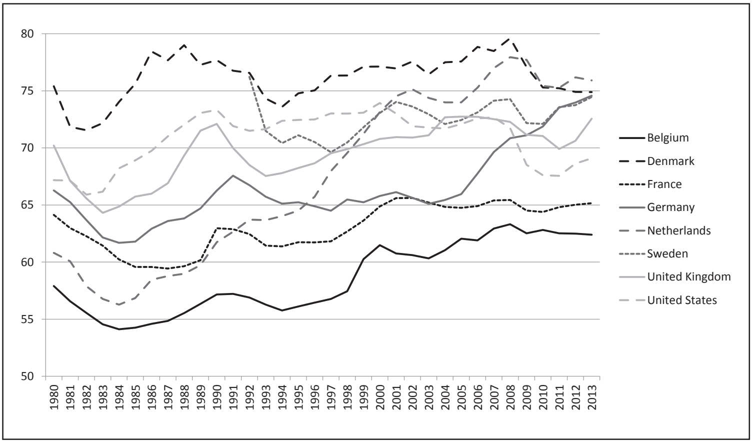
However, since the beginning of this century, the roles have been reversed. The performance of the Netherlands is faltering. Even though the Netherlands is still one of the best-performing EU member states in terms of unemployment and employment rates, no progress has been made in the past ten years. Since 2002 the leadership has been taken over by Germany. Especially during the Great Recession that started with the global credit crunch of 2008, Germany outperformed most other EU countries in terms of employment growth and the reduction of unemployment. Now, many Dutch experts are turning towards Germany to learn from their success.

On closer examination, the Dutch success of the 1990s and the German success of the 2000s share quite a number of similarities. Both success models were based on a combination of wage moderation and a flexibilization of the labour market, both were accompanied by strong export growth, both resulted in strong employment growth but relatively weak or modest productivity growth. Moreover, the success of both countries followed a period in which the countries performed rather poorly. This often-neglected fact already offers part of the explanation for the later success. After all, it is much easier to improve one's score if one has recently performed rather poorly from a historical, long-term perspective than if one's recent scores were excellent.

German and Dutch successes compared

Let us compare the Dutch success model of the 1990s and the German success model of the 2000s in more detail, including the performance of both countries in the preceding decade and, in the case of the Netherlands, also in the following decade.

Figure 1



Source: OECD Statistics

In this article the socio-economic performance of Germany and the Netherlands will be compared with the (unweighted) average of six other countries, including five prosperous north western European countries (i.e. Belgium, Denmark, France, Sweden and the United Kingdom), and the United States. As the main indicator determining whether a country performed better than the other countries, the change of the employment rate is used (i.e. total employment as percentage of the total population of working age, 15-64). Figure 1 shows the evolution of the employment rate of these eight countries from 1980 until 2013. The Dutch employment rate increased strongly from 1984 until 2008. However, since the employment rate of the other countries also increased in the second half of the 1980s, but declined after 1990, 1990 will be taken as the starting point of the Dutch success period in which employment growth significantly exceeded employment growth in the other countries. 2002 is considered to be the final year of the Dutch success, since employment growth stagnated for three years, before catching up again in 2006. From 1990 until 2002, the Dutch employment rate rose from 61.7 to 75.1 percent. The German employment rate started to accelerate in 2003 and continued rising until 2013. Therefore, this period is taken as the German success period, during which the employment rate increased from 65.1 percent to 74.5 percent.

Table 1 compares the performance on a number of socio-economic variables of Germany and the Netherlands with the six aforementioned countries in three periods: 1980-1990, 1990-2002 and 2002-2013.[2]

The upper panel of table 1 confirms that the performance of the Netherlands and Germany regarding the employment rate did stand out compared to the other six countries in the years 1990-2002 and 2002-2013, respectively. Notably, this outstanding performance was exceptional for both countries, since their employment growth in the preceding period lagged behind the average of the other six countries. Thus, their good performance can be partly considered a catch-up effect. Dutch employment growth in the most recent period, 2002-2013, equalled the average growth of the other countries, showing that high employment growth in the Netherlands did not continue after 2002.

Table 1 Performance of Germany and the Netherlands compared with six other countries, 1980-2013 (total change over indicated periods)

	Germany	Netherlands	Average BE, DK, FR, SE, UK, US	DE – other 6	NL – other 6
1. Employment rate (%-points)					
1980-1990	0.0	0.9	1.3	-1.3	-0.4
1990-2002	-0.6	13.4	0.3	-0.9	13.1
2002-2013	8.7	0.4	0.4	8.3	0.0
1980-2013	8.1	14.7	2.0	6.0	12.7
2. Unemployment rate (%-points)					
1980-1990	1.6	1.5	1.0	0.7	0.6
1990-2002	3.8	-5.1	-0.6	4.4	-4.5
2002-2013	-3.3	4.1	1.1	-4.4	3.0
1980-2013	2.1	0.5	1.5	0.6	-1.0
3. Real GDP (%)					
1980-1990	25.9	24.7	27.8	-1.9	-3.1
1990-2002	23.0	39.3	31.9	-8.9	7.4
2002-2013	13.2	10.7	13.8	-0.6	-3.1
1980-2013	75.3	92.3	93.0	-17.6	-0.7

4. GDP per head, constant PPPs (%)					
1980-1990	24.2	18.0	23.7	0.5	-5.7
1990-2002	18.4	29.0	24.3	-5.9	4.7
2002-2013	13.8	6.4	7.2	6.6	-0.8
1980-2013	67.2	61.9	65.0	2.2	-3.1
5. GDP per hour worked (%)					
1980-1990	32.6	18.2	26.7	5.9	-8.5
1990-2002	28.2	15.4	28.1	0.1	-12.7
2002-2013	10.5	8.4	10.1	0.4	-1.7
1980-2013	87.8	47.8	78.6	9.2	-30.8
6. Real labour compensation per unit labour input (%)					
1980-1990	4.5	-5.4	10.8	-6.3	-16.1
1990-2002	15.1	11.5	16.9	-1.8	-5.4
2002-2013	-7.8	0.4	3.1	-10.9	-2.7
1980-2013	11.7	7.2	34.3	-22.7	-27.2
7. Average annual hours actually worked per worker (%)					
1980-1990	-9.9	-6.6	-4.8	-5.1	-1.8
1990-2002	-8.7	-3.0	-4.6	-4.0	1.7
2002-2013	-3.7	-2.0	-1.7	-2.0	-0.2
1980-2013	-17.7	-9.3	-9.1	-8.5	-0.2
8. External balance of goods and services (%-points of GDP)					
1980-1990	4.8	3.9	1.9	2.9	2.0
1990-2002	4.6	2.7	1.4	3.1	1.3
2002-2013	1.6	3.6	-0.2	1.8	3.8
1980-2013	11.0	10.3	3.2	7.8	7.1

Source: OECD Statistics, Eurostat, The Conference Board (GDP per hour worked); calculations by the author

The changes in the unemployment rate largely mirror the changes in the employment rate. In their success periods, the unemployment rate in the Netherlands and in Germany dropped by about 4.5 percentage points compared to the other countries. However, for Germany this decrease just compensated for the large increase in the preceding period. Over the last three decades, the overall change in the unemployment rate of the two countries did not differ much from the average of the other six countries.

Causes of the Dutch and German job miracles

Let us now turn to a number of factors that may explain the varying labour market performance of Germany and the Netherlands over time. An obvious explanatory factor is economic growth. The third panel of table 1 shows that the success period of the Netherlands indeed coincides with a period of relatively strong economic growth, measured by the change of real GDP, while economic growth lagged behind the other countries in the preceding and the consecutive period. However, German economic growth was lower than the economic growth rate of the other countries in all periods considered, even in the last period in which the employment rate rose strongly. Yet, this underperformance of Germany is largely explained by the shrinking population. Indeed, if one calculates the average growth of real GDP per capita, Germany outperformed the other six countries in the years 2002-2013. Over the entire period 1980 until 2013, the growth of real GDP per head in the two countries did not differ much from the average of the other six countries. Thus, in the long run, neither the German economy nor the Dutch economy grew more strongly than that of the six reference countries.

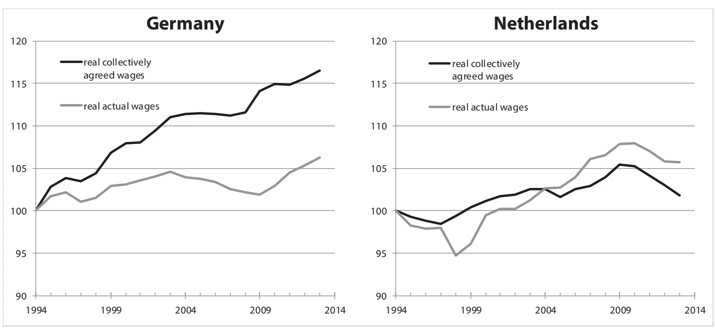
If one takes real GDP growth per head into account, Dutch employment growth in the period 1990-2003 was still remarkably high. This can be explained by the very moderate growth rate of labour productivity (GDP per hour worked) in the Netherlands compared to the other countries, in particular in the period 1990-2002. In this period, Dutch labour productivity grew only half as much as labour productivity in the other countries. Put differently, Dutch economic growth in this period was highly labour intensive. This component is not part of the explanation of the German performance. Since 1990, labour productivity growth in Germany just equalled the average growth in the other countries. As a consequence, a larger real GDP growth per capita in the years 2002-2013 in Germany compared to the Netherlands in the years 1990-2002 resulted in a smaller rise in the employment rate in Germany.

The sluggish productivity growth in the Netherlands is sometimes related to the continuing trend of wage moderation. The famous 1982 Wassenaar Agreement between the social partners is often considered to be the starting point of wage moderation in the Netherlands, although real wage moderation had actually already started three years earlier, in 1979. Indeed, since 1980, real wage increases have been consistently lower in the Netherlands than in the other countries, although the difference was, by far, the largest in the 1980s. Comparing panel 5 and 6 suggests that wage moderation translates into lower productivity growth only after a considerable number of years. This is plausible, since wage moderation will probably reduce investments in new labour-saving technologies only after older vintages of capital equipment are depleted.

Although real wage increases in Germany had lagged behind the other six countries since 1980, the difference was much smaller than in the most recent period. Only since 2002 have German real wages declined. In the event that this will affect investments in Germany in the same way as it did in the Netherlands, it will mean that German labour productivity will probably lag behind the other countries in the coming years.

It is interesting to note that the causes of Dutch wage moderation are different from Germany's, as figure 2 shows. In the Netherlands, wage moderation was the result of an agreement between the social partners on the desirability of labour cost reduction (a key element of the Wassenaar Agreement). As a consequence, real collectively-agreed wages have effectively stagnated for the past 35 years. From 1994 until 2013, real contractual wages increased by only 1.8 percent. Due to a positive wage drift, actual real wages increased a little more, by 5.8 percent. This is almost equal to the real wage increase in Germany from 1994 to 2013, which amounted to 6.2 percent. However, the causes of real wage moderation in Germany were quite different. Real contractual wages increased by almost 17 percent from 1994 to 2013. However, actual pay lagged significantly behind contractual wages. This large negative wage drift can probably be attributed to the declining bargaining coverage in Germany; from 76 percent in 1995 to 61 percent in 2010 (Visser 2014). So an increasing number of German employees are no longer covered by collective agreements and, apparently, their wages lag significantly behind the collectively-agreed wage levels.

Figure 2 Real collectively-agreed wages and real actual-wages in Germany and the Netherlands (index figures; 1994 = 100)



Source: OECD Statistics (actual wages and prices); Bispinck & Schulten (2012) (collectively-agreed wages Germany 1995-2011); Destatis (collectively-agreed wages Germany 2012-13); CBS (collectively-agreed wages Netherlands); calculations by the author

The overestimated role of shorter working hours

The Dutch job miracle of the 1990s is also attributed to the increase of part-time work. Indeed, after 1980, the share of part-time jobs increased more rapidly in the Netherlands than in the other countries. However, to assess the impact on the employment rate, one should also take into account the changes in the working hours of full-time workers. If one assumes, for the sake of the argument, that the total number of hours is fixed, a ten percent reduction of the full-time working week would have the same effect as an increase of the share of halftime workers with twenty percentage points. Therefore, panel 7 in table 1 shows the change of the average number of annual working hours per worker, which includes both the effect of the reduction of the fulltime working week and the increase in the share of part-time workers. In Germany, the annual number of working hours decreased significantly more than in the other countries. However, the largest reduction of working time occurred in the 1980s and the 1990s, when the German employment rate did not increase. In the most recent period, working hours have only reduced slightly more than in the other countries. Consequently, working time reduction cannot explain the good German employment performance since 2002. Apparently it was also not an important ingredient of the Dutch job miracle of the 1990s, despite the strong growth of part-time jobs, since average annual working hours fell even less than in the other countries.

Beggar-thy-neighbour policies?

Finally, it is sometimes suggested that the Dutch success story of the 1990s and the recent success of Germany are, at least partly, based on a beggar-thy-neighbour model. That is, the Netherlands and Germany would have created more jobs by strengthening their international competitiveness through wage moderation. Indeed, since 1980, the external balance of trade in both the Netherlands and Germany has improved compared to the other six countries. However, it is remarkable that this (relative as well as absolute) improvement was the smallest in the years in which both countries performed best in terms of job growth. There is therefore no apparent relationship between the improvement of competitiveness and employment performance and, thus, no evidence that the Dutch and German successes depend on beggar-thy-neighbour policies.

Conclusion

The main conclusion that can be drawn from the preceding analysis is that the Dutch success of the 1990s as well as the German success of the 2000s was an exceptional but relatively short-lived episode. If one takes a longer time perspective, the Netherlands and Germany only outperformed the other six countries concerned with respect to employment growth. Over a period of 33 years, the Dutch and German performance regarding the unemployment rate and economic growth was rather mediocre. Apparently, both countries went through a period of transition from a relatively low employment rate to one of the highest employment rates in the EU. This was mainly achieved by the massive absorption by the labour market of groups with a low participation rate, especially women and the elderly (aged 50 and over). Now that both countries have (almost) completed this transition, there is little room for further expansion.

In both countries the strong employment growth was facilitated by wage moderation. However, the causal relationship probably also runs somewhat in the opposite direction: the strong increase in labour supply exerted a downward pressure on wage development. In the Netherlands, wage moderation was the outcome of very moderate collectively-agreed pay rises, in Germany it resulted from a large negative wage drift in non-unionized industries and companies.

Just as the Dutch miracle ended around the turn of the millennium, the German success will probably not continue much longer. Recently, German economic growth has been faltering. Wage moderation seems to have come to an end, now that wage drift has become positive in the past four years. Moreover, increasing attention is being paid to the weak sides of German success, such as lagging investments (cf. Fratzscher 2014). Capital formation declined from 24 percent of GDP in 1991 to 18 percent in 2009 (source: OECD Statistics). In the longer run this will undermine the growth potential of the German economy.

Thus, there are not many reasons to recommend the German model of the past ten years to other European countries, just as there was no reason to believe that the Dutch "miracle" of the 1990s was a recipe for success. The most positive lesson that one can learn from the experience of both countries is that a country that succeeds in raising its labour participation rate and absorbing the new labour supply in the labour market, can temporarily increase its rate of economic growth. However, inevitably, after some time the increase of labour participation will level off and economic growth will slow down again.

Notes

1. Henri Polak professor of industrial relations at the University of Amsterdam, co-director of the Amsterdam Institute for Advanced Labour Studies, director of De Burcht, Scientific Bureau of the Dutch Trade Union Movement.
2. Since the German employment rate only started to rise in 2003, 2003-2013 might be the preferred period to compare the German with the Dutch success period, but then one calendar year would have to be left out of the comparison.

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