The Potential Return of the German Economy to the «Sick Man Of Europe» Status: Causes, Risks and Possible Implications

ANA-CRISTINA BÂLGĂR, PhD.
Institute for World Economy, Romanian Academy
ROMANIA
Bucharest, ROMANIA
anacristinabalgar@gmail.com /https://iem.ro/

Abstract: Around a quarter of a century since Germany was labelled "the sick man of Europe" for the first time, the weak performances the federal economy experienced this year brought the country back to the centre of European and international debates regarding the likely risks posed by the possible lengthening or acceleration of the current cycle of economic decline. While, in the past, the triggers of the first stage of profound contraction experienced by Germany were mainly endogenous (i.e. huge costs required by the completion of the reunification process, a stagnant labour market, an excessive taxation system etc.), at present they are mainly based on the interaction of destabilising forces of exogenous origin: the impact of the Covid-19 pandemic, followed and amplified by the consequences of the Russian-Ukrainian conflict and the resulting energy crisis. Against the background of the recent geopolitical context, our article seeks to provide a comparative analysis (past vs. present) of the two recession phases that Germany went through, revealing both the causes of their occurrence, and the steps taken (or envisaged) by the national decision-makers to help the federal economy recover and to relaunch growth. We will also highlight in our research the potential domino effects for the other European Union Member States, which could be triggered by a lengthy or profound German recession.

Keywords: German economy, "the sick man of Europe", German growth model, structural challenges, reform

JEL classification: E00, E01, E32, E66

1. Past references: Germany's journey from "the sick man of Europe" to a new "economic miracle"

1.1. Explanation of notions

With its first use attributed and attested by historians to have belonged to tsar Nicolay I of Russia[1] (de Bellaigue, 2001), the phrase "*sick man of Europe*" was employed over the years to designate a large European power in a (prolonged) stage of decline (e.g. economic, (geo) political, structural etc.), which generates destabilising forces able to trigger chain effects for other states, thus inducing a risk of contagion.

Later on, during the 20th century, this label began to be used by analysts, researchers and representatives of the academic environment and/or of the international economic media to describe the poor situation experienced by Russia during the 1917 Revolution or the decline of the British Empire (in the 1970s). In 1998, as a result of the major challenges generated by the reunification and the subsequent low-performance results, economist Holger Schmieding[2] used it to refer to Germany (Prakash, 2023; Schasfoort, 2023). Then, in the context of the launch of the euro, which fed into the Community fears that the prolonged decline experienced by the federal economy could cause contagion effects for other European countries, in 1999, an analysis developed by the British publication *The Economist* called Germany "*the sick man of euro*" (The Economist, 1999). Despite the unfavourable circumstances briefly descried above, both as a result of the ample reforms started in the early 2000s ("the 2010 Agenda"), and of the somehow unique structure of the German economy (i.e. a profoundly decentralised wage negotiation system) – which we will present in the course of this analysis –, beginning with 2005, the country started a sustained recovery and relaunch process, turning from a stagnating economy into a

[1] Who, in the second half of the 19th century (1853), used it to describe the progressive weakening of the Ottoman Empire, which threatened to undermine Europe's already fragile balance (McCollum, et al.).
[2] Who was at the time the chief economist of the European Division of the U.S. investment bank "Merrill Lynch".

true development model, being metaphorically named an “economic superstar”[3] (Dustmann C. , Fitzenberger, Schönberg, & Spitz-Oener, 2014; Dustmann C. , Fitzenberger, Schönberg, & Spitz-Oener, 2018).
In 2023, two decades and a half after being called the last in line in Europe, contradictory discussions have begun again at national and international level regarding both the medium- and long-term evolution of the largest European economy, as well as regarding the likely chain effects that its possible entry into a phase of prolonged recession could have for other EU Member States.

1.2. The first “disease” of the German economy (1998/1999-2005)

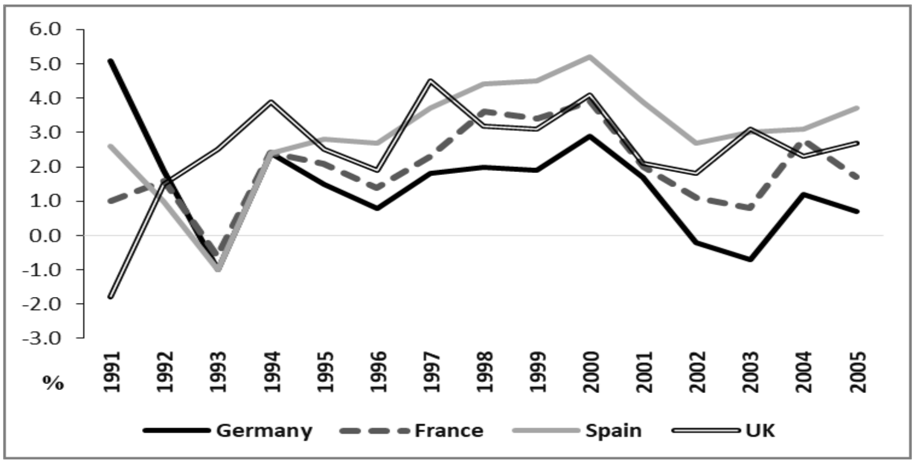
1.2.1. Causes of the onset of the first major economic contraction

In the period immediately preceding the start of the new millennium, the German economy was facing ample challenges caused by the cumulated action of a set of factors of both internal, and external nature: a) the impact of the economic costs generated by the reunification (1990) and by the need to bridge the productivity gaps between West Germany and East Germany, two countries that were situated on very different levels in terms of development and social welfare; b) the adoption of the West German currency[4] at a greatly overvalued rate, of 1:1 DM/DEM, in the conditions in which, prior to the reunification, the parities on the currency market varied between 1:3-1:7 (Dauderstädt, 2013); c) the negative consequences of adopting an erroneous economic policy (on the labour market, in particular on the labour market), which led to the intensification of pre-existing deficiencies; d) the effects of the economic shocks occurring on the world stage – i.e. the Mexico crisis (1994-1995) and the Asian financial crisis (1997-1998) –, which, in correlation with a significant appreciation of the national currency, affected the evolution of German exports, already on a downturn as a result of the discontinuation of certain economic flows of the former GDR (i.e. to the ex-communist block) (European Commission, 2002).

As a consequence of the rapid increase of the salary income above the productivity rate of the former GDR – on the one hand, as a result of the exchange rate overvaluation and, on the other hand, as a result of the trade union pressures which determined salary increases up to the level of those in the West –, correlated with the discontinuation of the traditional commercial flows[5], the East German economy started to collapse. In these conditions, the completion of the GDR incorporation process – desirable and politically indispensable – required that around 50% of the consumption of the former democratic republic be financed by West Germany, using funds that mostly came from transfers from the social security system, together with government loans[6]. As it turned out, the enormous cost of the unification burdened the German economy to an unprecedented degree, partly accounting for the weak performances the country achieved during the 1990s and until the early 2000s. Also, it must be noted that while Germany was trying to overcome the major difficulties it was facing during the final years of the 20th century, the economies of other EU Member States were going through a stage of sustained growth (Chart 1).

[3] In the period of more than a decade (2006-2018), that the “new German miracle” lasted, a series of EU Member States took turns at being called “the sick man of Europe”: Italy (2005), Portugal (2007), Greece (2011), and even the Eurozone as a whole (2013).
[4] In 1990, the Deutsche mark (DM) replaced the former East German currency – *Ostmark* (in German) [DEM].
[5] In the conditions in which, on the one hand, the former socialist states that were traditional trade partners of the GDR were facing their own imbalances caused by the collapse of the communist regime and, on the other hand, because reunification required a reconfiguration of the commercial relations of the two ex-republics that were now forming a unitary state.
[6] According to estimate calculations made by the *German Council of Economic Experts*, in the period between 1991 and 2003, these transfers totalled approximately EUR 900 billion, which represented around half of Germany’s annual GDP at the time (German Council of Economic Experts, 2004).

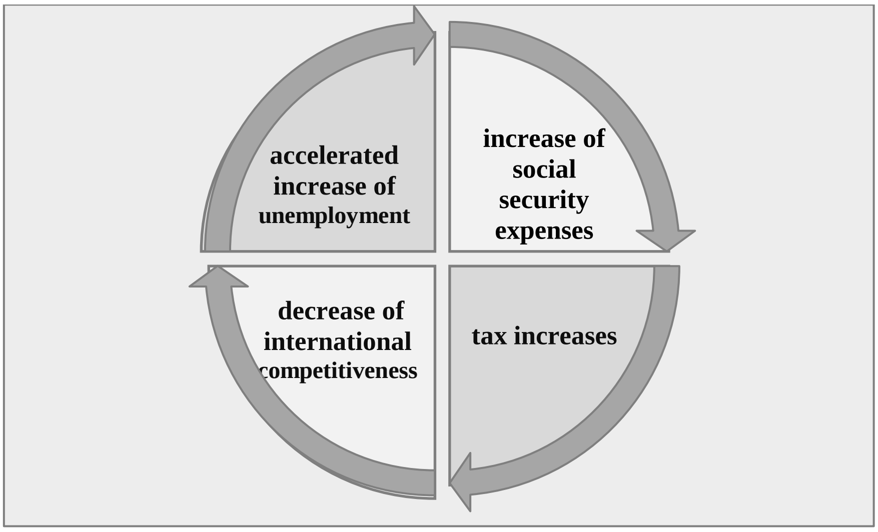
Chart 1: Year-on-year variations of Germany's real GDP growth rate compared to other EU Member States, 1991-2005 (%)



Source: Author's graphic representation based on the data published by the Federal Statistical Office (Destatis), Eurostat, World Bank (2023).

At the same time, East German unemployed persons and persons at the standard retirement age – or those who requested early retirement before reaching this age – were receiving social benefits without having paid contributions to the West German social security system and, furthermore, without any solid basis of similar contributions in East Germany. In these circumstances, to maintain the sustainability of the national social security system, the monthly individual contribution rates were substantially increased, determining an increase of non-wage related workforce costs. On the medium and long term, this measure determined an accelerated trend among German companies, including SMEs, considered to be the backbone of German industry, to externalise production to Central and East-European countries (as a result of the intensified globalisation process), thus exercising new pressures on the labour market and causing a further deepening of unemployment (already a two-digit figure). This is how a vicious circle was created which in the end led to a reduction in the competitiveness of German exports (Figure 1), the foundation around which the national growth model was gravitating.

Figure 1: Components of the vicious circle that affected the German economy in the late 1990s and early 2000s



Source: Synthetic processing and graphic adaptation by the author based on The Economist (1999) and Schasfoort (2023).

Against the background marked by the tensions described, the integration into the Economic and Monetary Union (EMU), accompanied by the introduction of the European single currency beginning in 1999, represented a new source of concern for the German governmental authorities, because it brought with it the loss of national control over the monetary policy in favour of the European Central Bank (ECB), as it was now impossible for the Deutsche Bundesbank to establish the interest rate and/or use the exchange rate as an economic policy instrument, or to resort to other alternative adjustment mechanisms in the future.

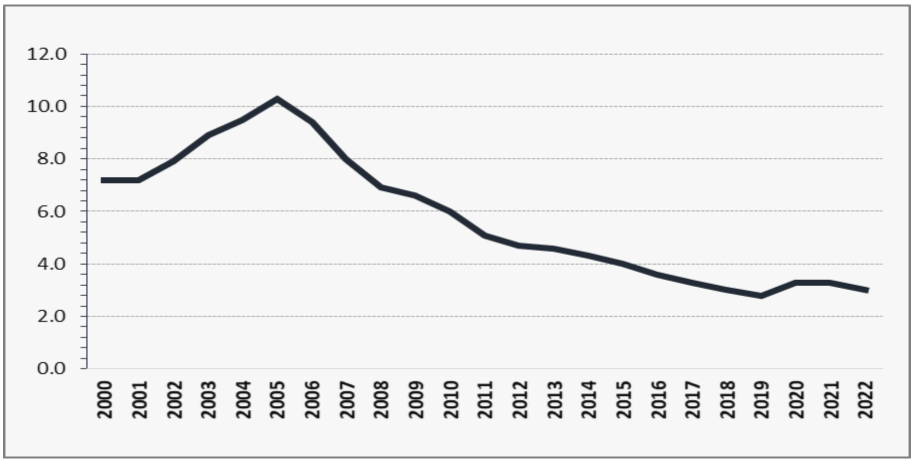
As we stated at the beginning of our analysis, a direct consequence of Germany's low-performance economic results in the period after 1990 was that of being labelled "the sick man of Europe". However, this perception was by far more dominant domestically than abroad, with a very large number of German economic analysts, representatives of the national political and business environment, as well as numerous economic research groups and think tanks pleading in favour of the strict necessity to reform the labour market and the social security system, and warning against the imminent risk of otherwise losing external competitiveness (Dauderstädt, 2013). Although, at first, the federal government led by Gerhard Schröder (1998-2005) received with scepticism the arguments brought by the national economists, as Germany was recording a permanent surplus balance of trade, despite the reduced competitiveness invoked by reform promoters, the coalition formed of the social democrats and the environmentalists eventually aligned itself with the dominant internal rhetoric.

1.2.2. Measures intended for economic recovery and relaunching growth

The reform package proposed by the Schröder Chancellery – a series of measures reunited under the title "Agenda 2010", but generally known as the "Hartz Reforms" (IV) – materialised in the preparation of four distinct regulations (with a phased applicability: 2003-2005), centred on a few main directions of actions and aimed at: a) revitalising and streamlining the labour market and the national social security system (by reducing social benefits and/or strengthening the conditions for their granting); b) speeding up the processes for the reintegration of unemployed persons on the labour market (such as: the introduction of professional training courses, the reduction of the period during which the unemployment benefit was granted, the extended use of fixed-term contract employment etc.); c) the liberalisation and flexibilization of the market in order to boost workforce demand (e.g. extended use of marginal employment forms; the granting of subsidies to enable the transition from unemployment to entrepreneurship etc.) (Ruoff, 2016); d) restructuring the pension system (e.g. the reduction of the share of the gross monthly salary used in the pension calculation formula, increase of the retirement age etc.) (Bastasin, 2013).

Structural reforms introduced on the labour market and in the German social security system (Hartz IV) represented the building blocks for the future economic growth, due to the enhanced pressure exercised on the unemployed to re-enter the labour market, which proved to be effective in a few years (Chart 2).

Chart 2: Evolution of unemployment rate in Germany[7], 2000-2022



Source: Author's graphic representation based on data published by Destatis (2023).

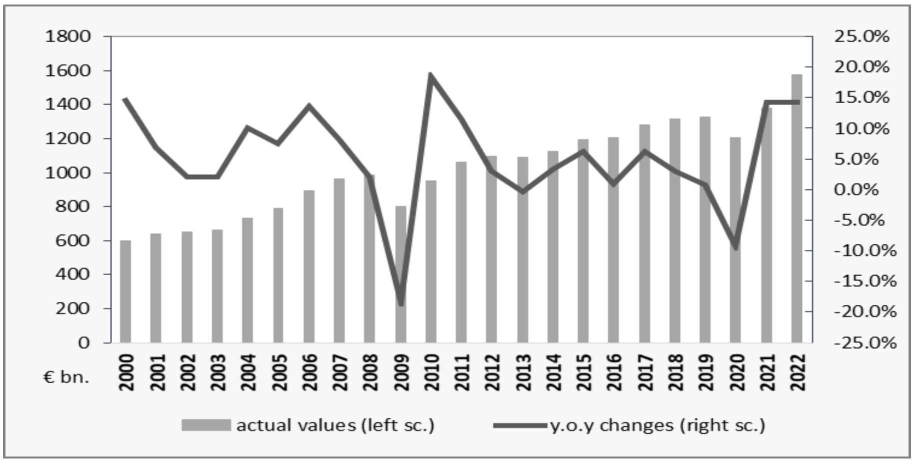
Nevertheless, although according to some authors the Hartz reforms represented the catalyser for the achievement of the future "German miracle" (Bouvard, Rambert, & Romanello, 2013), others consider that their scope was too modest to have been able to trigger a significant increase of competitiveness and the major decrease of German unemployment, or to have generated later on the performances reached by the federal labour market during the deep recession of 2008-2009 (Dustmann C. , Fitzenberger, Schönberg, & Spitz-Oener, 2014). As such, economic analysts belonging to the second group argue that the main factor that determined the relaunch of economic growth was the German wage moderation policy[8], a direct result of the acceleration of the

[7] According to the concept of the International Labour Organization (ILO).
[8] Initiated in the mid-1990s, i.e., before the launch of the "Agenda 2010" reform program.

decentralisation of the German collective bargaining co-decision procedure in each and every company[9], which shifted from the sectoral and regional level (previously), to a company-specific one. In other words, the new realities of the time and the increasing trend among German companies to externalise their production activities to the emerging economies of Central and Easter Europe – where labour costs were significantly lower – led to a change in the pre-existing relations established between employer federations, on the one hand, and unions and/or works councils on the other, in the sense that, in order to re-establish the health of the national economy, the latter proved a flexibility that exceeded initial expectations, and accepted a series of concessions and derogations from the sectoral conventions (Baccaro, 2018).

In our opinion, the two types of measures – the Hartz reforms and those seeking to curb down the salary income dynamics – acted concomitantly and strengthened each other, with their combined action resulting, on the one hand, in the decrease of labour unit costs[10] and, on the other hand, in the increase of employment (in particular in export industries). The simultaneous action of these favourable vectors, coupled with the depreciation of the euro (at the beginning of the 2000s), enabled the German industry (weakened during the post-reunification period) to regain its external competitiveness, leading to the progressive acceleration of the demand for German exports (Chart 3).

Chart 3: Evolution of German exports, 2000-2022



Source: Graphic representation and calculations of the author based on the data published by Destatis (2023).

As we have shown, until 2005, the year in which Angela Merkel became Chancellor (in November), the state of the German economy was not yet stabilised, as the country's economic growth was still falling short of potential (Chart 1) and its unemployment was still high (a double-digit rate; Chart 2) – indicating that the effect of the measures adopted by the previous government had yet to be felt[11] –, the position of government finances was and had already been for several years in breach of the EU regulations in the field, while exports, the main growth pillar, continued to be exposed to the risk of losing competitiveness.

1.3. The pathway towards the new German "economic miracle"

Beginning in 2006, the German economy started to feel the first stimulating effects caused by the structural adjustments implemented in the previous years. The economic relaunch process that began was mainly driven by exports and investments – in the conditions in which, against the background of salary limitations and the resulting budget constraints, private consumption continued to remain at a low level –, determining the additional increase of employment and the creation of jobs with a high technological component. In addition, there were also other factors that played their part in the economic revival installed in the federal economy: a) the increase of the volume of global trade, fuelled by the growing demand from the emerging Asian countries (China, in particular); as well as b) the favourable conditions resulting from the creation of the EMU which eliminated the risk of appreciation of the exchange rate in relation to the currencies of European partners.

[9] This process was possible because of the specific governance structure of the German industrial relations system at business sector level. Although this structure is not regulated by law, nor dictated by political decision-makers, it is still stipulated in the contracts and agreements concluded between the main three categories of social partners active on the labour market: union organisations, employer associations and works councils (employee representatives).

[10] For example, in the 2000-2008 interval, nominal unit costs with the workforce only grew 5% in Germany compared to 30% in countries such as Spain or Italy (Delorme, Leron, & Padis, 2021).

[11] Being known that the labour market is slow to react to external stimuli.

Subsequently, the government led by Angela Merkel continued the series of reforms aimed at creating jobs, increasing the competitiveness of national companies and speeding up investments. From among these, we mention: a) the reduction of unemployment insurance contributions, a measure funded from the increase of the VAT rate (from 16% to 19%) [in 2007]; b) the decrease of the tax rate applied to undistributed company profits[12] [in 2008].

As a consequence of the reforming policies which contributed to the increase of the international competitiveness of German exports, the labour market continued to improve its performances even during the two consecutive crises that affected the international and European economies beginning with the end of 2008[13]. Germany's high external competitiveness was reflected by the permanent trade and current account surpluses (after 2001, when the last one was recoded) [Table 1].

Table 1: Germany's main macroeconomic indicators, 2000-2022

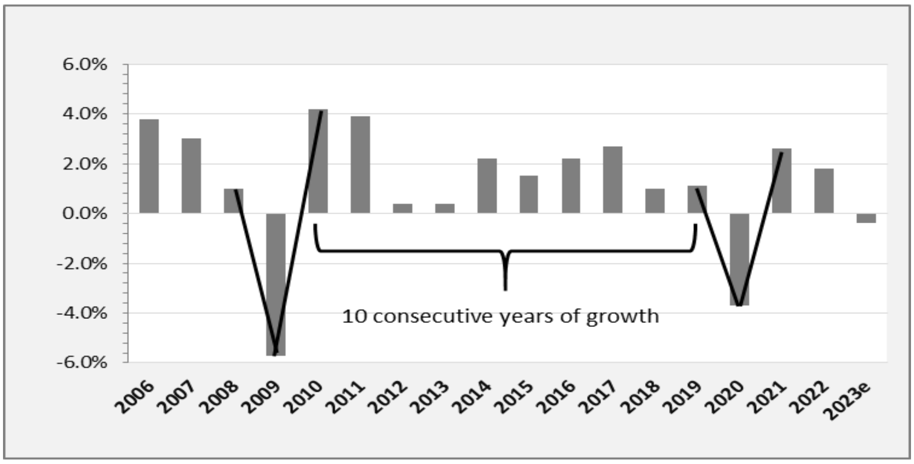
	2000	2005	2010	2015	2020	2021	2022
GDP (EUR bn.)	2,109.1	2,288.3	2,564.4	3,026.2	3,403.7	3,601.8	3,869.2
GDP/inhabitant (EUR bn.)	25.892	28,134	31.942	37,046	40,929	43,481	46,264
Persons in employment (domestic concept, mil.)	39.8	39.2	41.0	43.0	44.8	44.9	45.5
Unemployment rate (ILO concept, %)	7.2	10.3	6.0	4.0	3.0	3.2	3.1
Trade balance - goods (EUR bn.)	59.1	158.2	154.9	244.3	180.4	175.3	82.3
Trade balance - goods (as % of GDP)	2.8	6.9	6.0	8.1	5.3	4.9	2.1
Current account balance (EUR bn.)	-38.8	105.5	142.1	261.1	240.2	266.7	162.3
Current account balance (as % of GDP)	-1.8	4.6	5.7	8.6	7.1	7.4	4.2

Source: Author's compilations and calculations based on the data published by Destatis and Deutsche Bundesbank (2023).

Even in the years in which the world economy was affected by the financial crisis (2008-2009) or by the sovereign debt crisis (2012-2013) – which were shocks that severely affected international trade –, the Germany's current account surplus against the GDP was of around 6% (Deutsche Bundesbank, 2023).
However, it must be noted that the occurrence of the financial crises had a particularly severe impact on the German economy too, causing the most serious contraction of the annual GDP in the post-war period (of 5.9%: Chart 4), in the context in which the ample decrease of global demand affected the fundamental pillar of the federal economy – exports (which decreased by more than 18%: Chart 3). In response, the federal government led by Angela Merkel launched two Keynesian-inspired anti-cyclic packages comprising a series of interventionist measures that were unusual for the German standards on budget austerity. These consisted of tax cuts accompanied by the use of reduced working hours (*Kurzarbeit*) which, during the crisis, covered over 1.5 million jobs[14]. The government's strategy proved to be a successful one in the conditions in which the global economy recovered surprisingly fast and, with it, the demand for the products of the German economy as well, a trend that significantly boosted the rapid relaunch of growth.

[12] In fact, this was the only tax cut measure adopted during Angela Merkel's administration, except for those comprised in the packages that sought to counteract the crisis situations (of 2009 and 2020), because with the "debt brake" introduced as a Constitutional amendment – in the context of the financial crisis of 2009 –, the country's tax system became much stricter.
[13] For example, while during the financial crisis states such as Spain or Greece were seeing unemployment rates that fluctuated between 21 and 25%, in Germany, the number of unemployed persons progressively decreased and, at overall EU level, Germany became one of the countries with the best results in this area (Petersen & Esche, 2016).
[14] Despite the overall disturbances in the economic activity, Germany was the only major economy that recorded a decrease of unemployment during the financial crisis.

Charts 4: GDP growth in Germany: percentage changes on the previous year, 2006-2023*



Note: * current estimates for 2023;
Source: Author's graphic representation based on the data published by Destatis (2023) and the European Commission (2023, for estimates).

As shown by the data above, the abrupt reduction of the federal GDP in 2009 was followed by a very strong recovery beginning with 2010 – a "V-shaped" recession –, which repositioned the German economy on the trajectory started in 2006.

As a result of the performances achieved in the 2010-2011 interval – respectively: a) a GDP_{2011} higher than that achieved in the years before the crises; b) an employment rate on a dynamic trajectory; and c) a manageable public debt ceiling which could be supported by the increase of tax revenue (although public debt was significantly higher than in 2006-2007, at approximately 79% of the GDP in 2011, compared to 64% in 2007, it remained well below the levels seen in other Eurozone countries) –, Germany gained its "superstar" status among European economies.

Looking at German economy's evolution, we can see that except for the post-reunification period, major imbalances were not triggered from the inside, but were caused by a series of exogenous factors. Following the same path, immediately after the end of the global financial crisis, Germany faced another major challenge of external origin: the sovereign debt crisis. Although the tensions caused in the Eurozone slowed down the impetus of the federal economy in 2012/2013, the acceleration of the demand coming from the U.S. and from the emerging markets (especially from China), the continued low exchange rate of the euro and the reduction of the interest rate generated a new boom for German exports, contributing to the recreation of the conditions favourable for economic growth. Also, it should be reminded that the new geo-economic context remodelled by the financial crisis caused a change of direction in the German economic policy, leading to a closer cooperation with China. After the orientation of external commercial activity towards China supported the federal economy during the financial crisis (exercising a sort of buffer effect), the executive led by Angela Merkel focused on the business and other future economic benefits that Germany could obtain from further consolidating mutual relations and from collaborating with China (the reiteration of the development paradigm governed by the axiomatic principle of the *change through trade* – substantiated by the Ostpolitik –, which had been at the basis of the German growth model for several decades).

The strong economic growth after 2005, the record employment level and the low unemployment rates – which led (at first) to an equilibrium in the federal budget and to public finance surpluses –, the resulting major and systematic current account surpluses represented the results which created the auspices for the second decade of the 20th century to be called the period of glory of the German economy, with the best performances achieved in the post-reunification era, despite the negative effects caused by the two successive crises that Germany went through.

Nevertheless, beginning in 2018, the German economy started showing signs of stagnation, caused both by the pronounced slowdown of the manufacturing industry – against the background of the escalation of commercial conflicts at international level and of the induced state of uncertainty –, as well as by the structural challenges faced by the automotive industry[15], one of the main sectors of German exports.
Before the outbreak of the Covid-19 pandemic – whose impact generated the second largest contraction of the German economy in the post-war period –, the state of the German economy was much less robust than in the

[15] As a result of the increased demand for electric cars.

period of the 2008/2009 recession or of the 2012/2013 stagnation, as a result of the absence of structural reforms during the last decade, the profound demographic changes the country went through, as well as the reduction of international competitiveness because of the reduced investments, both in the traditional and in the digital infrastructure (Brzeski, 2019).

The onset of the pandemic crisis, the subsequent restrictive measures adopted in order to slow down the spreading of the virus and the blockages occurred in the supply chains caused the federal economy to enter a new period of profound recession which marked the discontinuation not only of a period of ten consecutive years of economic growth, but also of a decade of performances, which could have gone down in history as the period of the greatest economic achievements after Germany's reunification.

2. Present aspects: the current state of the German economy

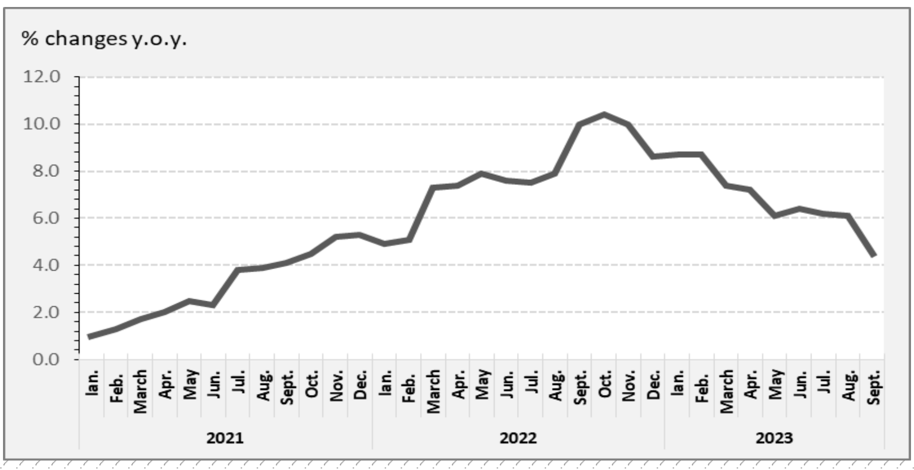
2.1. The profound negative impact caused by the recent successive shocks

After facing the severe effects caused by the rapid spread of the COVID 19 pandemic, in successive waves, in 2020 and 2021 – a situation that required the implementation of large-scale and lengthy restrictive measures to counteract the installed sanitary crisis –, the beginning of 2022 brought with it another major challenge for the national economic activity: the start of the military aggression of the Russian Federation against Ukraine. The start of the of the Russian-Ukrainian military complex further deepened the ample imbalances already existing on the European and international energy markets[16], because in addition to the accelerated price increase, the deterioration of the geopolitical climate enhanced the risk of a natural gas supply shortage, if the Russian Federation decided unilaterally to discontinue its exports as a reaction to the sanction packages applied by the EU Member States (which actually happened in August 2022).

Moreover, for Germany's strongly industrialised economy, the escalation of geopolitical tensions generated a series of distinct challenges, *first of all* because Germany was a net importer of almost all fossil fuels (except lignite), which made it extremely vulnerable to energy crises (with all the implications they can cause) and, *secondly*, because it was highly dependent on the supply of natural gas from the Russian Federation which, during the last two years (2020 and 2021) supplied Germany with over 55% of total imports (Federal Ministry for Economic Affairs and Climate Action, 2022).

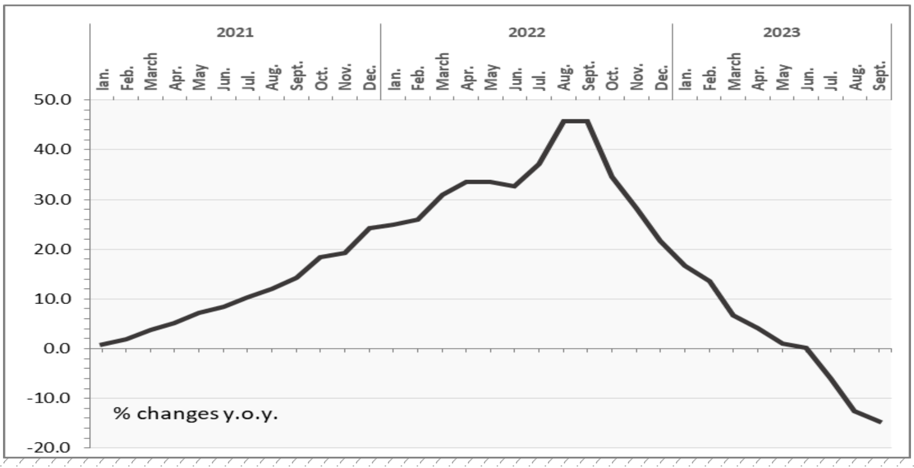
The steep increase of the quotations of energy raw materials on the international market – in particular after August 2022, when the Russian Federation totally stopped the flows of natural gas to Europe through the Nord Stream 2 gas pipeline – exacerbated the inflationist pressures that were already on an upward trend (Charts 5 and 6), exercising a deep unfavourable impact on both the German households' propensity for consumption and on the internal industrial production already affected by: a) the impaired functioning of global supply chains; b) the Chinese isolationist policy (i.e. "zero-COVID"); c) the slowdown of global demand, and d) a series of structural deficiencies progressively accumulated after 2018 (Heyman, 2020).

Chart 5: Consumer price index (CPI) in Germany – percentage changes for the same month, year-on-year, 2021-2023



[16] Caused by the sudden and generalised demand after the pandemic "peak" was overcome and the world economic activity was resumed.

Chart 6: Producer price index for industrial products in Germany – percentage changes for the same month, year-on-year, 2021-2023



Source: Graphic representations by the author, based on data published by Destatis (2023).

As it results from the data presented, CPI maintained a strong upward trajectory throughout 2022, with maximum intensity thresholds in September-November, when it reached a two-digit figure. The same trend was followed by the prices of industrial goods, but in their case the decrease occurred more rapidly and was steeper. Nevertheless, by the end of the year, the cumulated action of all the aforementioned external factors with negative influence was mitigated by the launch of ample support packages aimed at stabilising population income and the activity of national companies. These schemes were continuously adjusted by the tax authorities, so that, on the one hand, they could temper the consequences of energy price increases and revitalise consumption, and, on the other hand, provide an optimum response to the recently emerged contextual need – that of natural gas savings. Despite a relative improvement of the international climate at the beginning of this year – due both to the reopening of the Chinese market[17] as a result of the relaxation of the measures imposed by the "zero COVID" policy, and to the reduction of energy prices –, the deep negative effects generated by a (still) very high inflation could not be counterbalanced. As such, during the first three months of the year, the high price dynamics continued to represent a major disturbing factor for the performances of the German economy, in the conditions in which the erosion of the purchase power and the continued savings by the population were reflected in a considerable decrease of household final consumption expenditure. The reduction of the propensity for consumption – a direct consequence of the consumers' reaction to price increases – was reflected in demand for most categories of goods (both essential, and non-essential). Also, the increase of interest rates and the restriction of crediting – as a result of the stricter monetary policy aimed at slowing down inflation – put new pressures on consumption and investments.

In the conditions described, for the first time after the "peak" of the pandemic crisis (year 2020), in Q1/2023, the German economy saw its second consecutive quarterly contraction, which marked its entrance into technical recession (Table 2). After the stagnation noted in the second quarter, the blockages triggered by the combined action of the cyclic vectors we mentioned with the many structural challenges faced, the federal economy entered a new negative territory in Q3/2023.

Tab1e 2: German GDP: quarter-on-quarter percentage changes*, 2021-2023

2021			2022				2023		
Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3**
2.2	0.7	0.0	1.0	-0.1	0.4	-0.4	-0.1	0.0	- 0.1

Notes: * seasonally and calendar adjusted data; ** provisional results;
Source: Destatis (2023).

Although the "peak" of the inflationist wave was overcome and the annual inflation rate began descending since early in the year, it continued to be high and there was no visible downward trend of consumer prices. According to the estimates of German economic analysts (Ifo Institute, 2023), the total CPI inflation

[17] Which favoured the dissipation of bottlenecks currently existing in the supply chains.

will remain at a high level – well above the limit "threshold" of 2% established by the ECB and above the one recorded in the period prior to the energy crisis – until the end of the current year, fuelled both by the continuation of the government measures adopted in order to stimulate consumption, and by the salary increases applied in Q3 to stabilise the available real income of the population. Despite these measures, for reasons related to precaution, the population' s savings rate was relatively slow to decrease, with a more dynamic trend only towards the end of the last quarter of 2023.

The high degree of uncertainty that the ongoing military conflict continues to exercise this year as well on the national and European economic climate, the less alert development pace of the world economy, as well as the still high level of energy prices and of the basic inflation – compared to the period before the onset of the energy shock – will hamper the internal economic development in 2023, despite the tax incentives adopted by the government and which are still in force. More than that, given the German economy's dependence on exports – e.g., in 2022, exports accounted for over 50% of the GDP –, the slowdown in global demand and the internal imbalances faced by its main trade partners (i.e., China and the U.S.)[18] represent other cyclic factors that will have a negative impact on the federal economic performances this year.

The events occurred during the recent years highlighted the increased risks that arise from the deep unilateral dependence on the supply of intermediate inputs from the external markets. After the occurrence of the Covid-19 pandemic and, afterwards, the conflict initiated by the Russian Federation in Ukraine caused the discontinuation of the supply chain, more recently, the onset of the geopolitical and economic crisis between certain Western States, including the EU Member States, and China, placed the latter at the centre of German debates on the preparation of a new economic strategy that would enable a distancing from the Chinese market. This is due to the fact that, during the recent years, China was the most important source for the German imports of intermediate inputs. A detailed analysis made by Germany's central bank this year (Deutsche Bundesbank, 2023b) provides a detailed image of the possibilities now available for national companies to reduce the purchase of intermediate products from China. During the surveyed period (April-June 2023), around 29% of German companies purchased critical intermediate products[19] from the Chinese market. The analysis also revealed that approximately 50% of the companies in the German manufacturing industry depend on inputs of Chinese origin for the proper conduct of their production processes. Amount these, 80% reported they would find it "difficult" or "very difficult" to substitute Chinese imports by resorting to other external sources. Overall, companies for which the possibilities of sourcing substitute products are "very difficult" total around 1/4 of the turnover of the German manufacturing sector in 2022.

Against a background governed by instability, uncertainty and risks which, at present, characterises the global economic and geopolitical climate, recently aggravated by the intensified tensions in the Middle East, most forecast reports prepared by national economic research institutes, federal governmental bodies and/or international entities predict that the German economy will contract this year (Chart 4).

2.2. Persistence and deepening of structural deficiencies

In addition to the cyclic aspects detailed in the previous section, Germany also faces a series of structural vulnerabilities which, though not recent, have been brought back to the forefront by the situation created by the shocks of the last three years (i.e., the pandemic crisis followed by the energy crisis).

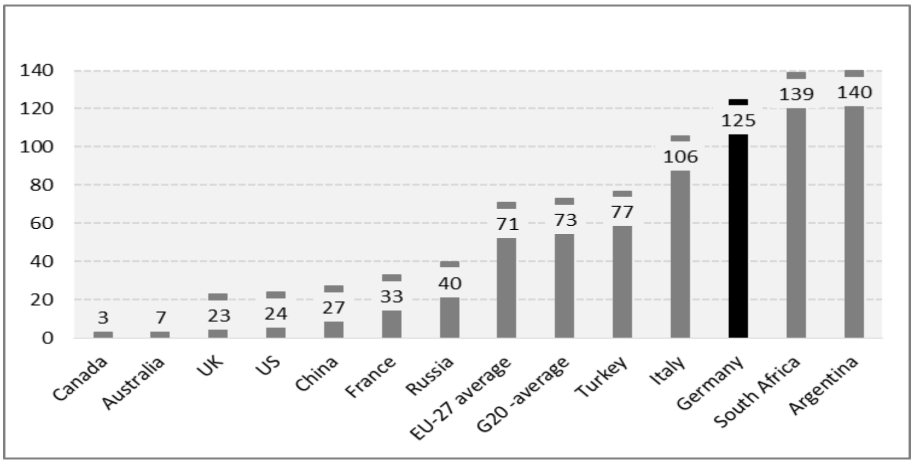
A. Excessive bureaucracy – caused by numerous rules and regulations that hinder the smooth conduct of activities in state institutions, the lack of personnel as well as the insufficient digitalisation of the public sector[20] – represent a significant barrier for investments, while also causing increased costs for investing companies. It is worth noting that the length and complexity of procedures required for setting up new companies placed Germany among the most excessive countries worldwide (rank 125) in terms of bureaucratic burden in 2020 (Chart 7).

[18] China was during the last seven years Germany's main commercial partner (import + export) and the U.S. is the main outlet market for German exports.

[19] Critical intermediate inputs represent that category of goods or services without which an enterprise's production processes or commercial activities could not be possible or, if possible, it would involve major delays and/or lower quality standards.

[20] Although based on a law adopted in 2017, over 550 services were required to be available online by 2020, only 130 of them were digitalised.

Chart 7: Ease of doing business in Germany: starting a business, 2020 ranking



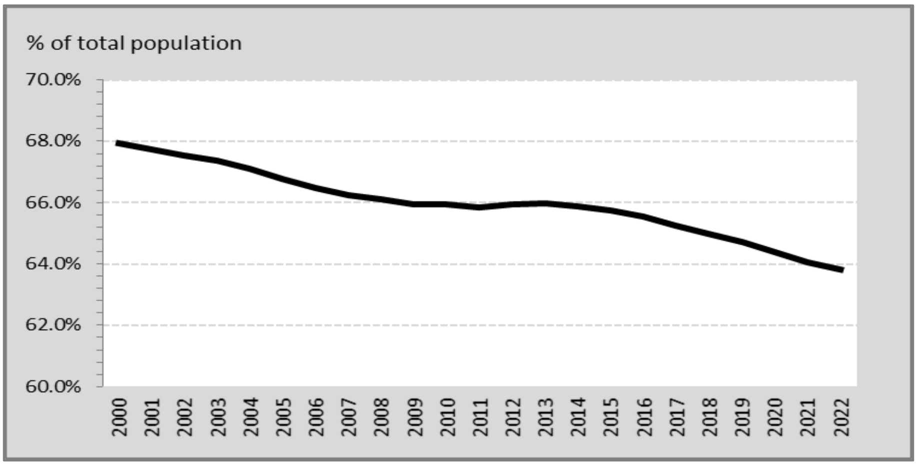
Source: Graphic representation by the author based on the data published by the World Bank (2023).

The strictness of federal regulations makes the starting of a business in Germany a much lengthier process than in other European economies. As such, while it takes around 120 days to obtain the operating licence for a start-up in Germany, in countries such as Italy or Greece, it takes approximately 40 days on average. Also, the time required for obtaining a construction permit is two or three times longer.

B. Major infrastructure deficiencies – as a result of the low public investment during the budget austerity period – which hinder the activity of national companies, generating supply chain blockages. According to a survey conducted by the Institute of German Economy/Cologne (Puls & Schmitz, 2022), 80% of German companies claim that their activity is hindered by the poor state of the internal transport infrastructure (around 20% more than in 2013). Although as early as 2015, the federal government created several investment funds for the transport infrastructure, the amounts are mostly absorbed by high prices of the construction sector. As a consequence, in 2022, the value of inflation-adjusted investments was at the same level as in 2009.

C. The rapid pace of demographic changes and the high level of population ageing have been affecting the German economy for several years, resulting in the reduction of employment (Chart 8) and, implicitly, in a considerable shortage of qualified workers[21]. According to forecasts, the workforce shortage will become increasingly acute during the next decade, once the “baby boomer” generation – which includes the persons born in the time frame 1955-1969 – leaves the labour market and retires (Table 3).

Chart 8: Population of working age* in Germany as percentage of total population, 2000-2022



Note: * The working age population is defined as those aged 15 to 64.
Source: Graphic representation by the author based on the data published by the OEDC (2023).

[21] According to recent studies, at present, over 40% of the companies in the German industrial sector claim a lack of qualified personnel (Born & Krys, 2023).

Table 3: Number of people at working age in Germany, prognosis until 2070 (million persons)

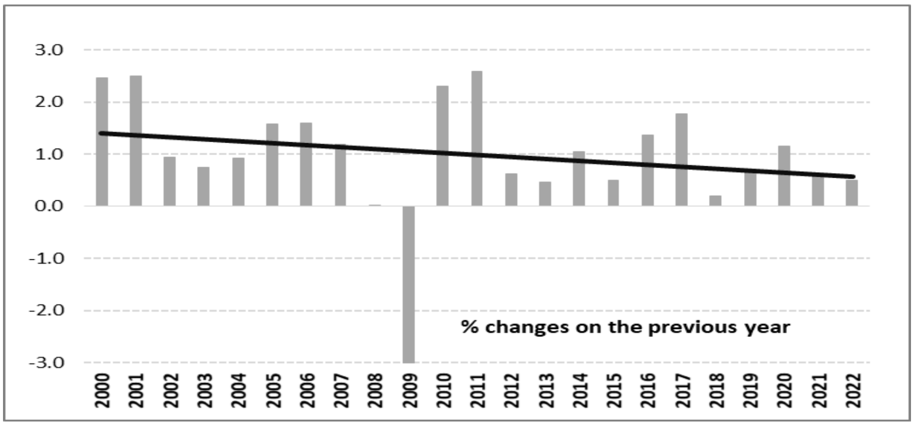
2021	2030	2040	2050	2060	2070
51.4	48.9	46.0	44.5	44.5	41.4

Source: Destatis (2023).

Although Germany is not facing a nationwide shortage of skills, in certain regions and industries, the occupation of vacant positions with qualified personnel has become impossible. In quantitative terms, in the July 2021- July 2022 interval, there were 530,000 vacant positions which could not be occupied because of the lack of qualified persons among the German unemployed.

The increasingly alert pace of population ageing affects individual productivity (Chart 9), because according to statistic evidence it tends to decrease among older workers, in the conditions in which ageing reduces the capacity for innovation and adaptation to the new technologies (Deutsche Bundesbank, 2023b). As a consequence, on the medium term, the demographic decline of the workforce risks endangering the potential productivity of the German economy.

Chart 9: Percentage changes in German labour productivity*, 2000-2022



Note: * Price adjusted GDP per hour worked by persons in employment;
Source: Graphic representation and calculations by the author, based on the data published by Destatis (2023).

In addition to all the structural deficiencies presented above, Germany also faces radical tax burdens, with excessive energy prices caused by the inadequate energy policies adopted in the past, coupled with a high level of political uncertainty. As shown, the interaction between cyclic vectors and the structural issues accumulated and consolidated in time acts as a major obstacle for the future economic development.

However, compared to the erosive factors that were active in the period prior to the economic decline (1998-2005), Germany now has a quite stable employment rate and tax position, which are attributes that facilitate adaptation to shocks. Nevertheless, the current recession may serve as a warning sign for the federal authorities, which should speed up the preparation of the measures comprised in the announced recovery and reform plan centred on several directions of action (Box 1).

Box 1: Several directions of action aimed at helping Germany relaunch its economy and resume its sustainable growth path

1. The reduction of the degree of uncertainty related to the national policy on energy transition and a better use of market forces to drive the transition to a "green" economy. In this sense, government authorities must outline an adequate regulation framework that would enable companies involved to plan their investments accordingly. Because the transition is inevitable for most companies and economic sectors, it is necessary to draft policies focusing on the improvement of framework-conditions, on ensuring the required investments for an adequate supply of cheap and low carbon energy supply, and on promoting research and the development of new products and services with added-value potential;
2. The preparation of an efficient plan enabling the acceleration of the transition to renewable energy, in order to maintain prices at competitive levels and avoid an exodus of companies from the energy intensive industry which have not yet fully resumed production and are currently looking for alternative places to relocate their business;
3. The increase and acceleration of infrastructure investments to maintain and further improve Germany's attractiveness as a location for business;

4. The acceleration of the public administration digitalisation process, the reduction of regulatory requirements, the streamlining of the current approval procedures, and administrative capacity building in order to stimulate investments;
5. The law on the immigration of qualified workers, which reduces the barriers against the immigration of qualified personnel, is a significant step in the effort to mitigate workforce shortage. In addition, to stimulate internal supply, the German executive is envisaging the implementation of a tax reform and the restructuring of the pension system.

Source: Adaptation and synthesis by the author after Allianz SE (2023) and Born & Krys (2023).

2.3. Is the German economy the "sick man of Europe" (again)? Pros and cons

As we stated at the beginning of this analysis, the current state of the German economy gave rise to contradictory currents of opinion among national and international economic analysts. This is to say that while some of them consider that the current situation in Germany is of a brief and transient nature, other claim that the country has entered a new phase of prolonged decline.

Holger Schmieding – the first economist who called Germany the "sick man of Europe" in 1998 –, this time pleads in favour of the current recession being a temporary one, caused by the contraction of the manufacturing industry in the U.S. and China, in the conditions of an increased dependence of the federal industry on the exports/imports of auxiliary inputs to/from these countries (Schasfoort, 2023). In his opinion, compared to years 1998/1999: a) unemployment is reduced; b) public revenues are more stable than those in other EU-27 MS (Chart 10 and Chart 11), which provides a leeway; and c) the permanent trade surplus could be used to finance an episode of reduced competitiveness.

Chart 10: Year-on-year changes in general budget balance (as % GDP), 2018-2023

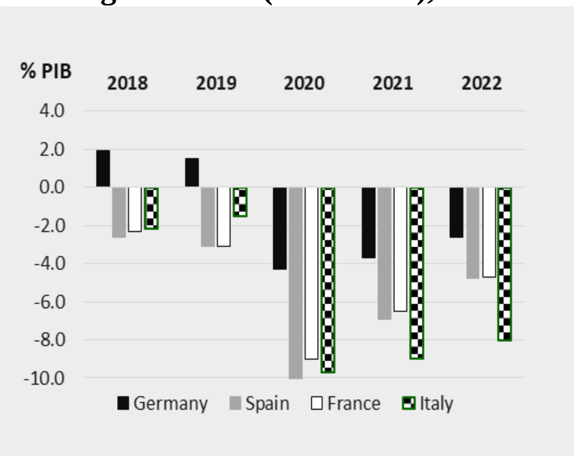
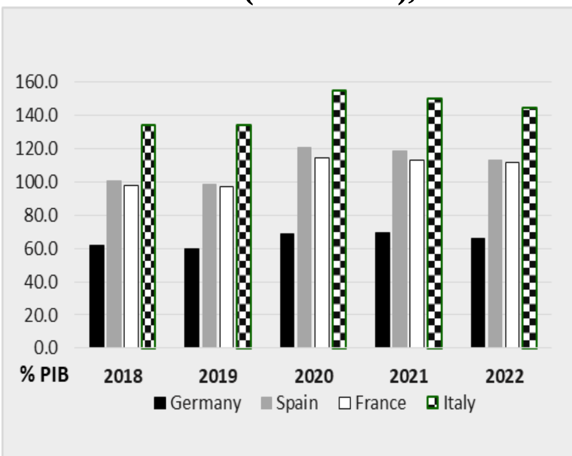


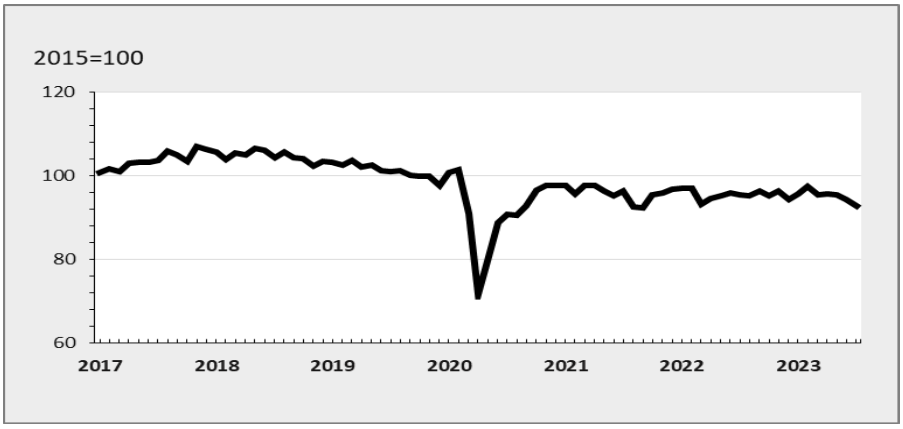
Chart 11: Year-on-year changes in current account balance (as % GDP), 2018-2023



Source: Graphic representation of the author based on the data published by Destatis (2023).

A completely different opinion is outlined by Hans-Werner Sinn (president emeritus of the Institute for Economic Research, IFO), who claims that the decline of the manufacturing industry is not transient – given that it started in 2018, under the impact of the decrease of external demand for the goods produced in the automotive sector –, and continues through 2023, when the German's industrial production came to be ranked below the level of the pre-pandemic years (Chart 12).

Charts 12: Month-on-month changes in German index of production in manufacturing, 2017-2023



Source: Graphic representation by the author based on the data published by Destatis (2023).

In his vision, the voluntary decision to discontinue the production of nuclear energy, coupled more recently with the cease of gas deliveries from the Russian Federation (2022) had a devastating effect on an economy based on the manufacturing industry (highly energy-intensive) (Sinn, 2023). Sinn also claims that an important risk factor for the manufacturing industry at present is Germany's increase dependence on China (its main commercial partner since 2016). The progressive externalisation of the automotive production beginning in 2016 (due to profit-related reasons), currently exposes German producers to the risk of losing their market share to local competitors. The poor state of the German economy is also caused by a plethora of structural shortcomings which require the recalibration of the German growth model and the reformation of the federal economy.

3. Implications that German's entry into a phase of prolonged decline could have for the European Union states

Being a main contributor to the EU budget – with a around EUR 33.2 billion in 2021 –, an economic contraction in Germany could trigger the reduction of funds intended for the EU revenues. In fact, in June this year, German Finance Minister Christian Lindner declined the European Commission's request for a supplementation by the Member States of the amounts transferred to the UE budget and required for the granting of a new aid package to Ukraine for and paying part of the joint debt. Invoking the country's own financial constraints and the expenditure cuts applied internally to avoid the public finance deficit, Christian Lindner declared that, in the current situation, Germany was unable to subscribe to additional contributions to the Union budget.

Also, the decrease of the productive force of the federal industry would exercise a cascade effect on other EU Member States, given that Germany is the main investor and commercial partner for many of them. In the aftermath of the German reunification and of the fall of communism in Eastern Europe, many small and middle-sized enterprises (*Mittelstand*, considered to be a true "backbone" of the German economy) externalised their activity in the region, producing mainly for the European market. In these conditions, it is evident that a prolonged economic decline in Germany would also have negative consequences in the host countries, risking to endanger the entire regional stability.

As in the previous years, in 2022, Germany was the main trade partner for more than half of the EU-27 Member States: for 16 of them (including Romania), it represented the first export destination, while for 15 (including Romania), it constituted the first source of imports. Also, through the indirect commercial connections, the federal economy is strongly interconnected with all EU states. Implicitly, a prolonged and ample decrease of the federal economic activity – which would cause the reduction of both the internal demand, and the supply on the external market – would generate domino effects.

Finally, the German desynchronization with the rhythm of the other the Eurozone countries would generate major difficulties for the ECB in establishing the optimum monetary policy directions for the entire region.

4. Conclusions

Around 25 years since the German economy was first labelled "the sick man" of the Eurozone on the international stage, the possibility of its re-entering a new phase of severe and lengthy economic decline, which generates the risk of contagion for other EU states has again been brought forward. Unlike the main recession cycle, the main cause of the "disease" this time was the interaction of factors that triggered a "perfect storm" – the Covid-19 pandemic, followed by the Russian-Ukrainian conflict and the subsequent energy crisis –, highlighting the errors in the German growth paradigm centred on export supported entirely by the supply of energy, raw materials and intermediate inputs mainly from two countries with totalitarian regimes (Russian Federation and China). The economic context thus underlined the existence of a series of latent structural deficiencies of the German economy during the recent years (namely, the degraded internal infrastructure, enhanced bureaucracy, slow government services digitalisation process, issues related to demographic aging etc.). The intensified geopolitical tensions brought with them an unequivocal awareness of the risks that arise from cooperating with countries dominated by totalitarian regimes, and this caused decision-makers to take steps to reduce the commercial dependence from China.

All these current realities, coupled with the structural challenges currently faced by Germany, risk endangering the basis of its development model which is export-oriented and based on a strong industrial sector and highly-qualified workforce.

However, despite the imbalances faced at present, Germany has strengths that make it highly resilient to shocks: a) the presence of many small and medium-sized enterprises (Mittelstand), with a high capacity for adaptation; b) healthier public revenues than the majority of developed states, which allow for more leeway, as well as c) a high degree of competitiveness compared to external partners, despite the recently observed losses. To help the economy adapt to a more fragmented international climate, government authorities should implement reforms, but the German political "compass" does not appear to be oriented towards long-term growth, and the members of the governing coalition do not seem to reach a consensus. However, a new growth strategy must be found for 2030, to create the optimum formula for combining international dynamics with a national policy adequate for the current context.

References

[1] Allianz SE. (2023, September 14). Germany needs more than a plan. Retrieved from Allianz - Economic research: https://www.allianz.com/en/economic_research/publications/specials_fmo/2023_09_14_GermanEconomicPlan.html#china.

[2] Baccaro, L. (2018). The flexibilisation of German industrial relations. In D. Marin, Explaining Germany's Exceptional Recovery (pp. 31-40). London: Centre for Economic Policy Research (CEPR) Press.

[3] Bastasin, C. (2013). Germany: a global miracle and a european challenge. Washington DC: The Brookings Institution. Retrieved from https://www.brookings.edu/wp-content/uploads/2016/06/05_germany_economy_euro_challenge_bastasin.pdf.

[4] Born, D., & Krys, C. (2023, October 18). What if Germany becomes the sick man of Europe again? Retrieved from Roland Berger: https://www.rolandberger.com/en/Insights/Publications/What-if-Germany-becomes-the-sick-man-of-Europe-again.html#!#download.

[5] Bouvard, F., Rambert, L., & Romanello, L. S. (2013). How have the Hartz reforms shaped the German labour market? Paris: Ministère de l'Économie, et des Finances et Ministère du Commerce Extérieur.

[6] Brzeski, C. (2019, December 16). Germany: Entering the lost decade. Retrieved from ING Economic and Financial Analysis: https://think.ing.com/articles/germany-entering-the-lost-decade.

[7] Dauderstädt, M. (2013). Germany's socio-economic model and the Euro crisis. Revista de Economia Politica, 33(1), 3-16.

[8] de Bellaigue, C. (2001, July 05). The Sick Man of Europe. The New York Review of Books, 48(11). Retrieved from https://www.nybooks.com/articles/2001/07/05/the-sick-man-of-europe/.

[9] Delorme, M., Leron, N., & Padis, M.-O. (2021). Angela Merkel, un portrait politique : beaucoup de petits pas et quelques volte-face. Paris: Terra Nova. Retrieved from https://tnova.fr/democratie/politique-institutions/angela-merkel-un-portrait-politique-beaucoup-de-petits-pas-et-quelques-volte-face/.

[10] Deutsche Bundesbank. (2023a). Statistics. Retrieved from Deutsche Bundesbank: Current account of the Federal Republic of Germany (Seasonally adjusted): https://www.bundesbank.de/dynamic/action/en/statistics/time-series-databases/time-series-databases/759784/759784?listId=www_ssb_b4_ah_lb.

[11] Deutsche Bundesbank. (2023b, September 19). Monthly Report - September 2023; Germany as a business location: selected aspects of current dependencies and medium-term challenges. Retrieved from Deutsche Bundesbank: https://www.bundesbank.de/en/publications/reports/monthly-reports/monthly-report-september-2023--915836.

[12] Dustmann, C., Fitzenberger, B., Schönberg, U., & Spitz-Oener, A. (2014). From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy. Journal of Economc Perspectives, 28(1), 167-188.

[13] Dustmann, C., Fitzenberger, B., Schönberg, U., & Spitz-Oener, A. (2018). From sick man of Europe to economic superstar: Germany's resurgence lessons for Europe. In D. Marin, Explaining Germany's Exceptional Recovery (pp. 21-30). London: Centre for Economic Policy Research (CEPR) Press.

[14] European Commission. (2002). Germany's growth performance in the 1990's. Brussels: Directorate General for Economic and Financial Affairs. Retrieved from https://ec.europa.eu/economy_finance/publications/pages/publication1878_en.pdf.

[15] European Commission. (2023, September 11). Summer 2023 Economic Forecast: Germany. Retrieved from European Commission - Economy and Finance: Economic surveillance of EU economies: https://economy-finance.ec.europa.eu/economic-surveillance-eu-economies/germany/economic-forecast-germany_en.

[16] Federal Ministry for Economic Affairs and Climate Action. (2022, Merch 06). FAQ list LNG terminal in Germany. Retrieved from Federal Ministry for Economic Affairs and Climate Action/Bundesministerium für Wirtschaft und Klimaschutz (BMWK) - Press Releases: https://www.bmwk.de/Redaktion/DE/Downloads/F/faq-liste-lng-terminal-in-deutschland.html.

[17] Federal Statistical Office of Germany/Destatis. (2023). GENESIS ONLINE. Retrieved from Database of the Federal Statistical Office of Germany: https://www-genesis.destatis.de/genesis/online?language=en.

[18] German Council of Economic Experts. (2004). Success abroad, challenges at home. German Council of Economic Experts. Retrieved from https://www.sachverstaendigenrat-wirtschaft.de/publikationen/jahresgutachten.html.

[19] Heyman, E. (2020, May 05). Deutsche Bank Research. Retrieved from German industry - Coronavirus crisis distracts from structural problems: https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000507658/German_industry%3A_Coronavirus_crisis_distracts_from.pdf?undefined&realload=NpLJBFTVA~tNYLtTEcfb7p7x8nu6pXZLr7DDLwlFbnTbPVRG8kHJfwaTusekedxh.

[20] Ifo Institute. (2023, April 05). Joint Economic Forecast Spring 2023: Inflation High at Core - Strengthen Supply Forces Now. Retrieved from Ifo Institute: https://www.ifo.de/en/facts/2023-04-05/joint-economic-forecast-spring-2023-inflation-high-core.
[21] McCollum, A., Greenwood, N., Vick, A., Kemp, M., Toye, D., & Widener, N. (n.d.). Statewide Dual Credit World History. Retrieved from Open Educational Resources (OER) Commons: https://oercommons.org/courseware/lesson/87942/overview.
[22] Petersen, T., & Esche, A. (2016). Preserving an Old Model in a New World: German Economic Policy. In Bertelsmann Foundation , Newpolitik: German Policy Translated (pp. 21-29). Washington: Bertelsmann Stiftung. Retrieved from https://www.bertelsmann-stiftung.de/en/publications/publication/did/newpolitik/.
[23] Prakash, P. (2023, September 21). Deutsche Bank CEO says Germany risks becoming 'the sick man of Europe' unless structural fixes are made. Retrieved from Fortune: https://fortune.com/2023/09/21/deutsche-bank-ceo-christian-sewing-germany-sick-man-of-europe-structural-change/.
[24] Puls, T., & Schmitz, E. (2022). How much du infrastructure problems affect companies in Germany? Results of IW Survey. Retrieved from Institute of german economy (IW): IW Trends: https://www.iwkoeln.de/presse/pressemitteilungen/thomas-puls-edgar-schmitz-marode-infrastruktur-bremst-unternehmen-aus.html.
[25] Ruoff, B. (2016). Labour market developments in Germany: Tales of decency and stability. Geneva: Global Labour University&, International Labour.
[26] Schasfoort, J. (Producer), & Schasfoort, J. (Director). (2023). Why Germany's Economy is Stronger Than You Think [Motion Picture]. Retrieved from https://www.youtube.com/watch?v=vTY6H9RWiqQ.
[27] Sinn, H. W. (2023, September 01). Germany is the sick man of Europe. (CNBC, Interviewer)
[28] The Economist. (1999, June 03). The sick man of euro. Retrieved from The Economist: https://www.economist.com/special/1999/06/03/the-sick-man-of-the-euro.
[29] World Bank. (2023). Statistic data: Doing business archive - Ease of doing business in Germany . Retrieved from World Bank: https://archive.doingbusiness.org/en/data/exploreeconomies/germany.