

Germany

The Eurozone's economic powerhouse



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Germany is the fourth largest global economy today¹. Its exports amounted to EUR107 billion in March 2015 – an all-time high since the 1950's². Despite being the only European nation with a strong manufacturing base and rising employment rate, will Germany succeed to drive Eurozone's stagnant economy? And what lessons does Germany's economic success hold for the rest of the world?

Germany's resurgence

With the second lowest unemployment rate in the European Union (EU) at 5.3 per cent, Germany's economy has survived many setbacks. The economic success dates back to the Industrial Revolution due to the early adoption of coal production and rail transportation³. Moreover, the fall of the Berlin Wall – the reunification of West and East Germany – and the expansion of the EU created huge market opportunities for Germany⁴.

Often regarded as the 'Sick man of Europe', Germany had almost lost hope of returning to rapid economic growth, undergoing recessions in 2003 and a dismal 1.2 per cent (year-on-year) growth rate (between 1998 and 2005)⁵. As of Q2 2015, Germany's Gross Domestic Product (GDP) expanded 0.4 per cent. This is better than the (year-on-year) average of 0.3 per cent from 1991 until 2015⁶.

Path to recovery

As Germany's economy continues to progress forward, some factors responsible for its steady growth include:

¹ Germany GDP Growth rate, Trading Economics, Destatis, Rida Husna, 25 August 2015

² Germany Exporters, Trading Economic, retrieved on 10 October 2015

³ Germany: 25 years later and no looking back, Turner Broadcasting System, Inc., Yermi Brenner, 29 October 2014

⁴ Ibid

⁵ From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy, Journal of Economic Perspectives, Christian Dustmann, December 2014

⁶ Ibid

Export-driven growth

Germany's export-led growth model continues to be one of the key drivers of growth, with export figures valued at EUR215.3 billion in 2014⁷. This accounts for 7.4 per cent of the nation's total Gross Domestic Product (GDP)⁸.

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The majority of Germany's exports are produced by small to medium-sized manufacturers for niche products⁹. These clusters of small and mid-sized companies – known as the Mittlestand – account for half of Germany's economic output. Mittelstand companies contributed to 18 per cent of exports in 2012¹⁰.

Skilled labor force

Germany's holistic VET involves both hands on experience through corporate training and education at vocational schools.

Germany's dual system of vocational education and training (VET) is one of the key factors for its economic success. VET enjoys huge support from the Federal Government. A traditional approach that dates back to the 12th century, Germany's holistic VET involves both hands on experience through corporate training and education at vocational schools¹¹.

This means that much of the young population – at the ages of 15 to 16 – take vocational training and apprenticeships leading to a guaranteed full-time job¹², with a 90 per cent completion rate for

⁷ German exports could defy crisis, hit new record, Deutsche Welle, 3 October 2015

⁸ Is Germany Carrying The European Economy, Investopedia, Trevir Nath, retrieved on 26 August 2015

⁹ Ibid

¹⁰ Germany's export engines, Bloomberg L.P., Alex Webb, 1 April 2015

¹¹ Germany's dual system of vocational education and training, World Skills Leipzig 2013, 2013

¹² Ibid

apprentices' training¹³. This system provides training to approximately 1.5 million people in a single year¹⁴.

Low unemployment rate

After reunification, the drop in wage rates in the early 1990s and the introduction of the Hartz package of reforms in 2004 improved the employment rate significantly. The reforms – modified today – include reductions in measures and benefits to make the labor market more flexible¹⁵.

As a result, the unemployment rate fell to 6.5 per cent in January 2015 – the lowest since reunification in 1990. This is around half of the EU's average unemployment rate of 11.4 per cent¹⁶.

Consumer confidence

Consumer confidence in Germany is at a new high. The Consumer Sentiment Index rose to 9.7 points in March 2015 – up from 9.3 points in February – the highest since October 2001¹⁷.

With cheaper mortgage rates, it has become easier for renters to own homes. A total of EUR190 billion worth of property exchanges were recorded between 2010 and 2014¹⁸.

Growth potential

Germany has already surpassed the Eurozone's 0.7 per cent economic growth in 2015¹⁹. Key sectors to look out for include:

¹³ The Secret To Germany's Low Youth Unemployment, National Public Radio, Eric Westervelt, 4 April 2012

¹⁴ Ibid

¹⁵ The pathway to Germany's low unemployment, The Irish Times, John Fitzgerald, 3 March 2015

¹⁶ Ibid

¹⁷ German consumers in buoyant spending mood, Deutsche Welle, 2 February 2015

¹⁸ Ibid

¹⁹ Eurozone Economy Grows 0.3% As Germany Powers Ahead, The Guardian, Graeme Wearden, 13 February 2015

Automotive manufacturing²⁰

One out of every five cars is German-manufactured²¹ with a turnover of EUR384 billion in 2014 – equivalent to 20 per cent of the total German economic revenue. Germany continues to host Europe's biggest automotive industry.

German automobile manufacturers produced approximately 15 million vehicles in 2014, or more than 18 per cent of total global production.

Renewable energy storage

Germany has been investing aggressively in renewable energy and storage for over 25 years. The nation aims to produce 80 per cent of its electricity through renewables²². Renewable energy sources include wind power, bioenergy, solar energy as well as combined heat and power (CHP) energy²³.

With increasing demand from Europe, the energy storage system market in Germany is expected to take a jump by 2016. Germany is the first choice for various companies who seek to invest in this industry. Close to 15,000 households in Germany were Photovoltaic (PV) Battery enabled in 2014²⁴.

Innovation hub²⁵

German business is synonymous with innovation – a driving force behind the country's successful economy. Its expenditure on research and development is about USD49 billion – 2.6 per cent of its GDP – with a likely increase to 3 per cent this year (2015).

²⁰ Ibid

²¹ Germany – The World's Automotive Hub of Innovation, German Trade & Invest, retrieved on 27 August 2015

²² Germany: Lead Market for Energy Storage & Fuel Cell Systems, German Trade & Investment, retrieved on 27 August 2015

²³ Ibid

²⁴ Ibid

²⁵ Germany Country Report – Innovation drives economy, South China – Morning Post, Ed Peters, 17 July 2015

It continues to be one of the leading nations in several technologies such as nanotechnology, biotechnology, aerospace, electrical engineering to name a few.

Taking a cue from Germany

Germany has outpaced its neighbors, with GDP growth of 1.6 per cent in 2014 – comfortably above the Eurozone average of 0.9 per cent. With most economic indicators pointing to strong economic growth, a few sectors help sustain this momentum.

Services sector

Germany's private service sector continues to grow as the Purchasing Managers' Index (PMI) – which tracks services and manufacturing activity – rose to 54.0 in June from 52.6 in May²⁶. Service sector firms continue to be optimistic with new customers and increasing capabilities²⁷.

Affordable healthcare services²⁸

The nation spends approximately 10.7 per cent of its GDP on healthcare – more than any other European country. Furthermore, the healthcare system is funded through social contributions (taxed at 10 per cent), with the backing of private medical insurance.

Government and private sector in sync²⁹

With high levels of cooperation between the public and private sector, Germany aims to be the most research-friendly nation in the world by

²⁶ German private sector grows, points to 0.3 per cent growth in second-quarter: PMI, Thomson Reuters, Michelle Martin, Toby Chopra, 23 June 2015

²⁷ Service sector provides optimism toward growth in Germany, Market Realist, Inc., Lara Sheldon, 24 September 2015

²⁸ Why Germany and France still lead the way in healthcare, Associated Newspapers Ltd, retrieved on 1 September 2015

²⁹ America must learn from Germany – before it's too late, Global Publics Square, Robert D. Atkinson, 24 October 2011

2020. Germany focuses not only on applied industry-related research but also invests heavily in it.

Germany's Fraunhofer system consists of 60 research institutes and 18,000 employees working with colleges, government agencies and private firms across Germany.

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Challenges

Even as Germany's economy has held up in the face of crises, there is fear of an economic slump due to sluggish market demand in China and other emerging markets³⁰.

Dismal domestic demand³¹

Domestic demand in Germany has been dismal. Most Germans recognize that the country must make stronger efforts to improve domestic demand through employment reforms. Relaxing barriers for women in employment and introducing tax reform could improve domestic demand by giving more purchasing power to the common man.

³⁰ Ibid

³¹ What Germany offers the world, The Economist, 14 April 2012

Labor shortage³²

At present, there are 117,000 vacant jobs in engineering, technology and science – a gap that could widen to about one million by 2020. To further woo more immigrants, Germany has eased restrictions for foreign qualifications which are crucial to fill the shortage of workers.

Aging transport infrastructure

Germany is at a geographic focal point in the Eurozone. Its geographic position helps explain why it has become the hub of strong export-oriented manufacturing³³. Maintenance and repair of roads in recent years has been insufficient even though EUR35 billion (a year) is spent on roads via private and public investment³⁴.

Aging population³⁵

Germany's working-age population (between the ages of 15-64) is expected to decrease by 14 percent by 2040. Women could help address this shortfall. Despite 70 per cent of women being in the workforce, half of them are engaged in part-time employment, thanks to a combination of tax disincentives and limited public childcare options. However, economic output could increase by 7.5 per cent if women clocked in the same average working hours as men.

Future outlook

As the world's fourth largest economy and holding its own with the second lowest unemployment rate in the EU at 5.3 per cent, Germany has truly come a long way. The reunification of West and East Germany and the expansion of the EU helped it tap into market opportunities.

³² Needing skilled workers, a booming Germany woos immigrants, The New York Times Company, Alison Smale, 18 July 2014

³³ Ibid

³⁴ Germany' growth threatened by creaking transport network, The Financial Times Ltd, Claire Jones, 8 September 2014

³⁵ Germany charts a steady course, International Monetary Fund, 15 July 2015

What factors explain Germany's success and how can emerging markets emulate this economic powerhouse?

A number of factors stand out. There is a strong base of private owned firms who are historically committed to innovation and exports in their individual niches. There is a robust public-private infrastructure for training, supported by a public culture that respects the role of technicians and the vocations. There is good public-private co-operation on R&D such that private firms can tap into the Fraunhofer system for R&D co-operation.

The country has also succeeded in uniting all stake-holders – companies, unions, NGOs and government – in order to keep large manufacturing industries rooted and thriving in Germany, such as automotive, industrial and chemical manufacturing. Lastly, Germany's world-class healthcare system ensures that no one is held back from taking risks by the fear of being bankrupted by healthcare costs.

What this suggests is the importance of public culture. Successful countries need to cultivate a culture of pride in innovation and competitiveness. Such a culture needs to be supported by strong institutions such as Germany's VET system. Both culture and institutions are mutually reinforcing. Without these, countries will find it hard to get all stake-holders (including companies, youth, consumers and workers) to make the decisions necessary for sustained economic competitiveness.

Germany needs to improve its domestic demand, fix its aging transport infrastructure and address its labor shortage crisis through engaging more women in the labor force. The fact that it is taking these problems seriously speaks well of Germany's political culture and economic research ecosystem – yet another pre-requisite of national economic success.