

UNCLASSIFIED  
SAVING TELEGRAM

FROM BONN  
FRAME ECONOMIC

TO FCO TELNO 4 SAVING OF 31 MARCH 1988. Info. Brussels,  
Luxembourg, The Hague, Paris, Rome, UKRep Brussels,  
UKDEL OECD, UKMis Geneva, all Consulates-General in the  
Federal Republic and West Berlin, Washington, Tokyo,  
Vienna.

FRG ECONOMY

SUMMARY

1. During the debate in the Bundestag on the Government's Annual Economic Report, the Federal Finance Minister was bullish about economic development: 1.5% to 2% was realistic. The debate touched on suggestions by the SPD Deputy Chairman for a cut in working hours without full wage compensation to reduce unemployment. Support from some quarters but union leaders generally opposed. There were further moves towards a shorter working week: agreements were reached with public sector workers and in the construction industry for wage increases and for reductions in weekly hours to 38.5 and 39 respectively.
2. Independent forecasts for the economy indicate greater optimism and some now agree with the Government projections. There was concern about a further fall in the value of the dollar and in investment. Annual reports from the major companies give a mixed picture but turnover is generally lower than in 1986.
3. Provisional Q4 figures and revised end-year results were released confirming growth in real GNP of 1.7% last year. Exports rose by 0.8% in real terms and imports grew by 4.8%. Revised Federal spending figures were also released indicating a 2.9% increase to DM 269.047 billion against a 1.2% rise in revenue to DM 241.129 billion. Federal deficit was confirmed at DM 27.89 billion. Länder spending also increased by 4% to DM 252.2 billion while revenue rose by 3.5% to DM 233 billion. The Länder are seeking ways of raising their revenues or reducing their obligations.
4. Agreement was reached on financing DM 18.9 billion of the gross DM 39.7 billion tax reductions planned for 1990, though there were reports of friction within the coalition. Parliamentary approval is to be sought by the summer recess.
5. The debate continues concerning further development of the EMS and progress towards European Monetary Union. The Federal Finance Minister has issued a memorandum which is intended to form the basis for a Cabinet decision on the German position. The first meeting of the Franco-German Economic and Finance Council in Bonn on 21 March appears to have concentrated on reviewing economic prospects in the two countries.
6. The privatisation programme took a step forward with the sale of the Government's remaining 16% holding in Volkswagen AG raising DM 1.14 billion. The programme appears to tail off after next year though the Government claims to have other plans.
7. The February business climate survey indicated a continued improvement. Provisional new order figures for January rose by 4% while production rose by 2%. Construction soared by 21% helped by the mild winter.

8. Inflation, cost of living index, rose to 0.9% in February and provisional estimates for March indicate a small rise to 1%.

9. Unadjusted unemployment in February fell to 2.52 million (9.9%), a smaller fall than had been predicted. The adjusted total was 2.22 million.

#### DETAIL

10. March began with the debate in the Bundestag on the Government's Annual Economic Report (my telno 2 Saving). Introducing the debate, the Federal Economics Minister struck a typically bullish tone: the upturn in the economy was continuing; growth in real GNP of 1.5% to 2% was realistic; industrial production was healthy, capacity utilisation had increased further, private consumption was growing strongly and even the troubled construction sector was stronger in seasonally adjusted terms. The opposition called such optimism misguided but in the end the debate passed off with little excitement and no discomfort for the Government.

11. In his speech to the Bundestag, Bangemann praised the SPD Minister-President of the Saarland, Lafontaine, who had earlier suggested a reduction in working hours without full wage compensation as a way of easing Germany's unemployment problems (my telno 3 Saving). Genscher called the idea forward looking. Coming as they did from a Deputy Chairman of the opposition SPD, Lafontaine's comments caused consternation among leading trades union figures. The leader of one of the largest, the metalworkers' union IG Metall, called the suggestion a stab in the back for the labour movement. The party leader, Vogel, supported Lafontaine, though the party's working group on labour questions made clear their opposition at a meeting in the Hesse Land capital, Wiesbaden. The leader of the DGB (TUC equivalent) gave his qualified support. The employers' association, the BDA, claimed that a 5% cut in hours and wages would add a corresponding 5% more jobs. Polls conducted for national newspapers indicated that some 60% of those questioned would accept the suggestion if it resulted in more jobs.

12. The debate rumbled on in the midst of negotiations for wage increases and a shorter working week by the public sector workers' union and in the construction sector. The public sector claim went to arbitration following which it was agreed that wages would rise by 5.2% in stages up to 1990. The 40 hour week will be reduced to 39 next year and to 38.5 in 1990. The deal covers 2.6 million workers. The construction sector settled with a 3.6% wage increase this year followed by 3.3% next year and a reduction in weekly hours to 39 in 1990. Both agreements are indicative of the extent of the movement towards a shorter working week across the whole range of industrial and service sectors.

13. The peaceful wage settlement apart, there is little else to cheer the construction sector. The Federal Statistical Office released provisional Q4 and revised end-year figures for 1987 GNP (see below) which showed that construction investment grew by only 0.2% compared with Q4 1986 and that the annual growth was only 0.1%. The residential sector remains particularly badly hit. Housing completions in 1987 fell to their lowest level ever, 217,000, a 14% drop on 1986. Despite a good start to this year helped by the mild winter weather, the Construction Association admitted that it expected stagnation, although it was slightly more optimistic about the residential sector. In its latest forecast for the economy, however, the Deutsche Bank reported an increase in building permits

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THE ECONOMY OF THE FEDERAL REPUBLIC OF GERMANY: HICCUPS OR FEET OF CLAY?

Summary

1. The German economy was once regarded as a model for us all. Yet grudging admiration has turned into fierce international criticism at the perceived under-performance of the economy. There are signs too that domestically all is no longer well. The Government has only part fulfilled its election commitments. Promises to reduce taxes have been kept but little action has been taken to tackle more serious structural problems. The Ambassador examines the causes and their effect on Germany and Britain. (Paras 1 and 2)
2. The structure of the economy is gradually changing but rigidities ensure the predominance of manufacturing industries. Services, particularly financial services, remain the handmaiden of industry. There are few pressures for radical change. Subsidies abound, particularly in the "rust belt" industries and certain politically sensitive regions. (Paras 3-5)
3. Is desirable structural economic reform likely? Debate has proved difficult to stimulate. The "Solidarität" of the social market economy is preferred, evidence the Ruhr Conference of 24 February. (Paras 6-8)
4. The German political system is ponderous and indecisive. Economic action is conditioned by public perceptions of the Government's social responsibilities. Politicians have limited ideas and/or influence. The Bundesbank, at odds with the Government last year, has failed to throw its weight behind the declared Government policy of reducing subsidies and increasing competition. (Paras 9-11)

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5. The main agents of structural change will be external. The GATT may provide a forum, especially with agriculture and services now on the agenda. But intra-European trade relations are a more effective catalyst. Work in the EC concerning subsidies and regional aids will need careful management. Progress towards the internal market will be an incentive to liberalisation. We need to consider how best to harness the German commitment to the Single Market to develop their national economy. Our service industries need to be ready to take advantage of the opportunities provided. (Paras 12-16)

6. Radical progress is not on the cards but the fundamentals of the German economy are strong. It will continue to grow, albeit slowly. In trade, the importance of Western Europe will increase and Eastern Europe will be given attention. Demographic pressures will make the need for structural change appear more urgent but the Government will avoid difficult choices as long as it is able. (Paras 17-20)

7. The problems are part cyclical but mainly structural. They will not go away. The Government's response will reveal whether or not the feet are made of clay. (Para 21)