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Weak productivity growth in Germany – is it a problem?

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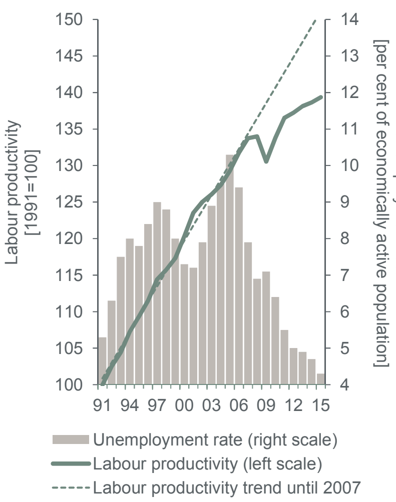
For many decades, a constantly increasing share of the economically active population remained without jobs in Germany. In every economic downturn, the unemployment rate rose more than it fell in the subsequent recovery. Structural unemployment swelled across all economic cycles and appeared to be unstoppable – with the unemployment rate reaching a high of 10.3 % in 2005.

Nevertheless, relative to other countries, the German economy grew respectably, as those in work were very productive. Labour productivity – price-adjusted gross domestic product (GDP) per hour worked by persons in employment – increased from 1980 to 2007 at a very stable annual rate of 2.0 % when adjusted for economic fluctuations. Even the reunification of Germany did not affect this trend. As a result, growth in German productivity during just over a quarter of a century, from 1980 to 2007, was even more dynamic than in the leading industrialised nation, the USA (+1.7 % p.a.).

Figure: Productivity growth and unemployment



Source: Destatis, own calculations.

The turning point in 2007

After 2007, however, the countries switched places. Since then, the USA (+1.2 % p.a.) has outperformed Germany (+0.5 % p.a.) by an impressive 0.7 percentage points per year. It is true that increases in labour productivity fell significantly worldwide in the wake of the financial and economic crisis, with weak investment activity, as well as too little innovation in many cases, being important causes of this development in many countries. In Germany, however, the decline is not only sharper than in the USA but also sharper than in just under two-thirds of all OECD countries. While Germany is among those countries with weak investments and its innovativeness is also decreasing, it stands out internationally in one area: contrary to the global trend, it has significantly reduced unemployment over the last ten years.

Weak productivity growth – the flip side of labour market success

This positive labour market development may be an important cause of the current weak increase in German productivity. The goal of the Hartz reforms implemented in 2005 was to increase employment among the long-term unemployed and people with low qualifications, in order to break the five decade trend of increasing structural unemployment. It was a success. By 2007 cyclical unemployment had been reduced almost completely. The annual average unemployment rate was 7.9 %, a level close to the previous cyclical low in 2001 and from which it then fell even further, to 4.3 % in 2015. In other words: starting in 2008 at the latest, structural unemployment also fell. Simultaneously, trend productivity growth weakened noticeably (see Figure). However, this was to be expected since in this case the reduction in structural unemployment means nothing other than an increasing share of (initially) less productive persons in total employment.

This development is not a cause for concern. Material prosperity is higher overall when less productive people actively contribute what they can to GDP than when they only let themselves be supported passively by more productive persons in employment through the social system.

Justified hope of recovery

Hopes for recovery are also justified. The downward pressure on productivity growth is especially high during the transition period of a reduction in structural unemployment, while the percentage of less productive persons in employment increases. Usually individual productivity also increases through perfecting old skills or learning new ones 'on the job' and can also be raised through appropriate measures, such as better training and continuing education. This simultaneously addresses an important political measure. It is also necessary to increase investment and innovation significantly. To achieve this, the German federal government has pursued various initiatives such as the EUR 10 billion investment programme.

The Autumn 2015 Joint Economic Forecast is in any case optimistic that German productivity growth will recover to a good 1 % p.a. during the period from 2015 to 2020. That would not match the former top performance but would be substantially higher than the average 0.7 % p.a. achieved by OECD countries since 2008. ■