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Germany: outperformer in times of crisis, but major challenges ahead

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1. Laszlo Varro, Head of Gas, Coal and Power division at the International Energy agency.

At this event Dr. Jörg Zeuner, Chief Economist of KfW gave a lecture on the performance of Germany since 2008 and presented an outlook for possible future developments, structural challenges and the need of federal reform.

a. Performance & Outlook

Dr. Zeuner pointed out that Germany was clearly ahead of major advanced economies in terms of economic performance if we compare, for instance, GDP per capita with the pre-crisis levels. Due to its large industry it could benefit from the strong growth in emerging markets. Germany's sizable SME sector and its crisis adopted labour market policy, Kurzarbeit, (short term labour market instrument subsidizing wage cost by government) helped to avoid a drop in employment. Additionally, Germany could benefit strongly form the monetary policy of the ECB during this period. The KfW projection for 2014 shows an increase in growth to 2% which will be mostly dominated by private and public consumption.

b. Challenges

Despite this development, capital formation by businesses and the government has been noticeable low and follows a declining trend since 1991. Compared to a group of similar economies, Germany lags around two percentage points behind in terms of business capital formation. The picture in the public sector is quite similar. Governmental capital formation ratio halved in the respective period. This lack in investment can be identified as determinant of productivity in the years to come.

A second challenge is Germany's demographic development. Estimations predict working-age population to lower by 4.9% in 2030 whereas total population is predicted to fall by 3.2%. Investments are necessary to cope with these adverse demography dynamics.

In the long run, Germany's growth potential is predicted to decrease if Germany does not undergo severe structural reforms.

c. Need for federal reforms

Looking at public capital formation we can see a systematic decline in investment on municipality level, not however, on federal level. This development calls for fundamental reforms in local financing structures such as reforms of underlying tasks, cost and revenue structures.

Discussant Jakob Wegener Friis, Head of unit at European Commission, recognizes Germany's great performance in the crisis period but underlines the fact that looking from a longer term perspective, i.e. from 1993, Germany fell behind in terms of production, overall GDP, investment and consumption. Its TFP growth halved between 2000 and 2012. He pointed out two important issues for growth. The first is

private consumption: disposable income growth has been week before the crisis and its only growth driver is property income since labour income has been flat and the wage share has fallen. The rise in savings rate of private households is driven mostly by the richest part of the economy. This shows a need for policy reform on income distribution. The second is the low corporate investment rate. His hypothesis is that financial conditions in the last decade did not promote investment. Also, the tax system did not create favourable conditions for firms. Policy action in this area is needed.

Notes by Olga Tschekassin