Kajsa Borgnäs and Christian Kellermann

Germany's recovery strategy

Setting the course for a climate-neutral and digital future?

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About this publication

The corona pandemic and the restrictions imposed on economic and social activities to contain it have led to a sharp economic contraction in Germany as well. Furthermore, they met with an already weakened growth momentum and an economy with structural problems and a considerable investment deficit in basic and especially digital infrastructure. In view of this situation, it was possible to suspend the so-called "debt brake" and to invest in a strengthened economic performance with massive government support programmes. Although the massive state intervention during the acute phase of the crisis directed considerable resources into supporting existing (often fossil-based) infrastructures and companies, focusing the recovery programme on green technologies and digitalisation can accelerate the urgently needed transformation efforts in these areas and thus help to reduce structural deficits in the German economy. There is also widespread agreement that, in view of the enormous challenges, a more active state that is both capable and willing to act is needed, as well as a coordinated European approach.

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THE ECONOMIC CONSEQUENCES OF THE CORONAVIRUS CRISIS

In the wake of the coronavirus pandemic the global economy is going through one of its deepest crises since the Second World War. The German economy is also under great pressure. The fall in German GDP of 9.7 per cent in the second quarter of 2020 was the sharpest decline since quarterly GDP statistics were first published in 1970.[1] The basic reasons for this decline were the disruptions in global supply chains caused by the coronavirus crisis and the politically imposed lockdown of the economy in spring 2020. Furthermore, the coronavirus recession struck at a time when economic growth momentum was already weakened. In 2019 the German economy grew by only 0.6 per cent, with the fourth quarter showing zero growth when adjusted for inflation. In the first quarter of 2020 GDP fell by 2.0 per cent.

Like all crises, the coronavirus pandemic has affected economic sectors asymmetrically. Although almost all branches and businesses have felt the consequences of the crisis, the pandemic and the measures taken to counteract it affect certain sectors disproportionately. These include travel, hospitality, the creative sector, entertainment, business-related services, and health and social care, including personal services. The essential reason for the sometimes drastic sales losses of up to 80 per cent or more has been the abrupt fall in home demand. Also, some branches were seriously affected by a drop in exports. Foremost among these are export-intensive industrial sectors such as manufacturers of chemical and pharmaceutical products, as well as vehicle manufacturing and engineering. In the manufacturing sector incoming orders collapsed for heavy goods vehicles and their spare parts.

European countries have been affected differently: while European industrial production as a whole had shrunk by an average of 27 per cent at the lowest point of the crisis (April 2020), the collapse in Germany, as well as in Spain, France and Italy reached as much as 30 to 40 per cent. On the other hand, clear signs of recovery also appeared relatively soon (as early as July), and industrial production rose again in many countries to its normal average. A short abrupt collapse was followed in summer 2020 by a similarly strong recovery. On the whole, growth in Germany in the third quarter of 2020 was again very strong: 8.2 per cent up from the previous quarter. It remains moot, however, whether the recovery will follow a V curve, or whether the economy and industry will continue to function in the long term below their pre-crisis potential. In particular, many sectors of the economy have experienced a delayed impact from the crisis: only now are redundancies and in some cases also closures occurring, particularly in the automobile and motor accessory sectors. Many small businesses and micro-enterprises in particular see their very existence threatened. They find themselves in a very fragile state to cope with the crisis, especially with regard to capital and relatively low reserves. In contrast to larger businesses, small companies can offer their employees little medium- to long-term protection beyond reduced working hours and state support.

Looking at the crisis from an employee perspective the situation looks similar. The phase between the resolution of the 2009 financial crisis until the outbreak of the coronavirus crisis was characterised by strong growth in the German labour market. In the fourth quarter of 2019 employment rose above the previous year by 0.6 per cent, before the trend in the second and third quarters of 2020 tipped into negative territory (in the first quarter it was still slightly positive at 0.3 per cent). It is true that in September 2020 unemployment fell by 108,000, the first sign of labour market recovery from the coronavirus crisis. In comparison with the same month in the previous year, however, unemployment was at least 600,000 higher. The unemployment rate was around 6.2 per cent, which – compared with developments over the past decade – is relatively high. It remains to be seen exactly how the second coronavirus wave in autumn/winter 2020/21 will affect the labour market.

Apart from higher unemployment rates, one of the most visible signs of the economic collapse was the increase in short-time working. In Germany the number of employees on short-time work increased dramatically, from around 145,000 in May 2019 to 7.3 million in May 2020. By comparison, in the wake of the 2009 financial crisis slightly over 1 million employees went onto short-time working. What is more, by 2011 the number had once again sunk to the long-term average of around 150,000 workers. Short-time working has shown itself to be one of the most important means

1 ll figures are from the Federal Statistical Office unless otherwise stated.

of tackling the crisis and softening the pandemic's social and economic consequences. Without short-time working, the unemployment rate would have been significantly higher. The ongoing economic uncertainties arising from the pandemic have forced the German Federal government to extend the availability of the short-time working allowance: the maximum duration of the allowance was increased to 24 months. A higher short-time working allowance will remain available until the end of 2021, totalling up to 70–80 per cent of the normal net salary (77–87 per cent when there is a dependent child in the household). This relief makes it easier for businesses to continue to employ their workers despite a collapse in orders, partially enabling redundancies to be avoided. This relatively high net wage compensation makes it possible to mitigate social hardship, which would otherwise have occurred with such a high unemployment rate (and a lower rate of benefit in lieu of income).

How the crisis will affect the socio-economic situation of private households in general cannot currently be foreseen. On one hand, the rapid and massive intervention of the state – in particular through the lockdown in spring 2020 to control the virus infection rate – has contributed to the economic downturn. On the other hand, the comprehensive social programme – including such measures as short-time working compensation, credit assistance for businesses, as well as the increase in child allowance and a three-month extension of the time limit for claiming unemployment benefit stage 1 – has cushioned some of the negative social consequences. But although many households have been financially compensated in the short term, it currently remains unclear what social upheavals the crisis will cause in the medium term. One particular uncertainty concerns the scale of private insolvencies. Demand for debt counselling has increased dramatically in the past few months. As coronavirus support gradually expires, there may be (delayed) losses of employment and income. Social groups in particular danger are those that were already in a relatively weak position before the crisis: single-parent families, women working part-time, and marginal or fixed-term employees.

A further social consequence of the crisis is the possible increase of inequalities in terms of skills and educational development among those put on short-time working and among children. If the period of short-time working is not used for skills development by the employees forced into it, skills losses loom. Children in households with highly educated parents can make up for it more easily at home when schools close than the children of parents with lower educational attainment. Faced with this uneven impact of school closures, it is to be welcomed that Germany, along with other countries in Europe – which closed schools and day-care centres during the first coronavirus wave – are trying to keep schools and day-care centres open as long as possible during the second wave.

Although the political response to the crisis has been relatively swift and comprehensive, the coronavirus crisis is increasing social inequalities in Germany, in particular because poorer and less resilient households have been disproportionately affected by the crisis.[2] In particular, the uneven effects on incomes strengthen this trend. According to a survey by the Hans Böckler Foundation, lower income groups have had to cope with significantly larger losses than higher income cohorts: almost 48 per cent of those questioned in the lower income group, with a maximum of 900 euros net monthly income, admitted to suffering income losses, whereas in the upper group – with more than 4,500 euros net monthly income – barely 27 per cent were in this situation.

THE ACUTE CRISIS REFLECTS STRUCTURAL DEFICITS

From the structural point of view the coronavirus pandemic has exposed many old and new weaknesses of the German (and European) economy. For example, right at the beginning of the crisis it became clear that simple medical products such as protective clothing and masks (personal protective equipment or PPE) were not available in sufficient quantities in Europe, or were no longer produced in Europe. Industrial businesses suffered production interruptions because input products could no longer be delivered from abroad. As long as factories in China stood idle, geopolitics and protectionism experienced a resurgence in international trade relations. The coronavirus pandemic revealed that supply chains normally regarded as highly efficient had in fact become (too) strongly dependent on China, and – in a crisis situation – could quickly become fragile. Subsequently, a debate began in many countries about strategic supply chains and beyond that, which product lines should be brought back to Europe to improve resilience. Although (in the short term) we should not expect a comprehensive re-regionalisation, it may be expected that businesses will try to set up more resilient supply chains by relying less on single suppliers (in Asia), and instead organising their supply chains to draw on more than one region.

Secondly, the crisis has exposed shortcomings in important areas of fundamental infrastructure, such as digital infrastructure and education. On one hand, the increase in the number of people working from home and in home schooling has led to an overdue boost for digitalisation in many businesses and schools. On the other hand, the fact that the use of digital technologies and big data in fighting the pandemic has frequently suffered from insufficient technical infrastructure has demonstrated how far the public digital infrastructure has lagged behind societal requirements. The deficiencies in digitalisation are also evident in the education system. Only around a third of all German classrooms has access to a fast internet connection and WLAN, and only one in three schools has computers in sufficient numbers for each class. This digital deficit in the education system also disproportionately affects children from poorer households because they are less likely to own digital devices or have a fast internet connection at home.

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2 Institute of Economic and Social Research (WSI) study – Prepublication of results on 29.10.20: https://www.boeckler.de/pdf/pm_wsi_2020_10_29.pdf

Apart from other structural deficiencies, such as in health and care homes (for example, a shortage of staff and low wages), the pandemic has, more fundamentally, affected a number of long-term and potentially deep-rooted transformation processes. This is putting the whole German economy under severe pressure. They include, notably, the climate crisis and the decarbonisation commitments in the transport and heating sectors, as well as in industry. Although in combating the crisis substantial government resources are being deployed to support existing (often fossil fuel-based) infrastructure, businesses and technologies through the acute phase of the crisis, a decisive and transformation-focused coronavirus and post-coronavirus policy could simultaneously accelerate the necessary transformation efforts. Suitable crisis management could also help to remove some of the structural deficits in the German economic system and in particular promote socio-economic and digital modernisation.

PANDEMIC CRISIS, CLIMATE POLICY AND DIGITALISATION

One positive aspect is that most actors – whether trade associations, businesses, trade unions, science or politics – are *not* arguing that the crisis requires that the transformation process towards sustainability be slowed down. Instead, most countries in Europe have tried to make their coronavirus stimulus packages more or less »green« and in doing so to pursue longer-term goals beyond the acute economic stabilisation they are aiming for.

Germany's 130 billion euro stimulus package launched at the beginning of June is its biggest since the Second World War. Also noteworthy is its focus on green technologies and digitalisation. Germany is receiving around 23 billion euros from the EU Recovery Plan (Next Generation EU) (although the last tranche for 2023 has not yet been calculated). These are contributions from Brussels for investment components within the framework of recovery measures. For example, in the German stimulus package over 50 billion euros are earmarked for investment in climate-friendly technologies and infrastructure. This investment includes boosting the extension of renewable energies, infrastructure for charging electric cars, the energy-efficient renovation of buildings and public transport, emission-reducing technologies in energy-intensive industries, as well as investments in the expansion of a completely new sector, the green hydrogen economy. Although there remain many open questions concerning implementation, especially in detail, the package is a step in the right direction.

For Germany the stimulus package is also structurally relevant from another point of view. It was already clear before the coronavirus pandemic that Germany's basic infrastructure is suffering from an enormous investment deficit. It is estimated that in the coming decade around 450 billion euros need to be invested in streets, railways, digitalisation, distribution grids and education, just to maintain quality – and that does not include comprehensive decarbonisation. Furthermore, in view of the crisis situation in the spring it was deemed possible to release the »debt brake«, which hitherto had constrained the state's ability to borrow and its debt ratio, in order to invest in support of economic output. The German EU Council presidency similarly supports a combined focus on defeating the coronavirus, economic recovery and (sustainable) modernisation. For example, efforts will be made to specify climate goals, European industrial and hydrogen strategies and the Green Deal as soon as possible. With the aim of promoting a policy of European stabilisation and modernisation, the federal government spoke out for the first time in summer 2020 for a common borrowing policy for EU member states. The vehement »austerity policy« that has long been a predominant feature of German economic policy has – at least temporarily – been set aside.

Along with the focus on ecological transformation, digitalisation has also been prioritised in the German recovery strategy. Thus the federal government is planning to achieve a nationwide rollout of 5G – without coverage gaps – by 2025. For this purpose the new national mobile network infrastructure company (among others) has been awarded 5 billion euros. And 1 billion euros has been made available to accelerate digitalisation in the private and public sectors. Further boosts to the digitalisation of the economy should come from measures such as the extended write-off facilities for digital assets and a programme for promoting IT platforms.

Furthermore, investments should be promoted to establish Germany more solidly as a smart research centre in the fields of AI and quantum computing. Here the stimulus package plans to raise the planned investments for promoting AI by 2 billion euros to 5 billion euros by 2025. In addition to augmenting existing programmes these funds are to be used to establish additional supercomputers in Germany. The medium-term objective of this strategy is to make Germany more attractive as a location for leading researchers and up-and-coming talent through attractive conditions and digital infrastructure, as well as to strengthen the European »AI network«. Some 2 billion euros from the stimulus package are to be earmarked for the construction of at least two quantum computers. A further 2 billion euros will be used to promote innovative businesses in the development and testing of new software-controlled networking technologies, while supporting technological change in communications technologies such as 5G and in the long run also 6G.

IDEAL AND REALITY IN THE CORONAVIRUS CRISIS

Germany is still in the middle of the pandemic and dealing with its consequences. It is also to be expected that further state support measures will have to be introduced in the coming months to deal with a more serious second wave. Nevertheless it is possible to draw a few – preliminary – conclusions.

First, it is already clear that tackling the present crisis differs from the last serious economic crisis almost 10 years ago. Then most governments reacted far too late with economic and fiscal support measures, which unnecessarily prolonged the crisis and the recession. Furthermore, in response to the financial crisis measures were naturally focused on supporting the banking sector, while this time support is directed more to the direct needs of businesses, employees and households. It is welcome that the distributive effects of the measures to be taken constituted an important criterion in designing the stimulus package and the EU recovery plan. Nevertheless, the effects are asymmetrical, with some groups who have lost out economically and socially not being sufficiently compensated. On one hand, that increases social polarisation, while on the other it weakens private demand, which before the crisis had become a mainstay of the German economy. Measures such as the (temporary) reduction of VAT rates are not adequately targeted to compensate for this trend.

Second, the crisis has led to a broader social debate on appropriate compensation and support for major groups of employees. In this context the trade unions and workplace employee representatives have been at the forefront in formulating ideas and policies for employment protection. For instance, Ver.di (United Services Union) negotiated a special supplement for care workers within the collective agreement in August 2020. The industrial trade unions IG Metall and IG BCE have fought for medium-term support programmes for the motor manufacturing sector – for example, a fund for automotive supplier businesses. Additionally, IG Metall has suggested that a four-day working week should be combined with a »further training day«. In general, it would be sensible to combine short-time working with further education. Early empirical research shows that company worker participation arrangements (codetermination) have also proved invaluable during this crisis: the flow of information, new company regulations – such as those dealing with working from home and hygiene measures – and the implementation of short-time working have been made easier through good worker participation arrangements within companies.

Third, as a result of the crisis the state has taken on a significantly stronger economic role than before. This is not unusual in acute phases of crises. In the medium term, however, political and social actors are increasingly accepting a more active role for the state – even from the structural point of view, in terms of both (short-term) crisis mitigation and medium- to long-term economic and industrial policy. This development away from a passive vision of the state was already evident before the coronavirus crisis, against the background of the climate crisis and growing economic inequalities. But the crisis has reinforced it. A far-reaching political consensus has emerged that decarbonisation and digitalisation are not processes that can just be left to the market. In general, a more active, more competent and more engaged state is also required.

Fourth, the centrality and necessity of a coordinated European approach when major challenges are at stake have become clearer with the crisis. It is relatively undisputed that both the campaign to overcome the pandemic and the ongoing ecological and digital transformation can be successful only through closer European cooperation. Many of the infrastructure requirements which are essential for substantial decarbonisation – such as the development of a hydrogen economy; a common strategy for renewable energies and distribution grids; the conversion of the European mobility and transport sectors; the transformation of European (basic) industries; as well as the related rollout of new competitive supply chains for fundamental future technologies, such as batteries, hydrogen and CCU/CCS – are achievable only at a pan-European level and through the pooling of resources and responsibilities. Innovation and investment initiatives must be more closely coordinated internationally so that the costs and risks of such projects can be shared by several (private and public) stakeholders.

Fifth, this is also connected to the intensive discussions about stronger European sovereignty and resilience beyond just-in-time business methods. It is true that the European Commission described China as a systemic competitor as early as in 2019, thereby contributing to a discussion about strategic supply chains. And only this year, and as a consequence of the coronavirus pandemic, concrete steps have been taken to supervise foreign direct investments and takeovers more closely, and to start a debate on which key technologies should be produced (or continue to be produced) in Europe. In Germany, a debate has also arisen on how, against the background of the new political and technological situation, European state aid law should be modified and loosened.

In conclusion, in the short and medium term, the coronavirus pandemic is generating enormous challenges for our society: for health policy, the economy, and private households and businesses. How deep-seated and disruptive the effects on our societies will be remains unclear for the time being. But it is crucial to understand that the crisis has significantly amplified and accelerated tendencies that were already developing.

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Recovery strategies in Europe

The restrictions imposed to combat the COVID-19 pandemic have led to a pronounced drop in production, a steep rise in unemployment and public debt. As a result, profound social distortions have arisen. Further, the pandemic has also revealed the strong dependence of Europe's economy from the production of vital products beyond the continent. Accordingly, national governments as the EU have had to devise wide-ranging programmes to support and revive the economy.

The development of these "recovery" programmes is taking place at a point in time when the European economies at a crossroads. They are faced with meeting the immediate challenges stemming from social and ecological transformation and digitalization. As result, there is significant pressure to ensure that the measures to implement economic revival to do not lead to a restructure of the pre-pandemic status quo. Instead the countries should seize the opportunity of massive public spending programmes to start the transformation of the economy and society towards climate neutrality and social equality.

A series of reports form several European countries analyse their respective national recovery plans and assess them in view of meeting the complex challenges. A synopsis offers a comparative perspective by interpreting and classifying the events and individual measures introduced in the individual countries. The aim is to develop policy recommendations that not only meet the long-term structural challenges faced by the EU-member states, but also to combat the immediate effects of the pandemic.

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