

# ***How the German Economy Went from Being the “Sick Man of Europe” to Being a European Leader***

**Yichang Wang<sup>1,a,\*</sup>**

<sup>1</sup>*Haidian Foreign Language School, Beijing, 100195, China*  
*a. charles\_wang2020@163.com*

*\*corresponding author*

**Abstract:** Germany's economy has been stagnant since the 21st century, and was once called the “sick man of Europe”. However, in just a few years, Germany's economy has soared to become the leader of the European economy. This economic miracle is inseparable from Germany's economic reforms. Germany solved the problems of its own indebtedness and the solidification of the labor market by reducing welfare support. Secondly, Germany has also shown a solid performance to the world economic crisis, through its usual low consumer demand, good trade performance before the crisis, and short-term labor to reduce the financial burden for the enterprise, to ensure the employment rate during the economic crisis, so that it can quickly come out from the crisis. Not only that, Germany has also fully utilized its own advantages, Germany through the investment in education to ensure that the manufacturing industry continues to innovate, to maintain the competitiveness of the manufacturing industry in the international market, to ensure its export surplus and the advantages of the manufacturing industry.

**Keywords:** German, economy growth, 2010 Agenda

## **1. Introduction**

In 1989, the Berlin Wall's fall caused a significant economic disparity between West and East Germany, which the reunified German government sought to bridge by instituting a solidarity tax to provide financial aid to the eastern region, with an annual net transfer of approximately 4-5 percent of Germany's GDP; however, the results were meager [1].

In addition, Germany's welfare system is “overdeveloped”, and the labor market is too rigid, for example, Employers must give appropriate compensation according to the family situation of the dismissed employee, which leads to enterprises not dismissing difficult employees; and even if the unemployed, the unemployed can still get a subsidy equivalent to 60-70% of the salary before unemployment, which can last for up to three years. The maximum can even last for 3 years. In 2002, Germany's social welfare expenditure was 487 billion euros (23 percent of that year's GDP), and from 1991 to 2002, the government debt doubled. The German government, in order to cover the exorbitant welfare costs, has been compelled to continually raise taxes; in 1997, taxes made up 40.3 percent of GDP, with a peak of 53 percent for personal income tax and 51.83 percent for corporate tax. The high demand for wages brought about by high taxes further increased labor costs, which in turn reduced corporate profits and led to an outflow of capital [1].

After the year 2000, the economic performance of the newly launched Eurozone stagnated, with Germany's GDP growth rate hovering at zero for three consecutive years, and forecast to be negative in 2003, with the number of unemployed exceeding 4 million (exceeding 7 percent). The poor economy has led to a huge drop in government tax revenues, coupled with massive unemployment that has put a heavy burden on the social security system (unemployment insurance, poverty assistance) on the verge of collapse, and the worry of an aging society has finally come to the fore in the post-war period when baby boomers are retiring and the birth rate is the world's first low, resulting in an explosion of pension payments and a sharp drop in incomes. Instead, Germany's long history of enviable labor security and social insurance has become an investment concern for companies in times of recession [1].

From 1998 to 2003, the German economy experienced a meager 1.2 percent yearly growth, while the unemployment rate skyrocketed from 9.2 to 11.1 percent, which is too much so that it was derisively dubbed "Europe's sick man" [1].

However, Germany's economy grew by leaps and bounds in the twenty-first century, all the way from the bottom of the pile to become a leader among the ranks of Europe's economic powers. This feat is also regarded by economists as a major miracle. Germany's economic recovery is incredible not only because of its amazing speed of recovery but also its rapid emergence from the recession, completing the success of the reverse. The 70 years of development have been a miracle for the German economy: In addition to the remarkable economic growth, what is even more intriguing is the "robustness" of the German economy [2].

Thanks to the rapid development of the Marshall Plan, the oil crisis, globalization, the sub-prime crisis, and the European debt crisis, the German economy has nevertheless remained relatively robust. The German economy seems to have saved the day in every crisis: the successive blows of the subprime and European debt crises still allowed Germany to return to a growth rate of 4.1 percent in 2010. Examining the GDP growth rate of the United States, the United Kingdom, Germany, and Japan from 1973 to 2017, it is evident that the US had a standard deviation of 2.03, the UK 2.12, Germany 1.97, and Japan 2.5 - all with a similar standard deviation. The economic growth rate of Germany is far more stable than that of other economies, a fact that is not hard to discern [2]. As can be seen in Figure 1, Germany's GDP has been in a state of recession since 1995, with GDP once below \$20,000,000,000,000 from 2000 onwards it began to grow steadily and rapidly, and in 2008 it once surpassed Japan, and eventually surpassed Japan as well. An orderly recovery in German productivity after the subprime crisis. Since the subprime crisis, national economies have been on a recovery track and productivity levels have been repaired compared to the pre-crisis period, but Germany's productivity recovery has been stronger than that of Japan, the U.S., and the U.K. In 2016, Germany's productivity maintained its upward trend in comparison to the downward turn in productivity in Japan, the U.S., and the U.K.: Japan's total factor productivity growth for the year was 0.4%, the U.S. saw virtually no growth, and the U.K. was at -0.3 percent, while Germany's total factor productivity reached 1.2 percent that year [2].

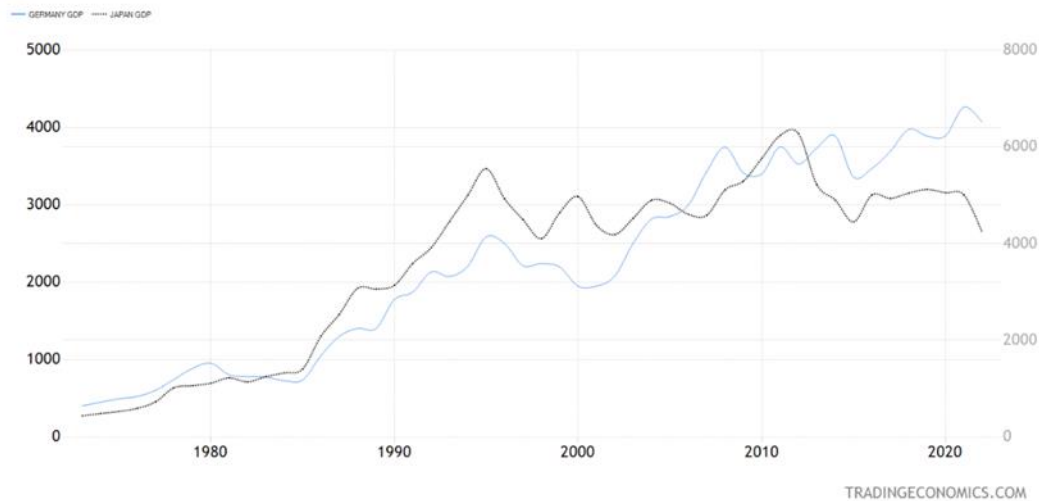


Figure 1: German GDP vs Japan GDP [3].

## 2. Addressing Internal Economic Issues

### 2.1. Content of Agenda 2010

At the beginning of 2002, the Schroeder government commissioned the “Hartz Group”, led by entrepreneur Peter Hartz, to study the options for transforming the labor market, promoting employment, and reducing social welfare spending, and the group completed its study in August 2002 and published the “Hartz Plan”. “After the parliamentary elections at the end of 2002, Schroeder was re-elected as the 15th chancellor, and the Bettmann Foundation, a renowned economic think tank in Germany, published “Economic Policy Advice for the First 100 Days of the New Government”, which was published in *Capital*, a highly credible economics journal in Germany. *Capital*, a highly credible German economics journal, and many of the recommendations were adopted by the new government. The “Hartz Programme”, together with this 100-day advice, and the Schroeder-Blair-White Paper, which Schroeder published with British Prime Minister Tony Blair during his 14th term as Chancellor, form the core of Agenda 2010. Much of this program was supported by the opposition parties, including the Christian Democratic Union/Christian Social Union and the Liberal Democrats who were also actively involved in its development. In her inaugural speech on 30 November 2005, after Schroeder left office, the incoming Federal Chancellor, Angela Merkel, mentioned: “I would like to personally thank former Chancellor Schroeder for bravely and decisively crashing through the door of reform with Agenda 2010 and for following through against all odds” [1,4].

#### 2.1.1. Funding Concessions

Agenda 2010 implements several preferential policy concepts that are particularly friendly to employers: because in a market economy, the state cannot create jobs by just giving a directive, nor should public expenditure be used to stabilize existing jobs or create new ones, but only through economic incentives that give private investors an incentive to step up their investments and thus create new jobs from them. Reduce the additional cost of salaries, such as retirement insurance, health insurance, unemployment insurance, and the employer’s portion of various social insurance. Relaxation of dismissal restrictions: The provisions of the law on dismissal protection are relaxed for small companies with up to five employees and for craftspeople so that personnel costs can be dispatched more freely. Lowering the threshold for handicraft trades: The Handicrafts Act was

amended so that most handicraft trades (except highly dangerous trades such as electricians and optometrists) will be able to open their businesses without a technician's certificate, thereby increasing employment opportunities and incentives to engage in handicraft trades. At the same time, an international certification system will be introduced to ensure technical quality [1,4,5].

### 2.1.2. Labor Market

The most important guiding spirit is: "help and demand", "tell everyone who can work to get a job", and conversely, "those who don't work hard will have their social welfare payments scaled back". An increase in employment increases the number of people who are responsible for their own lives, increases tax revenues, increases social security receipts, and reduces the number of social welfare recipients; and in good imagination, all social and financial problems can be alleviated and solved by employment. The "unemployment benefit" for job-seekers should be abolished and replaced by the "unemployment benefit II", which has a wider range of use and is funded at a rate equal to that of social aid for the impoverished, and is classified as one of the four fundamental stability benefits [4,5].

To reduce the duration of unemployment insurance benefits, a maximum of 12 months should be allowed, with the option of extending it for those over 55 years of age. In principle, as long as the existing income (whether from a low-paid job (usually for those who depend on part-time work), "unemployment benefit 1" [although this is rare, as "unemployment benefit 1" is 60 percent of the previous job], or no income) is insufficient to cover the "minimum subsistence needs", the "minimum subsistence needs" are not covered. "Anyone who has insufficient income to meet his or her "minimum subsistence needs" can apply for Unemployment Benefit 2 (which does not require unemployment, so the name "Unemployment Benefit" is a bit misleading). Those who apply for this benefit must disclose their property status, including old-age savings (e.g., insurance) and children's savings, the former to avoid purchasing too much old-age insurance, and the latter to avoid parents transferring their property to their children, and general to prevent the situation from "pretending" to be a situation where they are now having difficulty in making ends meet. (See the German Wiki entry on Arbeitslosengeld II for more information on the conditions for claiming, pension insurance and child savings allowances) [4,5].

Unemployment Benefit II recipients must not be too picky when it comes to finding a new job. Any job that is "reasonably available" must be accepted, and any unjustified refusal may result in a reduction or even suspension of payments (daily subsistence allowance component: 30 percent for the first time, 60 percent for the second time, and abolished altogether for the third time). Allowances for long-term expenses are not affected, e.g., rent, heating). The conditions for "reasonably sustainable" are rather loose, and any work that is not contrary to good morals is considered reasonably sustainable, except the following: if the unemployed person's health does not allow him to do so, or if doing so would seriously affect his future return to a similar previous position, or if it would seriously affect his ability to care for his children or dependents [4,5].

Unemployed persons who are still able to work are counseled by the Federal Labor Office on vocational training and job intermediation. Expand the scope of mini-jobs, including raising the wage ceiling and allowing the employment of mini-workers as domestic helpers. Mini jobbers will be compulsorily covered by statutory health insurance, occupational accident insurance, and statutory retirement insurance at a lower rate than for full-time work and only at the expense of the employer, who will have to pay an even higher rate than if they were full-time employees (but at a lower rate because of the much lower salary). Employees are free to choose whether or not they want to self-insure beyond the statutory rate until it is the same as a full-time job. This provides additional protection for mini-workers [4,5].

Expanding the application of labor dispatch: The Manpower Service, or the government's labor dispatch department, was set up to match the unemployed with enterprises. Through an administrative

contract, while subsidizing the use of dispatched manpower by enterprises from the government, the PSA (Petroleum Productivity Association) also obliges operators to improve the situation of the dispatched persons, to help the unemployed get a job and live partly on their own, and then gradually move on to a full-time job. Existing private labor dispatchers can also apply to PSA for the same subsidy program. However, the PSA has not been very effective: most of the seconders of labor dispatches have failed to transfer the dispatched manpower to regular jobs as agreed, and many private dispatchers have abused the subsidy system so that only one out of nine dispatched persons is sent to work. That is why it took three years, and in 2006, PSAs were no longer required to be set up in all administrative districts, and all administrative districts have gradually stopped this business due to budgetary considerations [4,5].

### **2.1.3. Many Benefits Have Been Removed**

Transparency of medical costs: Detailed medical costs are listed on the bill to avoid overstatement. The use of an electronic insurance card containing the insured's data to avoid unnecessary wasteful medical consultations, but the insured's data is also subject to a high degree of privacy protection. The deductible for in-patient treatment is at least 10 euros per day, and is tax-deductible for those whose deductible exceeds 2% of their pre-tax income in a year for the general public (you will have to attach documents to prove this when filing your tax return); it is 1% for chronically ill patients. A registration fee of 10 euros is payable at the first registration of each quarter (but this has been abolished since 1 January 2013). Dental and long-term (more than 6 weeks) injury and illness benefits instead of wages are no longer compulsory but are optional for the employed person. The purpose of this change was to reduce the statutory insurance premium rate (14.4 percent in 2003, planned to be reduced to 13 percent) and, of course, the employer's payroll surcharge. However, the planned reduction did not materialize and was even raised to 15.5% in 2009; only the employer's burden was lowered from half for employers and half for employees to 7.3% for employers and 8.2% for employees as of 2009 [4,5].

## **2.2. Small and Medium Enterprises in German**

To maximize the use of domestic human resources, Germany has given strong policy support to SMEs (Small and Medium Enterprises). Germany adopted a regional economic policy. The most important instrument of the regional economy is the common task of the federal states to "improve the economic structure of the region", which was introduced in 1969. Germany has set up special government agencies and complete intermediary organizations to provide SMEs with all-round services, introduced special laws and regulations to protect the rights and interests of SMEs, and provided SMEs with strong financial and intellectual support. German federal support for SMEs is only one part of the whole support policy. The whole support policy has three levels, i.e., the EU policy support, the German federal support, and the support of the federal states. These three levels cooperate and complement each other to provide comprehensive services for the development of German SMEs [1,4].

Thanks to the unremitting efforts of the German Government, Germany has finally completed the reform of its economic structure and solved its structural problems and the weak economic growth brought about by the rigidity of the labor market. As can be seen in Figure 3, German government debt as a percentage of GDP has declined significantly since 2010, from as high as eighty-two percent way down to less than sixty percent. One of the most notable consequences of this series of measures is that the labor market in Germany is very flexible, for example, German companies can even adjust or even deny existing trade union agreements under certain conditions, and until 2015, there was no minimum wage system at the national level in Germany, which makes cost of labor is much smaller

than that of France. In Figure 2, the growth of labor costs in Germany slowed down a bit after 2009 and even declined slightly. Moreover, the relatively weak position of workers in the labor market contributes to some extent to the very low unemployment rate in Germany [1,4].

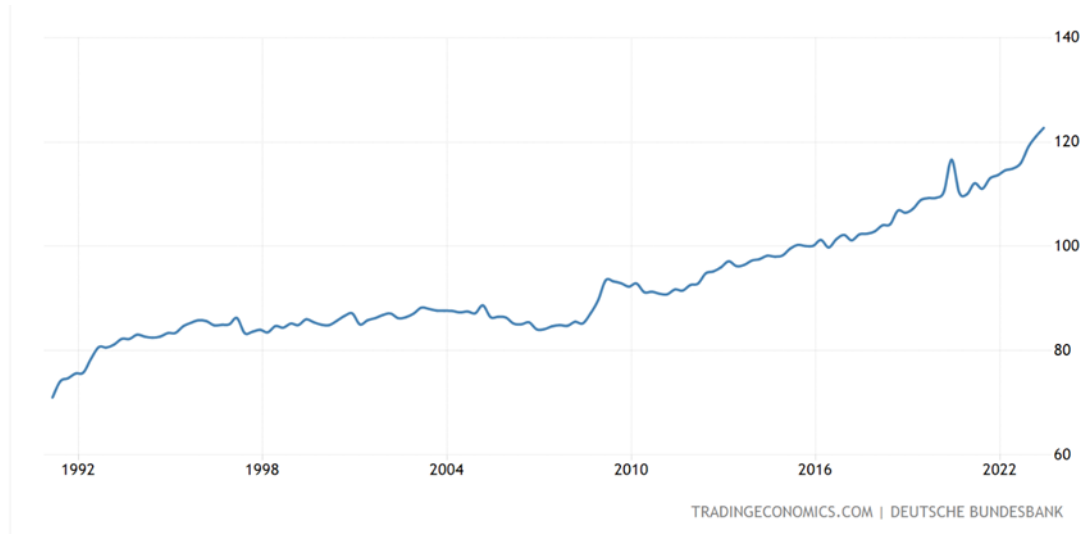


Figure 2: German labor cost [3].

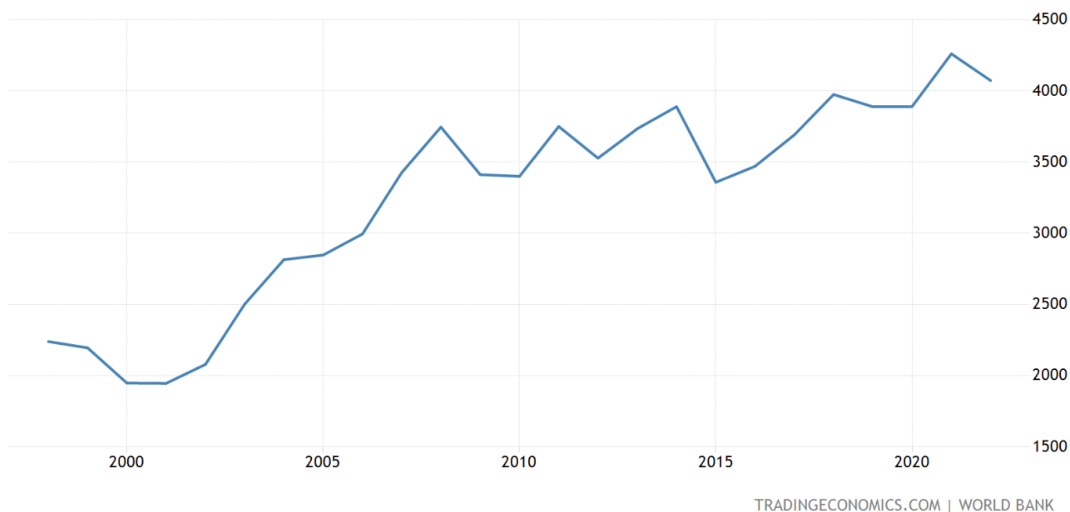


Figure 3: German government debt as a share of GDP [3].

### 3. Facing the World Economic Crisis

When the European debt crisis hit, the economies of most European countries took a huge hit, while Germany could not recover quickly and rapidly from the crisis. This was due to Germany's previous economic reforms. Before the onset of the European debt crisis, Germany introduced Agenda 2010, which increased labor market mobility and reduced many subsidies [4,5]. This kept the treatment of the labor force in an okay state and this policy reduced the consumer demand in Germany as well as the fiscal pressure on the government. The competitiveness of German firms has been enhanced by wage restraint and corporate restructuring over the past decade, and this strategy has been further facilitated by the adoption of a 'wait and see' strategy in Germany as a whole, which has contributed to the pre-crisis export boom and put firms in a position of financial health [6,7]. Thus, the response

of firms to the Great Recession demonstrated their willingness, means, and ability to protect their comparative advantage and the skilled labor in which they had invested [6,8]. It can be seen that the employment rate in Germany rose steadily after 2005 and returned to 70 percent after the financial crisis in 2008, and then rose to 76 percent. The German Government also reacted quickly to the economic crisis by increasing employee protection and encouraging companies to work short hours, which reduced the financial burden on firms during the crisis, secured employment, and kept the German economy from being crushed by the European debt crisis, as was the case in high-welfare countries such as Italy [8,9]. Figure 5 shows Germany's GDP for several years, from which you can card that the German economy has grown by leaps and bounds since 2000, except in the year of the economic crisis when the GDP was very depressed, after which Germany has returned to its usual economy at an alarming rate.

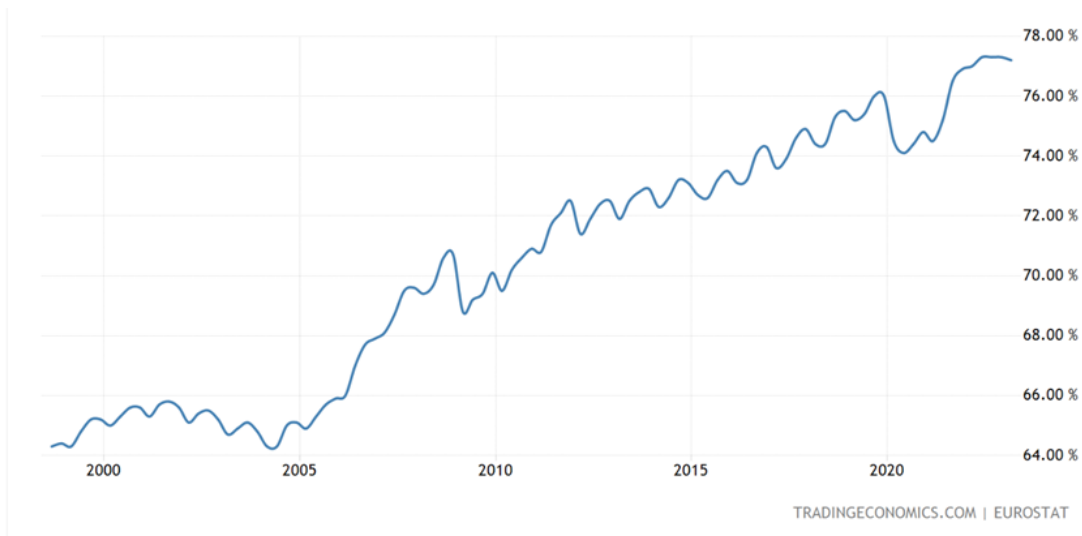


Figure 4: German employment rate [3].



Figure 5: German GDP [3].



#### 4. Expanding the Strengths

As we all know, Germany is a major manufacturing and exporting country, and Germany's export surplus reached \$2611100 million in 2008. However, Germany can always maintain such a large trade surplus, and its use of advantages and the continuous expansion of comparative advantage have an inseparable relationship [9,10]. As early as before the Second World War, Germany's manufacturing industry reached the world's top level. The German government attached great importance to this advantage, and they gave a lot of subsidies to technical education every year to ensure the output of local high-quality and high-skilled labor. This has ensured the continuous innovation of the German manufacturing industry and the maintenance of high product quality, maintaining the competitiveness of the German manufacturing industry in the international market [10,11]. Figure 6 compares German and British exports after 2000, and we can see that since the second millennium Germany's exports have always been higher than Britain's, only occasionally being overtaken in times of economic crisis. Secondly, Germany also makes full use of the geographic advantage, due to the proximity of the United Kingdom, France, Italy, Portugal, and other countries, coupled with the advantages of the European Union brought about by the unity of the currency, so that Germany can be very efficient to export products to the neighboring countries [10,11].

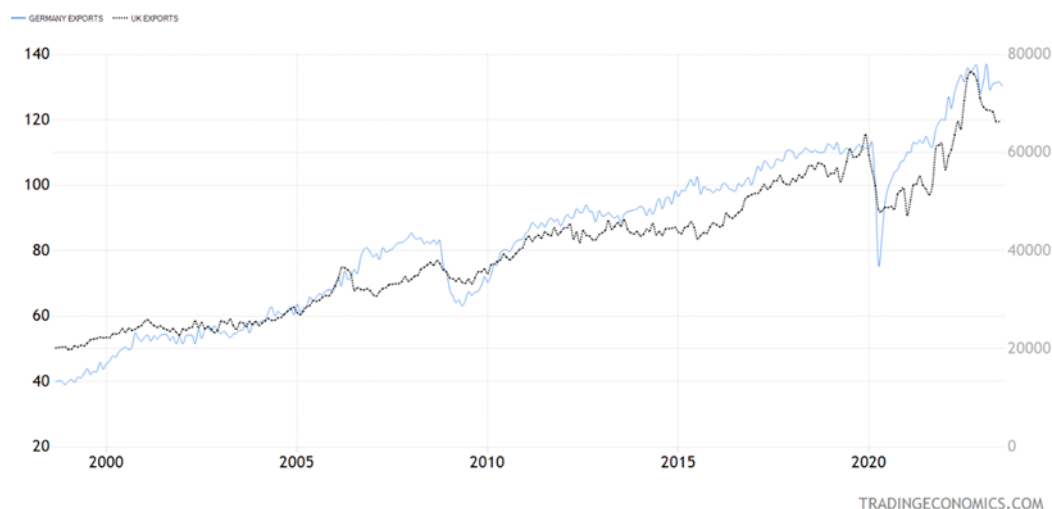


Figure 6: German Export vs. British Export [3].

#### 5. Conclusions

The German government and businesses' decisions have been the cause of Germany's remarkable economic revival, not a mere coincidence. The Government, in response to public opinion, implemented economic reforms and remedied the economic structure and labour market solidification issues that had been plaguing the nation for many years. It was calm and collected in the face of the international economic crisis, which ensured that it suffered losses in the economic crisis and quickly resumed economic growth. Germany's use of its advantages is also not to be ignored, and its emphasis on education has kept the manufacturing industry constantly innovating and maintaining its competitiveness in the international market.

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