

# German Economic Policy at a Crossroads

*Eckhard Hein and Achim Truger*

Ever since the mid-1990s, the German economy has performed far worse than the economy of the euro zone as a whole.<sup>1</sup> However, public awareness only really focused on this lag after the 2000/2001 downturn. From 2001 to 2005, real gross domestic product (GDP) growth rates were low, at times even negative. The economic stagnation led to a significant radicalization of the economic-policy debate. The overwhelming majority of German economists, journalists, and business representatives maintained that Germany was undergoing a deep “structural crisis” as a result of over-regulated labor markets and employment-adverse social security systems. Radical “structural” reforms therefore appeared to be the only way out of the crisis. By the second legislative period of the Social Democrat-Green government, proponents of radical reform managed to also push through corresponding economic policies, the AGENDA 2010 and the Hartz Laws. The grand coalition in power since the end of 2005 has not deviated from these policies to any significant degree.

In 2006 Germany experienced an unexpectedly strong expansion. In international comparison, German’s economy grew at the same rate as the economy of the entire euro area. Nevertheless, warnings still persist that the reform efforts must not be relaxed, so as not to endanger the results of past efforts and cutbacks. This point of view is astonishing and – if it has economic policy consequences – dangerous. It is astonishing because it does not ask why the German economy stagnated for more or less five years, while most of the euro zone economies and also those of very different countries like Great Britain, Sweden, and the USA recovered quickly after the 2000/2001 downturn and had significantly higher growth and lower unemployment rates than Germany.<sup>2</sup> And such a standpoint is dangerous, because a continuation of “structural reform” policies threatens to further burden economic developments in Germany.

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<sup>1</sup>See Eckhard Hein and Achim Truger, “What ever happened to Germany? Is the Decline of the Former European Key Currency Country caused by Structural Sclerosis or by Macroeconomic Mismanagement?” *International Review of Applied Economics* 19 (2005): 3-28.

<sup>2</sup>For a comparison of Germany with Great Britain and Sweden, see Eckhard Hein, Jan-Oliver Menz, and Achim Truger, “Warum bleibt Deutschland hinter Schweden und dem Vereinigten Königreich zurück? Makroökonomische Politik erklärt den Unterschied,” *IMK Report* Nr. 15 (2006), Düsseldorf.

In this article, we call into question the diagnosis of “structural sclerosis” of the German economy and the resulting strategy of “structural reforms.” In our opinion, the German stagnation from 2001 to 2005 cannot be explained by the failure to implement structural reforms of the labor market and the social security systems or delays in implementation of such reforms, but by macroeconomic mismanagement, in other words, by misguided monetary, wage, and fiscal policies, imposed, in part, at the European level (European Central Bank – ECB, Stability and Growth Pact – SGP) and promoted, in part, by the mistaken German reform zeal.

## **Germany’s Stagnation from 2000 to 2005**

Compared to the euro zone average and to the USA, Germany was particularly hard hit by the downturn of 2000/2001 (Table 1). While average annual real GDP growth of the euro area (including Germany) was 1.4% and thus significantly less than that of the USA in the period from 2001 to 2005, Germany’s average annual growth in that period was 0.7%, just half of the euro area’s growth rate.

In contrast to the euro zone as a whole, the weak German growth was carried exclusively by the export surplus. Domestic demand, on average, had a negative impact on growth from 2001 to 2005. Overall, the German economy was characterized by a high degree of international competitiveness, on the one hand, and considerable weakness of domestic demand, on the other hand. Because of the weak growth, employment declined in Germany from 2001 to 2005, whereas it increased in the euro area and in the USA. The German unemployment rate, which had always been below the euro area average before 2002, rose above it. German inflation, on the other hand, was well below the euro area average, as it had been since the mid-1990s.

**Table 1: Real GDP Growth, Growth Contribution of Demand Aggregates, Unemployment Rate, and Inflation Rate in Germany, the Euro Zone, and the USA average value for 2001-2005 (in percent)**

|   | Germany | Euro zone | USA  |
|---|---------|-----------|------|
| Real GDP, annual growth rate                                      | 0.7     | 1.4       | 2.6  |
| Growth contribution of domestic demand including change in stocks | -0.2    | 1.3       | 3.0  |
| Growth contribution of private consumption                        | 0.2     | 0.8       | 2.2  |
| Growth contribution of public consumption                         | 0.0     | 0.3       | 0.5  |
| Growth contribution of fixed capital formation                    | -0.4    | 0.2       | 0.5  |
| Growth contribution of balance of goods and services              | 0.9     | 0.1       | -0.5 |
| Employment, annual growth   | -0.2    | 0.8       | 0.7  |
| Unemployment rate   | 8.7     | 8.5       | 5.4  |
| Inflation rate <sup>1</sup>                                       | 1.6     | 2.2       | 2.5  |

Notes: <sup>1</sup>Germany and euro zone: Harmonized Consumer Price Index (HCPI), USA: national Consumer Price Index (CPI)

Source: European Commission, annual macro-economic database (AMECO), 2006, [http://europa.eu.int/comm/economy\\_finance/indicators/annual\\_macro\\_economic\\_database/ameco\\_en.htm](http://europa.eu.int/comm/economy_finance/indicators/annual_macro_economic_database/ameco_en.htm) (February 8, 2007). OECD (2006), Economic Outlook, 2006, [http://www.oecd.org/document/61/0,2340,en\\_2649\\_201185\\_2483901\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/61/0,2340,en_2649_201185_2483901_1_1_1_1,00.html) (February 8, 2007). Authors' calculations.

## Reform Deadlock?

For most German economists, the explanation for the growth and employment problems at home is clear and simple: rigid and over-regulated labor markets, as well as employment-adverse social security systems are held responsible for the German crisis. This viewpoint is based on a simple neo-classical model, according to which (long-term) unemployment can only be caused by disruptions to the labor market that prevent a market-clearing real wage from emerging.<sup>3</sup> Collective wage bargaining (for example, sector-wide wage agreements), labor-market

<sup>3</sup>See, for example, Horst Siebert, "Labor Market Rigidities: At the Root of Unemployment in Europe", *Journal of Economic Perspectives* 11 (1997): 37-54.

regulations (for example, employment protection, minimum wages), and the social security systems (for example, unemployment benefits, tax wedge) have been identified as the cause for long-term unemployment and therefore also for weak growth. In this view, there is only one solution for the problems: reduction of labor-market rigidities through more flexibility and decentralization of collective wage negotiations (for example, through company-level pacts), deregulation of the labor market (for example, by dismantling employment protection), reduction of unemployment benefits (for example, Hartz IV), and lower non-wage labor costs.<sup>4</sup>

We have elsewhere explored at length the general theoretical and empirical deficiencies of such a viewpoint.<sup>5</sup> However, far more important for the German discussion is the fact that even if the “institutional sclerosis” view were theoretically and, in general, empirically convincing, it would not be applicable to developments in German labor market institutions, social security systems, and unemployment. Looking at the indicators usually cited for the rigidity of the labor market and social security systems (employment protection, unemployment benefit replacement rate and duration, union density, bargaining coordination, tax wedge) in Germany, one finds that these have not worsened, either absolutely or relative to the European Union (EU), the euro area, or the Organization for Economic Cooperation and Development (OECD) countries, since the slump in growth and employment during the mid-1990s. Table 2 demonstrates this by way of an aggregate indicator for institutional sclerosis and its development from the beginning of the 1980s until the end of the 1990s, which we calculated from the individual indicators. It shows that Germany reduced “institutional sclerosis” more clearly than all other countries or groups of countries, significantly reduced the gap vis-à-vis the OECD countries, completely overcame the gap vis-à-vis the EU average, and even did better than the euro area average.

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<sup>4</sup>See, for example, the majority view in German Council of Economic Experts, Annual Report 2005/2006, *Seize the Chance – Boldly Advance the Reforms*, Berlin, 2006, as well as the Joint Forecast of the Working Group of German Economic Research Institutes, “Die Lage der Weltwirtschaft und der deutschen Wirtschaft im Herbst 2005,” *DIW Weekly Report* 43/2005: 605-655. See also Deutsche Bundesbank, “Ways Out of the Crisis,” Frankfurt, 2003; European Commission, “Germany’s Growth Performance in the 1990’s,” Economic Paper Nr. 170, Brussels, May 2002; and *OECD, Economic Survey – Germany 2004*, Paris, 2004.

<sup>5</sup>See Hein and Truger, “What ever happened to Germany?” (Footnote 1).

**Table 2: Aggregate Indicator for “Institutional Sclerosis” 1980-84 and 1995-99**

|                             | 1980-84 | 1995-99 |
|-----------------------------|---------|---------|
| Germany                     | 57      | 52      |
| OECD <sup>2</sup>           | 49      | 47      |
| European Union <sup>3</sup> | 53      | 52      |
| Euro zone <sup>3</sup>      | 52      | 53      |
| USA                         | 20      | 18      |

<sup>1</sup>Arithmetic mean of the indicators for employment protection legislation, unemployment benefit replacement rate, unemployment benefit duration, union density, bargaining coordination, and tax wedge, each scaled to the interval [0;100].

<sup>2</sup>Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, The Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, USA.

<sup>3</sup>without Greece and Luxemburg.

Source: Dean Baker, Andrew Glyn, David R. Howell, and John Schmitt, “Labor Market Institutions and Unemployment: A Critical Assessment of the Cross-Country Evidence”, in *Fighting Unemployment. The Limits of the Free Market Orthodoxy*, ed. David R. Howell (New York: Oxford University Press, 2005). Authors’ calculations.

The conclusion that structural reforms in Germany have proceeded at an above-average pace in international comparison – particularly in the last ten years – is also supported by two newer studies: first, a study by Deborah Mabbett und Waltraud Schelkle of reforms in employment protection legislation and unemployment benefits to the end of 2002 (Table 3)<sup>6</sup> and secondly, the recent “OECD Jobs Strategy Reassessment.” The OECD, which has been one of the most prominent proponents of the need for structural reform, in general and particularly in Germany,<sup>7</sup> certifies that Germany’s reform activity was well above the average from 1995 to 2005:<sup>8</sup> according to its “reform intensity indicator,” Germany places fourth among the 30 countries studied and third within the euro zone, behind the Netherlands and Finland.

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<sup>6</sup>See Deborah Mabbett and Waltraud Schelkle, “Bringing Macroeconomics back into the Political Economy of Reform: the Lisbon Agenda and the ‘Fiscal Philosophy’ of EMU,” *Journal of Common Market Studies* 45, no.1 (2007): 81-103.

<sup>7</sup>OECD, *The OECD Jobs Study: Evidence and Explanations* (Paris: OECD, 1994).

<sup>8</sup>OECD, *OECD Employment Outlook: Boosting Jobs and Incomes – Policy Lessons from Reassessing the OECD Jobs Study* (Paris: OECD, 2006).

**Table 3: Reform Intensity<sup>1</sup> in 14 EU Countries**

|                 | 1987-1994 | 1995-2002 | 1987-2002 |
|-----------------|-----------|-----------|-----------|
| Belgium         | 5         | 7         | 12        |
| Denmark         | 4         | 10        | 14        |
| <b>Germany</b>  | <b>-2</b> | <b>17</b> | <b>15</b> |
| Finland         | 4         | 16        | 20        |
| France          | -3        | -12       | -15       |
| Greece          | 0         | 9         | 9         |
| Great Britain   | 5         | 5         | 10        |
| Ireland         | 5         | 3         | 8         |
| Italy           | 1         | 13        | 14        |
| The Netherlands | 2         | 24        | 26        |
| Austria         | -1        | 13        | 12        |
| Portugal        | 0         | -3        | -3        |
| Spain           | 5         | 0         | 5         |
| Sweden          | 4         | 15        | 19        |

Note: <sup>1</sup>Sum of the two reform intensity values assigned by Mabbett and Schelkle, i.e. the sum of the reform intensity value of reform measures in the areas of employment protection and unemployment benefits for each country in the respective period on the basis of the Fondazione Rodolfo De Benedetti Social Reforms database. Positive values signal “increasing flexibility” (i.e. less labor protection and lower benefits). Negative values indicate “decreasing flexibility” (i.e. more labor protection and higher benefits). Mabbett and Schelkle measure the reform intensity of a reform package by assigning a value of 1 to reforms the databank classifies as “marginal,” and 2 to those classified as “structural”. Reform packages with more than one measure receive an intensity value of 2 if they contain two or more marginal measures and an additional 2 for including a structural measure (thus 4 is the maximum value for any one reform package, while 2 is the maximum value for packages that contain only marginal measures). Source: Deborah Mabbett and Waltraud Schelkle, “Bringing Macroeconomics back into the political economy of reform: the Lisbon Agenda and the ‘fiscal philosophy’ of EMU”, 2005, <http://eprints.bbk.ac.uk/archive/00000259/01/BringingMacroeconomicsBackIn.pdf> (February 8, 2007). The Fondazione Rodolfo De Benedetti Social Reforms Database, [http://www.frdb.org/documentazione/centro\\_doc.php](http://www.frdb.org/documentazione/centro_doc.php) (February 8, 2007). Authors’ calculations.

Given the background of this empirical evidence, it is very difficult to attribute the German growth and employment problems to overly rigid labor markets and a lack of structural reforms. The suspicion thus arises that the diagnosis behind the current economic policies was and is wrong.

**Table 4: Indicators for Monetary, Fiscal, and Wage Policies in Germany, the Euro Zone, and the USA**

average 2001-2005

|  | Germany       | Euro zone     | USA  |
|--|---------------|---------------|------|
| <b>Monetary policy</b>   |               |               |      |
| Short-term real interest rate, percent   | 1.2           | 0.6           | -0.2 |
| Long-term real interest rate, percent  | 2.6           | 2.1           | 1.9  |
| Short-term real interest rate minus real GDP growth, percentage points                       | 0.5           | -0.7          | -2.8 |
| Long-term real interest rate minus real GDP growth, percentage points                        | 1.9           | 0.7           | -0.7 |
| <b>Fiscal policy</b>   |               |               |      |
| Government budget balance, percentage of GDP   | -3.5          | -2.5          | -3.5 |
| Structural budget balance as a percentage of potential GDP, annual change, percentage points | -0.1          | 0.0           | -1.0 |
| Output gap as a percentage of potential GDP, annual change, percentage points                | -0.8          | -0.6          | -0.3 |
| Number of years with pro-cyclical fiscal policy during an economic slowdown                  | 3<br>(2003-5) | 3<br>(2003-5) | 0    |
| Negative fiscal stimulus in an economic slowdown, cumulative, percent of potential GDP       | 1.7           | 1.1           | --   |
| <b>Wage policy</b>   |               |               |      |
| Compensation per employee, annual change, percent  | 1.8           | 2.5           | 3.9  |
| Nominal unit labor costs, annual change, percent   | 0.2           | 1.7           | 1.7  |
| Labor income share, <sup>1</sup> percent   | 64.9          | 65.3          | 67.2 |
| Change in labor income share to previous year, percentage points                             | -0.6          | -0.3          | -0.4 |

Notes: <sup>1</sup>Compensation per employee divided by GDP at factor costs per worker.

Source: European Commission (Table 1). OECD (Table 1). Authors' calculations.

## Macroeconomic Mismanagement

A macroeconomic explanation for the weakness in German employment and growth can be based on both Post-Keynesian and New Keynesian theory. The latter now comprises the new international mainstream in macroeconomics.<sup>9</sup> According to these theories, an inadequate or uncoordinated use of macroeconomic instruments, that is, monetary, wage, and fiscal policies, can easily be the explanation for low growth and high unemployment over a longer period.

### Monetary Policy

With the start of the European Monetary Union in 1999, Germany lost the status of a regional key currency country in the European Monetary System (EMS) and the related interest-rate advantages. Because nominal interest rates have converged since 1999 while the inflation rate in Germany is below the euro zone average, Germany now has significantly higher real interest rates than the rest of the euro area. On average for the years 2001-2005, the policies of the ECB resulted in a short-term real interest rate of 1.2% for Germany, although it was only 0.6% for the euro zone as a whole (Table 4). And while the short-term real interest rate in the euro zone was positive throughout the 2001-2005 period, the Federal Reserve pushed through a negative short-term real interest rate of -0.2% in the USA. This expansive monetary policy contributed to the rapid recovery of the US economy after the 2000/2001 slump. The difference between short-term real interest rates and real GDP growth, as an indicator for the growth friendliness of monetary policy, was on average clearly negative for the years 2001-2005 in the USA. The ECB reacted much more hesitantly and less expansively to the growth downturn and thus contributed to the weak growth in the euro zone and particularly in Germany since 2001. While the difference between short-term real interest rates and real GDP growth was slightly negative on average in the euro area between 2001 and 2005, it remained positive in Germany.

The German economy thus not only suffered from the loss of the interest rate advantage as a result of the currency union, but was also especially affected by the growth-unfriendly policies of the ECB after 1999. However, Germany's poor performance from 2001 to 2005 can be attributed only in part to these factors, given that monetary policy in a currency union can take into account only average inflation and GDP developments, and not the special situation of an individual country.

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<sup>9</sup>Eckhard Hein, Arne Heise, and Achim Truger (eds.), *Neu-Keynesianismus – der neue wirtschaftspolitische Mainstream?* (Marburg: Metropolis Verlag, 2005).

## Fiscal Policy

Given that the ECB was neither willing nor able to stabilize the German economy after 2000, German fiscal policy should have worked to counteract the macroeconomic shock. However, it did exactly the opposite: it attempted to consolidate the budget pro-cyclically and thus worsened the crisis. One reason for this was the pressure from the Stability and Growth Pact (SGP), as Germany's budget deficit continually exceeded the 3% limit from 2002 to 2005. On the other hand, however, it was also the result of the economic policy recommendations of the German economics mainstream, which pushed for expenditure consolidation of the government budget, regardless of the cyclical situation.<sup>10</sup> The attempt was obviously unsuccessful (Table 4).

The actual budget balance is not an appropriate indicator with which to evaluate the cyclical orientation of fiscal policy, because it cannot be controlled by economic policy, but is the result of the overall macroeconomic process. We therefore use instead the structural budget balance, in other words, the cyclically adjusted budget balance in relation to potential GDP, and compare its development with movements in the output gap, in other words, the difference between actual and potential output.<sup>11</sup> If there is a positive change in the output gap, the economy is in an upturn; a negative change indicates a downturn. The change in the structural budget balance indicates the direction of fiscal policy: if there is a positive change, structural deficits fall or surpluses increase and fiscal policy has a restrictive impact. If there is a negative change, structural deficits rise or surpluses are reduced and fiscal policy is expansionary.

Measured in this way, German fiscal policy from 2001 to 2005 was pro-cyclically restrictive in three of these years and thus intensified the downturn (Table 4). The cumulative negative fiscal impact amounted to 1.7% of potential GDP over the entire period. Fiscal policy in the euro zone was also pro-cyclically restrictive in three of the years, although the cumulative negative fiscal impact was only 1.1%

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<sup>10</sup>See, for example, the majority view in German Council of Economic Experts and the Working Group of German Economic Research Institutes (Footnote 4).

<sup>11</sup>The cyclically adjusted budget balance is the budget balance that would have resulted if actual GDP were exactly equal to potential GDP (output gap = 0). If capacity is outstripped (output gap > 0), i.e. a cyclical upturn, actual tax receipts are greater than potential tax receipts, and because of low unemployment, actual public expenditures are less than potential public expenditures. If capacity is not fully utilized (output gap < 0), the reverse is true. Through this cyclical adjustment, the cyclical elements of the budget balance are calculated out. The resulting cyclically adjusted balance can be interpreted as a measure of the true influence of fiscal policy on the economy, while policy and cyclical factors are mixed in the actual budget balance. Of course, short-term cyclical and long-term structural influences cannot be statistically separated with absolute certainty.

of potential GDP. Thus, although the cyclical downturn was much stronger in Germany than in the entire euro area – the output gap declined annually by 0.8 percentage points in Germany versus 0.6 percentage points per year in the euro zone – German fiscal policy was considerably more restrictive. The fiscal-policy response in the USA, in contrast, was strongly anti-cyclical between 2001 and 2005: the structural budget balance was reduced by one percentage point per year on average. In the euro area and in Germany, this balance was maintained or reduced by only 0.1 percentage point a year, although both experienced a much steeper decline in the output gap.

The restrictive and destabilizing orientation of German fiscal policy becomes even clearer, when the development of individual expenditure categories is examined (Table 5). Real total government expenditures fell by 0.2% per year from 2001 to 2005, while they increased by 1.4% a year in the euro area and, even more sharply, by 3.6% per year in the USA. Real public consumption in Germany declined by 0.3% a year; real public investment fell dramatically by 4.0% a year. The ratio of public investment to GDP was therefore only 1.5% in the 2001-2005 period and thus a good percentage point below the values for the euro zone and the USA. This development is particularly alarming, given that public investment is not only an essential component of effective demand in the short term, but also a key prerequisite for private investment and economic growth, through the related provision of public infrastructure.

**Table 5: Annual Growth Rates of Selected Fiscal Policy Aggregates in Germany, the Euro Zone, and the USA**  
average 2001-2005 (in percent)

|   | Germany | Euro zone | USA |
|---|---------|-----------|-----|
| Real total government expenditure <sup>1</sup>            | -0.2    | 1.4       | 3.6 |
| Real government consumption <sup>1</sup>                  | -0.3    | 2.0       | 4.3 |
| Real government fixed capital formation <sup>2</sup>      | -4.0    | 1.5       | 3.2 |
| Real government revenue <sup>1</sup>                      | -1.3    | 0.8       | 0.3 |
| Government gross fixed capital formation (percent of GDP) | 1.5     | 2.5       | 2.7 |

Notes: <sup>1</sup>deflated using the HCPI; <sup>2</sup>deflated using the deflator of gross fixed capital formation.

Source: European Commission (Table 1). Authors' calculations.

## Wage Policy

The development of wages, measured as compensation per employee – compared with the rest of the euro zone or the USA – was also particularly restrictive in Germany from 2001 to 2005, as it had been already since the mid-1990s (Table 4). Growth in German unit labor costs was therefore well below the euro area average, which was the main reason for the below-average inflation. In 2004 and 2005, unit-labor-cost growth was even negative, so that wage developments represented a significant risk of deflation, in other words, the risk of falling output prices and rising real debt, particularly of businesses, with the corresponding negative effects on investment. Falling output prices did not materialize because the prices for imported energy as well as government fees and taxes rose, and firms could also increase their profit margins.

Although German below-average wage developments, compared to the rest of Europe, were dominant for long phases even before the currency union, at that time they were the basis for the German position as key currency country in the EMS, which allowed the German Bundesbank to set lower nominal and real interest rates than prevailed in the other countries.<sup>12</sup> In contrast, after the monetary union, German wage restraint, as the basis of the below-average inflation rate, was penalized by above-average real interest rates. The moderate wage movements in Germany also contributed to a greater fall of the labor income share. Together with the general uncertainty caused by the structural reform policies, the massive redistribution to the detriment of workers was the main reason for the everywhere bemoaned weakness of consumption and internal demand. The trend of falling labor income share continued also in the entire euro zone in the 1990s, although with a slower speed than in Germany since 2001. In the USA, in contrast, it proved possible to arrest the tendency towards falling labor income shares in the 1990s, so that this share now lies around two percentage points above that in the euro zone or Germany.

Wage restraint in Germany certainly increased the international price competitiveness of German firms, so that export surpluses almost quadrupled between 2001 and 2005. Nevertheless, this export success was not enough to compensate for the weakness in domestic demand. Because over 40% of German exports go to the euro zone, the growing German export and current account surpluses are accompanied by increasing current account deficits or declining surpluses in the partner countries within the monetary union. Since the other countries can no longer use a nominal devaluation to defend themselves, they are under growing pressure to also pursue wage moderation and demand-dampening

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<sup>12</sup>See Hein and Truger, “What ever happened to Germany?” (Footnote 1).

policies in order to improve their competitive position. The deflationary risks emanating from wage developments in Germany therefore increasingly threaten to radiate into the euro area. German wage movements have thus become a dangerous powder keg for the currency union.

## **Final Remarks and Conclusion**

The essential causes of German stagnation from 2001 to 2005 are not found in over-regulated labor markets and employment-adverse social security systems. On the contrary, unmistakable macroeconomic mismanagement, in part at the European level (ECB, SGP) and in part homegrown, was responsible for weak growth and high unemployment. The fact that there was an upturn in 2006 and that the five-year stagnation did not continue is the result of the reform pause and the less dampening position of the public budget in that year, which made it possible for the foreign trade stimulus to spring over to internal demand, especially to investment. However, the recovery has nothing to do with the reform policies of previous years; these explain only why the recovery in Germany was so long in coming.

The continuation of structural reform policies and attempts to consolidate the government budget by means of expenditure cuts would again destabilize the economy. What is required instead is macroeconomic policy reorientation, in other words, more expansive monetary and fiscal policy and stabilizing wage developments, which again make use of the room to maneuver between the target inflation rate of the ECB and long-term national productivity growth.