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Author:
Marta Götz

German economic growth during the time of crisis

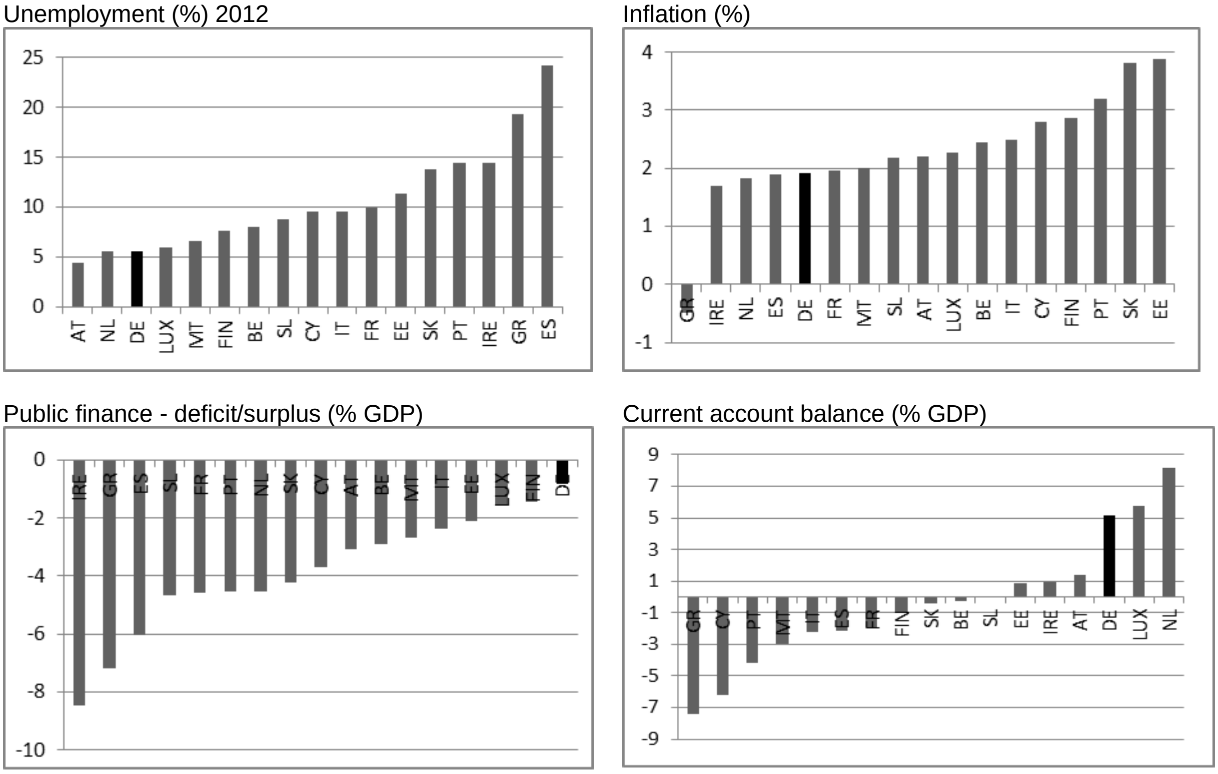
The issues related to economic growth become especially important during the time of crisis. On the one hand, growth is the only way to overcome recession and provides the opportunity to break free from the economically destructive spiral of deflation. It helps to improve the most important economic categories, such as the relation of debt to GDP, at the same time enabling many countries to return to the path of sustainable development and ensuring the favor of financial markets, whose ruthless evaluation often aggravates existing problems. On the other hand, the turbulences cause by the crisis, including the spectacular slumps in economies such as Ireland, being one of the model tiger economies, make one reconsider the previously applied approach to and perception of economic growth as a constant and systematic increase of GDP. They also make worthwhile the discussion concerning the actual, sustainable factors and sources of economic growth. This is undoubtedly an issue which should be carefully analyzed, after the world manages to deal with the most urgent problems, by both theoreticians and practitioners of the economic life. Publications, also German ones, such as *Exit. Wohlstand ohne Wachstum* by M. Miegel or *Das Ende der Welt, wie wir sie kannten* by C. Leggewie and H. Welzer, as well as initiatives, including *Beyond GDP*, *Glücks BIP* or *Zintegrowany indeks pomyślności* seem to be a good start for the discussion concerning the subject.

When discussing growth and the factors determining it, one has to distinguish two main approaches – "supply-based", focusing on the function of production, and "demand-based", referring to the business cycle. The traditional macroeconomic approach distinguishes production factors, including workforce, real capital and land with its natural resources, as well as productivity evaluation of all these factors. One of the most popular tools to research economic growth from this perspective is *growth accounting*. It enables the decomposition of growth to its components – physical capital, human capital and the so called *total factor productivity* (TFP), which is the measure of immaterial technological development. Growth accounting is an empirical study based on establishing the degree to which economic growth results from the changes in the outlays of measurable production factors and the level of technology. In most analyses, especially "political and economic", the approach to growth is "demand-based", because it is focused on such elements as domestic consumption, export volumes, investment activity of companies or government sector outlays. Economic growth is then estimated on the basis of four main components: foreign trade, private consumption, investment and public spending. It makes it possible to 1) establish the contribution of export (positive or negative) to economic growth, which depends mainly on external situation (foreign demand) and, to a lesser degree, on currency exchange rates, 2) assess the role of private demand, which depends mainly on the income of the population and the situation on the job market 3) establish the importance of investment outlays, mainly the actions aimed at increasing the production power of the economy, which are forecasted on the basis of company results and credit costs.

These two approaches can be supplemented by the evaluation of the general economic condition, the frames within which growth is generated. The macroeconomic condition of a country can also be briefly outlined by means of MSP – the macroeconomic stabilization pentagon. This concept includes, apart from GDP growth pace being the synthetic expression of the economic growth increase of a country, the following elements: unemployment rate measured as the ratio of the number of people employed to the workforce reserves capable of work; inflation rate (consumption price index) as percentage; the relation of budget balance to GDP as percentage and the relation of the current account balance to GDP as percentage. The components of the pentagon enable quick and easy view of the current condition of a particular economy and the general macroeconomic condition of a country.

With 5.6% unemployment level, Germany is on the good third place in the eurozone when it comes to the situation on the job market. The inflation of 2% is also one of the lowest among the countries of the eurozone. It seems, however, that it does not stop the Germans to bandy around the argument concerning the decreasing price stability as one of the main future economic dangers. With a deficit not exceeding 1% of GDP, Germany is undoubtedly a leader when it comes to the condition of public finance. The strive to achieve a balanced budget results not only from the general EU regulations implemented, among others, by the Fiscal Pact, but mainly the accepted restrictions including the so called *debt break*. At the same time, one of the highest current account surplus in the eurozone, over 5% of GDP, confirms the competitiveness of German export.

Basic macroeconomic categories – eurozone countries in 2012



Source: MFW, World Economic Outlook Database, April 2012 update.

The improving economic situation in the job market gives hope that German households will not limit their spendings in reaction to the possible changes in the fiscal policy. However, potential danger is associated with the likely weakening of the global economy caused, among others, by the increasing prices of food and energy. At the same time, an analysis prepared by the ZEW center in Mannheim, commissioned by the Ministry of Finance, points to the fact that the famous German export surplus will disappear completely about 2030. This will happen because of negative demographic changes. The shrinking and aging society will use the previously accumulated savings instead of investing. Moreover, the lack of people in productive age will make it impossible to generate an appropriate export offer. From 2033 onwards, Germany may be dependent on the influx of foreign capital because of insufficient domestic means.

On the basis of aggregate data, it should be stated that the macroeconomic situation of Germany, when compared to other countries of the eurozone, is very good. Therefore, the conditions for economic growth can be considered favorable. This is rewarded by financial markets, which direct to Germany both the means of large investment funds (real negative interest of the German bonds) as well as individual depositaries (withdrawing funds from South European banks and transferring them to Germany). Being the so called *safe haven*, Germany can count on the constant trust of markets, but also the growing aversion (hostility?) of other countries, mainly the societies of Southern Europe suffering because of the fiscal consolidation policy promoted by Berlin. Even though some claim that the Germans are "strong with the weakness of others", one cannot forget that this weakness can hold back the German economy as well. Therefore, even if it was possible to use the constant demand for the competitive German products in, among others, the *PIGS* countries, the forced solidarity with them during the crisis, for example in the form of guaranteed ESFS loans, may show the other side of this "success".

The calculations of OECD and MFW indicate that the German economy is one of the least affected by the crisis. It has the lowest "*Proust index*" – the so called lost time – and it needs the shortest time to return to the condition from before the crisis. According to the calculations of the Council of Experts for the Evaluation of General Economic Development (*SVR – Sachverständigenrat Verantwortung für Europa wahrnehmen, Jahresgutachten* 2011/2012), the pre-crisis level of GDP was regained by Germany in the middle of 2011. After the exceptional rebound of 2011 and 3% growth, it was forecasted that in 2012 the growth will naturally decrease to 1%, which would locate the growth line close to the path of optimal long-term production. However, because of the unstable global situation, the development scenarios for Germany include also some less optimistic assumptions, the worst being the collapse of global trade – decrease of GDP, which would result in recession.

The "supply-based" approach, referring to production factors, was used, among others, in the analyses of the cited Council of Economic Experts. To evaluate the potential of economic growth, a production function method was used, which makes it possible to divide the production potential into individual components. The forecasted increase of potential GDP for 2012 was supposed to reach 1.6%. It was supposed to be a result of the changes in TFP (*total factor productivity*) – 1.1 pp, then capital – 0.4 pp and, to the lowest degree – only 0.1 pp – work. The contribution of the last element was supposed to be related to the positive changes in the number of people in productive age – 0.1 pp, an increase in the level of participation, which is the index of the participation of the employed to the population in productive age equal to 0.2 pp and the negative influence of working time reaching -0.2 pp.

According to the newest forecasts, the economic growth in 2012 may reach about 0.8% (*Institut für Weltwirtschaft an der Universität Kiel* (IfW) and *Rheinisch-Westfälische Institut für Wirtschaftsforschung* (RWI) of Essen) or 1% (*Institut der deutschen Wirtschaft Köln*). In 2013 it may reach only 0.75% according to the center in Cologne, 1% - according to the specialists from Essen and "as much as" 1.1% according to the institute in Kiel. At the same time, while referring *post factum* to analogous previous forecasts, one may get the impression that the state of the German economy and its forecasted development are systematically underestimated. Contrary to the worst case scenarios, the economy of Germany is doing great – the previous forecasts are going up and the strong rebound of the internal consumption and excellent budget income suggest that the German economy is blooming after all (literally - *die deutsche Wirtschaft kann einem ungünstigen Umfeld trotzen*, „Wirtschaftswoche" 22.09.2012). Even though such evaluations, in light of global tendencies, need to be considered with caution, they cannot be disregarded.

The mentioned demand-based approach is used, among others, in the analyses performed by the European Commission. According to the forecasts presented in spring (*European Economic Forecast, Spring 2012*), consumption demand is becoming the main driving force of the German economy. In 2011 it was responsible for 2.2 pp in the 3% GDP growth which was most likely the result of increased real wages. In 2012, the contribution of private consumption to economic growth, reaching about 0.7% GDP according to forecasts, will reach 1.2 pp, investment – minus 0.2 pp and net export – minus 0.3 pp. To be more precise, the increase of GDP at the level of 0.7% annually is composed of: the increase of investment reaching 2.1%, increase of export by almost 3% and import by 3.8%, as well as the increase of private spending by 0.9% and public spending by 1.2%.

During the crisis the potential of the German economic growth is obviously restricted by the situation in Europe. The economic recession in the South means less trade and investment, which exerts negative influence through the traditional and popular signal transmission channels between economies. Also the general market moods play an important role – uncertainty, lack of trust, lack of perspectives for development or aversion to risk and even, paradoxically, the new solutions employed to combat the crisis. The European Financial Stability Facility and the related burden to EU member states, including Germany as the main shareholder, pose the danger of possible default of one of the countries. This is why the excellent economic results of Germany, in comparison to other highly developed countries, may be puzzling. The influential "The Economist" talks about an "economic miracle" and treats the dynamic growth of the German economy as a European equivalent of the growth in China. Germany is praised for its payroll moderation, which guarantees, apart from the high quality, the competitiveness of German products on global markets, solid foundations for industry or good relations between science and business, conducive to the commercialization of innovation and exhibited by a large number of patents. Among the downsides there are the still relatively poorly developed service sector and the level of internal consumption. However, according to data, these area are already improving. The economy of Germany is no longer asymmetrically based on the pillar of export, but is beginning to “lean” more towards domestic consumption. The excellent results achieved after the collapse in 2009 can partially be interpreted using the so called bungee effect or base effect – a strong rebound. Nonetheless, in short and mid-term perspective, the condition of the German economy seems very good. Public finance discipline, the lower scale of credit expansion and the lack of a real estate bubble undoubtedly helped Germany in comparison to other countries. The Germans also fully utilize the benefits of globalization, both when it comes to demand – thanks to the developing Asian countries in need of the famous German durable goods, as well as supply – thanks to the availability of inexpensive and qualified workforce from East-Central Europe. This success would not be possible without the radical reforms of *Agenda 2000*, proper industrial policy supporting new technologies and the development of renewable energy or the dynamic sector of small and medium companies. As “The Economist” puts it, even if the elite G7 may be hobbling economically, Germany is still sprinting.

Low unemployment, dynamic GDP changes, small household debt and almost balanced public finance – all this distinguishes Germany from other most industrialized economies in the world. According to analysts, the true German economic miracle will take place only when the current weaknesses, namely the low internal consumption and underdeveloped service sector are eliminated. Statistics, especially concerning domestic private spending, show that it is slowly becoming reality.

The crisis seems to be revising the previous view of economic growth. The more important thing than growth, understood as an increase of GDP, seems to the resistance of economies to domestic and foreign turbulences. This resistance is exemplified, among others, by healthy macroeconomic foundations and balanced structure of economy. It is confirmed by the country's position in international rankings and the evaluations of rating agencies. Even though *Moody’s* reduced the prospective rating of Germany and several other countries in summer 2012, the rating was still relatively high. Germany still has the opinion of a competitive country – the 6th place in 144 in The Global Competitiveness Index 2012-2013 issued by the *World Economic Forum*, and business friendly – 19th place in 183 economies in the *Doing Business* 2012 ranking of the World Bank.

In the long run, the economic success of a country arises from many factors. In the case of Germany, the most important ones are demographic changes and demand for qualified workforce. The external situation is, as always, hard to overestimate. When it comes to the German economy, this should mainly be associated with the condition of the economic partners interested in the German export offer. At the same time, it should also be mentioned that the possibilities of sending positive signals from Germany to other countries are limited. According to the research of the MFW economists (Hélène Poirson, Sebastian Weber, *Can Germany be Europe's engine of growth?* 2011), Germany is not capable of performing the function of the „European economic growth engine" because of the relatively poor *spillover effects* generated by the German economy. In other words, even if the improvement in the German economy may result from global changes – its source is "external", it is itself not strong enough to be a stimulus for development for other economies. If this is actually the case, the hope that the improving situation in Germany will help significantly improve the situation in other EU countries would be vain.

To sum up, the macroeconomic condition of Germany should be conducive to economic growth. One of the lowest unemployment in the eurozone, moderate inflation, current account surplus and almost balanced situation of public finance constitute a strong economic foundation. It makes the country not only predisposed to growth, but also resistant to economic turbulences. The only shadow cast on that image is the negative contribution of the work factor in the increase of GDP which is visible in the analyses using the macroeconomic production function. What deserves praise, especially when taking into consideration the reservations systematically expressed towards Germany, is the increasing role of private domestic consumption in economic growth.

Marta Götz – economist, assistant professor at the Institute for Western Affairs in Poznań; research interests: business clusters, foreign direct investments, the economy of Germany.

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