Hans-Werner Sinn's Thesis of the Pathological Export Boom

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On 2 June 1999 the cover of the *Economist* referred to Germany as: 'the sick man of the euro.' From 1993 onwards Germany's real annual growth had been 0.8 percentage points lower than the other EU15 countries, while its unemployment rate was 1.1 percentage points above that of the other EU15 countries. By 2005 this differential had risen from 1.1 percent to 4.43 percent; while the growth gap had increased by over one percentage point.

All Germany seemed to have left was its traditional export strength. From 2000 to 2005 Germany's exports of goods and services grew by 7.4 percent on annual average, *versus* 5.1 percent in other EU-15 countries. This undiminished export strength, by contrast, seemed to contradict the idea that the surge in unemployment in Germany could have anything to do with slightly excessive wage levels. We faced a puzzle: Germany the 'sick man' and highly competitive in exports?

In this situation Hans-Werner Sinn came up with a provocative hypothesis: according to Sinn the export boom was not a sign of Germany's competitive strength, but could be explained as part of the 'sick man' pathology. The boom itself was to some degree 'pathological'; and not a sign of economic strength, but a symptom of its disease. Sinn presented his thesis of a 'pathological export boom' as a theoretical excursion in the context of an empirical finding: he had proven that out of 18 percent growth (1995–2003) the real production value of German manufacturing only accounted for a small share (2 percentage points) of the increase in domestic value creation, with the larger share represented by higher domestic and/or foreign input materials (7 and/or 9 percentage points). German firms were focusing on a steadily shrinking share of value creation related to industrial products. The same applied to exports. Opinions differ as to whether this trend was accurately described by Sinn's image of Germany as a 'bazaar economy'. There is, however, no doubt about the shift in the view of value shares in international trade that it triggered.

With this image of the 'bazaar economy' Hans-Werner Sinn wanted to counteract the slightly complacent use of statistics on the export boom to relativize the metaphor of the 'sick man', parallel to his theoretical argument supporting the pathological nature of the boom. There were two strands to his theoretical argument. The first was that citing booming exports as evidence against traditional explanations of very high unemployment was not theoretically tenable. In slightly simpler terms, the argument goes like this: real wages that are above the equilibrium level push up the prices of work-intensive goods on the one hand, while the production of all goods requires more capital on the other. In an age of globalization both effects not only apply to Germany, but also impact its trade partners. Moreover, if real wages are not fixed in those partner countries, then this more capital-intensive type of production is linked to a reallocation geared towards more labour-intensive goods; which means that employment remains high in these countries. This, however, gives rise to surplus demand for capital-intensive goods, and this is – to some degree residually – satisfied by the country with real-wage rigidity. If that country, as in Germany's case, exports capital-intensive goods, this leads to an export boom. That boom can be described as 'pathological', because it was originally related to excessively high real wages.

The second strand of Sinn's argument features a controversial economic policy message. In the case cited above an extremely strange exchange takes place between countries with different labour market situations. The country with wage rigidity 'exports' the implied changes in relative goods prices, and even the change in real wages, to countries that do not intrinsically exhibit any wage rigidity; and 'imports' the cor-

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related worldwide over-supply of labour in the form of unemployment. The price implications of wage rigidity are also internationalized, while the related quantitative volume effect – the *worldwide* over-supply of labour – is nationalised. The country with real wage rigidity effectively acts as a magnet for the whole world's unemployment.

Sinn's thesis of the 'pathological' export boom represents an elegant application of established theories on the potential solution to an empirical puzzle. The extent to which this argument can be used to empirically explain Germany's situation at that time remains open to debate. Germany's situation has since taken a turn for the better, but Sinn's point is of a more fundamental nature. It would be desirable for empirically-oriented trade economists to look at the empirical importance of those mechanisms underlying the idea of a pathological export boom. Exogenous real wage increases in large countries, and in trade partner countries without real wage rigidity, could be shown to cause real-wage increases, coupled with reallocation to capital-intensive sectors.