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**Article**

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CESifo Forum

**Provided in Cooperation with:**

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

*Suggested Citation:* Felbermayr, Gabriel (2016) : A World Champion, a Provocateur and the Impact of Economic Policy, CESifo Forum, ISSN 2190-717X, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 17, Iss. Special Issue, pp. 26-27

This Version is available at:

<https://hdl.handle.net/10419/166684>

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## A WORLD CHAMPION, A PROVOCATEUR AND THE IMPACT OF ECONOMIC POLICY

GABRIEL FELBERMAYR\*

Germany on 25 October 2004: the cover of the *Spiegel* magazine shows a rusty container and the headline *Germany: World Champion in Exports (of Jobs)*. The cover story explores what seems to be a paradox: how can Germany export more than any other country in the world on the one hand while suffering from record unemployment of 5 million and lagging behind in terms of economic growth on the other?

For Hans-Werner Sinn, this does not present any contradiction in terms – quite on the contrary. In his book *The Bazaar Economy. Germany: World Export Champion or Economic Slowcoach?* Sinn organises his attack on the complacent export fetishism of many of his contemporaries in two waves.

Firstly, high and growing exports are not necessarily linked to high levels of domestic prosperity and strong economic growth. An economy organised like a bazaar exports goods, whose main components it has previously imported without significant domestic value creation in the form of wages, profits or taxes. Such developments lead to booming exports and stagnating gross domestic product. In other words, what seemed like a paradox was not actually one.

Secondly, there is also no contradiction between being a world champion in exports and record unemployment. Hans-Werner Sinn shows that both are due to Germany's core problem: excessively high wages. Many German citizens in 2004 see this line of argument as provocative: if wages are too high, how can the German economy be so competitive that no other country exports more? The response originates in the

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standard model of international trade theory. The relatively capital-rich Germany exports capital-intensive goods – cars, machinery, chemicals – and imports labour-intensive goods. Wages above the market-clearing level create unemployment, lower employment and enable the country to appear more capital-rich than it is. It is obliged to increasingly specialise in capital-intensive export goods. This pathological overspecialization is accompanied by higher exports of cars, machinery and chemicals. And this is all due to – and not despite – higher wages.

Both points are closely related: the increasing capital-intensity of domestic production is only possible because the production of labour-intensive intermediate products is transferred to abroad and Germany increasingly becomes a bazaar economy. Both phenomena can be attributed to excessively high wages.

The term 'bazaar' has nettled Germans for years. Many companies with high-exports felt under attack because their high-tech products were semantically thrown into the same boat as trash and junk. In the *Financial Times Deutschland* (6 May 2005) Hans-Werner Sinn said: "at this point I would like to express my deepest regrets and would like to assure everyone that I also feel extremely sorry for German products. Please forgive me for my blasphemous choice of term".

As far as the facts are concerned, however, Hans-Werner Sinn proved an important empirical point. German exports as a share of domestic value creation has fallen from around 74 percent to 63 percent since 1995. It is clear that the higher the share of imported input goods, the less official export statistics are suitable as an indicator of economic strength. The OECD and WTO have recognised this and have been monitoring the phenomenon for the last two years with a self-constructed database. Moreover, current scientific research is focused on deepening our understanding of the value chain contents of international trade flows.

Since the publication of his book in 2005 Germany has changed significantly: the core problem of the pre-

vicious 'sick man of Europe' (*Economist*), namely rigid and excessively high wages, was addressed by the Hartz reforms. That fact that this turnaround actually took place was partly thanks to Hans-Werner Sinn's gift for provocation, which made technical economic arguments the focus of a broad economic policy debate. By dismantling the fable of Germany as an export wonder, Hans-Werner Sinn destroyed the illusions held by politicians and voters and paved the way for painful reforms, which defused the threat of deindustrialization.

Today Germany no longer occupies pole position in terms of export statistics. It has, however, made some progress as far as growth statistics are concerned: since its period as export world champion in 2003–2008, Germany's annual growth has accelerated from less than 1.5 percent to over 2 percent (since 2010). Others are now lagging behind as far as growth is concerned.

Germany's business model is nevertheless far from perfect. Germany once again became a world champion for several years now: no other country in the world has a higher current account surplus. Once again, however, this is no cause for joyful celebration. On the contrary, the surpluses are not sign of strength, but the result of misguided policy just like the pathological export boom. The distortion of the interest rate level through various euro bail-out policy measures channel German savings abroad, where they are used to buy German goods on credit. The intrinsic value of several of these investments is dubious. It is once again time for resolute reform. This time, however, Germany's fate does not lie entirely in its own hands and the reform required applies to the entire Eurozone.