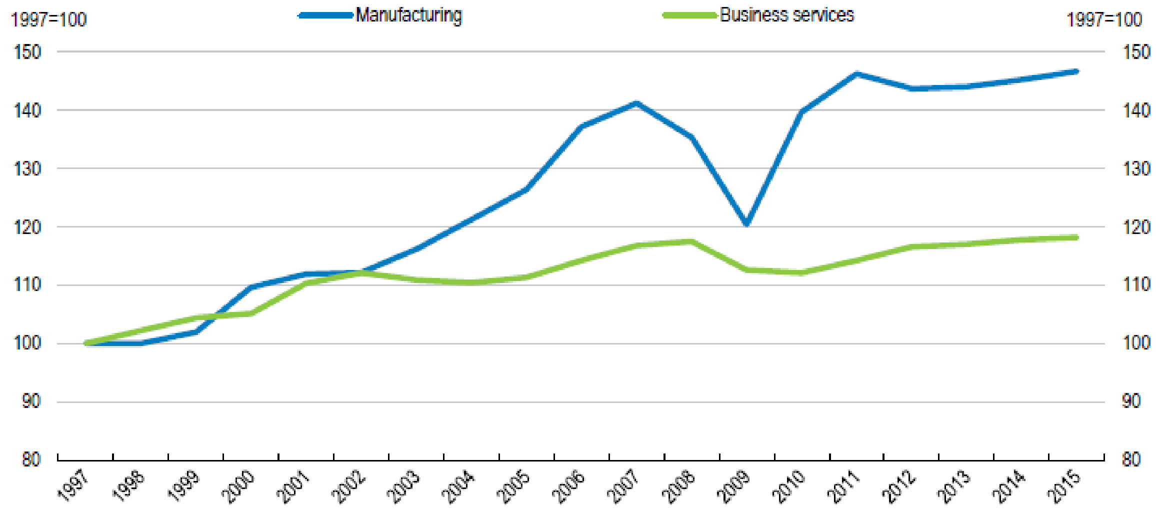
Germany’s economic performance is strong but productivity and investment need a boost

By Andres Fuentes, Head of German Desk, OECD Economics Department

The German economy has steadily recovered from the 2008 global crisis. Thanks to past reforms, the labour market has proved strong and export performance has been impressive. The unemployment rate is now the lowest in the European Union. On the back of rising wages, private household demand has strengthened. Germany has lower income inequality than most OECD countries and scores well in most dimensions of well-being. The recently introduced minimum wage has improved the income situation of many low wage earners.

So economic performance has been excellent. But there is a weak spot: Labour productivity has grown little since the outbreak of the crisis (Figure 1) and is relatively low in the services.

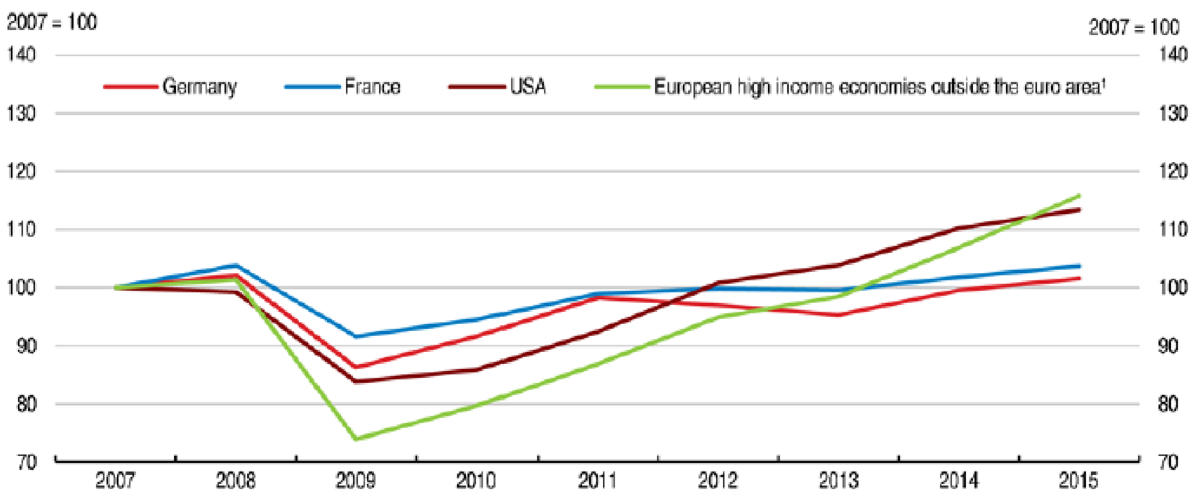
Figure 1. Gross value added per hour worked in Germany, at constant prices



Source: OECD (2016), *OECD Productivity Database*.

In part this is because business investment has been weak in both physical assets, like machinery, and knowledge based capital (KBC, like intellectual property and software) (Figure 2).

Figure 2. Business investment has grown little in recent years



1. Includes Denmark, Sweden, Switzerland and the United Kingdom. They are weighted on the basis of investment spending in 2011.
Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (database), and OECD calculations based on OECD Economic Outlook: Statistics and Projections (database) and on Main Economic Indicators Database.

Demand is a key determinant of business investment. Weak demand conditions in geographically close export markets and increased uncertainty, notably in the euro area, have been particularly damaging to investment. Policies that improve stability and growth prospects in the euro area would therefore raise German investment and its economic potential. Reinvigorating investment in Germany would also reduce its large current account surplus, and thereby promote more balanced global growth.

Reducing regulatory barriers to competition and market entry stimulates business investment and improves productivity. In Germany investment in KBC is particularly low in the services. Some regulations in professional services and the network industries are too restrictive, and easing them would boost productivity throughout the economy because these services are inputs to downstream economic activities (IWU, 2015). For example, restrictions on advertising and firm ownership should be eased. In broadband networks, technologies which supply the fastest speeds, notably “fibre to the home”, have barely been deployed. This has held back IT investment and the greater use of IT as a productivity generator.

Policies to avoid incumbents’ interests disproportionately affecting the design of regulation can raise innovation and productivity. Germany has made significant improvements to its regulatory policy system, but the administration could focus more strongly on the analysis of the economy-wide impacts of policies, rather than on sector-specific impacts, and on efforts to improve transparency of lobbying.

OECD, Economic Survey of Germany, OECD, April 2016, OECD Publishing.

Institut für Wirtschaftspolitik an der Universität zu Köln (IWU), Der Dienstleistungssektor in Deutschland. Überblick und Deregulierungspotenziale, Otto-Wolff-Discussion Paper, No. 1a/2015.