The Economist

Reform in Germany

Going backwards

Angela Merkel preaches pro-growth reforms to her neighbours but implements anti-growth ones at home

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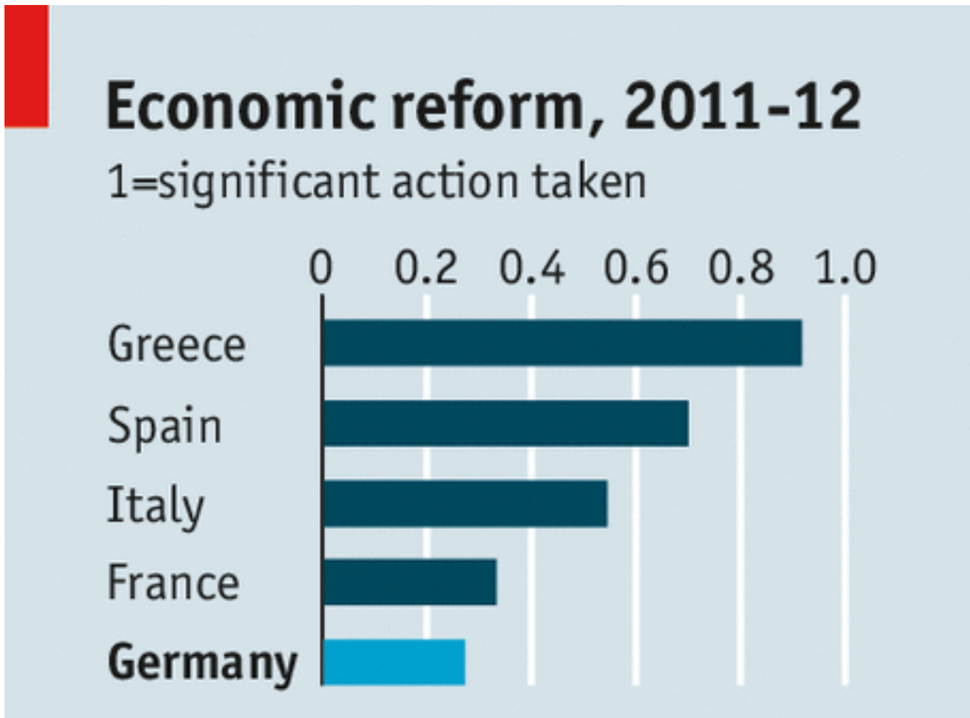

ANGELA MERKEL has a favourite mantra to offer troubled euro-zone countries: they should copy Germany. As she put it last autumn: "What we have done, everyone else can do." Fifteen years ago, the chancellor's analysis goes, her country was widely regarded as the sick man of Europe. Then it opted for fiscal austerity, cut labour costs and embraced structural reforms, turning it into an economic powerhouse.

The gap between Germany and southern countries in the euro zone is indeed wide. Its economy is growing faster than most of theirs; youth unemployment in Germany is at a 20-year low, whereas it remains at record highs in Spain and Greece; and the German budget is in surplus, even as France, Italy and Spain struggle to hit deficit targets fixed in Brussels.

When it comes to fiscal prudence, Mrs Merkel is a paragon. Indeed, this newspaper wishes she were a little less austere, and spent more to boost Europe's demand. But on structural reform, her record is weak. The credit for Germany's rebound should really go to the "Agenda 2010" reforms started by her predecessor, Gerhard Schröder, in 2003. Since then Mrs Merkel has had the odd flourish—she bravely raised the normal retirement age to 67 in her first term—but overall Germany comes a lowly

28th out of 34 countries ranked by the OECD in terms of reforms since the financial crisis hit.

The Germans have an obvious riposte to this: southern Europeans had a lot of ground to make up. Less easy to explain is the fact that Mrs Merkel's "grand coalition" government is now actually heading backwards, increasing the burden on German business (see article (http://www.economist.com/news/europe/21601312-indulging-her-social-democratic-coalition-partners-angela-merkel-risks-turning-germany)).

Three examples illustrate the trend. On pensions, instead of continuing to raise the retirement age, the government is actually cutting it for certain workers to 63 or even, in extreme cases, to 61. Second, it is introducing a national minimum wage at a relatively high level, which is likely to lead to job losses, especially in the east. And finally, Mrs Merkel's *Energiewende* (energy change) is not only eating up huge sums in subsidies for renewables, but also saddling German companies with electricity prices nearly three times as high as America's.

None of these things will cripple the German juggernaut in the short term. You can even make the argument that by pushing up German costs and increasing wages, Mrs Merkel is indirectly helping her euro-zone partners. But there are many less harmful ways for her to do that. If she had wanted to push ahead, plenty of areas—energy, retailing and professional services, where Germany has some of the OECD's most protectionist regulations—are ripe for reform.

Not north v south but reform v laggard

Europe's biggest economy is backsliding, and that sets a terrible example. Consider another big laggard in terms of reform: France. Only two years ago the Germans were rightly indignant when the newly elected French president, François Hollande, had the temerity to cut the pension age for certain workers. Now that Mrs Merkel is doing the same, why should Mr Hollande pay any attention?

One popular narrative in the euro saga is that it has pitched virtuous, hard-working and thrifty northerners against feckless, indolent and profligate southerners. The north has certainly done better during the crisis. Like Germany, the Netherlands, the Baltics and the Scandinavians did more to reform their economies and improve competitiveness in the years before it broke. But since then the reform momentum has been much stronger in Mediterranean countries. Even Italy and France, under two new youthful prime ministers, Matteo Renzi and Manuel Valls, are talking up the reform cause.

That is exposing the weakness not just of Germany but also of several other countries. In the Netherlands, for instance, there has been almost no reform lately, consumers are burdened by debt and growth has all but stopped. Even in Scandinavia, usually Europe's star performer, things are not looking as good as they were: growth has slowed in Denmark and Finland, which may soon lose its AAA credit rating, and there are signs of a reversal of reforms in some places.

These countries' leaders need to remember that the pursuit of greater competitiveness is not a one-off affair but a continuous process. Too often in the past two decades European governments have responded to crisis by pushing through painful changes, only to lapse into complacency as soon as they show results. Nor is it enough to be competitive only within Europe. There is another mantra Mrs Merkel likes to repeat to her colleagues: Europe accounts for 7% of the world's population, 25% of GDP and 50% of social-welfare spending. Germany's current course will exacerbate that problem.

From the print edition: Leaders