Post-crisis Situation of German Economy under Analysis

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Abstract

In 2010, both the EU and euro zone registered economic growth, mainly due to Germany's performance. Seen as a whole, the German economy grew stronger last year than in the last two decades, so that, for most sectors, 2010 brought gains despite experts' negative forecasts.

This positive development was, however, due to measures taken by the government in Berlin since the end of 2008, after the global financial crisis started. For 2011 the German authorities still expect a GDP growth in real terms of 2.3% and economic experts speak even of 2.8%, which would be an evolution over the euro zone states average economies.

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JEL classification: M20, M21

1. The measures taken by the government in Berlin led to German economic recovery

Europe's largest economy began to slow significantly in 2008 because of the financial crisis, the effects becoming more and more visible. By late 2008, the German export sector was severely affected by the crisis. Germany ranked first in the world in point of export for the 6th year in a row but for the last time in 2008, when the economic balance recorded a surplus, according to the Federal Office of Statistics, amounting to 6.4% of GDP.

In the context of combating the global economic and financial crisis, the Berlin authorities have adopted since 2008 a series of economic policy measures, as follows:

- *The act on stabilizing the financial system*

The package adopted by the Federal Government on October 13, 2008 to stabilize the financial system includes a framework for state guarantee of 400 billion euro and a fund up to 80 billion euros in order to support directly, with capital, the

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banks in difficulty, based on the state purchasing, under certain conditions, the "bad assets" of these banks.

- „Term package I“ – measures to ensure employment by strengthening economic growth.

To counteract the effects of global economic-financial crisis, the Federal Government adopted on November 5, 2008 a package of anti-crisis measures with long-term solutions, but applied quickly and with immediate effects, worth 30 billion euros. They were taken to ensure jobs and economic growth in Germany. Measures were taken to provide a significant boost to public and private investment, to ease the economic situation of citizens and businesses, revive consumption and ensure employment. The most important measures included:

- extension of partial unemployment period from 12 to 18 months. Thus, many employees could take advantage of reduced work programs without being fired;
- automotive sector support by eliminating tax payment for one year for new cars purchased between November 5, 2008 - June 30, 2009. Moreover, Euro 5 and Euro 6 cars tax exemption was for two years;
- corporate finance: Credit Institute for Reconstruction based in Frankfurt am Main (Kreditanstalt für Wiederaufbau) expanded funding especially for small and medium-sized enterprises. In this respect was provided an additional means of financing worth 15 billion Euros by the end of 2009;
- introduction of gradual tax reliefs, of about 25%, for fixed assets, as well as the possibility of granting additional special reliefs for SMEs;
- providing additional investment in the period 2009 - 2011 to increase energy efficiency in buildings, worth 3 billion euros;
- support for the rehabilitation of regional infrastructure programs (about 3 billion euros); promoting innovation and investment in the area of transport.

- „Term package II” – measures to ensure employment and stability in Germany.

At the end of 2008 it was ascertained that the financial and economic crisis was worse than initially estimated. Thus, to combat the adverse effects on the German economy, the government in Berlin announced in January 2009 the launching of a new action plan worth 50 billion euros, valid for 2 years. This package of measures was the largest since the Second World War and was meant to support Europe's largest economy. This extensive program was intended primarily to provide jobs, strengthen the middle class, increase cohesion and the progress of society.

Translating these goals into reality requires federal investment, mobilization of loans and provision of a new system of state guarantees, a broad offensive in the training of staff working across all industries, lower taxes and a reduction of debts of individuals, families or couples, by the local entities.

Following this action plan, employees’ payment for health insurance was lowered, a measure which equally benefited employers and employees, and tax on wages (the first tax level) decreased from 15% to 14%. The plan allocated

18 billion euros for new investments in construction and repair of roads, railways, schools and universities. The program also included aid to automotive industry worth 1.5 billion euros, tax cuts worth 2.9 billion in 2009 and 6 billion euros in 2010. The program also included guarantees up to 100 billion for loans to German companies to stimulate economic activity.

Here below is an extensive overview of the main chapters in **Term Package II**:

1. *Stimulating investments*

- allocation by the government in Berlin of 10 billion euros for investment at regional level (towns and villages) and 3.3 billion from local authorities; the money was intended primarily for education (6.5 billion for the rehabilitation of educational institutions) and infrastructure (3.5 billion to modernize hospitals, acoustic protection or local infrastructure development);
- investment of 2 billion euros for the expansion or rehabilitation of infrastructure at federal level;
- another 1.9 billion euros for the modernization of information and communication technologies.

2. *Public procurement*: public procurement legislation changes and streamlining of tender organization - for a limited period of two years (2009-2011), contracts of up to 100,000 euros can be assigned directly and the amount of public auctions is capped at one million euros.

3. *Loans and guarantees*: KfW (Kreditanstalt für Wiederaufbau), a state bank for promoting investments, set more flexible conditions for participation in special programs in 2009 to improve the financing of small and medium enterprises projects; KfW has provided a further approx. 40 billion euros by issuing government guarantees without mortgage and loans with preferential interests. The German government has also established a special fund for micro credits worth 75 billion euros to help small businesses that do not qualify to obtain loans from commercial banks. The facility is looking to offer individual loans up to 20,000 euros over a three-year period and does not involve the provision of guarantees from companies. The program is envisaged to run until 2015.

3. *Scientific research and innovation*: a special fund of 450 million euros (100 million strictly only for the new German states) was earmarked to support research institutes and universities.

4. *Communications and internet access*: coverage will be broadened and the frequency band will substantially increase, as well as the scope of services offered. On the horizon of 2014, it is intended to put conditions in place for 75% of households to have unlimited internet access and for a transfer rate of at least 50 MB/ second.

5. *Purchase of new cars*: until December 31, 2009 a directive was in effect which provided that, in the case of a new car acquisition, a scrap page premium of ***2,500 euros was offered for cars older than 9 years***. The amount provided by the

government was 5 billion euros (exhausted in September 2009, and car sales increased by 40% compared to the same period of one year earlier).

6. *Environmental protection and pollution reduction*: a fund worth about 170 million euros was set up to reduce CO2 emissions. This fund aims to cut at least 40% of the emissions by 2013.

7. *Electromobility research*: for the period 2009 - 2010 the German government provided over 500 million euros to develop technologies for hybrid engines, alternative fuels and other energy saving aspects. This area is a priority of the executive in Berlin, Germany wanting to become the most advanced country in this respect[2].

8. *Labour market*: to provide employment, the Federal Employment Agency (Bundesagentur für Arbeit - BBA) adopted several measures, including:

- The BBA bearing social security costs for all those working part-time (in a proportion of 50% in the first seven months and fully after the seventh month);
- extending the special program for elderly and low-skilled workers, in order to ensure specialization and prevent layoffs (the allocated fund was 1.2 billion euros);
- Allocation of 770 million euros for the creation of new jobs, helping those who are looking for a new job or for a second job;
- Improving the distribution of workers in the period of notice (job to job placement) through 1,000 employment consultants from labour recruitment agencies;
- Extending the period of guaranteed access to benefits for temporary work allowance from 12 to 24 months (as available by the end of 2010).

9. *Reducing income tax*: the state will cover from its own funds a difference of 2.9 billion in 2009 and about 6 billion per year as of 2010, to offset the increase in the minimum annual taxable income from 7,664 euro to 7,834 euro, as well as the decline from 15% to 14% in social contributions. In 2010 there was a new increase in the minimum taxable income from 7,834 to 8,004 euros/ year.

10. *Health insurance*: following a reduction of 0.6%, from 15.4% to 14.8%, in the contribution of employees, the federal state will compensate come up with 3.2 billion in 2009 and another 6.3 billion in 2010 and 2011 to compensate the budget of health care establishments and private hospitals.

11. *Supporting the family*: in April 2009, a bonus of 100 euros was granted for each dependent child. Also, for children from families affected by

[2] On May 18, 2011, the Cabinet of Berlin made public the new *Strategy on electromobility*, considered a priority for the current government. There are now 2,300 electric cars in circulation, but Germany wants to reach one million such cars in 2020 and six million a decade later. To this end, officials decided to supplement with one billion euros the research and development subsidies. The government also wants to develop rules to encourage owners of electric cars (reducing taxes, free parking, right to travel on dedicated bus lanes, location of charging stations in various public places).

unemployment, the allowance amount increased from early 2010. Moreover, new school facilities were granted for these children.

- *Law amendment to stabilise the financial system*

On April 7, 2009 a law was passed by parliament to stabilize the financial system, which simplifies the purchase of state shares and assets at risk from businesses in the financial system through the Financial Market Stabilization Fund. The law allows the state to take over banks in order to save them in three phases:

- establish the means for state takeover of the controlling stock, in terms of identifying the method that least affects competition and economic balance;
- if the first phase proves to be unsuccessful, the state uses all available means to obtain majority control, by increasing the capital. In this sense was adopted a simplification of the conditions for decision making in the shareholders general assembly, by a majority of 50% + 1;
- in the third stage the nationalization of the bank is carried out, for which control of 90% of the shares is needed. In this sense, the state submits a bid to the shareholders, and if they refuse, it moves to expropriation and compensation to shareholders. Initiation of procedures for expropriation was limited in time until June 30, 2009 and the corresponding governmental ordinance could be made by October 31, 2009. When the nationalized bank will be privatized again, expropriated shareholders will have right of preemption for share recovery[3].

All these measures were closely related to the Federalism Reform and were aime not only at overcoming the difficult moments of crisis, but mostly at ensuring a realistic, long-term basis for future economic development. The Government has kept in mind its international obligations, the provisions of the European Stability and Growth Pact, participation and active involvement in processes of globalization and interdependence worldwide. All domestic entities, the federal Länder, municipalities and citizens are asked to be fully involved, active and conscious in the earliest possible implementation of the measures actually adopted, whose essence is social advancement of the entire country, welfare and domestic stability, peace and security.

Federal Chancellor Angela Merkel stressed the importance of the package of measures adopted by the government in Berlin over the years and emphasized that one can speak of a true and real support of the entire national economy, of support both for large corporations, banks, private companies and the state, and for small businesses and ordinary employees, the Länder and the communes, though mainly for the financial and industrial sector (vehicles construction, public utility construction, housing).

Overall, the measures taken by Germany to stimulate the economy amount to 82 billion euros over a period of two years, equivalent to 1.6% of GDP, the largest injection of capital in Europe. The scale of the program is comparable to the

[3] The provisions of this law were applied to the mortgage bank Hypo Real Estate, in crisis, where the state has increased participation to 90% on June 2, 2009 taking over whole without expropriation.

plan drawn up by US President Barack Obama, of about 775 billion dollars over a period of two years, equivalent to 2.8% of GDP.

Regarding the German federal budget for 2010, it provided a record deficit of 85 billion euros, almost 6% of GDP (from approx. 3% in 2009), while launching a third stimulus package worth 10 billion euros (which includes tax cuts agreed in the CDU-FPD governance agreement).

Last year the German Executive continued applying the anti-crisis measures, even as the German economy recorded in the 2nd quarter (2010) the best economic growth since reunification. Thus, a bill valid for the next 4 years was adopted, worth 80 billion euros, which covers most of the austerity program.

2. German economic developments following the adoption of austerity measures

In the previous year, Germany posted the highest growth rate of real GDP since reunification. Overall positive development in early 2010 was underestimated by both the Federal Government and economic analysts. For 2011 the German authorities still expect a 2.3% GDP growth in real terms, while economic experts even speak of 2.8%, which would be an evolution above the average in euro zone member economies. However, dynamic growth is expected to decline compared to last year. According to analysts, external economic impulses will be weaker this year than in 2010, which would mean that the recovery from the crisis will diminish.

After having felt for four consecutive quarters, from the 2nd quarter 2008 until (and including) the 1st quarter of 2009 (see Chart 1), the largest European economy returned to growth in April-June 2009, being among the first states to emerge from recession. In 2009 the German economy had the worst development after the Second World War, even though the economic incentive programs realised by the government and export growth helped the state emerge from recession already in the 2nd quarter of 2009. GDP fell by 4.7% in 2009, whereas in 2008 the economy had advanced by 1.3%, according to Federal Statistical Office based in Frankfurt.

The German economy gradually increased from the 2nd quarter 2009 when it advanced by 0.5%, compared with the first three months of the year. During July to September of the same year, an 0.7% growth rate was attained, while from October to December the growth was of 0.3%. 2010 was also characterized by economic growth: 1st quarter: 0.6%; 2nd quarter: 2.3%; 3rd quarter: 0.7%; 4th quarter: 0.4 % (see Chart 1, Chart 2).

Data provided by German authorities showed that, overall, in 2010 the economy grew by 3.6% (*see Table 1*), far above initial estimates (1.6%). The strong economic advance came amid growth of exports and domestic consumption recovery. For 2011 analysts consider however that the growth rate will be lower, i.e. only 1.2%, industry remaining the circumstantial driving force.

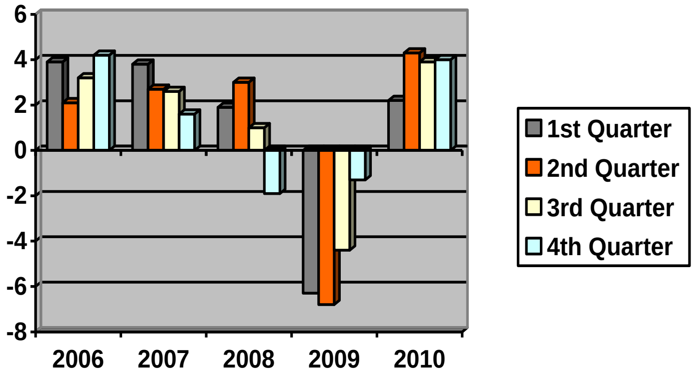

Chart 1: GDP evolution compared to same quarter of previous year (in %)

Source: Federal Statistical Office

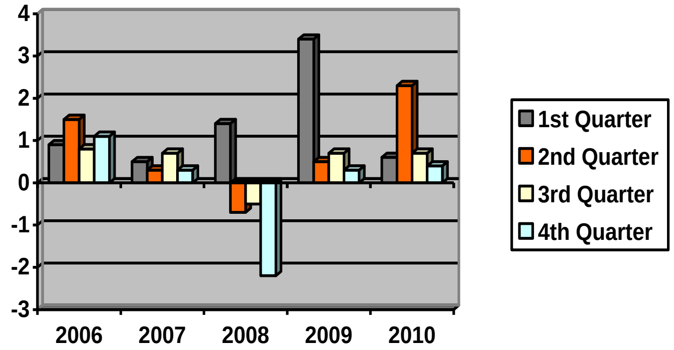

Chart 2: GDP evolution compared to previous quarter (in %)

Source: Federal Statistical Office

Table 1: Changes in GDP reported in the previous year, %

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
+ 3.2	+ 1.2	+ 0.0	– 0.2	+ 1.2	+ 0.8	+ 3.4	+ 2.7	+ 1.0	– 4.7	+ 3.6

Source: Federal Statistical Office

There is an awareness of various economic risks which are found mainly outside the German economy. However, overall, the country's economy has developed along a strongly ascending trend, managing to compensate, for the most part, the negative factors determined by the economic crisis.

Private consumption expenditure recorded further increases in 2010. After a sensible pick-up in the 2nd quarter 2010, in the 3rd and 4th quarter, consumption boosted overall economic growth.

External economic relations had a positive contribution to growth in the 4th quarter of 2010. A major contribution in this respect was that of the increase in exports of goods, which in September last year grew by 3.0% in current prices, after having registered a slight decrease of -0.2% the previous month.

As a trend, exports are still on an ascending line, albeit with lower dynamics. They have only slightly exceeded the maximum reached before the economic and financial crisis, with price and seasonal adjustments.

Germany is increasingly linked to trade with emerging markets which recorded high growth rates. But, as before, industrialized countries are the most important trading partner, accounting for three quarters of exports in 2010. However, many of these are fighting now with poor economic circumstances and high unemployment. Imports, too, have already reached pre-crisis levels, with price adjustments.

The trade balance and balance of current account registered surpluses in 2010, of 15.6 respectively 13.2 billion euros (with seasonal adjustments). Positive balances in the same period of last year were exceeded by 5.0 respectively 2.9 billion euros. Thus, after a long period of decline, the indices related to expectations regarding exports began increasing again.

According to analysts, the trend will be maintained also in 2011, when it will reach again the level before the crisis. Experts estimate that German exports will increase on average by 6.5% and imports by 6.4%. Global economic developments remain an advantage for the German economy, although the growth rate in 2011 will be a slower one. Germany's main export target is Europe, especially the European Union. 75.7% of total exports are to Europe, and 64.8% to the European Union, France and Great Britain being the main export destinations. Worldwide, Germany's main partners are the US and China.

As regards German imports, the main source is again Europe and the European Union with 72% and 59.5% of total transactions. France and the Netherlands are the main countries in Europe wherefrom Germany imports goods, and worldwide it is China.

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