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To the point!

Cross-Asset- and Strategy-Research

Nobel laureates with advice for Germany

Without disruptive change, German growth will continue to disappoint

Today, I would like to talk about the Nobel Prize. And no, not about the already thoroughly overanalyzed question of whether U.S. President Donald Trump deserved the Peace Prize – for having at least temporarily ended the war in Gaza and not starting a new one in Chicago. Instead, it's about the Nobel Memorial Prize in Economic Sciences, awarded by Sweden's central bank. This year's laureates, French economist Philippe Aghion and U.S. economist Peter W. Howitt, have a message for Germany.

Creative destruction 2.0

Aghion and Howitt will be recognized for their research in the field of growth theory. They follow in the tradition of Austrian economist Joseph Schumpeter, who became famous for his theory of "creative destruction." According to Schumpeter, the decline and disappearance of businesses with outdated models is a necessary condition for economic prosperity. The downfall of these companies clears the way and liberates resources for new, innovative, and forward-looking ventures. That's the "creative" side of destruction.

For the majority of human history, economic progress was largely stagnant. But since the industrial revolution, innovation after innovation has caused global prosperity to soar to previously unimaginable levels. Technologically superior products have continuously replaced outdated ones. In recent decades, this virtuous cycle has been propelled further by an ever more interconnected global economy.

Germany wasn't the specific focus of Aghion and Howitt's research, but their analysis fits Germany like a glove, although perhaps an uncomfortable one. For a long time, Germany has been

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October 24, 2025

Creative
destruction
helps!

No prosperity
without change

at the forefront of industrial technological progress. "Made in Germany" was the gold standard. And in many areas, it still is. But if we look at the economy as a whole, it's clear that Germany – like other European nations – is falling behind the worldwide technological cutting edge in more and more sectors. That famous slogan of German car manufacturer Audi, "Vorsprung durch Technik" (advancement through technology), applies less and less. This is evident not least in the fact that foreign trade, for years a driver of economic growth, has turned into a brake, as Germany's products are no longer as desirable as they once were. Meanwhile, productivity growth has been stagnating for years, as highlighted in [last week's column](#).

Be bold, Germany!

I can't believe that Germany has suddenly become less smart. Perhaps a bit too complacent, but not less capable. And while it may be easy for economists to focus on the "creative" and productivity-enhancing side of structural transformation, politicians are often far more preoccupied with the immediate and visible "destruction" it entails. That means jobs lost and companies shuttered. For those directly affected – and, of course, for the media – this is the main focus. Doom and gloom make for better headlines, after all. Month after month, the media reports an allegedly record-breaking number of insolvencies (see Fig. 1). But the truth is, market exits are as natural to a dynamic market economy as the "amen" in church.

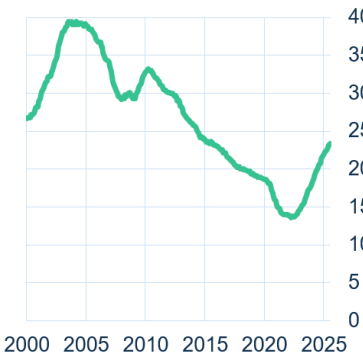
A particularly striking example of creative destruction in Germany came after reunification in 1990. And who – despite the challenges that persist to this day – would deny that prosperity in eastern Germany has grown massively since then? It's that kind of courage to embrace change that we need throughout Germany now. Industrial policy must stop centering on propping up declining industries. Instead, it needs to prioritize winning sectors of the future – much as it did during the pandemic with the mRNA vaccines developed by the German company BioNTech.

Unlike in the U.S. or China, however, industrial policy in Germany is often a kind of nostalgic preservation project. It's popular with voters, no doubt. But as the liberal economist Friedrich August von Hayek once noted, the popularity of bad ideas only makes them more dangerous. This nostalgic reflex also explains the still very high share of manufacturing in Germany's economy (see Fig. 2). Or to put it differently: the 40 most valuable German companies – essentially those listed on the DAX index – were on average 146 years old in 2023. More than twice as old as their U.S. equivalents.

146 years ago, Wilhelm II, who would later become Germany's last emperor, was just 20 years old! Incidentally, he is often (wrongly) credited with the famous phrase: "The automobile is a passing phenomenon. I believe in the horse." Laughable, sure. But also, worth reflecting on.

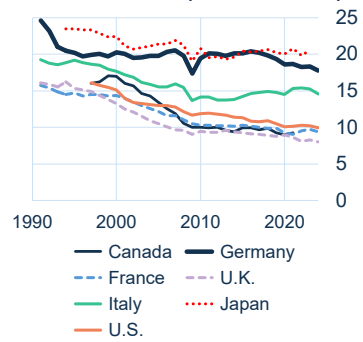
Germany is slowly losing its edge

Fig. 1: Insolvencies in Germany (in thousands, annual totals)



Source: Destatis, LBBW Research

Fig. 2: Manufacturing sector in G7 (% of GDP)



Source: The World Bank, LBBW Research

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