

Inflation differentials in EMU: why is Germany's wage growth slower than average?

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The impact of the EMU regime

Even if, in EMU, every national monopoly union is too small to affect average price conditions and to condition the ECB's reaction function, there remains evidence of significant wage restraint across the board. Why?

Theories of wage restraint in a monetary union

- Product market competition on wages (Bertola et al)
 - downwards pressures on mark-ups
 - exploitation of economies of scale
- Product market competition on LMI (too many)
 - decreasing union bargaining power (e.g. delocalisation)
- LMI on wages (Calmfors and Driffil, Hall, Soskice)
 - move towards decentralization and local wage bargaining
- Monetary credibility on wages (Franzese, Iversen, Posen and Gould, Soskice)
 - credibility of non-accommodating monetary policy in centralised wage bargaining systems

The argument

There exists a hump-shaped relationship between wage growth and country size

Large countries:

- they might affect average prices inducing a reaction by the ECB (-)
- an interest rate hike affects domestic C and I, but also C* and I*, hence X [f(openness)] with u costs across all sectors (- -)

Small countries:

- free riders with respect to the monetary regime (+)
- concern for cost competitiveness, but uncertain impact on X (see Carlin et al) (-)

Intermediate countries:

- uncertain impact on average prices (- +)
- no concern for cost competitiveness (+)

Our definition of wage growth

$W_n T - \alpha T-1$ – employment growth

Features:

- we focus on total W (ECB)
- we control for employment growth
- we look at nominal W (statistically significant): unions bargain over N
- we consider α in T-1 to account for monetary illusion
- we assume π_e at 2% across the board

The hump-shaped relationship between wage growth and size



An econometric exercise

$$\Delta W = \beta_0 + \beta_1 * \text{Openness} + \beta_2 * B + \beta_3 * S + \beta_4 * S^2 + \beta_5 * \text{TEU} + \varepsilon$$

ΔW is the average percentage change in nominal wages minus productivity in t-1 minus employment growth

Openness is the average contribution of trade to GDP formation

B is a composite index that sums up together the degree of wage bargaining coordination, centralization and coverage

TEU is the average ratio of exports towards euro-zone countries over total exports

S is the average size of each country in terms of total employment

S^2 is the square of size

ε is an error term.