Just when Germany’s mortgage debt started to decline seriously in the year 2000, the Italian one began to rise steeply and similar trends can be observed in house prices. At the same time, German export surpluses began to grow to unprecedented levels, while mortgage- and wage-repressed domestic demand left the housing and construction sector starving. Not surprisingly, we find a negative cross-sectional association between the importance of exports and construction in OECD countries from the 1980s onwards. As we argue in the discussion, construction- and export-driven economies require systematically different macroeconomic conditions. Construction, for instance, thrives with low interest rates, higher inflation, and relies almost exclusively on wage-driven domestic demand. Conversely, exports require stable inflation and, if possible, undervalued real exchange rates. For Germany, exports became cheaper due to its wage repression. One the one hand, the inclusion of structurally heterogeneous economies in one monetary union could therefore be seen as problematical, as macroeconomic policies cannot address contradictory demands. On the other hand, it could also be an insurance-mechanism, as construction cycle downturns are no longer as correlated between countries as they were previously.

1. Construction: A Neglected Core Component of Advanced Capitalist Economies

In the shadow of economic sectors as predominant as manufacturing, finance, and various services-sector branches, contemporary Political Economy has neglected core components of capitalist economies. Among those sectors left behind, the construction sector stands out not only with regard to its contribution to GDP, but also with regard to its contribution to employment (especially for low- and medium-skilled workers). It, moreover, contributes largely to the formation of the physical capital stock of modern economies, even if its added-value contribution varies significantly across OECD economies.
When we speak of construction, we distinguish it from the debates on housing and especially housing finance which have gained overwhelming attention since the dawn of the global financial crisis in 2007/08 (Schwartz and Seabrooke 2008b). These debates usually discuss aspects of wider financialisation, such as the effects of financial (de-) regulation, product developments in the financial sector for the purpose of insurance, hedging, and speculation, as well as general macroeconomic steering actions to create GDP growth in a globalising economy through capital attraction (Schwartz 2009, Fuller 2018). However, very few studies are actually interested in the real economy output of activities in the housing sector, which should accompany the rise of housing finance (Malpezzi and Maclennan 2001).

We want to stress the fundamental role of construction for any governmental gross fixed capital formation. Since governments in advanced capitalist economies usually do not own factory productions, they spend their investment necessarily not on machine goods, but largely on the production of infrastructure and (social) housing. They are thus the principal clients of the construction sector. The sector refers to all parts of an economy that are concerned with the construction, maintenance, and utilisation of buildings and other structures (i.e., dwellings and infrastructure), and the adjustment and change of building stock through construction activity. The stock of dwellings matters not only with regard to its absolute number, but also with regard to the level and development, that is, the cumulated (building) assets as well as the residential capital stock (Rußig, Deutsch, and Spillner 1996, 12f., Fleming 1988, Gornig and Michelsen 2017).

Yet, compared to other sectors, the construction sector shows certain industry-specific qualities. One of these is that the nature of the (building/dwelling) product demands for mostly individual solutions in the form of made-to-order production. This reduces repeatability, mass-standardisation, and thus continuous productivity increases within the sector. Moreover, the multitude of sites on which firms have to operate as well as the number of trades that are involved both within a firm as well as across construction projects create complex, industry-specific co-ordination problems. Furthermore, due to the close bond between producer and buyer, the mostly regional nature of the construction market, and the necessity to form consortia and small companies which act as suppliers to these trades limit competition and customer diversification severely. Last, high capital requirements and the longevity of production processes create a high sensitivity to changes in the monetary, financial, and regulatory environment.

Consequently, the different sectoral logic also promotes different macroeconomic repercussions. For reasons of space, we will focus only on two macroeconomic policy aspects of construction activity. First, the construction sector serves as a kind of natural buffer to macroeconomic shocks. Due to its dominant role as an investment goods industry in conjunction with a higher general level of volatility in investment compared to general demand, the construction sector faces additional vulnerability to changes in the general economic climate. Thus, the severity that booms and slumps have on construction activity goes hand-in-hand with a higher likelihood of adverse effects on the industry during these business-cycle events.

In contrast to manufacturing, a loss of demand in the construction sector usually represents a severe short-term threat to the regional business models of firms. On the one hand, although production lasts, on average, over a longer period of time, the dependence on long-term finance represents a threat to payment and fulfilment of contractual obligations both on the side of customers as well as on that of the construction firms itself. Hence, construction firms cannot simply “wait and see” during crises, but are under constant threat of insolvency despite full order books. On the other
hand, a reduction in employment – which is something necessary during times of reduced order numbers – is difficult to accomplish as a construction firm needs to retain various trades and skills in order to maintain its operational capacities. This retention of excess labor capacities in this “populated” sector prevents the immediate severe increase of overall unemployment in an economy.

Only in the case of a lasting recession and further reduced order numbers will small construction and specialized supply-trade firms face bankruptcy and thus ramp up unemployment overall. Hence, the delay of unemployment due to the necessity to retain intra-firm skills makes the sector a buffer for macroeconomic shocks and a bearer of significant adjustment costs of business-cycle downturns in general.

Second, the construction sector is a core playing-field for governments wanting to engage in macroeconomic management, because a government’s capacity to steer economic activity through investment depends on its access to the sector. For one, it is the easiest way to increase overall economic activity. An activist government can use the sector (in so far as labor capacity is available economy-wide) to enlarge positive employment and growth. However, a government willing to enforce construction activity has to provide conducive macroeconomic and monetary conditions (e.g., lower capital costs and increased capital availability in the domestic economy to be spent on housing and infrastructure). Yet, in so doing, it faces negative consequences for the overall export competitiveness which profits from quite different conditions such as a comparably lower inflation rate and unit labor cost developments (that result in an effective real exchange-rate under-valuation with regard to trading partners). Hence, construction companies benefit from the opposite monetary conditions than export-oriented manufacturing firms.

This, in turn, has consequences for the national growth strategies and the development of national housing regimes. If a government wishes to facilitate a national strategy of export-orientation, it has to curtail both the inflationary effects of construction activities as well as the overall size and contribution of the sector itself. On the other hand, due to its role for the active domestic macroeconomic management, one can attribute the promotion of construction activity to the domestic consumption-led growth model (Baccaro and Pontusson 2016). Since national housing and ownership patterns vary significantly across OECD countries for historical reasons (Kohl 2017), a government is unable to change the general role of construction activity in the short term. For instance, a government that encourages property ownership relies on the availability and the provision of new housing stock to make this model work.

Given the difference in the underlying monetary conditions as well as the importance that governments attribute to construction, there is an overall, distinguishable effect on the macroeconomic performance of an economy and, thus, potentially on the development of macroeconomic imbalances. For the discussion about European macroeconomic imbalances, this means that the construction sector is at the core of the origins of the North-South divide.

2. Diverging Housing and Construction Trajectories in Southern Europe and Germany

The differences in housing and construction between Southern and Northern Europe are not of recent origin. Traditionally, Southern European housing and construction regimes have been characterised as distinct from Northern European countries, and, even internationally, have been exceptional along a variety of dimensions (Castles and Ferrera 1996). First of all, all Southern European countries have developed into high-homeownership countries, comparable only to the completely privatised housing regimes of Eastern Europe and largely surpassing even the traditional Anglo-Saxon high-homeownership countries (Stephens, Lux, and Sunega 2015). In
the German-Italian comparison, the homeownership gap amounts to 30 plus percentage points, as shown in Figure 1.

Figure 1: Homeownership rates in Germany and Southern Europe

![Homeownership rates in Germany and Southern Europe](source: Kohl 2017)

The flipside of these differences in tenure is, of course, that the rental stock is much larger in Germany than in Southern Europe. One reason behind these diverging developments is that the regulation of private rental relations was historically much more intense in Southern Europe than in the North (Weber 2017, Kohlodilin 2018). All countries started rent regulation and tenant protection during the two World Wars. Yet, Southern European countries were both slower in de-regulating after the wars and more likely to re-introduce hard rent freezes when rent inflation risked endangering the social peace. One potential cause for these social policies via consumption price stops was the lack of functioning and effective wage co-ordination in the South (Höpner and Lutter 2018). A direct consequence of strong rent regulation, however, was the increasing conversion of private rental units into owner-occupied ones and a flight of landlords from this market segment. When Italy started its de-regulation of rent prices again in the 1980s, large conversions

had already taken place and Italy had become a country of homeowners.

A second dimension is the kind of homeownership which has mostly grown in the form of condominium or apartment ownership in Southern European countries. Legal arrangements of privately owning parts of a building on the same plot of land were absent in German Civil Code between 1901 and 1951. After being legally introduced, owner-occupied flats remained a very exceptional form of tenure until the late 1970s (Kohl 2017, Chapter 4). Even nowadays, flats that are available for purchase under condominium ownership law are still a minority in German cities, albeit a growing one. Much to the contrary, countries following the French Civil Code have either always known a sort of condominium ownership or introduced an updated form of it much earlier in the twentieth century. In Italy in the 1930s, still under Mussolini’s policies in favour of an ownership society (Bortolotti 1978), most of the new constructions were apartment buildings with flats in condominium ownership (Di Feliciantonio and Aalbers 2018). This mostly urban phenomenon makes Southern European countries’ housing stock appear as an exception among OECD countries (Hoekstra 2005) and creates crucial differences in how the urban fabric works. German major cities, for instance, are populated by majorities of (private) tenants, whereas Italian cities have long since moved to homeowner majorities. Given tenure and house-price related voting patterns (Ansell 2014), this can be a crucial political difference as well.

A third dimension of a South-Northern divergence is in the sector of new constructions. While all countries saw a similar post-war re-construction boom which peaked in the 1970s, the subse-
A final divergence was in house price and mortgage developments, as presented in Figure 3. While Southern European countries witnessed continuously rising real house prices over the last five decades, Germany’s house prices stagnated until the crisis of 2007, only to take off in 2010 when house prices started to decline again in all Southern countries. The German house prices, in relation to 1990, have even overtaken the Italian development again in recent years. House prices are, of course, closely related to mortgage indebtedness. Traditionally, Southern European economies were characterised by family-owned forms of housing finance. Rather than relying on bank credit, *ex-ante* savings and within-family credit were supposed to fill the gap left by a still underdeveloped social system (Schwartz and Seabrooke 2008a, Blackwell and Kohl 2018). Although elements of this system might still persist, the recent mortgage-debt growth in Southern European countries reveals a changing picture, as Figure 3 shows. Germany has had a higher mortgage debt per GDP until the late 1990s. But with the end of the re-unification boom, all Southern European economies overtook Germany in terms of institutionalised mortgage debt. This was driven by house price increases, but also by banks relying more on external (foreign) capital and new securitisation techniques.106

---

105 Numbers use housing completions. If not available, housing starts or permits were deflated by the first lag times 0.95 of permits issued. The displayed deflated Greek permit-based numbers still reflect speculative exaggeration before the crisis 2007 and need to be interpreted accordingly.

106 Spain being a prime case for the latter development (van Gunten and Navot 2016).
In Germany, by contrast, the construction sector has been running at full capacity and still not producing sufficient (affordable) urban housing to fill the run-up shortages or to drive down urban prices (Voigtländer et al. 2017).

3. Discussion: What are the implications of different housing/construction regimes for the broader political economy in Europe?

If it was not the construction sector that most employees and domestic credit was allocated to in Germany, where did the factor input go? Germany, much more than other Northern European countries, developed into an export-driven economy (Baccaro and Pontusson 2016). While tendencies of export-orientation or currency under-valuation can be traced back to the post-war period (or even earlier) in the German case (Höpner 2018, Scharpf 2018), it was not until the last three decades that Germany produced persistently high and even growing exports surpluses. This occurred at the same time that its construction sector and mortgage debt declined, while Southern Europe produced a mortgage-driven construction boom. Not surprisingly, OECD countries display a negative cross-sectional association between the importance of their export and their construction sectors in the economy, with Germany and Sout-
hern Europe choosing alternative strategies along this negative association.

The fact that countries usually do not have both - a thriving export and a booming construction sector - has to do with the different macroeconomic environments that the two sectors require in order to prosper. The construction sector works best in times of higher inflation and lower interest rates. Construction and particularly the purchase of houses requires cheaply available capital, and higher inflation makes the burden of mortgage indebtedness less onerous. It also motivates people to switch from financial to the intangible asset of housing. The mostly manufacturing export sector in the economy, by contrast, requires low inflation through higher interest rates in order to have reliable exchange rates, i.e., expectable prices both of goods imported and of goods sold abroad. Finally, on the demand side, the construction sector almost exclusively relies on domestic demand, whereas the export sector, by definition, is much less in need of domestic demand. Much to the contrary, it emphasises wage restraint to guarantee the competitiveness of goods exported abroad. Therefore, one can understand the worry of the Bundesbank in 2017 when discussing the potential negative macroeconomic consequences of an ongoing house-price boom in Germany (Bundesbank 2017).

Whatever initiated the divergence along different construction/export trajectories in the 1980s and 1990s, the different functional requirements of dominant sectors in conjunction with social blocs defending their interests acted as reinforcing mechanism to keep countries on the track (Baccaro and Pontusson 2018). A comparative look at party manifestos (Kohl and Spielau 2018), for instance, reveals that OECD countries with a large construction share in the economy, are associated with all manifestos that are more likely to defend infrastructure and housing investments, independently of party cleavages. In countries with large export sectors, by contrast, party manifestos are rather associated with the defence of free trade across party families. Thus, once construction or export-dominated regimes are in place, they tend to produce their own stabilisers.

In international perspective, the two different trajectories of economies can even help stabilise each other, as when export economies simultaneously export their surplus capital to lend it to the domestically consuming construction economies (Fuller 2018). Having countries with asynchronous construction cycles in a monetary union, however, can also be a blessing in disguise, because it could act as a risk-sharing mechanism. When construction is down in one economy, it could be compensated for by an upturn in another one. The risks of a construction-cycle and hence business-cycle downturn could thus become uncorrelated and work as a sort of insurance, with one economy absorbing the capacities and demand of the other. Yet, the extent of the insurance-mechanism might be limited, as the regional character of construction reduces the easy transferability of workers, firms, and building traditions from one country into another.

This rosier insurance mechanism could also be thwarted by the inability to adjust the macroeconomic steering of inflation and interest rates to nationally different construction markets. This meant in particular that the common European interest rate in the early 2000s was too restrictive for the German construction sector, where household debt was decreasing and construction output down (Scharpf 2018). Conversely, Southern European economies faced house-price, construction, as well as mortgage booms, and thus the risk of an overheated economy followed by an even deeper recession. Therefore, the current struggles within the Eurozone can also be interpreted through the lens of structurally different economies: some of them relying on debt-financed domestic demand with large construction sectors, and others relying on wage- and credit-restraint domestic demand in favour of a growing export sector.

108 See Schelkle for a related argument (Schelkle 2017).
109 One can compare this to times when urban construction cycles had not been synchronised in national economies and provided for regional balancing.
References


