

# Reducing Unemployment by Cost-cutting?

## Long-term impacts for Germany

Three years ago under the conditions of high unemployment and weak economic growth the DIW presented scenario calculations for the long-term growth perspectives in Germany.<sup>1</sup> One of the main results of the scenario calculations was, that the German economy can in no way be expected automatically to return to an appropriate growth path. Improvements in economic prospects were seen only to be possible if a comprehensive economic policy package is successfully put together.

A so-called 'integration' scenario showed that an economic policy strategy where politicians and the administration are acting together with the monetary authorities and the social partners will lead to solutions in important problem areas. This is true of government budgets and the social security institutions, and even on the labour market the reduction in unemployment is possible in the longer term if such a strategy is pursued. As a central element of such a strategy the modernisation of the economy was conceived.

On the other hand an increasing number of proposals for action are targeted towards an immediate and general reduction in the costs of production in Germany. They relate, in particular, to reductions in the burden of wage costs, taxes and social insurance contributions. These proposals are based on considerations derived largely from supply-side theory.

The aim of this report is to indicate the possible economic effects of such an economic policy concept oriented towards cost-cutting. To this end the various proposed measures were concretised and brought together in a 'cost-cutting scenario'. It is not the more or less precise economic policy proposals of a specific party or interest group that have been examined with regard to their economic effects; rather, it has been attempted to capture the underlying philosophy, with a package of measures that reflects the overall tenor of these proposals.

The 'cost-cutting scenario' is confronted with a 'reference scenario', which is based primarily on the former DIW long-term report. Since then, several new aspects had to be considered. First of all the scenario model had to be adapted to economic development of the recent years. Real values in the national accounts now are

deflated with prices based on the year 1995. Furthermore, the economic performance until 1998 had to be implemented. For reasons of comparison with the national accounts data the scenarios in most cases are confronted with a quantitative picture of the economic situation of 1995.

One of the consequences of the actualisation of the scenarios is a lower growth rate for the wage income per employee, resulting in a lower price increase as well. There are no changes in the estimated growth rate for Germany as a whole. However, due to the sluggish performance of east Germany in recent years the adjustment process does not have the dynamics as originally assumed.

## Key features of the reference scenario

The reference scenario is based on a comprehensive modernisation concept. It focused on the renewal and development of the institutional and material infrastructure. The aim of this modernisation strategy is to guarantee Germany's high level of social, technological and economic performance, while at the same time creating greater scope for individual and plant-level solutions by rendering institutional forms more flexible.

The central elements in the modernisation strategy are as follows:

- an incomes policy that, while allowing for greater scope for plant-level exceptions, enables broad sections of the workforce to participate in economic growth;
- a working-time policy that, allowing for the different conditions prevailing in German enterprises, creates greater scope for a more equitable distribution of work;
- an education policy appropriate to the increasingly highly differentiated skill requirements, by strengthening initial and particularly continuing training;
- an infrastructure policy that permanently improves the conditions for high-value production by means of qualitative improvement and expansion;
- a policy for eastern Germany that provides massive support for an adjustment to the conditions and standards prevailing in west Germany, based on an orientation towards a further capital intensification and a higher technological level.

Seen as a whole, this bundle of strategies relies upon government playing an active role in improving the conditions for production in Germany. This cannot be achieved without additional public spending and must, therefore, in many respects take precedence over current fiscal constraints.

<sup>1</sup> Cf. 'Prospects for Germany's longer-term economic development', in: *Economic Bulletin*, no. 10, October 1996, p. 3 ff.

The conversion of this strategy bundle into quantitative figures relies on a large number of variables. A central indicator is the real wage trend. Here an increase at an annual average rate of 1.5% is assumed, that is at a similar rate to that during the last 15 years in west Germany. Furthermore, it is assumed that the pace of working time reduction accelerates slightly in comparison past trends. The education and infrastructure policy strategies are reflected in a marked increase in the rate of growth of overall factor productivity in the business sector. The supply of government services expands at an annual rate of around 3.5%. The assumed strategy regarding the support policy for eastern Germany is concretised by, among other things, virtually constant nominal spending on investment grants.

## Elements of a 'cost-cutting strategy'

A central element in the cost-cutting scenario is to reduce business costs. The main role is played by a reduction in the burden of labour costs, achieved by means of wage moderation on the part of workers, coupled with a reduction in indirect labour costs. It was assumed that in real terms labour costs per employee remain constant in west Germany to the year 2010. This means that wage growth is even slower than that demanded by the various calls that have been made for real wage growth to follow a path below productivity growth.

Alongside the decrease in the burden of wages and indirect wage costs, the tax burden is also reduced or an increase limited. For unlike in the reference scenario, energy, as a production factor, is not subjected to higher taxes, so that an important component of input costs will not increase (at least not for this reason). In addition, firms can count on further reductions in the burden of taxes on profits, although at a markedly reduced pace compared with the first half of the 1990s.

Reductions in the tax burden are not limited to the business sector. Employee households also benefit from a cut in wage and income tax, so that the tax burden is reduced by almost one percentage point of earned income by the year 2010. On the other hand, households face a two-percentage-point increase in value added tax and an increase in the burden of social insurance contributions, of which they must shoulder a greater proportion (cf. table 1).

As a result of these measures, government receipts are almost three percentage points of GDP lower than in the reference scenario. In order simultaneously to reduce the budget deficit as a share of output, government spending is cut back on a broad front. In real terms gov-

ernment investment is frozen at its present level, while government consumption at constant prices is limited to a marginal annual average rate of growth of just 0.2%. Subsidies are cut back drastically to just 1.2% of GDP, and the level of many transfer benefits will be raised significantly more slowly than in the past.

The Growth and Employment-Promotion-Act has already indicated the direction in which the financial pressure on the social insurance systems is to be reduced within the context of a restriction strategy. One of the proposals is to raise the retirement age to 67, a strategy accompanied by cuts in higher education studying times, in order to reduce the average age at which young people enter employment. Changes in the regulations governing benefits for those with reduced capacity to work will make it much more difficult to claim such pensions.

## Impacts on output and employment ...

Given the trajectory of collectively agreed wage rates and indirect labour costs assumed in the cost-cutting scenario, unit labour costs are expected to decline across the entire prognosis period. On average this decline will amount to more than 1% per annum in west Germany and around 2% in east Germany. Germany's price competitiveness vis-à-vis the rest of the world will only temporarily improve to the same extent, however. Given that German wage trends are taken as an indicator within the EU, wage settlements in other Member States will also be moderate, causing Germany's cost advantages over its most important trading partners to melt away.

In addition, the restrictions on public spending lead to a relative deterioration in the qualitative conditions of Germany as a production location, particularly in the areas of infrastructure and education. In the longer term this poses a threat to its lead in terms of quality competition, particularly over the newly industrialising and central and east European countries. For this reason only moderate export growth to the year 2010 of around 3% per annum is expected, compared to 4% in the reference scenario. The restriction strategy, however, will be relatively successful in limiting imports. Taken together, there will be a substantial increase in the foreign trade surplus in real terms. However, the foreign-trade impulses on the domestic economy will be significantly weaker than in the reference scenario (cf. table 2).

The increasing demand impulses from abroad will have a positive effect on the domestic economy. This would have a favourable effect on the demand for investment goods and in particular for private consump-

Table 1

## A Cost-cutting Scenario for Germany

	Reference scenario <sup>1</sup>	Cost-cutting scenario
Institutional conditions	Stable and fair world trade Intensified goods exchange within EMU	Frictions in international trade due to exchange rate disturbances and to unbalanced export and import developments
Fiscal and monetary policy	Giving support to economic growth without endangering price stability	Restrictive fiscal policy to reduce government's share in GDP; further tax cuts for business profits, shift from direct to indirect taxation; cuts in public expenditure
Wage policy	Wage increases in line with labour productivity; wage share in GDP remains stable	Wage moderation and reduction of indirect labour costs, decreasing wage share in GDP

<sup>1</sup> Economic Bulletin, no. 10/1996, p. 3 ff.

tion. On top of this, privatisation will lead to a shift away from government in favour of private consumption. An additional positive effect is expected to emerge from the reduced incentives for moonlighting resulting from the lower indirect labour costs. However, these growth impulses will be almost completely offset by the weak development of mass purchasing power resulting from the unfavourable development of private household disposable income. In sum, therefore, private consumption can only be expected to expand by around 2% per annum in the cost-cutting scenario. This growth rate is one-half of a percentage point below that in the reference scenario.

Bringing together these various influences, it is expected that gross value added in the business sector (excluding housing rental) would increase by 2% per annum in the cost-cutting scenario, taking the depressed level of 1995 as a starting point. In the reference scenario, by contrast, in which the positive impact of government activities and higher investment boost demand, the growth rate reaches almost 3%.

The slower pace of wage growth leads to changes in factor inputs only in the case of new plant. A flattening out of the increase in capital intensity and thus also of labour productivity consequently occurs only after significant time lags. Even so, by the year 2010 it is to be expected that because of the slower pace of real wage growth, potential capital intensity in west Germany will increase by almost one-half of a percentage point less than in the reference scenario (1.6% compared to 2.0%). The growth of labour productivity is weakened to a roughly corresponding extent (cf. table 3). However, on balance the number of jobs created by investment activity will be lower than in the reference scenario, because investment growth will be weaker in the light of the slow growth of demand.

In eastern Germany an even more pronounced weakening of the rate of labour productivity growth is to be expected. Whereas until now firms have expected a rapid adjustment of east German to west German wage levels, in the cost-cutting scenario east Germany is to be irrevocably classified as a low-wage region as far as the investment calculations of firms are concerned. The growth of labour productivity in the cost-cutting scenario will accordingly be far weaker than in the reference scenario. On balance the impact on employment is negative. The specialisation on relatively low value-added products, produced at low wages with low labour productivity, means that this region will be unable to serve attractive, expanding market to the same extent as west Germany.

For Germany as a whole the annual average growth of potential labour productivity under the conditions of the cost-cutting scenario will, at 1.7%, be less than in the reference scenario (2.4%), but this weakening will be considerably less pronounced than the gap in real wage growth between the two scenarios (an annual average of 1.3 percentage points). This reflects the time lags inherent in the investment process, and is one of the reasons why the job effects of factor substitution are insufficient to offset the employment-reducing impact of weaker growth in the cost-cutting scenario.

### ... on growth and income distribution

The economic policy concepts depicted in both the scenarios lead to a marked acceleration of economic growth over the longer term. In the reference scenario the German economy as a whole is expected to grow at an annual average rate of almost 2.5% to the year 2010. The growth dynamic is perceptibly weaker in the cost-

Table 2  
Demand and Output

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
DM billion <sup>1</sup>				
Private consumption	1 861	1 975	2 845	2 667
Public consumption	626	675	815	695
Fixed capital formation	717	751	1 104	898
Government	84	87	126	87
Housing	195	260	352	306
Firms <sup>2</sup>	438	404	626	505
Change in inventories	5	28	20	20
Net exports	55	29	181	170
Exports	771	817	1 511	1 337
Imports	716	788	1 330	1 167
Gross domestic product	3 264	3 458	4 965	4 450
West Germany	2 965	3 077	4 206	3 868
East Germany	299	381	759	582
average annual change on the previous period in %				
Private consumption	–	1.5	2.5	2.0
Public consumption	–	1.9	1.3	0.2
Fixed capital formation	–	1.2	2.6	1.2
Government	–	0.9	2.5	0.0
Housing	–	7.5	2.0	1.1
Firms <sup>2</sup>	–	–2.0	3.0	1.5
Change in inventories	–	–	–	–
Net exports	–	–	–	–
Exports	–	1.5	4.2	3.3
Imports	–	2.4	3.6	2.7
Gross domestic product	–	1.4	2.4	1.7
West Germany	–	0.9	2.1	1.5
East Germany	–	6.2	4.7	2.9

1 At 1995 prices. — 2 Excl. housing rental.

Sources: Federal Statistical Office; DIW Scenario model.

cutting scenario. With annual average growth rates of 1.7%, however, the pace of growth is relatively high compared with the 1980s.

The achievement of a relatively high growth path in the cost-cutting scenario is conditional on decisive changes in the behavioural patterns of firms and households. It requires, for example, that firms pass on to a considerable extent the reductions in their wage cost burden in the form of lower prices. This implies that the price level would have to remain constant on average between 1995 and 2010 (cf. table 4). It also requires that households permanently increase their propensity to consume, while the savings-to-income ratio would have to decline from its current level of 11% (1998) to 9%.

The main reasons for the lower growth trajectory in the restriction compared to the reference scenario lie in

the reduced impulses from government demand and private-sector demand for investment goods. Whereas in the reference scenario government consumption and public capital spending increase by between 1% and 2% each year, in the cost-cutting scenario both variables remain virtually constant. In the case of private-sector investments (excluding housing rental), annual growth of almost 3% in the reference scenario contrasts with growth of just 1.5% in the cost-cutting scenario. The dampening of investment demand is explained largely by the reduced extent to which capital is substituted for labour in response to wage moderation.

The failure to exploit the potential for economic growth has a negative effect on the catching-up process in east Germany. In the cost-cutting scenario, in the year 2010 the level of income in east Germany is more than

Table 3  
Potential Output of Firms<sup>1, 2</sup>

	Unit	1991	1995	2010	
				Reference scenario	Cost-cutting scenario
Gross fixed assets	DM billion	6 177	6 862	10 413	9 466
Capital productivity <sup>3</sup>	in 1 000 DM	451	431	414	406
Potential output	DM billion	2 786	2 955	4 308	3 839
Gross value added	DM billion	2 429	2 576	3 872	3 443
Capacity utilisation	%	87	87	90	90
Capital intensity <sup>4</sup>	in 1 000 DM	178	212	313	289
Productivity per job <sup>5</sup>	in 1 000 DM	80	91	129	117
Jobs <sup>6</sup>	in mill. pers.	34.8	32.4	33.3	32.7
Employment	in mill. pers.	29.1	27.6	30.0	29.5
Job-fill quotient	%	84	85	90	90
Labour productivity <sup>7</sup>	in 1 000 DM	83	93	129	117
		annual average change on the previous period in %			
Gross fixed assets		–	2.7	2.8	2.2
Capital productivity		–	–1.2	–0.3	–0.4
Potential output		–	1.5	2.5	1.8
Gross value added		–	1.5	2.8	2.0
Capital intensity		–	4.5	2.6	2.1
Productivity per job		–	3.3	2.4	1.7
Jobs		–	–1.8	0.2	0.1
Employment		–	–1.3	0.6	0.4
Labour productivity		–	2.8	2.2	1.5

1 Excl. housing rental. — 2 At 1995 prices. — 3 Productive potential per 1000 units of gross fixed assets. — 4 Gross fixed assets per job. — 5 Productive potential per job.— 6 Gross value added per employee. — 7 Potential employment at full capacity utilisation.  
Sources: Federal Statistical Office; DIW productive potential calculation and DIW Scenario model.

30% below that in west Germany. But not only regional differences remain more pronounced in the cost-cutting scenario. It is also to be expected that the disparities in the functional and personal distribution of income will also be wider. Wage income, for example, will continue to decline sharply as a proportion of GDP, despite the fact that the wage share in Germany is already below the west European average. According to the calculations, wages decline from around 61% of GDP in 1995 to just 50% in 2010 (cf. table 5), which would imply a renewed acceleration of the pace of income redistribution compared with the period since the start of the 1980s.

On top of this come the cutbacks in the transfer benefits to private households. Hardest hit by such cuts are recipients of minimum social benefit, the unemployed and pensioners. It is therefore to be expected that in the

cost-cutting scenario broad sections of the population would not only miss out on real income growth, they would actually suffer serious income losses.

### ... on the public sector

In the cost-cutting scenario government attempts to reduce the burden of taxes and contributions on firms and households by limiting spending at all levels of government and in virtually all spending areas. Compared with 1995, spending on service provision and public investment remain virtually constant in nominal terms (cf. table 6). Subsidies are cut back markedly, falling by almost two-thirds as a proportion of GDP by the year 2010. Additional spending is only to be expected on

Table 4  
Prices and Wages

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
price index in west Germany 1995 = 100				
Gross domestic product	87	100	137	102
Private consumption	88	100	133	102
Public consumption	89	100	140	103
Gross fixed capital formation	92	100	139	103
Exports	94	100	130	101
Imports	102	100	122	101
annual average change on the previous period in %				
Gross domestic product	–	3.5	2.1	0.2
Private consumption	–	3.2	1.9	0.1
Public consumption	–	3.0	2.3	0.2
Gross fixed capital formation	–	2.1	2.2	0.2
Exports	–	1.6	1.7	0.1
Imports	–	–0.5	1.3	0.1
annual average change on the previous period in %				
memo item:				
West Germany				
GDP deflator	–	2.9	2.1	0.2
Wage rates <sup>1</sup>	–	3.8	3.4	0.2
Labour productivity <sup>2</sup>	–	1.5	1.6	1.2
Unit labour costs	–	2.3	1.8	–1.1
East Germany				
GDP deflator	–	9.7	2.3	0.1
Wage rates <sup>1</sup>	–	14.9	5.0	0.7
Labour productivity <sup>2</sup>	–	10.0	4.4	2.9
Unit labour costs	–	2.1	0.8	–2.1

1 Gross wages and salaries per employee. — 2 GDP per employee.  
Sources: Federal Statistical Office; DIW Scenario model.

social transfers, reflecting the continued rise in the number of benefit recipients. The overall effect is a decline in public spending as a share of GDP of more than five percentage points by the year 2010 (39%) compared with 1995.

At the same time taxes and contributions will fall by almost 3.5 percentage points of GDP. Both the burden of taxes on profits and the proportion of social insurance contributions borne by companies will be reduced. Although employees will pay higher social insurance contributions, total contributions will decline by 2.5 percentage points of gross wage and salary income compared with 1995. On the other hand, employee households will benefit from a reduced burden of taxes on wages. Over the next 15 years wage tax receipts will fall

by more than one percentage point of wage income. Despite an increase in value added tax of two percentage points on the 1995 level, the deficit can only be reduced to around DM 90 billion. The annual public borrowing requirement declines to 2% of GDP.

It cannot be claimed that comprehensive fiscal consolidation would be achieved by the measures summarised in the cost-cutting scenario. Despite the efforts to cut spending, outstanding government debt will increase markedly. According to our calculations, net government debt will rise from 48% of GDP in 1995 to 64% in 2010. This would mean that in the longer term Germany would lastingly fail to meet an important convergence criterion for European Monetary Union. The scope for government action would be further con-

Table 5  
Income Distribution<sup>1</sup>

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
DM billion				
GNP	2 882	3 445	6 845	4 541
Depreciation	362	453	987	657
Indirect taxes minus subsidies	261	364	940	630
Indirect taxes	358	447	1 029	675
Subsidies	98	83	89	45
Gross wage income	1 612	1 876	3 481	2 010
Social insurance contributions	491	608	1 071	602
Wage tax	221	294	559	298
Net incomes	900	974	1 851	1 110
Gross profit income	648	752	1 437	1 244
memo item:				
Indirect taxes as a % of private consumption	22.0	22.6	27.2	24.7
Subsidies as a % of GDP	4.4	3.1	1.6	1.2
Social insurance contributions as a % of gross wage income	30.5	32.4	30.8	29.9
Wage tax as a % of gross wages	13.7	15.7	16.0	14.8
Taxes on profits etc. as a % of gross profits	15.7	10.6	10.8	10.1
Gross profits as a % of GNP	22.5	21.8	21.0	27.4

<sup>1</sup> Following the addition of subsidiary budgets from 1991 onwards.  
Sources: Federal Statistical Office; DIW Scenario model.

strained by a continued increase in the burden of interest payments. The debt problem would be particularly serious for state and local governments in eastern Germany, as the increase in outstanding debt is not matched by a corresponding improvement in economic performance.

### ... and on employment

As far as the central economic and social policy problem, that of mass unemployment, is concerned, a restriction strategy does not produce the desired results (cf. table 7), although the volume of employment rises significantly to the year 2010. The employment impulses in the cost-cutting scenario emanate from the private sector, and more than offset the job losses in the public sector. The greater part of the job creation effects in the pri-

ate sector is directly due to the weakening of the capital intensification of production induced by the slower pace of wage growth. This leads to a significantly slower rate of productivity growth, which (per employee-hour) amounts to an average of around 2% per annum during the prognosis period. The employment-intensity of economic growth increases accordingly. Over the period 1995 to 2010 employment is expected to rise by around 1.6 million.

Yet this increase in the number in employment is not reflected in a decline in unemployment. The reason for this does not only lie in the immigration from abroad of people of working age, it is indeed to be expected in the cost-cutting scenario that immigration will slow down compared with the first half of the 1990s. Rather, the reason for the increase in the labour supply is to be found in the restriction strategy itself, which serves to prolong working life, in particular by shortening higher education study periods and postponing retirement. In

Table 6  
Government Budget<sup>1</sup>

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
DM bill.				
Revenue	1 165	1 430	2 814	1 700
Indirect taxes	358	447	1 029	675
Social insurance contributions	491	608	1 071	602
Wage tax	221	294	559	298
Taxes on profits etc.	95	81	154	125
Spending	1 301	1 547	2 852	1 789
Gross investment	75	87	175	89
Public services <sup>2</sup>	537	649	1 092	679
Social transfers	428	556	1 115	751
Transfers to promote entrepreneurial activity <sup>3</sup>	149	114	133	67
Transfers to the rest of the world	66	53	200	87
Interest payments <sup>4</sup>	47	88	137	116
Financial balance	-136	-117	-39	-89
memo item:				
Government revenue as a % of GDP	40.8	41.4	41.2	37.3
Public spending as a % of GDP	45.6	44.7	41.8	39.3
Deficit as a % of GDP	-4.8	-3.4	-0.6	-2.0
Net borrowing <sup>5</sup> as a % of GDP	38.9	48.2	37.3	64.4

1 Central, state and local government plus social insurance institutions and special assets (Treuhandaanstalt, Railways, east German housing sector). — 2 Public consumption minus depreciation. — 3 Subsidies and investment grants. — 4 Interest payments minus income from assets. — 5 Liabilities minus amounts receivable.  
Sources: Federal Statistical Office; DIW Scenario model.

2010 these measures will increase potential labour supply in Germany by around 1.6 million in persons (cf. table 8).

Under the conditions prevailing in the cost-cutting scenario, the extent of the excess supply of labour in the year 2010 will, at 7 million people, be of a similar order of magnitude to that in 1995. At just under 9% of the workforce, registered unemployment will, however, be slightly below the current level, as people are forced out of the labour force into various forms of hidden unemployment: pressure to leave the labour market is likely to be particularly strong in east Germany, and there especially among women.

## Summary

The scenarios clearly show that the German economy can in no way be expected automatically to return to an

appropriate growth path, and that global economic recovery, taken by itself, is not sufficient to induce such a process. An improvement in economic prospects is only possible if a comprehensive economic policy package is successfully put together, giving support to economic growth rather than restricting it.

The reference scenario shows that the processes emanating from such an economic policy strategy lead to solutions in important problem areas. This is true of government budgets and the social security institutions, and even on the labour market a reduction in unemployment is possible in the longer term if such a strategy is pursued.

Under the impression of weaker growth it would however be dangerous to think, that a general strategy of reducing costs would be the remedy. The cost-cutting scenario shows, that positive connotations attached to the concept of cutting costs quickly lose their attraction when, as is frequently the case, this goal is seen as a comprehensive concept of reducing spending in all sec-



Table 7  
Employment and Labour Market

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
in 1000 persons				
Employment in Germany	36 511	34 868	37 500	36 500
Net cross-border commuters	-53	4	155	125
Resident population in employment	36 564	34 864	37 345	36 375
Labour supply	41 081	41 855	42 626	43 474
Excess labour supply	4 517	6 991	5 281	7 099
Registered unemployment	2 602	3 612	2 711	3 562
Hidden unemployment	1 915	3 379	2 570	3 537
memo item:				
Unemployment rate <sup>1</sup> in %	6.6	9.4	6.8	8.9
West Germany	5.5	9.0	6.2	8.4
East Germany	10.7	14.0	9.3	11.2

<sup>1</sup> Registered unemployed in relation to registered unemployed plus residents in employment.  
Sources: Federal Statistical Office; Labour supply calculation by the IAB; DIW scenario model.

tors of the economy. In such a context cost-cutting does not aim merely to reduce avoidable costs, in the sense of raising efficiency and productivity, but rather amounts, in the final analysis, to a defensive restructuring of the entire economy. As justified as many of the demands may be from a microeconomic perspective, at the macro

level a rigorous and comprehensive strategy of cost-cutting is ill-suited to resolving the problems facing the Germany labour market (cf. table 9).

A much more promising strategy would appear to involve adopting an offensive approach to resolving Germany's economic problems. The strategy of improv-

Table 8  
Population and Labour Supply

	1991	1995	2010	
			Reference scenario	Cost-cutting scenario
in mill. persons				
Population in Germany	80.3	81.8	82.4	81.5
Age structure in %				
Under 20	21.5	21.5	18.3	18.3
20 to 59	58.0	57.4	55.8	55.7
60 and older	20.4	21.0	25.9	26.1
Labour supply <sup>1</sup>	41.1	41.9	42.6	43.5
memo item:				
Net migration <sup>2</sup>	-	-	3.6	2.8
Immigration <sup>2</sup>	-	-	13.4	12.6
Emigration <sup>2</sup>	-	-	9.8	9.8
Foreign nationals in % of population <sup>3</sup>	7.6	9.0	13.7	13.0
Labour supply in % of population	51.2	51.2	51.7	53.4
Population, west Germany	64.5	66.3	67.2	66.7
Population, east Germany	15.8	15.5	15.3	14.8

<sup>1</sup> As defined by the Institut für Arbeitsmarkt und Berufsforschung. — <sup>2</sup> Cumulated for 1996 to 2010. — <sup>3</sup> Excluding those subsequently taking German citizenship.  
Sources: Federal Statistical Office; Labour supply calculation by the IAB; DIW scenario model.

Table 9

## Key Forecasts for 2010

	1998	Reference scenario	Cost-cutting scenario
Unemployment rate, in %	11.2	6.8	8.9
Inflation, annual average in % (1995 to 2010)	0.9	2.1	0.2
GDP, compound annual growth rate in % (1995 to 2010)	2.7	2.4	1.7
Government deficit as % of GDP	1.9	0.6	2.0

ing the conditions for growth establishes the prerequisites for higher incomes and is more likely to help reduce over-supply on the labour market. In such a strategy, cost-cutting does not result from reducing spending, but by achieving growth while simultaneously raising efficiency, and thus raising the incomes of all participants.

Nevertheless, in both scenarios, the report presents a picture of Germany which follows economically a growth pattern on a sustained basis where overall economic performance till 2010 is forecast to be more stable.

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