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Exchange Rates, Labour Costs and International Competitiveness

by Heinz Salowski, Cologne*

The international competitiveness of German industry, so greatly dependent on exports, is in large measure determined both by fluctuations in the rate of exchange and by the level of its labour costs in relation to those of its competitors in the world market. Recent trends in these two factors are discussed in the following article.

The Federal Republic of Germany considerably improved its foreign trade situation in 1981. Exports, at DM 397 billion, were 13 % higher than in 1980. This exporting success must be rated all the more highly as in 1981 world trade as a whole was characterised by a persistent slackness of demand and business activity in nearly all the industrialised countries. The marked increase of German exports was due primarily to an improved competitive situation in terms of prices of German products on the world market, and this in turn was due to the persistent inflation differential vis-à-vis other countries and the nominal devaluation of the D-Mark against the currencies of important buyer countries. However, the international competitiveness of the German economy – and indeed of any country – is determined not solely by changes in the rate of exchange but by a multiplicity of factors. A very important factor, which itself is also affected by fluctuations in the rate of exchange, is labour costs, i. e. the costs consisting of the direct hourly wage and the additional labour costs to be met by the employer. To obtain a basis of comparison the labour costs of each country must be converted to a uniform currency using the annual average of the official rate of exchange. For the Federal Republic of Germany a DM basis seems the most obvious choice since more than 80 % of German exports are invoiced in D-Mark. (Measured in terms of total world exports, the D-Mark is the most important trade currency after the US dollar and before the pound sterling.)

In 1981 the average costs of one man-hour in German manufacturing industry surpassed the DM 25 level for

the first time, reaching DM 25.03, having first crossed the DM 20 line in 1978. The Federal Republic of Germany therefore belongs, together with Sweden, Belgium and Norway, to the group of countries whose labour costs lie above the DM 25 line. The USA and Switzerland can be included in this group of countries since their labour costs come close to the DM 25 line.

High Supplementary Labour Costs

The high level of labour costs in the Federal Republic of Germany is due principally to the high additional labour costs. Whereas total labour costs rose by 166 % over the period 1970 to 1981, direct wages over the same period rose by 128 % while additional labour costs went up by 238 % – largely because of increased employers' contributions to social insurance, benefits laid down in collective agreements and increased payments for non-working time, i. e. predominantly for extended annual leave and the continued payment of wages during sick-leave. This phenomenon is not confined to the Federal Republic of Germany alone. In most industrialised countries the additional labour costs showed relatively high growth rates. However, the supplementary labour costs in the various countries differ from one another, both absolutely and relatively, almost as much as direct wages. On a DM basis the range of additional labour costs extends from DM 2.81 per man-hour (Greece) to DM 11.31 per man-hour (Belgium).

The relative proportion of additional labour costs means very little, however, since a high percentage of additional labour costs does not necessarily also mean

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high overall labour costs. Italy, a country with relatively low direct wages and salaries but relatively high additional labour costs, occupies, in terms of overall labour costs, a position in the bottom third of the range of comparable industrialised countries. With additional labour costs of 108 % – related to direct wages and salaries – Italy has the highest relative additional labour costs and Denmark, with 23 %, the lowest. The structure of additional labour costs in each individual country is determined by the country's social insurance system. Alongside systems in which the State, or legislation, prescribes the level and form of financing of social benefits (for the most part by means of general taxation and to a lesser extent through direct social insurance contributions) – as, for instance, in Denmark, Ireland, Britain and Canada – there exists the practice, in most of the other countries, of the two sides of industry determining the structure and magnitude of additional labour costs, even though the State almost everywhere lays down minimum levels. It is true that the economic slowdown in nearly all countries has acted as a brake on the above-average growth of additional labour costs. Nevertheless increases – though sometimes slight ones – were recorded again in 1981 in many countries: in Belgium, in February 1981, the insurance liability limit was raised and contributions to health and old age pension insurance were increased; in France health insurance contributions were increased and the insurance liability limit raised; in Ireland the income limit for contribution assessment was raised; in the Netherlands there was an increase in rates of contributions to unemployment insurance; in Britain there was mainly an extension of holidays; and in the Federal Republic of Germany there were extended holidays and an increase in social insurance contributions as well as a raising of the income limits for contribution assessments.

Exchange Rate Fluctuations

The extent to which fluctuations in the rate of exchange affect cost levels is shown by the USA, which at the time of dollar weakness during the second half of the seventies recorded a comparatively low level of labour costs but, as the dollar rose again in 1981, now once more belongs to the high-wage countries. Sweden, too, which between 1975 and 1978 recorded the highest level of labour costs of all industrialised countries, again moved to the top of the labour costs table in 1981. But it was not only vis-à-vis the USA and Sweden but also vis-à-vis Canada, Austria, Norway, Switzerland and Japan – all of them countries whose currencies gained in value against the D-Mark during the past year – that the

Federal Republic of Germany improved its labour cost position and hence its competitive position. The recovery of the yen was also the main reason why, in spite of only modest increases in wages and modest improvements in additional labour costs, Japan's level of wages and labour costs has continued to move upwards and has by now reached the cost level of major European industrialised countries. Vis-à-vis the Federal Republic of Germany the cost ratio diminished from 2.4:1 to 1.5:1 during the period 1970 to 1981. Yet the most far-reaching levelling of costs occurred between the USA and Japan. The cost ratio of 4:1 in 1970 diminished in manufacturing industry to 1.5:1 by 1981. (The American automobile industry achieved a cost ratio of 1.7:1, i. e. it defined the labour cost gap between the American and the Japanese automobile industry at US \$ 7.82 per hour.)

Swedish Labour Costs Highest

In the rank order of labour costs Sweden in 1981 once more clearly held the top position. This position had previously been held by Sweden from 1975 to 1978. Before that period it had been the USA which recorded the highest labour cost level, after 1978 it was Belgium. All three countries complain about the weakness of their competitive position.

Table 1
Structure of Labour Costs¹
in Manufacturing Industry, 1981
(on DM basis²)

Country	Labour Costs per Hour: total	Direct Hourly Wage	Additional Labour Costs per Hour
Sweden	27.45	16.44	11.01
Belgium	26.29	14.98	11.31
Norway	25.37	17.25	8.12
FR Germany	25.03	14.14	10.89
USA	24.97	18.03	6.94
Switzerland	24.95	16.97	7.98
Netherlands	23.55	13.23	10.32
Canada	22.87	16.94	5.93
Denmark	21.52	17.60	3.92
France	19.91	10.94	8.97
Italy	19.32	9.29	10.03
Austria	17.80	9.37	8.43
Japan	16.32	12.90	3.42
Great Britain	16.00	12.12	3.88
Spain	13.40	8.40	5.00
Ireland	13.26	10.08	3.18
Greece	7.92	5.11	2.81

¹ Male and female workers.

² Some of the figures are provisional; 1981 annual average of official rates of exchange.

Sources: National statistics and own calculations.

Belgium's exceedingly critical economic situation compelled the Belgian government in February 1982 to devalue the Belgian franc for the first time since 1949. The devaluation of the Belgian franc by 8.5 % against the currencies of Belgium's EMS partners was part of the austerity programme by means of which Belgium hopes to overcome its precarious situation. The Belgian economy has long been suffering from structural problems. This is true in particular of the iron and steel industry. Governments have resorted to huge subsidy payments in order to keep uncompetitive enterprises alive and preserve jobs. Public expenditure and public debt have risen correspondingly fast. Nevertheless the trade unions have opposed the necessary rationalisation and restructuring measures. On the contrary, the shortening of working hours and the indexing of wages, i.e. the automatic adjustment of wages and additional labour costs to price trends, have resulted in a progressive deterioration of the country's international competitiveness.

Sweden's share of world trade and also of world industrial production declined by 20 % during and after the years of marked labour cost increases, i.e. between 1975 and 1978. As an investment country, too, Sweden is increasingly losing its attraction. According to data released by the Swedish State Bank, Swedish foreign investments in 1981 rose by 70 % to reach Swedish crowns 6.5 billion, while foreign investments in Sweden declined by 15 % against 1980, to Swedish crowns 1.3 billion.

Table 2
Index of Labour Costs¹
(Federal Republic of Germany = 100)

Country	1970	1980	1981
Sweden	118.0	102.4	109.7
Belgium	83.2	104.3	105.0
Norway	97.2	91.5	101.4
FR Germany	100.0	100.0	100.0
USA	167.7	77.9	99.8
Switzerland	82.0	93.0	99.7
Netherlands	84.7	99.0	94.1
Canada	135.1	71.8	91.4
Denmark	92.9	88.9	86.0
France	68.5	74.1	79.5
Italy	73.6	74.8	77.2
Austria	55.4	64.5	71.1
Japan	41.8	52.8	65.2
Great Britain	62.2	56.8	63.9
Spain	32.7	49.7	53.5
Ireland	47.2	51.7	53.0
Greece	29.0	28.3	31.6

¹ Hourly earnings and additional labour costs per hour worked, male and female workers in manufacturing industry, on DM basis.

Sources: National statistics and own calculations.

Table 3
Labour Costs in the Major Industrialised Countries¹, 1970-81

Year	USA	Japan	FR Germany	France	Britain	Italy
1970	15.80	3.94	9.42	6.45	5.86	6.93
1971	16.02	4.46	10.34	6.93	6.39	7.69
1972	16.04	5.45	11.35	7.80	6.95	8.38
1973	14.40	6.35	12.83	8.53	6.53	8.82
1974	15.30	7.66	14.48	9.33	7.44	9.34
1975	16.10	8.29	15.95	11.35	8.49	11.02
1976	17.85	9.20	17.11	12.21	8.13	11.10
1977	17.76	10.57	18.92	12.23	8.09	11.83
1978	16.99	12.15	20.06	14.07	8.82	13.72
1979	16.95	11.77	21.14	15.05	10.20	15.25
1980	18.23	12.35	23.40	17.35	13.30	17.51
1981	24.97	16.32	25.03	19.91	16.00	19.32

¹ Labour costs per hour in manufacturing industry, male and female workers, on DM basis (official rates of exchange, annual averages).

Sources: National statistics and own calculations.

In the USA, whose economic policy has been characterised by a restrictive monetary policy in 1981, the strong revaluation of the US dollar has greatly weakened the competitive position of the American economy. Real exports declined markedly in 1981, while real imports continued to increase. Thus, German exports to the USA showed a vigorous increase of 21 % over the 1980 figure, a circumstance which is certainly connected with the considerable devaluation of the D-Mark against the US dollar.

Table 2 shows clearly that in spite of the changes of position within the top group and the sometimes different effects produced by rates of exchange, the convergence of labour cost levels, which began in the mid-seventies, is continuing. The reasons for this are either increased wages, increased additional labour costs and/or changes in the rates of exchange. Six countries now lie relatively close together with labour costs between DM 25.00 and DM 27.50 : Sweden, Belgium, Norway, the Federal Republic of Germany, the USA and Switzerland. Relatively high labour costs are recorded also by the Netherlands, Canada and Denmark. A further bloc of countries – France, Italy, Austria, Japan and Britain – succeeded in further narrowing the gap between themselves and the Federal Republic of Germany. Even though the labour cost levels of the various countries have come closer to one another over the past few years, and even though the German labour cost situation and hence also the competitive situation of the Federal Republic of Germany have relatively improved, labour costs in the Federal Republic continue to be higher than those of most of its major competitors in world markets.