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In Germany, a Limp Domestic Economy Stifled by Regulation

By JACK EWING FEB. 22, 2012

FRANKFURT — Torsten Emmel may have looked like an innocent florist, a gentle guy with a shaved head and an apron, clipping the stems of fresh freesia. In fact, he was on the verge of breaking the law.

Mr. Emmel's crime: Setting a placard on the sidewalk outside his shop advertising that he would stay open from 9 a.m. to 4 p.m. It was, after all, Mother's Day. But a city inspector noticed the sign and warned Mr. Emmel that it was illegal to stay open so long on a Sunday. Close earlier or be fined, the inspector said.

It was a lesson in how, despite its vaunted industrial sector, the German economy suffers from some of the same overregulation and sclerosis usually associated with much more troubled European countries.

"On special days, I don't think one should watch the clock so closely," Mr. Emmel said last week, still grumpy months later about the lost sales.

Germany is rightly known for Porsches and BMWs that are coveted by affluent buyers around the world, as well as much of the machinery that keeps factories running from China to Michigan.

Alongside the export juggernaut, though, is another, creakier economy that operates well below its potential and holds back not only Germany but the rest of Europe, some economists say.

This economy is overregulated, intended to insulate insiders from competition and deeply resistant to change. Though Germany's chancellor, Angela Merkel, often harangues countries like Spain, Italy and Greece to become more competitive, the German economy features some of the same flaws that they do, including protected professions and zoning laws that favor existing businesses over new ones.

"Germany has what I would call a dual economy," said Andreas Wörgötter, a senior economist at the Organization for Economic Cooperation and Development in Paris.

"On one side, we have this very dynamic, innovative, competitive and refreshingly unsubsidized export sector," he said. "On the other side, there is a much less glamorous services sector which depends on barriers to entry, subsidies and not developing and reaching out for new activities."

Mr. Wörgötter oversaw an O.E.C.D report issued last week that amounted to a warning to German leaders not to get complacent. Though the German economy grew a healthy 3 percent last year, it will grow only 0.6 percent this year and 1.9 percent in 2013, the O.E.C.D. forecast.

On Wednesday, a survey of purchasing managers by the research firm Markit, a closely watched indicator of business sentiment, said that German manufacturing was slowing.

At the end of 2011, the German economy, the world's fourth-largest, shrank for the first time since 2009. The decline in the fourth quarter of 0.2 percent was not as bad as expected, and growth has probably resumed. Still, most economists do not expect brisk growth to return any time soon.

Germany could add about 10 percent to growth over the next decade if it removed barriers to competition and other inefficiencies, according to the O.E.C.D. Surprisingly, the untapped potential in Germany was almost as high as that in Italy and higher than that in Spain, according to the O.E.C.D., an indication that the German domestic economy is not as superior to its southern neighbors as is often assumed.

Germany's huge trade surplus, more than 145 billion euros in the first 11 months of 2011, was partly a tribute to exporters like Siemens, Bosch and Daimler. But it also reflected chronically anemic spending by consumers and businesses on imports.

If Germany built up its services sector, it might buy more products from hard-pressed trading partners like Greece or Spain, whose debt problems are closely tied to their longstanding trade deficits. Everybody would win, the argument goes.

Germany would also become less vulnerable to the economic ups and downs of major markets like America and China, said Ulf M. Schneider, chief executive of Fresenius, a German health care company that is the world's largest provider of dialysis products and services. Mr. Schneider said he worried about Germany's dependence on the auto industry.

"If there was a more resilient domestic economy, it would at least cushion things a little bit," Mr. Schneider said.

The barriers to entrepreneurship in Germany are often obscure, but cumulatively act as a significant drag on job creation and investment.

For example, two years after a promised deregulation of domestic transportation, intercity long-distance bus service is still effectively prohibited in Germany. The decades-old ban shielded the government-owned rail company, Deutsche Bahn.

"It's frustrating," said Michael Svedek, chief operating officer of Deutsche Touring, a bus company based in Frankfurt that offers direct service to foreign cities like Istanbul or Belgrade, Serbia, but is still not allowed to operate domestic lines to, say, Munich.

Legislation to open up the market has been creeping through the German Parliament. "Not a lot is going to happen before the end of the year," Mr. Svedek said.

Germany has made huge progress in the last decade toward removing strictures on the economy. In the 1990s, stores closed at 6:30 p.m. and were open only a few hours on Saturday, a hardship for working parents. Shops in train stations, which were exempt from the rules, were known to charge extortionate prices during off hours for essentials like disposable diapers.

Now, German states can set their own shop hours, and most have lifted restrictions during the workweek — though Sunday is still taboo in most places. Florists and bakers are typically allowed to open a few hours on Sunday.

Germany has also eased strict licensing rules that required years of qualification even for professions like basket weaver or violin maker.

But years of training are still required to qualify as a house painter, chimney sweep or bicycle mechanic, to name a few examples. The O.E.C.D. has called on Germany to loosen restrictions on advertising and fees, which limit competition among architects, lawyers and engineers.

In 2005, Germany also changed rules to put more pressure on people to find jobs and make it easier for companies to hire temporary workers. Those changes contributed to a significant decline in the unemployment rate, to 7.3 percent in January from 13 percent in 2005. German unemployment remained low throughout the recession of 2009 and the debt crisis that followed.

Germany also has its public spending under better control than most of its neighbors. The German government budget deficit in 2011 was 1.1 percent of gross domestic product. At the same time, total debt is about average for the euro zone, equaling 80 percent of G.D.P.

But Germany's export success seems to have sapped political will to address remaining flaws in the economy, and could lead to a competitiveness gap several years from now.

Recent talk of the powerful German economy has obscured memories of how, not so long ago, the country was considered the sick man of Europe.

"As great as the export performance is, we forget that we had a significant growth problem for 15 years before that," said Mr. Schneider, the Fresenius chief executive. "If any of these stories come to an end, we are as exposed as anyone."

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