

Can Germany Be Saved From Decline?

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February 25, 2025

With an economy based on industry and exports of physical goods, Germany is particularly vulnerable to a global environment of geopolitical tensions, trade wars, and rapid technological change. As the far right grows, what will it take to revitalise the German economy and save Europe's green agenda? An interview with Wolfgang Münchau, author of *Kaput: The End of the German Miracle*.

Green European Journal: The German economy has been stagnating for a few years now. What makes you argue that this is not just an interlude, but a sign that the German economic model itself is *kaput*?

Wolfgang Münchau: Stagnation started in 2018. By definition, no economic recession can last seven years, because recessions tend to be cyclical developments. This is a structural slump, and it should have happened earlier, but there were some factors that delayed it.

Germany had a pretty good period of economic performance from 2005 to 2015 but that was, in many ways, a matter of luck. The country had an economic crisis in the early 2000s, but it was a different type of crisis, a competitive crisis. German companies were still making great products, but they had become less competitive and needed a reboot, and that's what they got through labour market reforms.

But what really prolonged Germany's economic success at the time was the EU's Eastern enlargement. German companies could offload large parts of their supply chain to cheaper production areas. There was also a supply chain revolution: container shipping became very big, and so did just-in-time production systems. The way companies organised their supply chains changed dramatically between the mid-1990s and early 2000s.

A third benefit was, oddly enough, the eurozone crisis, because it led to a devaluation of the euro, which really improved the competitiveness of German products. Fourthly, there were still the long-term consequences of labour market reforms. Lastly, there was cheap Russian gas, which helped keep up steel and chemical production, which were both very important. That explains why Germany did well until 2018, but the causes of decline started a lot earlier.

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What are these causes?

Germany has four dominant industrial sectors: the car industry, steel production, mechanical engineering, and chemical industries. Industry accounts for almost 30 per cent of German GDP – a much higher share compared to most countries. Germany's entire economic and financial system, as

well as the political system, was very much geared towards running those sectors. There wasn't enough flexibility or interest in innovation in areas that were outside of those. This is how Germany missed the digital revolution, and that became a very big problem because digital technologies encroached on analogue technologies. Electric cars are more digital than diesel cars, and the next generation of cars will be a digital device, not a mechanical one. E-cars are a whole other product, just like mobile phones are very different from old telephones. This first issue can be described as a lack of flexibility or an over-specialisation of the German economic system.

A second, separate issue, is that Germany has become dependent on export surpluses. Export surpluses – which are in essence an economic imbalance – became a celebrated feature of the German model. But Germany and German companies invested the earnings from their surpluses abroad. They didn't invest them in building bridges at home, or in upgrading a completely dysfunctional railway system, or the worst mobile phone network in all of Europe. This lack of investment is now really hurting Germany.

The outgoing government certainly made mistakes, but all these issues have been created long before it came to power in 2021. It's the failure of systems that are run by consensus rather than by competition.

Has Germany always been so resistant to technological innovation?

I grew up in a Germany that was highly innovative. Germans were innovative in their fields, certainly in all areas of engineering, but they have disregarded digital technologies, they underestimated their impacts. There are many examples of that: Christian-democratic Chancellor Helmut Kohl put his stakes on analogue high-definition television in the 1980s; companies like Siemens were betting on analogue telephony. The quality of German analogue technology was very high. It was actually quite innovative. The problem is that the world moved on. Digital technology produced all sorts of advantages in terms of data and stuff you could do with it.

The car industry is the same. They dismissed the idea of electric cars because they thought electric cars were for girls, and they were boys. For these men, a car is about the smell of an engine, the mechanics of it. The former chairman of Volkswagen once said that there was no space for electric cars in his garage. This kind of statement creates a dangerous cultural consensus. And Germany is a country that wants consensus. There was consensus on cheap Russian gas too, with the exception of the Greens. Anyone who disagreed got laughed at.

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Germany's overreliance on industry made it more dependent on Russia for cheap energy, and China and the US for exports. When Russia invaded Ukraine and China started rising as an industrial competitor, Germany found itself overexposed. What will be the consequences of Trump's trade war?

Germany's industrial sectors were developed in complete ignorance of geopolitics. Companies thought they were protected because the German government fixed the deals for them in the background.

Germany is exposed simply because of its surpluses. If you are running a very large trade surplus, you are going to lose a trade war. No matter how much the EU says we're going to hit back against Trump, we will run out of things to tariff before he does, because we're not importing as much from the US as they're importing from us. It's as simple as that.

If Trump starts a trade war, the best thing you can do is to just sit back and try to address the imbalances that made you overexposed.

When the “traffic light” coalition of Social Democrats, Greens, and Liberals was formed in 2021, it seemed a promising formula. They planned to invest in digitisation and the green transition, for example. Where did they fail?

I supported them back then, and I thought it was a good idea to start addressing the investment shortfall, which they eventually failed to do. I think they all contributed to their failure in their own way, including through the way they interacted with each other. If Robert Habeck [of the Greens] had been finance minister and Christian Lindner [of the Liberal FDP] had been economics minister, perhaps the coalition would still be standing: Greens would have pushed to open the debt brake, and the FDP would have avoided some of the mistakes Habeck made.

They were also ill-advised on their fiscal strategy. The coalition effectively collapsed when the constitutional court ruled that the government had misspent funds set aside for the Covid-19 pandemic by funnelling them into the climate budget. This ruling took around 50 billion euros out of German public spending; the whole financial basis for the coalition was gone, and the parties couldn't agree on anything anymore. At that point, Lindner's position to balance the budget would have required many cuts, killing the SPD's entire social programme.

As for the Greens specifically, I think the way in which the heating bill was introduced was really foolish.

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You also disagree with their push to phase out nuclear energy.

When the coalition came to power in late 2021, nuclear accounted for 14 per cent of German electricity. Shortly after coming to power, the government switched off three power plants. A month later, Putin invaded Ukraine. At that point, they should have turned the plants back on. In a political crisis, you keep your options open. Instead, they went on to shut down the remaining three nuclear power plants in April 2023.

The Nord Stream 2 gas pipeline was killed on day one of Russia's war on Ukraine, and there were serious questions about the continued gas flow from Russia through North Stream 1: if you're serious about sanctions, you have to do everything at once. If you wait, as we did, Putin can find a way around sanctions.

Nuclear wouldn't have solved all of Germany's problems, but it would have made a difference. For example, the number of coal-fired power stations you would have had to switch on would have been correspondingly less. Habeck should have gone to his party and said, as difficult as it was, that it was necessary to keep nuclear plants going, because doing otherwise could have killed the whole green

agenda. Unfortunately, I think that's essentially what happened. Not only because of that decision, but that certainly contributed to it.

The outgoing government was probably the first genuinely green government in Europe, because in no other country did Greens have such a position of power, including on economics. Now red-green stands for failure in Germany. That is something that we have to reflect on very deeply.

The first thing the green agenda would need is a Capital Markets Union in the EU, because the heavy lifting in terms of investment isn't going to come from governments but from the private sector.

Greens were also the only force critical towards North Stream 2 from the beginning, and they seriously questioned Germany's overexposure to China. Is your assessment of their experience in government purely negative?

Not at all. They were indeed the only party in Germany that was outside of the foreign policy consensus, and they were right, while most other parties were wrong. The Greens are clearer foreign policy thinkers than any other party. You cannot do foreign policy with the SPD. The CDU used to be very fuzzy, and now it has converted to a position closer to that of the Greens. So that is a very big plus on the Greens' track record.

A big minus is the way the green agenda was implemented, because it focused too much on regulation and not enough on innovation. The first thing the green agenda would need is a Capital Markets Union in the EU, because the heavy lifting in terms of investment isn't going to come from governments but from the private sector.

Europe had a chance around five years ago to become a world leader in green technology. It is failing. China and the US are the driving forces. We Europeans have the technology, the people, even the passion for green tech, but we have failed to create the conditions for it to flourish. Our regulatory approach was geared towards large companies meeting certain targets. The whole balance between regulation and innovation was wrong, and as a result, we will now see a rollback of the green agenda.

Is it too late for Germany and Europe to change this state of things when it comes to green tech, digital, and AI? Should we simply accept and prepare for deindustrialisation? This might increase our exposure in times of war and geopolitical tension.

It's hard to say. Europe could have a smaller industrial base, or it could go through some deep deindustrialisation. It will depend on whether companies can still run their activities at a profit in Europe. But with the trade war that is coming up – and I think Trump is very serious about this – our export-based business models are no longer going to be viable. This means that some deindustrialisation will take place, and some companies will relocate to the US.

On AI, it is going to be very difficult. Macron can make big speeches and declarations, but the problem for Europe is regulation. We have the world's most restrictive data protection rules. I don't think anyone in their right mind is going to invest in Europe with regulation that treats companies as lawbreakers. It's very difficult to comply with the laws, even if you want to. Only large companies have legal departments

that know how to do this. Most AI companies are startups.

On the bright side, AI is not proprietary technology. The programming is open source, and we have our own data. To benefit from AI, we don't need Google or OpenAI, but a good regulatory environment. Imagine you had a manufacturing assembly line, and sensors on every node of that assembly line that collect data at all times on product reliability. Your entire production process would generate zillions of data. This will bring production efficiency to a whole other level. AI is hugely exciting for Industry 4.0, and also for the Internet of Things. However, this data will not be transmitted through optic fibre, but through the next generation of mobile telephony, or 6G. The Chinese are already starting to develop it, while we are struggling to roll out 5G.

If we were serious about a European AI industry, we would need cheap energy, deregulated digital markets, and cutting-edge digital infrastructure. Since we're not going to have any of these in Europe, I think the answer is that we are too late.

Germany's industrial sectors were developed in complete ignorance of geopolitics.

The EU is now rushing to pursue a new “competitiveness agenda”. Is this effort going in the right direction?

If we don't call things by the right names, we shouldn't be surprised that we don't do the right things. The EU speaks of competitiveness because lots of business people keep nodding when they hear that word. But that's not what the EU needs. It should be talking about innovation and investments, and the goal should be productivity. The only macroeconomic definition of competitiveness looks at the current account, and we have current account surpluses with the rest of the world. We can write this problem off. We don't need to worry about competitiveness.

In fact, we are too competitive, because we're not investing enough. What we should be focusing on is raising domestic investment into cutting-edge technologies, and making life a little bit more bearable for small companies, but that is not happening right now.

You mentioned the Capital Markets Union earlier as the only way to save the green agenda. What will it take to bring it about?

The problem is that the EU is not serious about these things. It has actually renamed the Capital Markets Union as the “Savings and Investments Union”. Now, a European savings product is probably better than nothing, but in our current situation, we have to think big.

The Draghi report called for an additional 800 billion euros per year for green, digital, and defence investments. The EU Commission can't leverage this. And there's no way we can raise it in taxes. No one but the private sector can do it. To generate this kind of investment, you need to redirect loans that are currently going to Volkswagen, for example, to entrepreneurs who come up with something genuinely new. You need to build a very significant infrastructure of financial products and financial companies to realise this kind of investment scenario. Europeans have failed at this.

Without a real Capital Markets Union, nothing will work. You will not get green investment. You will not get a competitiveness boost, if that's what you want, nor more productivity. You will not get an increase

in defence spending either, because your economy will not generate enough growth to afford it. Virtually everything that is happening in Europe right now hinges on the fact that we do not have a capital market. This, by the way, also requires a fiscal union, which we failed to create during the eurozone crisis. I understand that there was no majority for that. But the problem is that if you accept this failure, you accept the failure of Europe. And Europe is failing right now. It's not just the green agenda, but a bigger failure.

This is the key, and yet virtually nobody is putting any political capital into it, because they think they can leverage money domestically with taxes and, in Germany, by reforming the debt brake. The debt brake reform is now treated as the magic wand. It will indeed have to be reformed, but this will not solve any problem.

Deindustrialisation is a result of low growth, and in turn, it impacts growth because there's less economic activity.

The German automotive industry alone currently employs almost one million people, and waves of layoffs are being announced almost monthly. What kind of social and political consequences can we expect from deindustrialisation and the transition to a different economic model?

Things would be less painful if you had economic growth. The more economic growth you have, the more leeway you have for policies to smooth things out, as we did with the coal industry. The coal industry died in the 1980s, and there were a lot of subsidies. That money is just not available now. If you look at all the money they are earmarking right now for environmental projects and for defence, you realise that there's no money left for anything else. So the transition will be fairly cold.

Deindustrialisation is a result of low growth, and in turn, it impacts growth because there's less economic activity. You need to start creating new activities, but it will take time until these companies grow. These are small companies to start with, and you need a lot of them, and some of them might become big and become viable industries. We haven't even started. This is a process that will take 10 years, and I think it will inevitably lead to more political fragmentation and more radicalisation. I think Alternative für Deutschland is headed for 30 per cent in a couple of years, and the question will then no longer be whether we have a coalition with them, but whether they will form a coalition with us.

The politics becomes very difficult at that point. The Trump agenda in the US can work in some way, because it's a coalition of the far right with some libertarian hyper-capitalists like Elon Musk. That is not the case in Europe. In Europe, it's the fascists only.

There's also the fact that Germany and France are growing more distant. France is gambling on nuclear energy, overblowing national budgets every year, and pushing for reindustrialisation, including in the AI sector. Do you see this as a source of more turmoil for the EU?

The Franco-German relationship is very bad, partly because the relationship between Scholz and Macron was bad, including on the Ukraine issue. The question is, what will Friedrich Merz do as chancellor? Will he be able to lead from the front? I don't think he will, and it won't be easy to get Macron into a common line because he now clearly sees himself as the senior partner in this relationship. He seems to be full of disdain for his European colleagues, especially for Germans, who don't want to help

or put troops into Ukraine alongside the British and the French. This will be very difficult.

I'm not entirely without hope, because bilateral relations can make a difference, but the vested interests of France and Germany go in very different directions, because their energy policies go in very different directions. Their ways are set: France with its emphasis on nuclear, and Germany with its emphasis on new renewables. Nuclear is gone for Germany, it won't come back. The question for Germany is how to deal with the intermittency of renewables, whether with gas or coal, and what the policy mix of those will be. In any case, Germany will not be a country with abundant energy supply. France and Spain may be better positioned in that respect. Spain in particular is strong on solar, and could import more from North African countries. Spain could become a hub for big data.

Germany has had many different centrist coalition governments, yet its structural problems have only gotten bigger. Parties on the extremes, from the AfD all the way to Sahra Wagenknecht's BSW, don't seem to represent a real alternative, as their proposed recipe is to double down on the old industrial system while cracking down on immigration. Would an alliance between the CDU and the Greens, already tested at state level, hold any promise?

I think that if he had a choice, Merz would prefer the Greens over the SPD. And I think it could be the best combination for Germany right now. Merz would get his way on economic change (and possibly on migration) more than with the SPD, which is more hamstrung on social policies and on its close ties with Russia. The Social Democrats also have very strange attitudes towards the military; they are not really supportive of any European initiatives.

On the contrary, Greens like Annalena Baerbock as foreign minister and Robert Habeck as finance minister wouldn't be a big problem for Merz. It would be a smoother project. I think there would be some reboot of the green agenda under such a government, but even Merz has never spoken about a Capital Markets Union, and he's not in favour of European debt.

In any case, it's going to be difficult for Europe. I don't have the hope that everything will be fixed. I see Europe in decline.

This interview was conducted on 18 February 2025, a few days before Germany's snap federal elections took place on 23 February.



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GREEN EUROPEAN JOURNAL

Article in English

Published in the *Green European Journal*

Downloaded from <https://www.greeneuropeanjournal.eu/can-germany-be-saved-from-decline/>

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