

Wage and Employment Developments in the Euro Area; Key Understandings from a Multi-Country Macro-Econometric Model

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Abstract:

The introduction of the Euro in 1999 and the common monetary policy under the ECB put a major task to the European economies. Especially for the wage developments and therefore for the employment paths in the Euro Area, this is one main challenge of the next years. For the conduct of economic policy it is therefore of major interest to understand if this institutional change altered the known response mechanisms (structural break or not) and what will be the new results under the now reinforced European integration.

For this research a structural macro-econometric models for 4 representative Euro-Countries (Germany, France, Spain and Netherlands) has been used. Special attention has been paid for structural breaks at the end of the 90's. Although the theoretical framework was the same for all countries, the differences in the estimated equations allowed to take into account country-specific features as institutions or economic structures (small/big, closed/open economies for example). With this first analysis it is already possible to identify the specific features of the wage, price and employment formations within these four countries and their expected outcomes for the future. Then the models are linked together through the common monetary policy, the real effective exchange rates and the external trade flows. Simulations of different wage policies have been done in order to understand the recent wage and employment divergence in the Euro Area and to assert what could be a better alternative.

The conclusion is that through the Euro and the fixed nominal exchange rates in the Euro zone, wages and prices in the single Euro countries become much more important to correct for external and internal shocks. Since no structural break had been detected in the wage and price formations, almost per definition, adjustments within the Euro Area do need much more time. This can be seen in the recent economic developments of Spain versus Germany for example. Divergences are thus likely to last for some time. The price and effectiveness of rapid adjustments appear to be different depending of the size and openness of the country; for example the gain of international competitiveness in Germany did not bring so positive effects for employment as it did for the Netherlands. Therefore the need for coordination in the monetary, fiscal and wage policies at the Euro Area level is straightforward and is our main conclusion.

Keywords: Euro Area, Wages, Employment, Macroeconometric Multi-country Model, Simulations