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**Germany's economy**

## Modell Deutschland über alles

**The lessons the rest of the world should—and should not—take from Germany**

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MUCH of the rich world is



fascinated by Germany. Despite being at the heart of sclerotic Europe, its GDP per head has risen by more than any other G7 country's over the past decade. Unemployment in the troubled euro zone is at its highest since the single currency's birth; in Germany it is at a record low. In most rich countries manufacturing exports have been hammered

by foreign competition; in Germany they remain powerful drivers of growth. No wonder hard-pressed political leaders in France, Spain, Italy and Britain are talking wistfully of becoming more like Germany.

Germany's recent success has both new and old roots. Only a decade ago, still struggling with the costs of unification, it was a basket-case. It has since bounced back to show that a high-wage country can succeed in top-end manufacturing, not least by holding down unit labour costs. The Germans have long since repaired their public finances—the budget deficit is barely 1% of GDP, public spending as a share of GDP is well below the European average and German bond yields are at record lows. Thanks mainly to the Agenda 2010 reforms begun by the Social Democrat-led government of Gerhard Schröder in 2003, Germany has liberalised many of its labour-market rules, one reason for today's enviably low unemployment.

Yet Germany's cutting edge has an ancient blade. The country's *Mittelstand* clusters of firms, which often specialise in niche areas of manufacturing, developed in the late 19th century. Impressively resilient and versatile, they have benefited from rocketing demand for high-quality capital and consumer goods in emerging markets. Germany's corporatist *Mitbestimmung* model, which gives workers a say in management, has made it easier both to push through structural reforms and to hold down wages. And the German system of apprenticeships and vocational training, divided into some 350 trades, has helped keep youth unemployment lower than elsewhere in Europe (see [article \(http://www.economist.com/node/21552567\)](http://www.economist.com/node/21552567) ).

### **The sincerest form of flattery**

So what should Europe's weaker countries be trying to copy? The relaxation of labour-market rules, certainly. That is beginning to happen, though as Italy has been discovering (see [article \(http://www.economist.com/node/21552603\)](http://www.economist.com/node/21552603) ), liberalising labour markets is harder in tough economic times. Germany freed up its job market when demand was strong in the rest of Europe. There is also

much to be said for emphasising vocational training instead of producing more and more graduates with often useless university degrees. But many of the things that work well in Germany—its corporatism, its business clusters, its manufacturing prowess—are part of a traditional culture that would be hard, if not impossible, to transplant from one country to another.

Nor should Germany's neighbours try to import the model wholesale. Its corporatist industrial relations, for instance, help companies hold wages down, but they can also be bad for shareholders. And while the country's manufacturing sector may be productive, its service sector is not; and services now account for some two-thirds of GDP. The financial industry is relatively unprofitable and has a record of investing in dodgy foreign assets (including rotten American mortgages). Germany's demographic outlook is lousy. Its native population is shrinking and ageing fast, and the country does not welcome immigrants.

Above all, the country's hair-shirt philosophy that favours austerity over growth, saving over spending, and foreign over domestic demand has often been damaging. It has held down Germans' living standards (despite faster growth, personal consumption has risen by less than in the rest of Europe over the past decade). And it has been catastrophic for the rest of the euro zone as Germany has acted, in effect, as a drag on demand. Investors who sold off Spanish and Italian bonds this week were worried as much about the effects of excessive austerity as about public-debt levels (see [article \(http://www.economist.com/node/21552582\)](http://www.economist.com/node/21552582)). Germany's reliance on exports has led to huge current-account surpluses that have been matched by deficits elsewhere, a big contributor to the euro crisis.

German policymakers who urge only austerity and wage restraint on the



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rest of Europe forget that the goal of growth is to raise personal incomes (and spending), and that the real benefit from higher exports is to pay for more imports. The rest of Europe would do well to copy the best features of the German model. But Germany too should learn from its partners about the importance of raising and sustaining domestic demand. Then everybody would be better off.

from the print edition | Leaders

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