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Germany's dangerous export fetish

The coronavirus crisis has exposed how dangerous the German economy's over-reliance on exports really is. China shows how to do it better

The coronavirus crisis has exposed structural weaknesses across our health systems, political institutions and economies. But one such weakness hasn't received enough attention, and that is the vulnerability of Germany's economic model. It's simply relying far too much on exports. Now, this observation should serve as an opportunity to consider a gradual rebalancing of the German economy. Strengthening domestic demand – the economy's number two driver after exports – could be organised effortlessly by increasing wages and state expenditure. And it would not just be useful for Germany alone, but would also show solidarity towards neighbours and partners.

Germany's exports have fallen by 9.3 per cent in the last year – the biggest contraction since 2009. This played a considerable role in the 5 per cent decline in Germany's economic performance. Even the services sector, which was badly hit in the crisis, hasn't posted such deficits. Meanwhile, we have seen solid growth in the construction sector and the expansion of state expenditure.

Germany's economic model went into the crisis and was immediately under pressure from two sides: on the supply side from collapsing supply chains and, on the demand side, from the massive slump in orders from abroad. With an export share of 43.5 per cent in 2020, Germany was hit much harder than other big industrial countries such as China (18.4 per cent), Japan (16.4 per cent) or the US (12.9 per cent).

Admittedly, the 2021 exports will rise again significantly because because of pent-up demand. But future prospects are still gloomy. Both of Germany's most important export markets, China and the US, are heading towards a systemic conflict, in which it would no longer be possible for Germany to easily trade with both sides at the same time. It doesn't look much better in other notable export markets. Trade with Britain is slumping because of Brexit and the ongoing economic woes of southern Europe, which have been with us for a decade now, will be

further exacerbated by the pandemic.

The very real threats to Germany's economic model

There are more dangers looming on the distant horizon. For a few years now, we've seen a structural stagnation of the process of globalisation. According to a recent study by the Prognos Institute and BayernLB, there has been a slump in terms of economic performance since the global financial crisis – especially in trade in goods, which is disproportionately important for Germany. And within the category of trade in goods, it is above all consumer goods that are holding steady, not investment goods, which are particularly important for Germany's machine construction sector.

It is only in the trade in services and data streams – both relatively negligible up until now for Germany – that globalisation is deepening. The Prognos Institute and BayernLB suggest that the German economy, which is far too export-oriented, needs a new 'business model' – not to speak of the deep structural crisis in the German automobile industry with its continued focus on combustion engines.

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However, the export-oriented nature of the German economy is not just very risky in the future because of its dependence on international developments. Despite solid growth rates, it was also fairly inefficient in recent years. In his new research, Lucio Baccaro, the director of the Max-Planck-Institute for Social Research in Cologne, shows that there is a serious conflict of interest between the export-oriented sectors of the economy – in which around a quarter of people find employment – and the domestic market-oriented sectors, which still provide most jobs.

Hence, the export-heavy growth model ends up being disadvantageous for the overwhelming majority of people: because of wage moderation, which is necessary due to the price-sensitive nature of goods for export, domestic demand remains relatively weak. Therefore, there is a clear conflict between consumption and (price-sensitive) exports. Such a radical export-based model is necessarily linked to phenomena such as wage moderation and fiscal austerity. Stimulating domestic demand –via higher wages or loan-based investments – would lead to the collapse of

these price-sensitive exports as they would become too expensive.

Those who are particularly affected by wage moderation are employees who work in simple services (for example in logistics or the catering sector). By extricating such services from industrial companies and wage agreements – and the associated reduction in wages – it has been possible to convince high-skilled workers in the German export sector to accept only moderate wage increases (in relation to productivity increases) as their purchasing power would remain the same or even increase.

The lack of innovation

A balanced growth model, on the other hand, largely avoids these problems. It stimulates the economy both via domestic demand as well as via exports. It allows for solid wages, high state spending *and* strong exports. However, that only works if exports are comparatively less price-sensitive: they should first and foremost be based on a very high level of product quality on which price differences have comparatively little impact.

The OECD, however, observes a rapidly growing trend in the German economy: export successes are no longer achieved mainly by the quality of its products, but increasingly by keeping its prices down – in contrast with earlier periods when it was rather innovations (measured by the number of patent applications) that had made it so successful.

For example, in the last decade China has has quickly and sustainably moved away from its one-sided export orientation – China's export share was still at 33.8 per cent in 2005.

These findings were recently confirmed by Sebastian Dullien, Heike Joebges und Gabriel Palazzo. They also stress the increasing significance of price-related competitiveness for German exports. This cost competitiveness was markedly improved in the early 1980s and between 1995 and 2012 – each time after fairly big economic crises in Germany.

Such observations do not bode well for the future of the German economy. The pandemic-related recession could lead to a further slump in German exports. We can already hear calls for restraint in wage increases and state spending. But that would be disastrous. It would choke off the gentle recovery in domestic demand and, in the long term, further deepen Germany's dangerous export-heavy economic model.

Towards a rebalancing of the German economy

Instead, the German economy needs to be rebalanced. As in other balanced economic models, domestic demand and exports must be recognised as equal sources of growth. In Germany, that would require above all higher wages and higher state expenditure – for example on education, protecting the climate and infrastructure. At the same time, the state would have to invest considerably more in promoting research and technology to stop Germany's disastrous descent into cheaper and cheaper exports.

Such a mission may sound utopian, but it's not. For example, in the last decade China has has quickly and sustainably moved away from its one-sided export orientation – China's export share was still at 33.8 per cent in 2005. In the meantime, the Chinese economy has succeeded in rebalancing itself through a massive stimulation of domestic demand and high levels of investment in research and technology – without losing out in terms of export volumes.

Rebalancing the German economy is therefore not only possible unilaterally – without protracted international coordination processes –, but would also enable Germany to gain a lot of international recognition. An increased demand via higher wages and state expenditure would lead to the reduction of Germany's current account surpluses *vis à vis* our European neighbours and the US, an important act of solidarity to overcome the coming recession.



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