



The German business model

The need for a new position agenda

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The German economy has run into rough waters: The Ukraine war and energy crisis have exacerbated existing problems - and prompted policymakers to focus primarily on current issues. However, inactivity in location policy is just as risky.

It is undeniable that the German economy is under considerable strain. The German government and the four economic research institutes expect economic output to decline by -0.4% in 2023, putting Germany at the bottom of the growth scale among developed countries.



Naysayers underestimate stabilizing factors

Many expect a de-industrialization due to the energy crisis and thus also a loss of prosperity in the German economy in the long term. Therefore, the consensus is that there will be a recession. But how deep will it be? At present, several downward forces are working together. The severe energy crisis has led to exorbitant price increases, especially for gas and electricity. Many private households, tradespeople, and companies are fearing for their economic existence because they cannot pay energy bills or are producing at a great loss. Together with rising food prices, the energy crisis has provided the impetus for inflation that dwarfs even the oil price crises of the 1970s.

The loss of purchasing power slows down the economy, especially since the high expenditures for energy imports are withdrawn from the domestic cycle. This braking effect is reinforced by an increase in interest rates, with which the ECB is fighting the rapid rise in inflation and the increasing inflation expectations.

However, there are also stabilizing factors. First, market-based adjustment to the gas and electricity price shock has begun. As a result of savings on consumption, the opening of new suppliers, and increased efforts to obtain gas and renewable energies, energy prices have already fallen significantly. With a certain delay, this will significantly reduce inflation rates and thus the loss of purchasing power for consumers.

Secondly, the countries of the euro zone and the OECD are in a situation of very high demand for labor and low unemployment. Many companies are desperately looking for workers to work off the high order backlogs, which mainly date back to the Covid restrictions. Certainly, the very high number of job openings will decline significantly during the current economic slowdown, but there is little to suggest that major waves of layoffs are imminent.

Third, substantial debt-financed government relief programs counteract the loss of purchasing power and cost increases. Government support is particularly necessary in lower- and middle-income groups

as many households are unable to pay monthly energy costs and many traders would be faced with going out of business. For large industrial energy consumers, regulations for the increase are planned for the beginning of 2023 in order to maintain international competitiveness and avoid further production shutdowns and insolvencies in energy-intensive sectors.

De-industrialization is a risk

However, the question also arises as to the long-term prospects of the German economy. Is there a threat of a loss of prosperity due to de-industrialization and a failure of the "German business model"? It is indisputable that the economy is more heavily burdened by energy prices than other economies due to its high industrial share and its dependence on exports.

German industry has always had to cope with high energy costs, but the sudden multiplication makes many productions unprofitable. If gas and electricity prices were to remain at the average level since March 2022 for a longer period of time, an exodus of energy-intensive production could be expected. To counter the risk of de-industrialization, the prospect of a safer and more economical energy supply is therefore important. The German energy turnaround, on the other hand, is creating great uncertainty. It is abandoning nuclear power, increasing gas-fired power generation, and is not making fast enough progress on renewable energies. As a result, climate-damaging coal-fired power will have to be expanded again.

New forms of globalization are emerging

Additional challenges for the German economy are posed by changes in the international environment. Since the financial crisis, there has already been a relative slowdown in global trade and capital flows. A consequence of the Ukraine crisis, new forms of globalization are emerging in which Germany still has to assert its position. It is less important that economic relations with Russia are likely to be on ice for some time. More important is the fact that business with China is also viewed critically from the perspective of high dependencies on the export and import side. China has not only strengthened its ties with Russia but has also created great uncertainty through state intervention in the economy and its unwillingness to compromise in the implementation of political goals.

Thus, many companies are in the process of rethinking their involvement in China. There will be no large-scale withdrawal,

as this would have catastrophic effects on prosperity in Germany. However, companies will gradually start to diversify their procurement markets, sales markets, and investment locations. In the Asian region, countries such as Vietnam, India, and Indonesia could benefit. A big winner, however, is likely to be the USA, which offers an attractive sales market and considerable subsidies for companies willing to invest.

In the future, trade relations and capital movements will be geared more closely to geopolitical conditions. Countries with similar values and calculable political conditions will intensify exchange. For the world economy, on the other hand, a certain fragmentation is to be expected, as autocratically governed blocs become more distinct from the economies of democracies. Trade advantages will be nullified and cooperation on global issues such as climate protection will become more difficult.

A new location agenda for Germany is needed

One may understand that the government is currently devoting its full attention to the Ukraine war and its consequences. However, inactivity in location policy is risky. After all, only a good location policy can guarantee that Germany's internationally and industrially oriented business model can continue to successfully provide jobs and prosperity in the future.

Location problems are reflected in long-term low growth, comparatively low investment and weak productivity progress. In addition to a reliable energy policy, a holistic view of the economic framework conditions is needed for an economy that is strong in export and industrial business. The more policymakers increase the price of energy consumption and environmental pollution, the more they must ensure that other cost drivers such as non-wage labor costs, bureaucratic requirements, and the above-average tax burden in Germany are reduced. If conditions in the country are good, domestic, and international companies will not fail to invest here.

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