German economic achievements measured against other EU member states are quite impressive. The country has outperformed the Eurozone average growth rate since the second quarter of 2010. Just released data shows German GDP increased by 1.7% in 2015, the best performance since 2011. Germany now has the strongest as well as biggest economy in Europe with a 4.5% unemployment rate in Q3 2015, leaving other member states of the Eurozone countries far behind with an average unemployment rate of over 10%. While many critics accuse Germany of contributing to global macroeconomic imbalances, it continues as the export nation *par excellence.*

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In terms of fiscal prudence, the CDU Finance Minister, Wolfgang Schäuble, achieved for the first time since 1969 a zero deficit target *(die schwarze Null)* for two consecutive years in 2014 and 2015. Just released figures show that the federal government has achieved a budgetary surplus of €12.1 billion for 2015, which is double the amount forecast in November of last year (n-tv, 13/01/2016). Germany's strong tradition of deficit fetishism aims to institutionalize restrictive fiscal norms across the European Union against a Keynesian push for aggregate demand.

Nevertheless, the economic and geopolitical problems facing Germany and the EU are manifold and multifaceted. The next sections will address how to explain the German success story in the midst of regional and global turbulences, whether the export model is sustainable, and whether the influx of immigrants presents itself as an opportunity.

The transformation of the German model

Most mainstream German economists and members of the government extoll the virtues of the "new German model", which is based on the narrative of "living within its means" according to the imaginary of a Swabian housewife. These ideas of fiscal frugality are a legacy of the traditional ordoliberal school hailing from the 1930s, which sees the culprit for the present Eurozone crisis in the fiscal profligacy of peripheral countries.

The re-emerging discourse of the fiscal rectitude follows the dismal German economic performance of the 1990s with slow growth and high unemployment, earning Germany the attribute of "the sick man of Europe". The incoming Gerhard Schröder SPD/Green coalition government (1998-2005) introduced the *Agenda 2010* with its goal to liberalize the highly regulated labour and social welfare markets. To strengthen Germany's export-led growth, the coalition government boosted wage restraints to increase competitiveness, reform the social insurance system by lowering the social wage, making part-time work more feasible and thus vastly expanding a low-paid, precarious secondary labour market. As a result, wage inequality increased and workforce flexibility benefitted greatly the German export-oriented industries.

The domestic explanation is one side of the story. Challenging this narrative of an economic success story is all the more important since German government leaders and mainstream economists present themselves as moral taskmasters to hold up the imaginary of the "hard" road Germany travelled to reach the present economic triumphs. German political leaders never tire of advocating stringent fiscal rules, lowering taxes, deregulating the labour market, reducing social spending, and privatizing state properties. These proposals fail to recognize the importance of the Eurozone currency regime locking in undervalued exchange rates to the advantage of German exports.

Two complementary models: Export-driven and debt-driven Growth

The introduction of the euro resulted in two complementary growth models that rely either on debt to finance consumption spending ("debt-led growth") in the Eurozone periphery or export surpluses ("export-led growth") mostly in Germany and other Northern Eurozone countries. Initially, the introduction of the Euro had a negative effect on Germany, since the country entered the EMU at a high exchange rate, and the monetary policy of the European Central Bank was too restrictive for low-inflation Germany. In addition, the high cost of German unification caused low economic growth and high unemployment during the 1990s. The strongly unionized West German workforce suffered further from the influx of a highly skilled East German workforce adding strong wage competition.

Given that the success of the German export-growth model is the result of the undervalued exchange rate and much less the result of the structural reforms implemented via the Agenda 2010, its long-term sustainability is in serious doubt.

To avoid large job losses, the industrial unions agreed to wage restraints below the existing collective bargaining agreements. As a result, unit labor costs in manufacturing did not only stagnate but actually declined by 9 per cent between 1999 and 2008. The wage moderation had an immediate effect on Germany's price competitiveness and its exports to the Southern peripheral countries. The economic weakness of these countries helped to lower the real exchange rate while increasing the German current account balance. As Scharpf has argued, "(T)he monetary union allowed a dramatic fall of the real effective exchange rate after 2001 which then caused a steeper rise of German export surpluses than at any time since the end of the Second World War".

From this perspective of currency undervaluation, German export performance and the sustained pressure on nominal wage increases have provided German exporters with the competitive advantage to dominate trade and capital flows within the Eurozone. At the same time, wage moderation led to declining real domestic demand in Germany. Weak German demand implied for the rest of the Eurozone a strong deceleration of their exports for goods and services to the country. This was different before 1999 when Germany's imports from Eurozone countries and its exports were growing in parallel. Given the overall weakness of the Eurozone economies, the strength of the German exports did not result in the corrective effect of increasing the Eurozone exchange rate as would have been the case during the DM-period.

Germany lacks the entrepreneurship and start-up culture in digital innovations and services demonstrated by

Facebook, Amazon, Google, and the like. This has much to do with the bureaucratized and underfunded university system.

The asymmetric imbalances in the Eurozone between current account surplus and deficit countries increased significantly before the financial crisis 2007, decreased during the sovereign debt crisis starting in 2010, only to reach a German all-time high surplus of 8% of GDP in 2015. This is the opposite of what was intended with the introduction of the Euro. It was expected that introducing a common currency would lead to a convergence of the economic competitiveness of the Eurozone countries. Exactly the opposite happened and there seems little hope for change since the fixed exchange rate regime so overwhelmingly favours Germany's export-led growth model.

Is the German growth model sustainable?

Given that the success of the German export-growth model is the result of the undervalued exchange rate and much less the result of the structural reforms implemented via the *Agenda 2010,* its long-term sustainability is in serious doubt. The outlook for Germany's short-term sustainability is less pessimistic. Germany continues to benefit from its highly competitive manufacturing sector having carved out a technological niche at the higher end of the product market, which is quite price inelastic. Germany was also very quick to substitute the declining Eurozone peripheral export markets with new markets in the United States, the Middle East, and particularly China. The introduction of quantitative easing by the ECB has also provided a huge bonanza for German competitiveness, since it lowered the euro exchange rate against the dollar by about 20% since 2014.

On the negative side, German exports consist mostly of high-tech machinery exports, factory plants, automobiles, and pharmaceuticals. At this time, it is difficult to predict the fall-out of the Volkswagen emission scandal, but it can be substantial if legal actions in the US and Germany lead to convictions and heavy fines. Germany's over-reliance on manufacturing is problematic, since the country is less competitive in areas of financial services and the cultural and performative arts. Most importantly, Germany lacks the entrepreneurship and start-up culture in digital innovations and services demonstrated by Facebook, Amazon, Google, and the like. This has much to do with the bureaucratized and underfunded university system, whose curriculum structure prevents flexibility, entrepreneurship, and innovation. The result is a brain drain particularly to Anglo-Saxon countries, which often provide lucrative scholarships for German graduates wishing to escape the bureaucratic educational environment.

But it is geopolitics that presents the greatest challenge to Germany's over-reliance on exports. European sanctions imposed on Russia for annexing Crimea and destabilizing Eastern Ukraine have affected many smaller and middle-sized companies in Southern Germany. Just as the country is turning to new export markets in the Middle East, the entire region is exploding in warfare. The outlook for the growth of China and other emerging economies is not much brighter. Chinese financial volatility in the first weeks of 2016 sent shock waves through the developed countries' stock markets. These global developments are bad news for the German export sector. A glimmer of hope may come from the Iranian nuclear deal and the repeal of economic sanctions in 2016.

The refugee crisis as an economic opportunity for Germany

While Angela Merkel was hailed for her human gesture to welcome the refugees from Syria and Iraq during the summer of 2015, the crisis has turned into a political nightmare for the Chancellor. Her oft-repeated, *Wir können das schaffen* (we can handle this) is becoming less clear with the arrival of 1.1 million refugees by the end of 2015. The turning point was the New Year's eve massive sexual assaults on women in Cologne, Hamburg, Stuttgart, and Düsseldorf. The perpetrators were supposedly young men from North Africa. The political right-wing-parties, such as the German *Alternative für Deutschland* greatly contributed to a mass hysteria about the danger of letting large numbers of single men enter Europe.

The political danger for Angela Merkel does not only come from the right-wing fringe. Members of her own party, as well as Horst Seehofer, Governor of Bavaria and leader of the Christian Social Union, demand a ceiling of 200,000 refugees a year, and urge to protect the Bavarian borders against refugees entering the country from Austria without papers. It is evident that this problem is not just a German task, it is part of the EU's duty to protect the outer borders in order to safeguard the Schengen agreement. However, the solidarity of other EU member states is surely wanting in this regard. Yet the single European currency depends crucially on free movement within the EU territory.

Aside from these geopolitical and security concerns, Germany is confronted with a heated debate about the economic benefits and costs of integrating refugees. Even prior to the refugee influx Germany discussed the skill shortage and the general gloomy demographic outlook. Many business elites saw young refugees as a means to counteract this skill shortage facing Germany in the coming years. In this context, a study by the Bertelsmann foundation provides support for the economic net benefits of refugees. Even Finance Minister Wolfgang Schäuble has recently declared that the integration of refugees has priority over the zero deficit target. This may open the gate to a new domestic-led growth model in Germany, and in the process return the Eurozone to a much needed balanced current account regime.

A longer version of this article was published on Near Futures Online

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