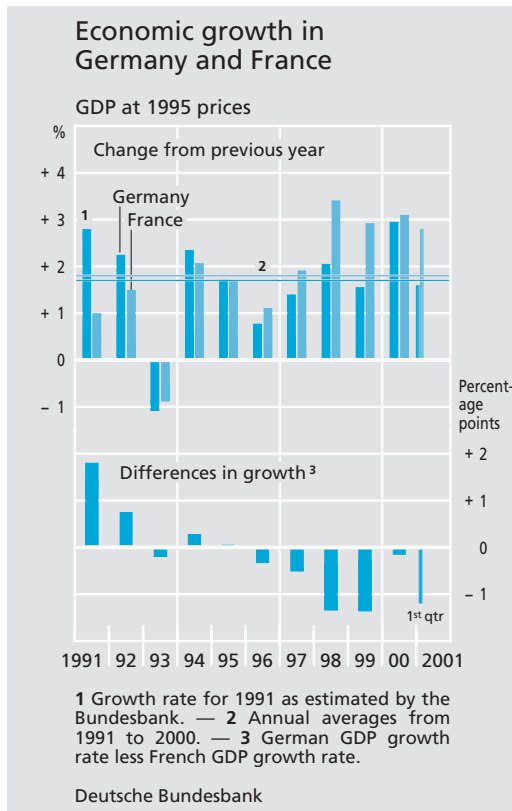


## Appendix: The growth differential between Germany and France

In the past few years the growth of the French economy was for the most part visibly stronger than that of the German economy. In the period from 1997 to 2000, French real GDP increased by an average of 2¾%, compared with +2% in Germany. For the first time since the beginning of the nineties the German economy showed some growth last year, mainly owing to a booming export demand. At 3.0%, this rise was significantly above the path of potential growth and only slightly lower than in France (3.1%). However, in the course of 2000 the pace of growth in German real GDP decelerated from an annualised 4% in the first six months to 2% in the second half of 2000, whereas in France it remained unchanged at an annual growth rate of 3% in both periods. For this reason the French "growth overhang" at the end of the year was, at 1½ percentage points, twice as high as in Germany. Furthermore, the underlying cyclical momentum showed a slower decrease in France after the turn of the year. All in all, there are many indications that as an average for 2001 the French growth lead will once again exceed its previous year's level. According to the IMF spring forecast, though, this growth gap is likely to diminish in 2002.

*France's higher  
growth in  
recent years*

This article aims to describe in somewhat greater detail the main reasons for the differences in growth in the second half of the nineties and in the recent past. In this context, the article critically examines the view held by many at present that the sluggish growth in Germany, compared with France and most of the other euro-area countries, is



not just a temporary slump but a long-term problem instead.

*A review of the nineties*

A review of the nineties shows that the economic implications of German reunification, in particular, caused the cyclical developments in both countries to drift apart. The whole decade can be broken down into three periods. In 1991 and 1992, i.e. in the first phase after political reunification, the German economy expanded much more strongly than the French economy. After a significant contraction in real GDP in 1993, the two countries showed more or less the same growth from 1994 to 1996, most of the time at rates beneath the respective path of potential growth. In the following period (1997 to 1999), the French economy accelerated markedly, whereas growth in Germany re-

mained subdued. It was only in the year 2000 that Germany managed to catch up and reached a pace of growth nearly as high as France. As an annual average over the 1991-2000 period, both economies grew at the same pace, at 1¾ %.<sup>1</sup>

The growth differential between Germany and France at the beginning and the end of the nineties is mainly due to differing cyclical developments in construction investment and investment in machinery and equipment as well as in private consumption. After the demise of the GDR, the demand for housing (which was boosted by massive government incentives), the need to eliminate public infrastructure shortages and also the housing shortage in the western part of Germany led to a construction boom. During this period, though, capacity in the construction sector and the supply of buildings, particularly in the new Länder, rose significantly faster than the ability of the real property market to absorb them. In addition, the public demand for construction projects was – also owing to the increasingly precarious situation of general government – reduced from 1993 on, and the numerous fiscal incentives for building owners were gradually scaled back in the second half of the nineties. As a conse-

*Divergences especially in construction...*

<sup>1</sup> The German national accounts include – on the basis of the ESA 95 – data on the levels for GDP and its components only from 1991; growth rates for the years from 1992 onwards can be derived from these data. It would make sense, however, to include the year 1991 in the growth comparison because the reunification boom reached its peak at that time and the actual collapse of production in eastern Germany already had a marked impact on developments in Germany as a whole. For that reason an estimated rate of change was included for 1991. There was no such approach with regard to the all-German series for demand components and other relevant ESA positions.

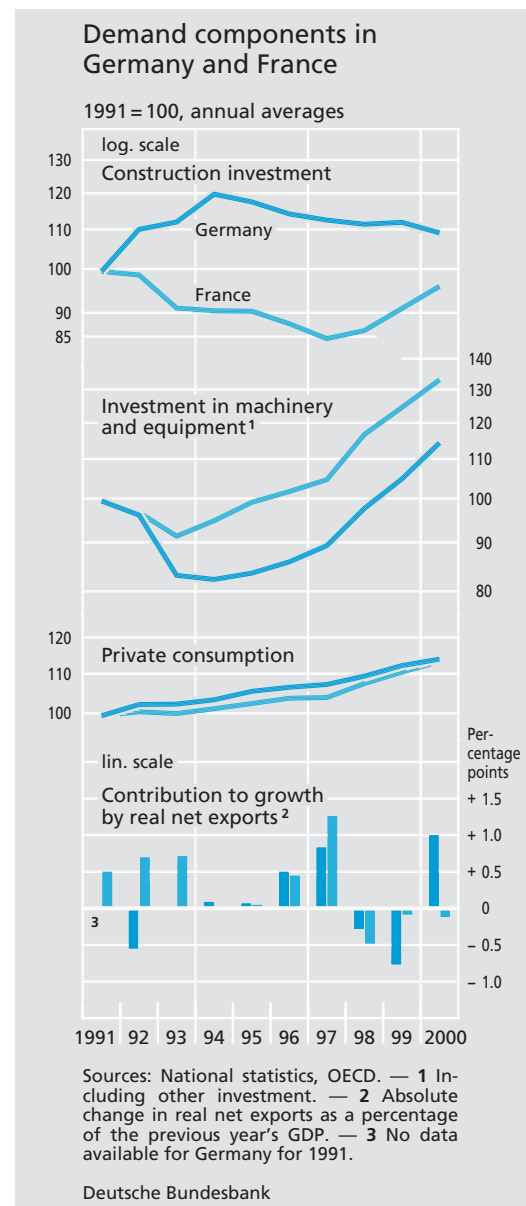
quence, the construction sector ran into a serious adjustment crisis in the mid-nineties, which it has yet to overcome. By contrast, real construction investment in France, which had sunk by one-sixth overall from 1991 to 1997, has been showing a clear rising tendency since 1998. Yet in 2000 it was still below 1990 levels.

*...but also in investment in machinery and equipment and...*

The sharp decrease in German investment in machinery and equipment (including other investment) in the period from 1992 to 1994 is likewise a reaction to the excesses of the past. During the reunification boom, the industrial sector, in particular, created capacities which could not be utilised in the short term. This had a restraining effect on the demand for machinery and equipment in the following years. Only since 1998 has investment activity recovered substantially. In France, the contraction of investment in machinery and equipment was markedly less pronounced in the early nineties than in Germany. Thereafter it strengthened considerably. In 1999 and 2000, the growth differential in investment in machinery and equipment shifted in favour of Germany.

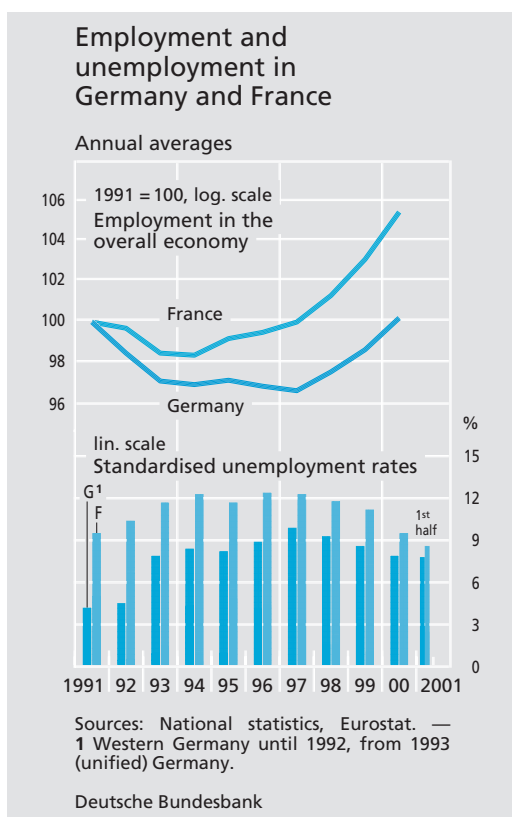
*...in private consumption*

A pattern of divergence similar to that in overall GDP can also be seen in private consumption. In 1991 and 1992, when consumer demand from German households was still increasing strongly, the French propensity to buy rose only marginally. That was followed by a phase (1993 to 1997) marked by relatively subdued consumption in both countries. Since 1998 private consumption in France has expanded more strongly than in Germany. On average throughout the nine-



ties, however, private consumption growth was no higher in France than in Germany. It must be kept in mind, though, that in the nineties the saving ratio of households in France showed an upward trend, whereas there was a marked decline in Germany.

Developments in French consumption over the past few years benefited from developments in employment being much more fa-



*Differences in developments in consumption are a reaction to diverging developments in employment*

vourable than in Germany. From 1998 to 2000, employment growth in France – which was supported by a generally moderate wage rate policy – was higher than in Germany; it rose by a cumulative 5½%, compared with + 3½% in Germany. This was due in no small part to measures to expand public sector employment. Furthermore, the compulsory reduction in working hours in the private sector entered into force at the beginning of 2000, accompanied (especially in large enterprises) by greater flexibility in working arrangements.<sup>2</sup> Even if it is not quite clear to what extent these measures have led to long-term employment growth, there are many indications that they had a stimulating effect on consumption in the period under review.

However, labour market trends in the two countries had already begun to diverge before then. The decline in employment in Germany in the early nineties had been significantly sharper than in France. Moreover, in Germany the decline in the number of people in work did not bottom out until 1997, when the French economy had already returned to its 1991 level of employment. In full-time equivalents, i.e. after the conversion of part-time jobs into full-time jobs, the employment rate differential was even greater in the nineties, owing in particular to the sharp increase in part-time low-paid jobs in Germany. The main reasons for the significant shedding of jobs in Germany in the years after reunification up to 1997 were wage policy excesses – especially during the economic upswing at the beginning of the nineties – and the considerable shedding of jobs in the new Länder, the latter having been triggered by the collapse of the east German economy. Added to this was the adjustment of east German wages to western German levels in the following years which was pushed through despite the sizeable productivity lag.

The growth advantage of the French economy in the past few years does not reflect advantages in foreign trade, though. In the period from 1997 to 2000, real exports as defined by the ESA increased in both countries by an average of just over 9%, and imports in France rose, at 9¼%, even more strongly than in Germany. Also in 1998-99 – when the

*Foreign trade developments at the end of the nineties largely similar*

<sup>2</sup> The reduction in the statutory working week from 39 to 35 hours has been in force since the beginning of 2000 for enterprises with more than 20 employees and since 1 January 2002 for all others.

crises in eastern Asia and Russia had a restraining effect on world trade – French exports did not outpace German exports. These crises could be felt much more in Germany, though, because the ratio of exports to GDP is traditionally much higher in Germany than in its neighbour to the west. On an average of the years 1997 to 2000, contributions to growth by real net exports in Germany and France, i. e. taking imports into account, were very similar to one another.

*Heterogeneous  
cyclical  
conditions in  
the second half  
of 2000 ...*

The growth gap between Germany and France, which had disappeared at one time, widened again in the second half of 2000. In particular in the last quarter of 2000, the underlying cyclical trend in Germany weakened substantially, whereas the French economy was still running at full tilt. There were two main reasons for these diverging tendencies. On the one hand, construction investment in France continued to witness strong growth, which contrasted again with a decline in Germany. French investment in machinery and equipment also expanded relatively sharply. On the other hand, real imports grew at a slower pace in France than in Germany. The result was a slightly positive contribution to growth by foreign trade in France, whereas in Germany it reduced overall economic growth – in purely mathematical terms – by  $\frac{1}{4}$  percentage point. The other demand components moved more or less in sync with one another.

*... and in early  
2001*

In the first quarter of 2001, French real GDP increased in seasonally and working-day-adjusted terms by  $\frac{1}{2}$  % compared with the previous quarter and thus only slightly more

strongly than in Germany. This increase was supported, however, by a robust final demand on the part of households which increased in France by 1 %, whereas it fell in Germany by  $\frac{3}{4}$  %.<sup>3</sup> For one thing, this reflects the continuing contrasts in construction. German construction investment undershot its level in autumn 2000 by not less than  $5\frac{3}{4}$  % in seasonally adjusted terms, compared with an increase of  $1\frac{1}{2}$  % in France. Secondly, the stagnation of private consumption continued in Germany, whereas a seasonally adjusted rise of  $1\frac{1}{4}$  % was recorded in France.

The stronger consumption growth in France in 2000 and in the current year is partly attributable to the fact that households do not spend such a large percentage of their budget on heating oil as do German private households and were therefore not hit quite as hard by the rise in oil prices. In the light of the negligible differences in dependence on oil and gas imports<sup>4</sup>, however, it is likely that the effect on the French economy as a whole was similar to that on the German economy, since the increase in crude oil prices and the depreciation of the euro influenced both countries to the same extent.<sup>5</sup> In this context,

*Differences in  
households'  
dependence  
on oil*

<sup>3</sup> This contrasted, however, with a sizeable reduction in inventories in France associated with extraordinary high exports of planes and ships. Hence the decline in inventories is only to a minor extent the result of a cycle-induced adjustment. In seasonally adjusted terms, French exports stagnated during the winter months, whereas German exports decreased by  $\frac{3}{4}$  %. When adjusted for the aforementioned settlement of large orders, French exports declined as well.

<sup>4</sup> Calculated on the basis of the OECD International Trade by Commodities Statistics and measured as a percentage of GDP.

<sup>5</sup> According to the national accounts data, the deterioration in the terms of trade in 2000 was smaller in France than in Germany. This might be linked at least partly to methodological differences regarding the deflators of exports and imports.

the greater importance of nuclear energy for power production in France is relatively insignificant, since in Germany not only nuclear energy but also, and in particular, lignite and hard coal are used to manufacture electricity. Like those of nuclear fuels, the prices of these components are, at least in the short run, largely independent of oil prices.

*Similarities and differences in taxation policy*

Private consumption in France was also influenced favourably by the fact that the French government, in its 2000 budget act, cut taxes (including the value-added tax as from 1 April 2000) and, in late summer, instituted various tax relief measures to cushion the oil-price-related losses incurred by households (and enterprises). All in all, the tax reduction programme brought relief amounting to 1% of GDP in 2000.<sup>6</sup> Added to this were tax relief measures introduced at the beginning of 2001 which will amount to a further 1% of GDP in the year in progress and are largely directed towards households. In Germany, the 1999-2000-2002 Tax Relief Act also led to a tax cut for households in 2000; however, this reduction was smaller in Germany than in France. Furthermore, there was not any significant direct government assistance for consumers of mineral oil products – apart from some relatively minor “socio-political” measures. The relief associated with the German tax reform, which entered into force on 1 January 2001, can be put at just over 1% of GDP. Moreover, the pension insurance contribution rate was lowered, as in the year before. However, this contrasted with the depletion of purchasing power owing to the third stage of the energy consumption tax as well as to increases in administered prices. The di-

verging developments in indirect taxes and administered prices in both countries also manifested themselves in the respective consumer price developments. Taking together both of the aforementioned price-boosting factors, inflation in Germany was pushed upwards by around ½ percentage point. Since summer 2000 the rates of price increase have been higher in Germany than in France owing mainly to these factors.

In spring, the pace of economic activity in Germany and France continued to slow down. This is shown by a number of indicators. The index of industrial confidence decreased significantly. In Germany and France, manufacturing output in the second quarter and in April-May, respectively, remained well below the levels reached in the first quarter. For the first time in a long while, French consumer confidence deteriorated. Construction activity also lost momentum in France. During the spring months, real GDP in France seems to have increased only marginally in seasonally and working-day-adjusted terms. However, there are no official data available yet. In Germany, economic growth appears to have come to a standstill in the second quarter (for more details see pages 36 ff.).

*Economic conditions in both countries in spring*

All in all, it is safe to say that the growth differential between Germany and France which has reappeared since mid-2000 is mainly the result of extremely weak construction output in Germany, but construction could bottom out this year. The yearly increases of the “ecology tax” also had negative effects on

*Summary of the comparison of economic cycles*

<sup>6</sup> See: OECD Economic Surveys, France, Paris, July 2000, p. 55.

*Growth of  
potential  
output and  
challenges of  
the labour  
market*

the German economy which were even reinforced by increases in administered prices.

Overall, the past and present growth differential between Germany and France explained in this article does not seem to be long-term in nature. It is primarily due to an asynchronous cyclical trend that is linked with special factors in the 1990s. This finding is supported by international institutions' estimates of potential growth, which estimate French potential growth to be, on average, no higher than  $\frac{1}{4}$  percentage point above that of Germany. This difference is not only considerably smaller than that in average GDP growth of the

past few years but must also be seen against the background of considerable uncertainties in the estimation of the medium-term production potential. As far as developments in the labour markets are concerned, both countries are facing great challenges to remedy the lack of jobs. Over the past few years, France has managed – also with the help of administrative measures – to achieve greater reductions in unemployment than Germany. In the middle of 2001, however, the seasonally adjusted standardised unemployment rate was still well above the corresponding German figure (8.5%, compared with 7.8% in Germany).