

Taking delight in decline



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appreciation of the euro compared to the US dollar; and now another increase in energy prices and reactions on financial markets.

These cannot be used as an excuse for the failures of the past. The structural problems of the German economy began before the COVID-19 pandemic. Industrial production already started declining by the end of 2017. However, the current situation is not just the government's fault. Sometimes, companies have failed to properly prepare themselves for the challenges posed by the structural transformation. The subsidies of misdirected industrial policies and the rescue packages during the COVID-19 pandemic have made many companies lazy.

Approximately one year ago, the federal government positioned itself as a reform government with the goal of strengthening the German economy. However, the massive easing of the debt brake (Schuldenbremse) was not immediately followed by reforms. Even the significantly higher debt leeway was not used for the intended purpose, namely to strengthen government investment activity; what did follow was the shifting of funds in the federal budget to enable higher consumer and transfer expenditures. The 2025 pension package increases the future burden. If benefits are not reduced elsewhere, contribution rates to statutory pension insurance will have to rise in the foreseeable future. The federal law on collective bargaining agreements increases the regulatory intensity and thus labor costs. In terms of energy policy, the industrial electricity price and subsidies for network charges are bridging measures that can only be financed for a brief period. And in the current energy crisis caused by the Iran war, the government's only idea has been a fuel rebate.

Still, some things did go right. The federal government's tax reform is heading in the right direction. The accelerated depreciation of 30 percent in three years and the reduction in the corporate tax rate by one percentage point a year over the next five years will reduce the effective tax burden and improve the future outlook for Germany as a business location. Shortly before Christmas, the federal and state governments came to an agreement on modernizing the government, which will result in an improved administration apparatus thanks to consistent digitization. The citizen's benefit (Bürgergeld) was reformed to become the new basic insurance; recipients are once again called upon to make themselves available in the labor market. Comprehensive health reforms and the reform of the electricity market are currently on the way; they include many meaningful reform components. The federal government also announced that the new basic insurance, housing allowance and child supplement would be consolidated on the basis of the recommendations of the welfare state commission. This is supposed to lead to a reduction in the housing allowance. Long-term care, pension and tax reforms are also on the agenda. Finally, the EU is also making a difference with new trade agreements and regulatory liberalization.

So things are changing in Germany after all. Hopefully the momentum can be maintained.

A handwritten signature in black ink, appearing to be 'Lars P. Feld'.

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An interested observer of German news reporting can be forgiven for thinking that Germany must be standing at the precipice. Deutsche Bahn is the textbook example of a Germany that has ceased to function properly. The resulting narrative goes like this, more or less: Germany's infrastructure is dilapidated, as confirmed by the train delays, traffic jams on the highways and public buildings in disrepair. Government administration is inefficient, not least because of the lack of digitization. Measured by the gross domestic product (GDP), the health care system is expensive, yet it does not offer the same quality of life as other similarly expensive systems (i.e. in Switzerland). The education system graduates students who have significantly less knowledge than before (key word: grade inflation).

This description finds its counterpart in the financial woes faced by the country. Private investment activity continues to be weak. Companies do not invest anymore because the costs are too high: labor costs, energy costs, regulatory intensity, tax burden – Germany is always in the top group with regard to these costs. No wonder then, that this performance leads to the current misery.

There is no way to sugarcoat this narrative. Germany urgently needs reforms that result in better government performance and an improved overall environment. At the same time, the situation also deserves a fair and more nuanced analysis.

Similar to other countries, Germany is affected by the geopolitical turbulences and resulting uncertainties. This is not just about the crisis of the day. The energy shock resulting from the Iran war joins a series of other crisis-like phenomena: COVID-19 pandemic, the Russian attack on Ukraine and the resulting energy prices, Trump's tariff policy that triggered a response on financial markets and the