

# Making Germany Grow Again

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(Adapted)

Germany does not lack jobs—the country lacks labour. Over the next ten years, around 20 million people are expected to retire from the labour market, while only 12.5 million new entrants will join. At the same time, older workers participate less and often work fewer hours. Demographic developments will therefore intensify labour shortages and put further upward pressure on wages.

Rising labour costs are already the main reason for Germany's declining price competitiveness—more important than high energy prices. Low productivity growth combined with rising wages has increased unit labour costs, also compared with countries such as France and Spain.

At the same time, strong job security—through schemes such as part-time work and short-time work—has slowed necessary structural adjustments. While these schemes have protected employment, they have also reduced incentives to reallocate labour from less productive to more productive sectors.

## **Decline of the manufacturing sector**

These problems are particularly evident in the manufacturing sector, which was previously the driving force of German growth but is now in persistent decline. Even when global demand—especially from China—rebounded after COVID-19, German export figures did not keep pace. Weakened competitiveness, a more fragmented global trading system, the risk of US tariffs, and increasing Chinese competition make it difficult for Germany to regain ground.

Energy prices also play a significant role. Although Germany managed the sharp increases in gas and electricity prices following Russia's invasion of Ukraine, output in energy-intensive industries has declined almost continuously since the beginning of 2022. Energy prices remain high—both historically, compared with the United States, and relative to many European neighbours—and this reduces the country's attractiveness for new, energy-intensive industries such as artificial intelligence and data centres.

## **Dependence on outdated technologies**

In addition, growth is constrained by Germany's strong historical position in the car, machinery, and chemical industries. Existing infrastructure, specialised skills, and established markets

## Appendix 7

have maintained a focus on familiar technologies and made it more difficult to develop new high-tech sectors such as IT and biotechnology. Although investment in research and development remains high, it is concentrated in so-called medium-technology sectors that can no longer drive growth.

### **Paths out of stagnation**

To break out of stagnation, Germany must adopt a dual approach: the country must both strengthen European cooperation and invest more strategically in its own future growth.

### **Greater European integration**

No European country can match the markets of the United States or China on its own. Germany should therefore actively promote deeper integration of European goods, services, capital, and energy markets. Rather than primarily reacting to US policy, the EU should focus on its own strengths and develop common strategies that strengthen the single market.

Although there is formally free movement within the EU, companies are still hindered by administrative burdens, a lack of tax harmonisation, and regulatory fragmentation. These barriers prevent European firms from scaling up and fully exploiting the potential of a market of nearly 500 million consumers. The EU should therefore prioritise removing trade barriers and improving the coordination of national regulations.

At the same time, stronger and more integrated capital markets are crucial for financing the digital transition, green investment, and increased defense spending.

### **More labour and long-term investment**

Domestically, it is necessary to expand the labour force, both by increasing labour market participation and by attracting more foreign workers. Better and more accessible childcare can encourage more women to move out of part-time work, and pension reforms can incentivise older workers to remain in the labour market for longer. Faster and more flexible immigration processes will also make Germany more attractive to skilled foreign labour.

Finally, Germany has for years underinvested in infrastructure, defense, and education. The new government has taken initial steps by establishing a dedicated infrastructure fund and relaxing fiscal rules for defense spending. This creates an opportunity to modernise outdated infrastructure, but success depends on whether fiscal space is used strategically.

If investment is focused on long-term competitiveness rather than short-term makeshift solutions, Germany can restore growth. Otherwise, the country risks ending up in prolonged economic stagnation.