Foreign & Commonwealth Office

Summary

The short term prospects for the German economy are reasonable: 1.8% growth, unemployment at 5.1%. But businesses are grumbling, and further growth depends on them increasing investment. Immediate past concerns had been more external, in particular the Eurozone. Business is now more concerned about domestic policy. Businesses worry about energy, a declining workforce, the introduction of a minimum wage, and the climate of regulation.

DETAIL

On 13 February, Vice Chancellor and Minister of Economic Affairs and Energy Sigmar Gabriel presented the Government's economic programme to the Bundestag. Following an increase in Gross Domestic Product of 0.4% in 2013, the German government forecasts growth of 1.8% in 2014 and 2% in 2015. After years of record trade surpluses, imports are expected to rise faster than exports, which will reduce Germany's trade surplus to 5.9%. Unemployment will continue to fall (current rate 5.1% overall (on the ILO definition: youth unemployment 7.4%). Despite new spending promises, the government still aims to achieve a structurally balanced budget this year and to reduce its debt to GDP ratio below 70% by end of 2017.

The new government has emphasised the importance of increasing domestic demand and has promised to invest an additional €5 billion in the public transport infrastructure over the next four years. Following a 4.0% and 2.2% drop in investment in the last two years, the government is predicting a turnaround with a rise of domestic investment of 4.0% in 2014. Private consumption is expected to increase by 1.4%. The rise in domestic demand is expected to help reduce economic imbalances in the euro area.

Over the last couple of years the principal concerns of German business and economists have been external – the risks from the Eurozone periphery, US fiscal and monetary policy, or emerging markets. Now their concerns are reportedly more about domestic policy choices. Germany has one of the lowest trend growth rates in the OECD at around 1 per cent, and in her meeting with OECD Secretary General Gurria in mid February Chancellor Merkel acknowledged the need to do more, in particular on female employment, to raise potential growth. One issue is German energy policy which Chancellor Merkel has described as the greatest challenge: managing the exit from nuclear generation in parallel with increasing the share of renewables while keeping prices under control, also in light of cheap shale gas prices elsewhere.

But there are four other key worries: pensions, people, pay, and paperwork.

Pensions

The pension reform bill was adopted by the Cabinet on 29 January. The reform will become effective from 1 July. It will extend benefits to mothers who gave birth before 1992 and allow employees with a statutory pension insurance record of 45 years to retire on a full pension two years before the legal retirement age of 65. A full state pension is now around two-thirds of net lifetime average salary, but this is falling as a result of the previous structural reforms mentioned above.

In the medium term, the additional costs of the new measures (cumulating to at least EUR 160 Bn by 2030, on the Government's own figures) will be funded by forgoing planned reductions in payroll contributions, and by federal tax funding after 2018. The pension reform bill is seen by many including then SPD Chancellor Schröder as a departure from Germany's internationally admired structural reforms of a decade ago.

People

Demography also affects German companies' growth prospects as they struggle to find skilled staff to fill regional and sectoral skills shortages (in particular skilled manual and IT sector workers as well as care professionals). This is a further reason for employers' concerns about early retirement, and explains their support for more child care and other effective measures to encourage increasing female participation in the workforce. However, maintaining the size of the workforce even at its current level will require net inflows of around 200,000 per annum, perhaps more if the economy starts to take off. As a result, the Economics Ministry and employers organisations are promoting targeted measures to encourage skilled immigration.

Pay and the minimum wage

Thanks to high employment, more generous wage agreements and buoyant economic growth from 2010, real wages have been growing, underpinning domestic consumption (+3.5% p.a. real wage growth from 2008-2012). However average wage growth rates conceal considerable differences between sectoral and regional wage levels, in particular for the significant minority not covered one way or another by collective bargaining. Even conservative economists admit that minimum wage thresholds should be introduced for those at the bottom of the pay scales in many services sectors. At the insistence of the SPD, the coalition agreed to introduce a national minimum wage at an initial level of 8.50 EUR per hour (about half the median German wage) which will be phased in between 2014 and 2017 for all workers not covered by collective bargaining arrangements. The German government plans to create a commission of social partner representatives to propose future minimum wage adjustments.

There is general acceptance of the need to introduce a minimum wage floor, but there is concern from business about the relatively high initial level, which might dampen employment prospects of low-skilled or inexperienced workers in some regions, particularly the former East. According to the left leaning DIW think-tank, in 2012 only 15% of German workers earned less than € 8.50 and this proportion was falling rapidly with the general level of wage increases. DIW believe that the minimum wage would in practice do little to damage Germany's international competitiveness, and even less if, as the CSU have called for, students and working pensioners are excluded. However, other studies have pointed to further potential risks, for example that the minimum wage combined with high social contribution rates and frozen tax bands will further encourage moonlighting.

Paperwork

Business also continues to complain about the burden of regulation. In response, the coalition has three priorities for better regulation at domestic and EU level: reducing burdens on businesses and citizens; improving the quality of law-making; and increasing public participation in the better regulation agenda. The underlying assumption of German policy makers is that without some (good) regulation, the public purse ends up bearing unforeseen costs of dealing with the possible adverse consequences of companies making their own decisions. Better to regulate well and save the downstream costs. Earlier this month the Association of German Industry (BDI) called for the adoption of the 'one in one out' principle at EU level. In January a consortium of the 10 leading organisations representing small and Mittelstand companies recommended '10 measures for Better Regulation in Europe', with a focus on subsidiarity, proportionality and sound legal process.