



“Hartz (or Herz) for Europe or should we save or spend in periods of crisis?”

Presented by Annette Godart-van der Kroon, president of the Ludwig von Mises Institute Europe at the second Mises Conference “Economics and Bureaucracy in an Open Society” in Lviv, Ukraine.

Keywords: Hartz IV, saving, investments, production process, Austrian school, Keynesianism

Introduction:

Hartz IV¹ is the expression for a set of recommendations that resulted from a commission on reforms to the German labour market in 2002. Named after the head of the commission, Peter Hartz, it went on to become part of the German government's Agenda 2010 series of reforms, known as Hartz I - Hartz IV. The reforms of Hartz I - III took place between January 1, 2003, and 2004; Hartz IV began on January 1, 2005.

The "Hartz Committee" was founded on February 22, 2002, by the federal government led then by Gerhard Schröder; its real name was “Kommission für moderne Dienstleistungen am Arbeitsmarkt” - the Committee for Modern Services in the Labour Market. Its 15 members were led by Peter Hartz, then Volkswagen's personnel director.

The committee devised thirteen "innovation modules", which suggested changes to the German labor market system. These were then put into practice as Hartz I - IV: There can be mentioned

- Improved service for clients-Job centers
- Family friendly quick mediation
- Encouraging elder employees and Bridge system.
- New reasonableness and voluntariness.
- A combination of unemployment benefits and social assistance

¹ For more information: See Wikipedia

- Youth unemployment –securing training time
- Employment record and Bonus system for companies.
- Personal – Transparent Controlling – Efficient IT-Support
- Organizational structure, Self-organization – labor market research – Change Management Personal
- Change Management

Hartz IV has become a synonym for a policy of saving, cutting wages and reforming labour markets and other markets. That is why this term has been introduced and used in this article.

Some time ago the inevitable question rose again after so many years: should we spend or not, should we save or not during times of crisis?

Keynes and his followers proposed a politics of spending during times of crisis, while his opponents advised to save money.

The theories of Keynes were explained in “A Treatise on Money”, while F.A. Hayek opposed to the theories of Keynes in his “Reflections on the pure theory of money of Mr. J.M. Keynes”.²

In the beginning of the recent economical crisis the topic of the discussion was not so much focused on this aspect. Now the Keynesians are back and we can start the discussion all over again.

What struck me when reading one of the most important German newspapers³, that proponents of Keynes are mentioned by name, but Keynes’ opponents are hardly known.

Pro Keynes are for example the members of the European Roundtable, Larry Summers, a former economical adviser of Bill Clinton⁴, or Bradford DeLong, Dawn Holland and Jonathen Portes of the London School of Economics etc.

The opponents of Keynes’ theory are reasoning as follows: if the governments (states) are saving money, then the fear for new debts-, bank- and economical crises will disappear and more confidence in the future will be created for the consumers and as result the economy will grow again. Good examples are Denmark and Ireland who started their savings politics in the eighties of the 20st century: Denmark in 1982 and Ireland in 1987. This politics of saving resulted in periods of prosperity⁵.

² Two parts in “Economica” I August 1931: p. 270-295; II February 1932: p. 22-44.

³ “ Die Zeit”, “Sparen” 27 December 2012, p. 33

⁴Idem. Remarkable is, that the same Larry Summers advised Bill Clinton in the nineties to start saving and reducing the public debt. With success, for afterwards came a period of unknown wealth.

⁵ Of course, then Ireland and Denmark could devaluate their

However, even if the opponents of Keynes' theories, a.o. Ludwig von Mises and Hayek, are not mentioned by name, they are well-known enough, for both von Mises and Hayek etc. were representatives of the Austrian School. They were prominent defenders of savings and had good arguments against Keynes and with good reason. Their ideas have been cherished and worked out by a new generation of Austrians, like Huerta de Soto, Bagus a.o.

Let us first compare the economic crisis in the 30ties and the recent one.

There are several theories⁶ about the causes of the crisis and how to fight it. There is the theory of the scarcity of capital and the theory of under-consumption, supported by Hoover, Ford and Keynes⁷. This is a very important aspect to take into account. Hayek also indicated the fact of a huge propaganda being used to spread this theory of under-consumption, especially in the English-speaking countries⁸.

This theory of under-consumption implies, that because people save their money the spending / purchasing power of the consumers will not be enough to buy the goods coming on the markets at a profitable price.⁹

This theory is supported by Foster, Catching and Keynes. Since "progress requires a constant flow of new money to consumers", it "follows, that the Government should borrow and spend money whenever the indexes show, that the needed flow of money will not come from other sources"¹⁰.

In fact, in order to regulate and compensate the fluctuations in the demand of consumer goods, and to divide the jobs in the public sector, Foster and Catchings recommended in "Progress and plenty"¹¹ the collection of statistical data and in order to manage that, the appointment of a "Federal Budget Board was advised"¹². These words have been

currency, a policy not possible in the Euro zone anymore.

⁶ For the moment I am only discussing the theories dominant in the thirties of last century.

⁷ See for this distinction the lecture of F.A. von Hayek, "Gibt es ein Widersinn des Sparens?" Vienna Julius Springer 1931, p. IV

⁸ F.A. von Hayek, "Gibt es ein Widersinn des Sparens?" Vienna Julius Springer 1931, p. 2

⁹ F.A. von Hayek, idem p. 1

¹⁰ Idem, p. 17-18. The quotation is from Keynes, Foster and Catching

¹¹ W. T. Foster und W. Gatchings: „Progress and Plenty. A Way out of the Dilemma of Thrift", copied from „Century Magazine", Juli 1928 (together with the essay „The Dilemma of Thrift") and not to be confused with the book with the same title of these writers. The „Road to Plenty" has the same quoted statements as in „Progress and Plenty". (translation by the speaker)

¹² Idem p. 17-18. It is a very old plan to re-organise jobs and reduce

written decades ago and are applicable again to the present situation.

Von Mises did not accept to make a difference between circulating and hoarded money, so he did not accept the theory (supported by Keynes and his followers), that in case of hoarding, the money will be withdrawn from the payment traffic and consequently will lead to depression¹³.

Von Mises shared on the contrary the ideas of Adam Smith, who had the view, that saving money would lead to economic growth.¹⁴

In fact von Mises and Hayek were followers of the Micro economic theories, while Keynes and his followers started from a Macro-economic approach, already used by the Mercantilists. Macro-economics study the aggregated entities or collectives, like consumption, investing, national income, import, export, employment etc, while micro-economics study the economic behavior of individual persons and the resulting price formation¹⁵

Hayek's reproach was, that for Keynes, saving was equal to investing ($S=I$). Another mistake made by Keynes, was that he used the same word for investing (the act) and investment (the result), nl. investment. Hayek also reproaches Keynes for not distinguishing the production of investment goods and the production of consumption goods. Keynes discusses the production process of the consumption goods as a whole, instead of looking at the different production phases. Hayek on the contrary distinguishes several production phases¹⁶. For that purpose he compares the different phases of production with the opening and closing of a fan. Both were fascinated by the question how the depression of the thirties of the last century could occur.

For that reason Hayek emphasized production and capital, while Keynes emphasized consumption, saving and investing¹⁷. Keynes could say: "Booms and slumps are simply the expression of the results of an oscillation of the terms of credit about their equilibrium position"¹⁸. In his "General Theory" he abandoned the theories of the Classical School concerning the (full) employment and advised Government spending which led to a deficit, fiscal measures (that is mostly increasing of taxes) and interest policy.

the unemployment rates in times of crisis.

¹³ L. von Mises "Human action", 1998, p. 402

¹⁴ H. Landreth, "History of economic theory", Miami 1976, p. 435 with a reference to Adam Smith' "Wealth of nations", p. 321.

¹⁵ H. Landreth, idem p. 507-509

¹⁶ See also F.A. Hayek "Prices and Production" (1931) New York, 1978, p. 78

¹⁷ F. A. Hayek, idem and J. M. Keynes "Treatise on Money", London (1930) 1978

¹⁸ Keynes "Treatise on Money", London (1930), 1971, Vol. I p. 165

Summarizing the theories of Hayek and Keynes concerning the crisis, the following:

- Hayek blamed the crisis to a savings deficit,
- while Keynes blamed the crisis to a surplus of savings.

This concern about the crisis was especially important for the employment policy (and here comes Hartz IV in the discussion).

Lowering the wages of the workers was not an option in the thirties of the 20th century (nor today), so Keynes proposed to lower the real wages via (a constant) money devaluation. Especially this constant government interference and its consequences resulted in a disastrous economic situation.

In the seventies and eighties of the last century the results of the continuous inflation and the employment policies was very obvious and as a result the politicians returned to a more savings policy. Keynes and his followers were convinced that the crisis could be overcome by an inflationary policy.

Mises and Hayek thought, that this same inflationary policy was the cause of the crisis.

Von Mises described this process as follows:

"The first stage of the inflationary process may last for many years. While it lasts, the prices of many goods and services are not yet adjusted to the altered money relation. There are still people in the country who have not yet become aware of the fact that they are confronted with a price revolution which will finally result in a considerable rise of all prices, although the extent of this rise will not be the same in the various commodities and services. These people still believe that prices one day will drop. Waiting for this day, they restrict their purchases and concomitantly increase their cash holdings. As long as such ideas are still held by public opinion, it is not yet too late for the government to abandon its inflationary policy. But then the masses wake up. They become suddenly aware of the fact that inflation is a deliberate policy and will go on endlessly. The crack-up boom appears. Everybody is anxious to swap his money against "real" goods, no matter whether he needs them or not, no matter how much money he has to pay for them. Within a very short time, ...weeks, ...days the things which were used as money are no longer used as media of exchange. They become scrap paper. ... That is what happened with the Continental currency in America in 1781, with the Mandats territoriaux in 1796 and with the German Mark in 1923".¹⁹

The boom is then a period of wrong investments, the crisis arrives when

¹⁹ L. von Mises "Human Action "Ludwig von Mises Institute, USA 1998 p. 424-425

the consumers try to restore the aimed situation and the depression is the recovery process.²⁰

The situation at the moment in Europe:

Despite all the protests against the savings politics, there is hardly any savings being done²¹:

- The unit labor costs have increased in the first decade of this century in all the Euro-crisis countries, while in the meantime these costs have not stirred in Germany in the same time. The wages have increased faster than the productivity and have made the goods, that "Club Med" has to sell to the world market, increasingly more expensive.
- The consequences are: unemployment, deficits, liabilities-that ugly Trio, that threatens the Mediterranean countries (and Ireland) with bankruptcy.
- The good news is: in Ireland, Greece and Spain, the labor costs are falling. These countries are on the road to recovery.
- The bad news is that in Italy and France the costs are increasing again. Even worse results are, that the people have voted against Labor Market Reforms and have voted against saving anyway. In France the people voted for Hollande, in Italy 25 % for Beppo Grillo plus Berlusconi.. The "Economist" called it "The time-bomb at the heart of Europe".²² "France is slowly heading towards a crisis", according to John Peet²³. The share of the industry to create wealth has shrunk to 12, 5 % - less than in Spain or Greece. We all know more or less the numbers: one on 5 people in France is a civil servant or is in public service. The public spending accounts for almost 57% of the national output, the public debt stands at over 90% of GDP (and rising).²⁴ As soon as an entrepreneur has more than 49 employees it tumbles in a swamp of regulations, higher taxes etc. The choice is quickly made: the enterprises prefer to stay small.

A dangerous omen: The average wage in Europe is 46 Dollar (per hour) vs 30 Dollar in the USA. The Italians do not want to shake the labor market, because of the high youth unemployment. The Italians did not

²⁰ M. N. Rothbarth, "America's great depression", Kansas City 1963 chapter 1, p; 14-17 and 28-29

²¹ Die Zeit, no. 11 March 7, 2013 Josef Joffe in "Euro-Krise, Teil 2" p. 14

²²France is slowly heading towards a crisis" in "So much to do and so little time," The Economist November 17th, 2012 p 3.

²³ Idem

²⁴ "France is slowly heading towards a crisis" in "So much to do and so little time" The Economist November 17, 2012 p 3-16.

save at all on the bloated public service. They saved on education and research, which are the sources of future competitiveness.

- In fact Germany and “Club Nord” can impose on the smaller countries, but not on Italy and France. These countries have to save themselves or the Euro is going to explode indeed.
- The last good news is that democracy (until now²⁵) has not failed yet. That is not a self-evidence, because in the thirties of the 20th century the political climate changed dramatically into an extreme leftist and extreme rightist movement, which in the end did lead to the second World War.
- As for the UK, the Economist advises to invest in infrastructure and education

I. What can be done in Europe?:

In the well-known newspaper “Die Zeit”²⁶, I could read an article on “Wachstum für die WG”, suggesting the introduction of the Hartz IV for Europe. This program was successful in Germany in the long run: after 5 years the economic situation in Germany was brought into line-under rather good conditions²⁷. “Agenda 2010 does not deserve all the credit for Germany’s success, but Germany would be foolish to ignore a real achievement-and an important lesson”.

What is going on right now in Europe, the USA and elsewhere, is not only an economic crisis, but also an oil crisis and a currency war, between the USA and China and the USA and the EU.

The situation is quite similar to that of the seventies and eighties of the last century. Then there was also a currency war, an oil crisis and economic disorder raging. Protests and strikes were the order of the day.

What could be done? Pissarides, Nobelprizewinner of 2010 (and Keynesian), who was the guest of Solvay Schools in Brussels, explained to the students of the VUB in Brussels, the following could be done:

Unemployment policy. Belgium (and also France) for example protects the unemployed too much and the same can be said about the EU concerning its unemployment policy. The activation policy is too passive

²⁵ Although there are extreme right-and leftwing movements coming up, like the the (Greek) Golden dawn)

²⁶ Die Zeit, “Wirtschaft” dd 10 May, 2012 p. 23

²⁷The Economist “Wunderreform”, March 16, 2013 p. 26-28. Even “Die Zeit” admitted that at that time the reform was necessary. “Zehn Jahre Agenda 2010. Politik entfesseln. Schröders grosse Reform hat die Bürger aufgerüttelt” March 14, 2013 p. 1

and –above all- there are hardly any conditions linked to the unemployment benefit.

- 1) The **housing market** is not flexible enough and the taxes are too high. That is the reason why people do not move. This problem also exists in the USA nowadays, where formally people just moved from one place to the other, to where the job was. Now the vacancies grow, while the unemployment does not decrease, because of the housing market fell into neglect. People can not sell their houses because of this crisis, which produces stagnation.
- 2) **Costs necessary to finding a job.** According to Pissarides, the employer and the companies can not easily find each other. Certainly not, when people get enough unemployment benefits. Then they certainly wait longer before accepting a job.
- 3) **Labor Unions.** In the countries, where Labor unions are too powerful, it is more difficult to get a balance between vacancies and persons looking for a job. Germany-for example- had the possibility to reform the labor market after Hartz IV. The south-European countries should make their labor market more flexible and the unemployment benefits should be reconsidered after a year. In Greece and Italy for example the labor markets are not so much dominated by labor unions, but by “who knows who”, a sort of nepotism.
- 4) **Too high taxes**, which is linked with the left-wing programs. In Belgium for example the taxes on work are far too high and there is still the index, by which raising prices result in raising incomes.
- 5) **A single European market** for services would help. As put in the “Economist” of June 1st 2012: ²⁸ “More ambitious ways of boosting growth, such as the completion of a single European market for services, are sadly not even on the table”.²⁹ Imagine what a chance that would be for the Spanish and Greek young people! We are talking about services, not work in general, but even that scares off.

This proposal does not mean, that the unemployed persons should feel neglected or that a policy of “hire and fire” should be pursued. A certain policy to retrain people and to prepare them to a working life again, could be the best solution. It is well-known that people who are not in the labor process for a very long time do not get into the labor market again or with great difficulty.

In fact each country should try to find their own solution. There is no possibility of a uniform measure. For example the Netherlands have

²⁸ The Economist: “Europe’s choice”, May 26- June 1, 2012, p. 11.

²⁹ The Economist: “Europe’s choice”, May 26- June 1, 2012, p. 11.

already a very flexible labor market. Their problems are not to be found in that field.

- 6) **Eurobonds**³⁰. That is a new possibility. The “Economist”³¹ seems to be rather pro the idea of European bonds.

There are **advantages**: the first and most prominent advantage is, that the bond market will be much bigger and therefore less vulnerable if the bonds are edited by all the 17 members of the Euro zone. There would be dealt with a lot of money, which would be much more attractive than the national bond-markets. In short: the Euro could survive then.

The **disadvantages** are:

- **first**, that we would make the same mistake as in the beginning of the creating of the Euro zone: pretending that we can speak of a single market and the countries who have spent most and have to pay back their debt, can continue to borrow money in a cheap way. There is one guarantee: each country can only finance their debt for 60% of its gross national product.
- **Second** disadvantage: it would be less attractive for investors, since the debt on top of the 60 % would mean a higher interest.
- **Third**: in case the Eurobonds would be edited, the pressure to reform in the Southern States would have been less urgent or even absent. Exactly because Angela Merkel hesitated so long to accept the rescue measures, she pushed the countries with a high debt to reform and thrift³².
- **Fourth**: this objection is heavier: the euro-bonds are incompatible with the European treaties. That has been the conclusion of the German Constitutional Court. Even if the concerned treaty would be changed, there will be the problem of the countries who are not members of the euro.

Perhaps those euro-bonds are probably for later.

Let’s start with a European version of a Hartz plan. We can see by the result of Hartz IV, how prosperous Germany became, despite the inevitable disadvantages.

Reforms on employment policy, reducing the role of Labor Unions and lowering taxes are necessary, as also economic measures and savings, but also stimulation and reforms on essential issues like R&D, Education, Infrastructure, etc. could stimulate European Economics.

³⁰ De Standaard “Gezocht: tegengif tegen crisis” dd 25-5-2012, p. 36-37

³¹ “The Economist “Europe’s choice” May 26- June 1, p. 11-12

³² “Alles bleibt anders”, Die Zeit September 12, Page 3 and “Merkelnomics” in die Zeit ,dd September 5, p. 34

Cutting wages, reducing the Public Debt and limiting the amount of civil servants is however necessary. As for the European budget: bravo, that the politicians dared to reduce the budget, but keeping 40 % of the budget for CAP is far too much. However that is the holy cow, no-one can touch it (yet).

Also keeping the interest rate at an artificial low level, just to discourage people to save money, is not a good policy. It has as implication that savers and the banks are desperate to find money. Because the interest is so low, they can not earn enough money.

I would like to end with a slogan "Wer ein Herz hat für Europa, wählt für Hartz" or in English: "He who has a heart for Europe, votes for Hartz"