CITY A.M.

Why are our politicians obsessed with Germany?

Ryan Bourne

August 22, 2018

IT'S LIKE the equivalent of Godwin's Law, but for economic policy debates. Just as sustained Twitter disagreements eventually result in a comparison to Hitler, so discussion about economic policies tends towards advocacy of "being more like Germany".

In the US, Democrat Elizabeth Warren wants to replicate Germany's codetermination laws which mandate workers on boards of corporations. Back in 2011, former chancellor George Osborne was pushing for adoption of the so-called Mittelstand model for small and medium businesses. While calls to emulate German approaches to technical training, manufacturing, and export-heavy growth are common.

Why are politicians so obsessed with the German model?

Yes, it's a perfectly wealthy and pleasant country. IMF data shows GDP per head is the second richest in the G7 – though still way behind the US.

But since 1980, it's been a relative growth laggard. Annual GDP growth has averaged just 1.7 per cent over that period, against 2.6 per cent in the US, and 2.2 per cent in Britain. Yes, Germany has performed better than the UK since the crash. But that was at least in part because of Germany's smaller financial sector. US growth is now storming ahead, and prior to the Brexit vote, the UK's annual growth rate had leapfrogged Germany too.

We can learn lessons from recent German success, but they might be very different from the lessons politicians advocate. Germany's unemployment rate stands at just 3.5 per cent today (compared with around four per cent in both the UK and US). But just 13 years ago in 2005, it stood at a lofty 11 per cent – the highest in the G7.

A series of supply-side policies, known as the Hartz reforms, are widely credited as important for the subsequent turnaround. This included cuts to business taxes, union-agreed wage restraint, deregulation of temporary and part-time employment, and drastic cuts in benefit levels to the long-term unemployed. That combined with strong emergent market growth for exports has led to a strong labour market, albeit with high levels of atypical work.

Unfortunately, this nuance is lost in debate. Warren seems to believe that worker representation on boards will create a fairer version of capitalism - redistributing from shareholders to workers, and reducing inequality. But this doesn't chime with the evidence.

Marcel Fratzscher of the German Institute for Economic Research reckons your ability to get on in education or income is more tightly linked to your parents in Germany than in the US. Meanwhile, research by Oxford University economist Max Roser suggests that the level of inequality in Germany before taxes and benefits is actually higher than in America too. It's the redistribution that evens things up, not policies related to corporate governance.

Nor are codetermination laws costless. They have been estimated to reduce the value of German companies by 27 per cent. At least part of that is due to companies being less efficient than they might otherwise be. The crisis at Volkswagen showed some of the mechanisms through which this might occur. A corrupt chief executive agreed to protect the jobs of worker representatives in return for their fealty on other voting issues, despite well-known inefficiencies at certain plants. For dynamic economies such as the US and UK, who knows what damage would result from a move to this model?

Now all this is not to say that the German economy is some basket case. It isn't. It has an extraordinary export performance in emerging markets, trade links Britain would love to emulate.

Politicians seem to be attracted to its large manufacturing base. And while some would balk at the restrictions on individual choices for young people, its streamlined education system seems to provide decent technical training, and result in low levels of youth unemployment.

Yet, even in these areas of obvious strength, there is cause for concern. If automation really does lead to a more rapidly changing jobs market, those immersed in particular technical skills may struggle to adapt. As developing countries get richer, there is a tendency for demand for services to grow much more quickly than for manufactured goods too. It would be particularly daft to re-orient our economy to be more manufacturing-based just at the time demand for services is set to rocket.

We should always be looking to learn policy lessons from abroad, of course. But it's unclear why the German economy gets so much attention. And with demographic, technological, and global growth trends, it would be misguided for the US or UK to replicate the parts our politicians admire.

Ryan Bourne occupies the R. Evan Scharf Chair for the Public Understanding of Economics at Cato.