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The German economy is falling back

by Michael Heise

The German economy is falling back. Even compared to the low-growth league of the euro countries, Germany is one of the countries lagging behind, just ahead of Italy, in 2018 and 2019. The much-reprehended French economy and the British economy, which has been battered by Brexit, are growing faster, albeit by only a few tenths. The weak growth in Germany is currently not playing a major role in the public debate, which can certainly be attributed to the very good employment situation and low unemployment. 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 industry also affects the other sectors.

The production of goods is currently particularly affected by the negative development of world trade, which is not only due to the trade policy conflict between the USA and China. Germany alone can do little about this. It would however be all the more important to increase the internal dynamics of the German economy through investment and innovation. Unfortunately, this has been neglected. Germany has lost its attractiveness as an investment location and assets are exported on a large scale. A series of factors come into play. Since 2017 labor productivity has hardly risen at all, wages and non-wage labor costs are rising faster than in other European countries and especially in the manufacturing sector, where the wage-level was already much higher. Concerning taxation, too, Germany is now once again one of the leading industrialized countries, both in terms of corporate taxes and the tax burden on small and medium-sized incomes. Above-average energy prices are also off-putting for production companies. The triad of high wages, taxes and energy prices would not have to have a negative impact if companies were offered first-class infrastructure and a highly qualified labor supply. But even that is only the case to a limited extent in Germany.

It will take some far-reaching political measures to improve the future situation. Tax reliefs and reforms that could achieve rapid effects are rejected with reference to scarce resources, even though public spending has been increasing in large steps for years and the tax rate has reached a peak value. Instead the abolition of the solidarity surcharge is being discussed and decisions on additional expenditures that won´t increase long-term growth potential are being made. The biggest spending decisions since 2018 concern pension increases, family benefits and structural support for the end of coal-fired power generation. Such expenditures are justifiable, but they do not tap growth potential. And these are urgently needed for the future financing of the welfare state.