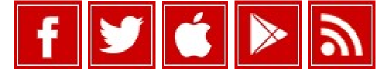

How the German Economy Is Falling Behind

With growth deteriorating, the day of reckoning for Germany's economic policymakers is approaching fast.

By Michael Heise, June 5, 2019

Credit: Mathias Liebing
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The German economy is lagging in its growth performance. Even in the group of the euro countries, not exactly a strong growth league to begin with, Germany has fallen to the lower GDP growth ranks in 2018 and 2019, just ahead of Italy.

The French economy, often falsely belittled by Germans, as well as the British economy, which has been battered by Brexit, are growing faster than Germany, albeit only slightly.

For now, the weakness of growth in the German economy has not yet become a big issue in the public debate in Germany, mainly because of still rather strong employment data and low levels of unemployment.

Many jobs are being created primarily in the service sector, which thrives on consumer spending. However, it is only a matter of time before the downturn in manufacturing that has been taking hold for about a full year now, will negatively affect the other sectors.

Takeaways

Both the French economy -- often belittled by Germans -- and the British economy -- which has been battered by Brexit -- are growing faster than Germany.

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Despite concerning trade and investment data, German policy makers are reluctant to address unpopular issues such as taxes or non-wage labor costs.

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US-China trade war

German goods producers have been hit by the slowdown and lately also by the contraction of world trade. The lack of trade dynamics has various causes, with the tariff and broader trade policy conflict between the United States and China ranking prominent among them.

By itself, Germany can do little to heal the weakness of global trade. Therefore, it should do all it can to create more internal dynamism of the German economy through investment and innovation.

Unfortunately, this area of economic activity has been neglected for years. As a result, Germany is losing attractiveness as an investment location and capital is being exported on a large scale. A series of factors come into play.

In addition, Germany's famed labor productivity has hardly risen at all since 2017, while wages and non-wage labor costs are rising faster than in other European countries. In the manufacturing sector, the level of wages has long been very high by international standards. That is also true for the level of taxes.

Following tax reform measures in other countries, Germany is once again among the industrialized countries with the highest level of corporate taxes and tax burden imposed on small and medium-sized incomes. On top of that, very high

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average energy prices also keep industrial companies from expanding in Germany.

This triad of high wages, high taxes and high energy prices would not have to be a matter of concern, if companies operating in Germany could rely on first-class infrastructure as well as a highly qualified labor supply that would justify those high taxes and business costs. But these traditional strengths of the German economy have been eroding in recent decades.

Half measures won't work

It will take some far-reaching political measures to improve the current situation in which the business sector finds itself. And yet, despite all the problems and concerns that are piling up and visible in the trade and investment data, German policy makers are reluctant to address the "old" and unpopular issues such as taxes or non-wage labor costs.

Any meaningful form of tax reform that could achieve beneficial results is rejected out of hand by referring to scarce resources. This is all the more surprising as tax revenues had been rising to record levels and spending on public consumption increased by rather large bounds.

While the long promised abolition of the temporary "solidarity" surcharge, passed at the time to finance the economic integration of the former East Germany into the Federal Republic, keeps getting pushed back.

Simply put, additional public expenditures seem more attractive politically. The biggest spending decisions since the new federal government was formed in 2018 concern further pension increases, the expansion of family benefits and big structural support for regions affected by the end of coal-fired power generation.

Whatever one thinks of these choices, one fact is beyond debate: Such expenditures do not strengthen future growth potential, even though that is urgently needed to support the welfare state in the future.

In conclusion, as much as Germany's politicians want to avoid acknowledging it, policies for growth must urgently address the hard facts of deteriorating business conditions.

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