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Beyond bureaucracy: A new vision for Europe

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Preface

It has long been clear that Germany and Europe will soon be required to spend enormous sums of money. Geopolitical, economic and security policy requirements make these expenditures unavoidable. States must significantly increase their investments and secure appropriate financing. This will not only impact the debt levels of individual EU member states – and possibly the debt of the EU as a whole – but also our growth rates. Businesses, too, must return to making large-scale investments in order to create the necessary capacities and maintain their international competitiveness.

But does Europe meet the requirements for a business location? The Country Index for Family Businesses has just highlighted that the larger countries in particular are falling behind. They are at risk of suffering massive losses in prosperity. It is therefore important to look to Europe – especially now, in the wake of the German federal elections.

We believe that fundamental reforms are imperative if Europe is to remain competitive. Rather than imposing ever more complex corporate governance requirements, the EU should refocus on its original treaties and the principle of free markets. Regulatory policy must once again take precedence.

Strengthening the EU single market, dismantling impractical regulation and promoting mobility: that is what the Advisory Board of the Foundation for Family Businesses would advise. In short, Europe should bid farewell to excessive dirigisme.

In this publication, six professors present six visions for Europe. They propose reforms and initiatives they deem necessary for the European project to remain viable.

Prof. Gabriel Felbermayr calls for a deepening and expansion of the single market, with the aim of bringing trade and mobility barriers down to the same level as that between federal states of the USA. This has the potential to generate significant efficiency gains and economies of scale. At the same time, the principle of subsidiarity must be more rigorously applied. According to Felbermayr, the EU should focus solely on tasks that member states cannot handle on their own, such as the protection of external borders, common defence, cross-border infrastructure and cutting-edge research.

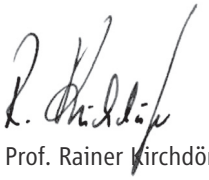
Prof. Clemens Fuest advocates for fiscal policy in Europe to be tightened. The debt levels of individual EU member state are truly alarming, and violations of the Maastricht criteria are not consistently penalised. The latest reform of the EU's Stability and Growth Pact was a step in the right direction, but it contains numerous exceptions and vague legal terms. Europe will not become more competitive through debt-financed community investments, but rather through reduced reporting obligations and reforms at the member state level. The EU should only intervene and coordinate in areas where there are cross-border inefficiencies.

Prof. Udo Di Fabio fears that the EU is veering towards a market-critical stance, with increased ambitions for economic surveillance and control. He reiterates the EU's commitment to an open market economy with free competition, as enshrined in the EU treaties, and argues that it is not acceptable to reduce an individual to a mere instrument serving a collective plan. Fundamental economic rights and economic freedoms are worth strengthening because they foster initiative and value creation. In his view, what Europe urgently needs is a capital market that enables high-growth enterprises to flourish.

Prof. Hans-Werner Sinn highlights how far the EU has yet to go to achieve a common energy market by casting a critical eye on Germany's unilateral approach to energy policy, which is effectively forcing deindustrialisation while failing to benefit the climate. **Prof. Kay Windthorst** draws attention to the plight of family businesses as a whole, which are affected particularly

severely by EU regulations that are out of touch with real-life practice. These businesses often have the impression that the EU is blind to their concerns and views them with suspicion. I myself shed light on how much entrepreneurial families have internationalised and how much their mobility is still restricted by German and European law. The freedom of movement of entrepreneurial families has thus far received little consideration in the context of exit taxation.

In summary: following the federal elections, Germany will remain preoccupied with domestic matters for the foreseeable future. And while the global situation necessitates a European approach to defence and trade policy, when it comes to economic and fiscal policy in particular, we must return Europe to its founding principle of liberty and establish it as a premier business location – especially for family businesses.



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Introduction: A regulatory framework for new growth in Europe

by Prof. Gabriel Felbermayr, PhD, Prof. Dr. Dr. h.c. Clemens Fuest, Prof. Dr. Dr. Udo Di Fabio, Prof. em. Dr. Dr. h.c. mult. Hans-Werner Sinn, Prof. Dr. Kay Windthorst and Prof. Rainer Kirchdörfer

Growth in Europe is stalling – that is the central message of the report published last year by former ECB President Mario Draghi. While the diagnosis is correct, there are significant differences between individual member states. Germany, Europe's largest economy, stands out due to its particularly low momentum. Slow economic growth not only poses a threat to prosperity, but also to social cohesion, security and political stability. To return the economy to a sufficient level of growth, economic policy needs to be realigned, both in Germany and at the European Union (EU) level.

In Germany, a new federal government is taking shape. Meanwhile, the EU has intensified its efforts to draw up the next multiannual financial framework. And just recently, the Commission unveiled its Competitiveness Compass, a plan to promote investment, reduce regulation and coordinate industrial policy. Its focus is on strategic sectors such as energy and digital infrastructure, an investment programme to promote innovation, and measures to cut red tape and support cross-border projects. The plan contains positive elements, but also some questionable ones.

Against this backdrop, there is now an opportunity to reset the course and refocus on the strengths of the old continent. The objective is to enable and demand a return to a freer market economy and more self-responsibility. The proven regulatory policy principles that helped Germany and Europe achieve prosperity must be applied more rigorously again. If we succeed in doing so, family businesses – with their long-term orientation and traditional loyalty to their location – will be among those making a key contribution thanks to increased investment. This annual bulletin outlines a number of policy options designed to put Europe back on course for growth.

Countless studies confirm that the single market represents the crown jewel of the European project. Since its introduction, it has provided significant impetus for growth thanks to its four pillars: the free movement of goods, services, capital and labour. Fewer barriers to cross-border trade, increased competition and the exploitation of economies of scale in a larger common market have helped to secure and expand value creation and employment – including in Germany. Without the European single market, German gross domestic product would be at least 3.5 percent lower (Felbermayr et al., 2024); measured in 2024 prices, this is equivalent to more than EUR 150 billion, or EUR 1,800 per person.

Many family businesses, especially those in industry, have been able to increase their sales and employment by systematically Europeanising their business models, both in Germany and in other EU countries. Building on a strong European foundation, many of them have also succeeded in internationalising their business in recent decades.

These figures are not merely theoretical. Recent history has clearly shown that the United Kingdom's withdrawal from the single market has significantly hampered economic growth there. Conversely, the various accessions to the single market by Central and Eastern European countries have given a significant boost to per capita income growth in these new member states.

The European single market was established in 1993. Along with other factors, it contributed to a slight increase in the EU's average per capita income (adjusted for purchasing power) compared to that of the USA up until 2008. Since 2008, however, the EU as a whole has been losing ground, as recently illustrated by the Draghi Report. The introduction of the single market thus had a positive effect on the level of per capita

income in the EU, but did not have a lasting effect on growth rates. Since 2008, no further consolidation of the single market has taken place; on the contrary, cross-border economic activity in the EU has been held back by new barriers, such as the Posted Workers Directive, the partial disintegration of capital markets due to stricter supervision of banks and increased bureaucratic regulation in many areas. The implementation of climate policy in particular has gone hand in hand with a shift away from market economy principles, resulting in a further loss of economic momentum, for example due to the relocation of companies and investments. This is harming family businesses themselves as well as the regions in which they are based and their German supplier networks.

Europe's economic weakness not only jeopardises jobs and social systems, it also undermines political cohesion within the EU. Insufficient growth exacerbates conflicts over the distribution of wealth, thereby intensifying polarisation in the political debate – with negative effects on the quality and stability of institutions and economic policy. This, along with the diminished appeal of the European model, is weakening the EU's international negotiating power. In times of renewed geopolitical rivalries, this is a major disadvantage that could further undermine Europe's position.

Long-term economic growth has slowed significantly in recent years. While this phenomenon can be observed in many developed economies, it is particularly pronounced in the European Union; see Celik et al. (2023). In this context, capital exports, as measured by the balance of capital transactions, have grown to around EUR 250 billion per year. A large proportion of European savings flows into foreign markets, above all to the USA, financing growth there. This trend reflects the poor return on investment to be expected in the EU, as reported by many family businesses.

All determinants of potential growth in the EU are currently very weak: the growth rates of labour supply measured in hours, as well as of capital stock and aggregate productivity. Insufficient work incentives, low or even negative net investments and low productivity growth have caused potential growth in Germany to fall to 0.4 percent (German Council of Economic Experts, 2024); in Austria the rate is 0.7 percent (Austrian Institute of Economic Research, 2024); in France it is 0.8 percent (French High Council of Public Finance, 2022). The report published by Mario Draghi in September 2024 also highlights the waning momentum of European growth. While the reasons for this lie not only in the economic policies of recent years, but also in demographic developments that began many decades ago, a reorientation of European economic policy could nevertheless help boost productivity growth and investment, which would in turn stimulate potential growth.

What is needed to counter this dynamic is a lasting shift in the fundamental orientation of European economic policy. This requires a change of course at the EU level, in conjunction with reforms at the member state level. For this course correction to succeed, there needs to be a thorough analysis of the oversights and mistakes made over the past 15 years. Many of the current problems can be traced back to the neglect of proven regulatory policy principles. For example, despite assurances to the contrary, the European Union has continuously moved further away from the principle of subsidiarity. Barely any funding is available for European public goods like cross-border infrastructure, while new collective debt is ultimately used to plug national budget deficits. Instead of relying on the market-based emissions trading system and perfecting it with a view to safeguarding foreign trade, climate policy has increasingly favoured micro-regulation, which suffers from an overconfidence of knowledge (Hayek), ignores the principle of technological neutrality and alienates trading partners. Rather than mobilising market forces to bring about transformation, policymakers have sought to enforce political primacy, imposing a flood of detailed regulations and reporting obligations.

A return to the fundamental market economy principles of the European Union, as enshrined in Article 3 of the

European treaties, would restore the EU's attractiveness as a location for family businesses. At present, there are no credible prospects that the conditions will become more favourable for businesses, causing investment in European locations to be postponed or abandoned altogether.

The European Union needs three things above all else to achieve renewed economic success. Firstly, it must press ahead with the ambitious completion of the single market by eliminating intra-European trade barriers and bureaucratic overregulation, while adhering to the principle of subsidiarity. Secondly, it must focus on investing in the future, with collective debt being used strictly for the expansion of European public goods, in other words for the creation of common net assets. And thirdly, the EU must pragmatically align its foreign trade policy with its own economic and security policy interests. This publication seeks to provide some impetus for reforms in this direction.

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Helping the EU's crown jewel – the single market – regain its sparkle

by Prof. Gabriel Felbermayr, PhD

I. Introduction

"Europe is far from having a single market." This was the finding of an empirical study by Santamaría et al. (2020), which used detailed intra- and extra-European transaction data to calculate the extent to which internal European borders still hinder economic exchange. The above quote from the summary of the work may sound exaggerated, but more than thirty years after the start of the single market programme, companies in the European Union (EU) still suffer as a result of fragmented markets. In many future-oriented industries – from bio-tech to the digital economy and new, green technologies – economies of scale are crucial to quickly and successfully rolling out new business models and new technologies. This is why larger, unified markets such as those in the US or China are also attractive to European companies, as they provide opportunities for growth.

Although the European single market is a great success (see Felbermayr et al., 2022) – two-thirds of the prosperity effects attributable to the existence of the European Union (EU) originate in the common market – high barriers still remain that do not exist in other economic areas. In the years since the great economic and financial crisis of 2008, it seems that integration has slowed down, and in some areas it has even taken a step backwards. While the increasing regulation of the banking sector may have made the EU more crisis-proof, the integration of the European financial market has slowed considerably since 2010 (ECB, 2022), with repercussions as regards the availability and cost of capital and financial services.

Surveys repeatedly show that Europe's excessive red tape is one of the main obstacles to business growth. Particularly in recent years, as a result of the implementation of the Green Deal, there has been a flood of new regulations, accompanied by various requirements and reporting obligations. It is not uncommon for the EU to issue directives that have to be transposed into the member states' own laws, which leads to further fragmentation of the single market. One example of this is the European Supply Chain Directive.

Calculations by the International Monetary Fund from October 2024 (IMF, 2024) show that if trade barriers between EU countries were reduced to the level that exists between US states, it would increase European productivity by seven percentage points, and thus also increase per capita income. Similar effects can be expected from greater integration of the capital and labour markets. The IMF study reports that the costs of labour mobility between EU member states are on average eight times higher than between US states. The analyses by Mooyaart and de Valk (2021) show that, since 2015, internal labour migration within Europe has been declining again, exacerbating the inefficient distribution of labour within the EU – while many regions suffer from a severe labour shortage, many others continue to experience high unemployment.

Breaking down barriers within the EU would make the single market a source of economic growth again. First and foremost, this involves fundamentally reorientating the common economic policy towards areas in which added value can actually be expected at the European level. This means that the principle of subsidiarity needs to be taken seriously again. Secondly, a new approach is needed in order to dismantle regulatory barriers within Europe. Thirdly, the relevant infrastructure must also be upgraded so that the single market can function properly. And finally, there needs to be an explicit plan to include other nations, even if they are not full EU

members. The following section presents the existing evidence on these points and offers recommendations.[1]

II. Focus on projects that deliver added value at the pan-European level

Is European economic policy focusing on the right areas? The distribution of activities between central EU agencies and the member states is supposed to be based on the principle of subsidiarity. According to this principle, all political decisions should be taken at the lowest appropriate level, as close as possible to the citizens. This means that the EU should only take action in areas where policy objectives cannot be sufficiently achieved at the national or regional level, and where added value can be achieved through collective action by EU member states. This is the case in matters with a cross-border dimension. If the member states have widely differing preferences on an issue, then even if added value were to be created, the costs of communitisation would be extremely high, which is why the issue should remain at national or regional level. This applies to numerous social and distributive policy issues. The principle of subsidiarity is intended to reinforce autonomy and freedom of choice at the regional or national level. It is enshrined in the EU treaties, and is monitored and reviewed by institutions such as the European Court of Justice and the European Committee of the Regions.

But one glance at the EU budget is all it takes to quickly identify the political priorities. While it is not possible to tell from the budget where European institutions set rules (because numerous agendas do not require funding at the EU level), one thing is clear: the EU is not adhering to the principle of subsidiarity, despite it being enshrined in primary law. This must be criticised because it undermines the acceptance and legitimacy of EU policy, and important policy areas remain underfunded.

In the current financial framework, the EU spends approximately 31 percent of its budget on the Common Agricultural Policy (CAP), a further 31 percent on cohesion policy and almost 32 percent on new and enhanced activities, which include research, border protection, industrial policy and, in particular, the major project of phasing out fossil fuels. The remainder, slightly more than 6 percent, is spent on administration. This focus is difficult to reconcile with the principle of subsidiarity, as is the case, for example, with agricultural subsidies. If these are not by design structured in a way that distorts competition, there is no reason why there should be uniform standards governing their scale and design, or why they should be paid out largely from a central budget rather than financed by the EU member states themselves. However, the EU budget only allocates a tiny proportion of its funds to traditional policy areas where common European action would obviously be more efficient than independent national efforts. Despite the experiences gained during the refugee crisis of 2015, the current financial framework allocates a mere 0.01 percent of the EU's gross domestic product (GDP) for border protection. Cross-border infrastructure, which unequivocally offers Europe a great deal of added value, also receives only 0.01 percent of EU GDP in funding. Such amounts are clearly insufficient to make a meaningful contribution to the provision of European public goods. The only area in which the existence of European added value and the EU budget do not conflict is the research budget. In 2020, the EU spent almost 0.1 percent of EU GDP on research. Since research funding, if successful, brings cross-border benefits and also allows economies of scale to be realised, it

1 The analysis follows that of Felbermayr (2024). More detailed explanations and calculations can also be found in Felbermayr and Pekanov (2024).

would make sense for the EU to step up its commitment in this area as well.

In the current financial framework, expenditure is increasingly being channelled towards projects with real added value for Europe. While for decades roughly half of the total budget was used for the Common Agricultural Policy (CAP), this situation has now improved. Nevertheless, there is still a significant discrepancy between the principle of subsidiarity and reality.

The EU should focus more on activities that cannot be efficiently handled by the member states alone. These include the protection of external borders as well as, from a long-term perspective, a common defence, ensuring security of supply by means of strategic reserves of critical goods, cutting-edge research and science policy, and the development of trans-European infrastructure in various areas.

If the EU were to systematically administer and finance only those issues which provide real added value at the European level, the member states and their citizens would benefit from greater economic benefits. The EU would thus be perceived as a more tangible and efficient organisation. At the same time, it should withdraw from projects that merely redistribute funds between member states without creating added value for the community as part of a win-win situation.

III. The EU's crown jewel: The single market

Economic studies repeatedly show that the European single market is the most significant achievement resulting from the economic integration process in Europe. In theory, the single market allows for the free movement of goods, services, labour and capital without legal barriers – otherwise known as the four freedoms of the single market. Since its introduction in the 1990s, numerous political and regulatory hurdles have been removed that had previously made cross-border economic activity within the EU difficult. For example, there are no longer internal customs duties, and market authorisations for products and services in accordance with European requirements are valid in all member states. Similarly, EU citizens can work and freely invest their capital in any member State.

The conservative estimate by Felbermayr et al. (2022) shows that the single market significantly increases the economic output of small, centrally located member states. In Luxembourg, for example, this effect amounts to more than 14 percent, in Austria approximately 6 percent and in Germany roughly 4 percent. In France and Italy, the increase is around 3 percent. Generally speaking, the smaller and more centrally located a country is, the more it benefits from the single market. Smaller countries feel the restrictions of a limited market more acutely, while centrally located nations benefit from low transport costs to and from other EU countries. By contrast, countries in more peripheral locations incur higher transport costs. Overall, the single market generates additional real income of approximately EUR 500 billion (in 2022 prices) for the EU-27 – an amount that exceeds Austria's annual income. These economic benefits are essential to counteract Europe's weak growth. Economic growth is not an end in itself, but it does support social cohesion and the achievement of non-economic goals such as climate action or security, provided it does not endanger them.

A large, integrated and dynamic single market also offers protection against existential risks. The energy crisis of 2022 made it clear that insufficient transport capacities within the EU, uncoordinated unilateral action by individual nations in the procurement of gas and a lack of harmonisation in the organisation of the electricity market are causing significant problems. These go-it-alone efforts led to supply shortages, extreme price increases and massive price differences within the

EU. In order to become more resilient, it is therefore absolutely essential that the EU improves cross-border infrastructures, harmonises electricity market regulation and acts jointly at the international level.

In the event of geopolitical crises – whether as a result of Russian aggression against Ukraine, tensions surrounding Taiwan or conflicts in the Middle East – the single market gives European policy international weight. Economic sanctions, for example, are only effective if access to the single market's customers and technologies is important to other powers.

The single market plays a crucial role in the EU's attractiveness as a trading partner. The smaller and less dynamic this market is, the less willing third countries are to make concessions to the EU in trade agreements – such as, by opening their markets or adopting European standards, for example in the area of environmental protection. This makes it clear that the quality of the single market also plays a central role in achieving the EU's goals, such as combating the climate crisis.

However, the single market's ability to function effectively depends on numerous requirements being met. Without adequate infrastructure for passenger and freight transport, data transmission or the transport of energy such as electricity and gas, the politically guaranteed four freedoms lose their value. Deficits are particularly common in the case of cross-border transport, because in border regions the advantages of infrastructure projects benefit both countries, but the high costs have to be borne nationally. This is an example of the "common pool problem" that regularly arises when providing public goods. In the case of infrastructure, the problem leads to the systematic underinvestment in border regions (Felbermayr and Tarasov, 2022). Although there are European programmes in place to coordinate such projects, they do not work optimally because additional national funding often leads to the benefits being maximised primarily for the respective country. This favours investments in the central regions of the respective countries at the expense of the border regions.

In addition to infrastructure, the regulatory framework also plays a crucial role. It must ensure that the four freedoms do not pose a threat to health, life, animals and the environment, while also promoting the economic benefits of the single market. This balance is not always achieved. For example, the Posting of Workers Directive, which is supposed to put posted employees on an equal legal footing with domestic workers, results in a considerable amount of red tape that makes cross-border posting of workers more difficult or uneconomical. This restricts the freedom to provide services, thereby squandering the economic potential of cross-border activities. Similar problems arise as regards all four freedoms, with trade in goods being the area in which things work best by comparison.

Another obstacle to the single market is that numerous important aspects, such as social security systems, continue to be regulated at national level. Disparities between the systems are making the free movement of labour considerably more difficult. For example, different pension entitlements or retirement ages in different countries can mean that employees only gain an overview of their actual financial situation years after retirement. Such uncertainties reduce mobility within Europe.

Despite its already considerable economic benefits, the single market is far from realising its true potential. This is evident, among other signs, from the price differences for identical products or services between the member states. In a fully integrated market, such differences should be explainable only by transport costs or tax systems. In Europe, however, this is not the case: studies show that products in German supermarkets are on average 14 percent cheaper than in Austria, the electricity market is highly fragmented and new cars also vary greatly in price from country to country. Market barriers such as oligopolistic structures, segmented market organisations and inadequate infrastructure contribute to these differences. Reducing these obstacles would significantly improve the lives of EU citizens.

The imperfections of the single market are evident not only from price differences, but also from trade flows within the EU. Empirical studies on how internal European borders restrict trade prove this. The study by Santamaría et al. (2020) cited above shows that the trade in goods between two comparable regions in different EU member states accounts, on average, for only 17.5 percent of the trade value achieved between regions within the same member State. By comparison, the effect of internal borders in the United States is significantly lower. Although Europe's cultural and linguistic diversity creates natural barriers, there is considerable potential for a further deepening of the single market. Necessary measures include investment in infrastructure, simplified and efficient regulations, consistent enforcement of competition law to avoid market segmentation, and further reforms.

IV. Less but better regulation

If the EU were to focus only on areas where it can add value in line with the principle of subsidiarity, it could withdraw from other areas. One example of this, as outlined above, is agricultural policy. To do so, however, it would presumably need new, common competences in policy areas not previously subject to the single market. The path to this point requires changes to the European treaties. Although this step is unlikely given the general political situation, it should not be ruled out from the outset. But when the EU has only partial authority, it has a hard time enacting regulatory measures. In these cases, it cannot issue regulations, but only directives. The latter are then transposed into national law by the individual member states. Experience shows that this can lead to regulatory differences between countries, hindering the free movement of goods in the single market and creating new bureaucratic burdens. It therefore makes sense for the EU to focus more on enacting regulations and to refrain from regulating in areas where this is not possible. The initiatives to reduce bureaucracy at EU and national level have largely failed thus far. The main lesson learned is that the only way to achieve a genuinely noticeable reduction in the burden is to reduce regulatory density, i.e. through deregulation.

In general, greater attention must be paid to the quality of regulation than has been the case to date. In the past, suspicions have repeatedly arisen that the EU is willing to accept negative effects on growth and employment when it comes to undisputedly important goals such as climate action or global human rights. Indeed, conflicts between economic interests and other concerns often inevitably arise. Effective regulation succeeds in easing the tension between conflicting objectives by finding the most efficient measures possible. Taking the example of Germany's Supply Chain Act, this means, for instance, that not all bilateral supply relationships between European buyers and their foreign suppliers should be subject to monitoring, but only the suppliers themselves. The number of such bilateral supply relationships is at least an order of magnitude fewer than the number of supplier relationships. The efficiency gains achieved in this way can be used to mitigate the conflict between economic and environmental or social objectives (Felbermayr et al., 2024).

V. European public goods as a means to stability and efficiency

The debate on the EU budget raises the fundamental question of which tasks should be performed at the central EU level in order to fulfil the desired stabilisation function. The EU budget should not be viewed primarily as an instrument of redistribution that collects funds and then reallocates them according to predetermined

rules. Rather, adherence to the principle of subsidiarity is crucial to the legitimacy and acceptance of the EU. A budgetary policy geared purely toward redistribution inevitably leads to conflicts between net contributors and net recipients.

Instead, the EU could promote stability by providing common public goods. Centralised provision of such goods – which to date has often been organised on a national level and in an uncoordinated manner – would relieve the burden on national budgets and enable economies of scale and efficiency gains. This could even lead to savings, while at the same time improving the quantity and quality of public goods. In addition, common provision would ensure that all member states would benefit, which is often neglected when organised in a purely decentralised manner.

One example is the protection of the EU's external borders. If this task were financed collectively, significant funds could flow from central regions to the peripheral areas, which are often economically disadvantaged. This would have a positive impact on cohesion and economic development in peripheral regions, for example through investment in infrastructure, personnel and equipment. This expenditure would also have knock-on effects that would strengthen other economic sectors, such as construction and food services. Since the intensity of border security must be guaranteed regardless of the economic cycle, common financing could also function as an automatic stabilising mechanism.

A common approach to national defence could also bring enormous benefits. Aligning such an EU policy with the NATO target of 2 percent of GDP for military spending could already cover a significant portion of the desired central budget. At the same time, it would be possible to realise significant savings by avoiding the duplication of structures and inefficient national policies. A coordinated European defence policy would also promote the development of a competitive defence industry.

The collective financing and organisation of such tasks would make the EU more visible to its citizens as a force for their benefit. In particular, the protection of the external borders must be communicated in a more tangible way than the economic advantages of the single market. This would be a way for the EU to strengthen both its legitimacy and its acceptance in the long term.

A stronger focus on common security in the face of external threats could also provide an important basis for the development of state structures. Historical examples such as the Swiss Confederation, which began as a defensive alliance, or the United States of America, which emerged from resistance to a colonial power, prove this dynamic. By contrast, the EU has prioritised economic integration, while the aspect of external security has not yet been communitised – which is an historically unusual approach.

In addition to security, the EU should also take more responsibility for the development and funding of central infrastructure networks. This applies, in particular, to roads and railways as well as electricity, gas and data lines. Currently, the member states bear the bulk of the costs, with the result that national interests are often prioritised over added value for Europe as a whole. This inhibits investment in border regions in particular, although these play a particularly important role for the EU due to their function as transit corridors.

Cutting-edge research is another field of endeavour which offers Europe considerable added value. The EU could create central, internationally competitive top-level universities that are collectively financed. Existing national structures such as the Max Planck Institutes could serve as a basis for this and be further expanded to spearhead European basic research. To boost international awareness, it would be crucial to market these research and teaching activities under a common brand.

VI. On the conflicting objectives of deepening and expanding

For decades, the European integration project was characterised by growth and expansion. But when the United Kingdom left the EU on 31 January 2020 – an event commonly known as Brexit – the EU suffered a significant defeat. The polarisation that had already emerged during the Brexit campaign and the often misleading arguments put forward by opponents of the EU led to profound tensions. The withdrawal had far-reaching consequences: the EU lost approximately 16 percent of its gross domestic product, one-eighth of its population and a significant net contributor. In addition, the loss of the City of London as an important financial centre and of the top British universities presents a challenge.

Although Brexit meant greater economic disadvantages for the UK than for the EU, the Union also suffered tangible losses. The rigid focus on the inseparability of the four freedoms of the single market made negotiations more difficult and ultimately led to Europe losing Great Britain in both economic and geopolitical terms.

The EU should consider developing a third model of co-operation, alongside full membership and traditional free trade agreements. This could enable participation in the single market and the customs union without demanding deep political integration. Such a model would be of interest not only to the United Kingdom, but also to countries such as Turkey or Ukraine, for whom full membership or a free trade agreement alone does not suffice.

To implement this model, new institutions would be needed, such as a customs parliament in which both members of the European Parliament and representatives of associated states are represented. Such an approach could help Europe to present a stronger and more united front in a geopolitically turbulent world.

VII. Europe, free trade and the new geoeconomics

Europe is a continent with limited raw material deposits and is therefore dependent on imports. At the same time, European companies export highly specialised goods and services worldwide. Countries like Germany and Austria have benefited particularly from globalisation in recent decades, as numerous studies have shown.

As regards trade policy, the EU has full competence. It decides on customs duties, trade agreements with third countries and access to the single market. This communitisation is necessary to ensure a functioning single market. For example, different import duties imposed by individual member states would lead to a "race to implement the lowest tariffs" or make it necessary to reinstate border controls – an enormous bureaucratic burden. The EU therefore forms a customs union, unlike the North American Free Trade Agreements, for example, which do not include a common external trade policy. This means that the EU can conclude separate agreements with countries such as Mexico or Canada, while the USA, for example, cannot negotiate with individual EU member states.

The EU has traditionally been committed to multilateralism. This system is based on non-discrimination in trade, as enshrined in the World Trade Organization's (WTO) most-favoured-nation principle. However, Article XXIV of the General Agreement on Tariffs and Trade (GATT) allows bilateral free trade agreements, which the EU has used to conclude agreements with roughly 80 countries. Approximately 45 percent of the EU's foreign trade is conducted on this basis. Nevertheless, no such agreements exist with its largest trading partners – the US, China, India and Brazil; WTO law applies in these cases.

The WTO has been coming under pressure in recent years. In particular, the US scaled back its support during the Trump administration, which paralysed the organisation's dispute settlement function. At the same time, increasing protectionism and the instrumentalisation of trade and currencies as geopolitical tools have slowed down globalisation. This "slowbalisation" has been accompanied by a decoupling of global supply chains in order to reduce dependencies.

The EU is particularly affected by these developments because it relies heavily on foreign trade. Increasing geopolitical risks and protectionist tendencies are making it more difficult for European companies to hold their own internationally. This is leading to a situation in which European companies are increasingly producing abroad for local markets rather than in the EU for the global market.

The single market is one possible response the EU could have to these challenges. By making access to the single market more restrictive, the EU can put pressure on other countries to avoid violating the rules. A larger, more dynamic and integrated single market strengthens the EU's negotiating position. At the same time, the EU should enter into new free trade agreements to reduce uncertainty and diversify its trade policy. In particular, it should finally conclude the agreement with the South American Mercosur countries, which has been under negotiation for over 25 years. Agreements with Australia and the modernisation of the agreement with Chile are also urgently needed. The EU should continue to discuss fair market access and the regulation of new technologies with the US.

One major obstacle to the conclusion of new agreements is the EU's increased sense of entitlement, for example in the area of environmental and social standards. Without appropriate concessions, particularly in the agricultural sector, negotiations, such as those currently underway with Mercosur, Australia and India, will stagnate. In addition, trade liberalisation in the EU is meeting with political resistance. Although studies show that existing agreements, such as those with Canada, South Korea or Japan, have not led to a lowering of standards or an influx of imports, populist forces are blocking new negotiations.

In order to strengthen the world trade system again, the EU must respond to justified criticism. Measures such as a border adjustment system for carbon emissions could balance out the competitive effects of different regulations. At the same time, retraining and social programmes are needed to cushion the impact of structural change. Well-designed supply chain legislation could minimise human rights and environmental abuses by trading partners without overburdening domestic business.

The EU must realistically recognise that its global influence has diminished. A pragmatic trade policy that concludes new agreements and addresses geopolitical risks is crucial to ensuring Europe's economic development and continued international importance. Otherwise, there is a risk of a gradual decoupling that jeopardises the EU's prosperity and strategic autonomy.

VIII. Conclusions

Among other things, the people expect the EU to contribute to prosperity and economic security, not weak economic growth and insecurity. If these expectations are not met, the risk of citizens turning their backs on the European integration project increases. Thus, the EU must continue to develop in a forward-looking manner to ensure economic security and prosperity. In concrete terms, this means:

1. The focus is squarely on the single market, the "crown jewel" of European integration. Deepening this further will mobilise economic growth, protect against global supply chain disruptions and serve as a strategic tool in a world of growing geopolitical risks.

2. A well-functioning single market requires robust infrastructure, especially in border regions, as well as reforms throughout the Schengen area to effectively protect external borders.

3. The EU must be able to expand the single market without necessarily extending the political union to include further countries. This would resolve the conflict between expansion and deepening. In view of current geopolitical challenges and the World Trade Organisation's crisis, additional trade agreements with third countries are essential.

4. At the same time, the EU should become a global leader in border adjustment systems to promote climate action, animal welfare and environmental protection in agriculture without weakening its own industry.

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Government debt in the European Union

by Prof. Dr. Dr. h.c. Clemens Fuest

I. Introduction: Stable public finances in the European Monetary Union

Since the establishment of the European Union's economic and monetary union (EMU), the stability of public finances and the question of the appropriate use of government debt as a fiscal policy instrument have been a central topic of discussion. One prerequisite for the acceptance of the monetary union project in Germany, as well as in other countries, was the political promise that the euro would be a stable currency, that the public finances of the member states would be managed soundly, that individual member states would not be able to shift their debts to other member states and that the monetary union would not become a transfer union. All citizens, but also family businesses in Germany and the other member states, depend on stable currencies and solid public finances as the basis for their economic activity. These promises have only been partially kept. When measured in terms of inflation rates, the euro is no less stable than comparable currencies. But member states limiting their debts and independently paying for the servicing of their sovereign debt did not pan out during the European debt crisis. This is partly due to flaws in the design of the EMU. It was foreseeable at the time of the EMU's establishment and many experts warned at an early stage that the EMU's policies would not be able to ensure compliance with the no-bailout clause (Fuest (1993)). During the COVID-19 pandemic, the EU again approved transfers to support highly indebted European states.

The European sovereign debt crisis of 2009 to 2015 showed that the EMU's policies were only fair-weather rules, and proved inadequate to maintain fiscal stability during the first major crisis. Extensive support programmes for heavily indebted member states and various institutional reforms have been proposed to solve the problems and address the instruments' weaknesses. In the next major crisis, when the COVID-19 pandemic broke out in 2020, the economic and financial stability of some EU member states was again at risk. In order to stabilise the situation, the decision was taken for the first time to use the Next Generation EU (NGEU) fund to take on common debt on a large scale at the European level and thus to finance substantial transfers in favour of the economically weaker member states.

This essay discusses the development of government debt in the Economic and Monetary Union of the European Union, and the state and current development of fiscal policy instruments at the European level. The rest of the essay is structured as follows: the next section discusses economic reasons for taking on government debt, as well as the costs and limits of government debt. The third section looks at the development of government debt in the eurozone, both in comparison to other groups of countries and internally, with a view to the different developments among the member states. Section 4 analyses the recent reform of the Stability and Growth Pact, the set of rules for surveillance and coordinating national fiscal policies. Section 5 focuses on debt at the EU level. Finally, the conclusions of the analysis are presented in Section 6.

II. Benefits, costs and limits of government debt

Government debt fulfils important economic functions. Under certain conditions, it makes sense for states to take on debt. However, this incurs costs and there are limits to public borrowing.[1] Both aspects must be taken into account in fiscal policy decisions and in the design of instruments such as rules for monitoring and coordinating debt policy.

1. Under what conditions does it make sense for governments to take on debt?

The most important reason for a government to take on debt is to stabilise the economy in times of crisis. If, for example, economic shocks result in a decline in aggregate demand, it can result in a destabilising spiral which causes the crisis to deepen. This risk arises when consumers or companies expect a further decline in demand or falling prices and therefore curb their own demand for goods or services, which intensifies the overall economic downturn. In this situation, credit-financed government stimulus can end the economic downturn.

Government borrowing can also help to stabilise a financial crisis, for example when investors' confidence in banks has been shaken to the core and they start withdrawing their deposits on a large scale. In this case, it may be sensible and necessary to support banks with state liquidity assistance. This can prevent the crisis from spiralling out of control due to bank collapses or a drastic reduction in lending.

A second function of government debt relates to the distribution of the benefits and costs of public investment over time. If the government uses funds today for public investment projects that will only yield some or most of their benefits in the future, then it makes sense to have future taxpayers contribute to the costs as well. This can be achieved by financing the investments at least partly through debt. This is linked to the "golden rule of government debt", according to which budget deficits are compatible with sustainable public finances if they do not exceed the increase in the net capital stock.[2] In this case, the state's assets remain constant. This rule does imply, however, that investments that merely offset the depreciation of the public capital stock should not be debt-financed.

The argument that future taxpayers should contribute to the costs of investments must, however, be seen in the context of the sustainability of public finances and the overall burden on future generations. The greater the burden weighs on future generations, for example as a result of the costs of pay-as-you-go social security systems, the less convincing the argument that they should share in the costs of today's public investments. At the same time, it is important to note that debt is not the only thing that can burden future generations; a failure to invest can as well.

Another justification for government debt is based on the argument of tax smoothing. In the event of a sudden and significant but temporary increase in government financing needs, it does not make sense to meet those needs by raising taxes by the same amount for the period of the increase in spending and then lowering them again afterwards. The reason for this is that the additional burden of taxation, i.e. the welfare losses caused by evasive reactions, increase disproportionately with growing tax burdens. It therefore makes sense to avoid major fluctuations in the tax burden over time and, in such a case, to increase tax rates moderately but for a longer period, and to bridge expenditure fluctuations temporarily by borrowing.

Government debt can also help to make capital markets more efficient, particularly if it leads to markets with

1 For the following, refer to Yared (2019), for example.

2 On sustainability indicators in fiscal policy, see the German Federal Ministry of Finance's Advisory Board (2001).

high liquidity and if government debt can be regarded as (nearly) risk-free investments (safe assets). In the case of this function, however, it is theoretically possible for the state to issue debt instruments and invest the funds in other assets. A positive gross debt would therefore be sufficient; net debt is not required.

2. Costs and limits of government debt

What is the cost of government debt? The direct costs of government debt arise from the fact that expanding the scope for financing today is offset by limited scope for financing in the future, primarily as a result of the interest that has to be paid on government debt. However, the costs may go beyond this. The costs of crowding out private-sector activity are a key factor. Debt-financed government spending leads to increased demand for goods. This raises the question of whether this demand can be easily met, or whether private-sector demand is being crowded out. If there is idle production capacity, for example in a crisis characterised by weak demand and high unemployment, the crowding-out effect is negligible. However, in times of full employment or when production capacities are fully utilised for other reasons, the crowding out of private demand is unavoidable. Crowding out also occurs when government borrowing drives up interest rates and private investment falls.

High government debt can also impair private sector activity due to debt overhang issues. If investors expect taxes to be raised or relevant public services to be cut in the future due to extremely high levels of government debt, they may decide against implementing projects.

What are the limits of government debt? Similar to private credit financing, the limits of government debt ultimately lie where creditors refuse to provide further credit. In the case of private debtors, there is the legal limit of over-indebtedness, which is reached when a company's debts exceed its assets. Private individuals are generally expected to repay debts incurred, for example, to purchase a residential property for their own use over the course of their working lives, because income often decreases upon retirement. Herein lies the difference from corporate or sovereign debt. The ability of companies and states to service debt is not limited by the cycle of a single working life. In this sense, government debt does not have to be repaid, only serviced or refinanced.

Occasionally, arguments are put forward that governments can incur almost unlimited debt because they can always raise taxes or resort to their central bank to service the debt. This is not a convincing argument, because whether taxes can be increased depends on political decisions. Furthermore, tax revenue can also fall if tax rates are increased so much that there is a strong tendency to evade them. Being indebted to its own central bank is possible in the case of states that have their own currency and a central bank that is willing or can be forced to finance their government. In this case, however, a conflict may arise between maintaining monetary stability and financing government spending. When this happens, the government's excessive debt is reflected in high inflation. So here too, there are limits to government debt. In the eurozone, the central bank is prohibited from financing government spending. However, the European Central Bank's acquisition of government bonds is creating a kind of grey area. The prohibition on financing government spending implies that government bonds may only be purchased for monetary policy reasons. Which purchases are part of monetary policy and which are not, on the other hand, is the subject of heated debate.

Another criterion often used to determine the limit of government debt is the fact that the government debt ratio, i.e. the ratio of government debt to economic output as measured by gross domestic product (GDP), should not rise permanently. This is also guaranteed without primary surpluses if nominal interest rates on government debt are not higher than nominal GDP growth. If government revenue is just enough to cover government expenditure excluding interest payments, then the national debt increases every year by the

amount of interest. If the interest rate equals the GDP growth rate, the interest-to-GDP ratio remains constant.

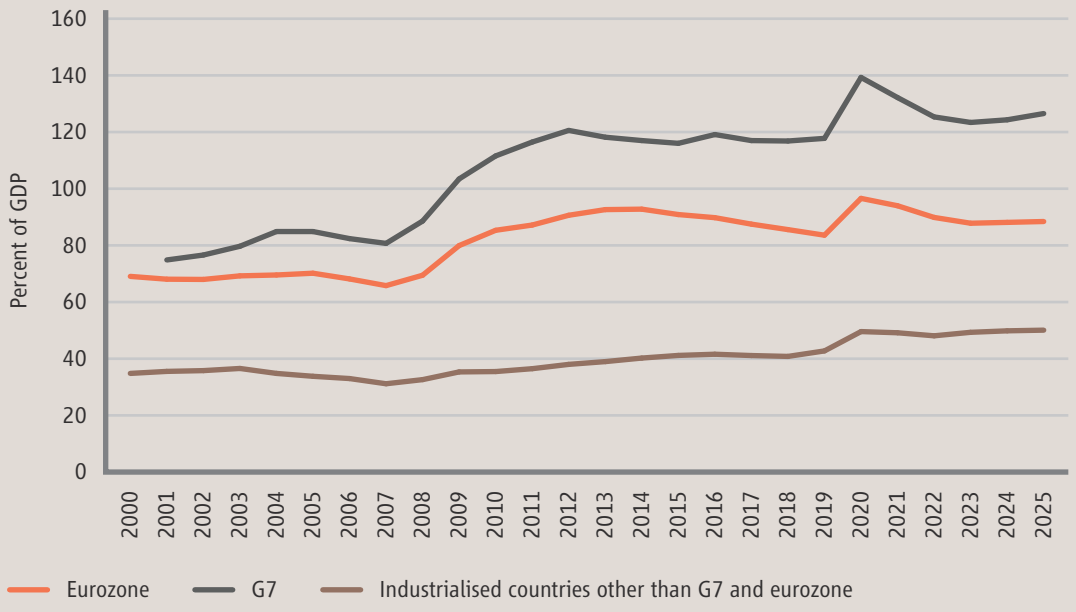
In the German debate on government debt, one argument that is often put forward is that Germany could take on more debt without the debt ratio increasing. However, this view tends to overlook one important fact: just because the government can incur more debt without the debt-to-GDP ratio rising or without shattering creditor confidence, it does not automatically mean that the benefits of higher government debt outweigh the costs. Instead, governments should take care to maintain a wide margin in normal economic times between debt levels and the levels at which creditors' confidence is undermined. Only then will there be enough leeway in crises to use government debt for stabilisation.

III. Development and status of government debt

1. Government debt in the eurozone versus other groups of countries

In many highly developed economies, government debt has increased in recent decades. This applies to the eurozone, but also to important countries outside Europe, especially the United States. Figure 1 shows the development of government debt in the euro area, the G7 countries and the developed economies that do not belong to one of these two groups. It is clear that debt ratios in the euro area and, to an even greater extent, in the G7 countries have risen sharply over the last 25 years. The increase was particularly pronounced during the global financial crisis of 2008–09 and the COVID-19 pandemic that hit in 2020. In particular, the increase in debt ratios during the global financial crisis was not reversed in the following years.

Figure 1: Government debt from 2000 to 2025

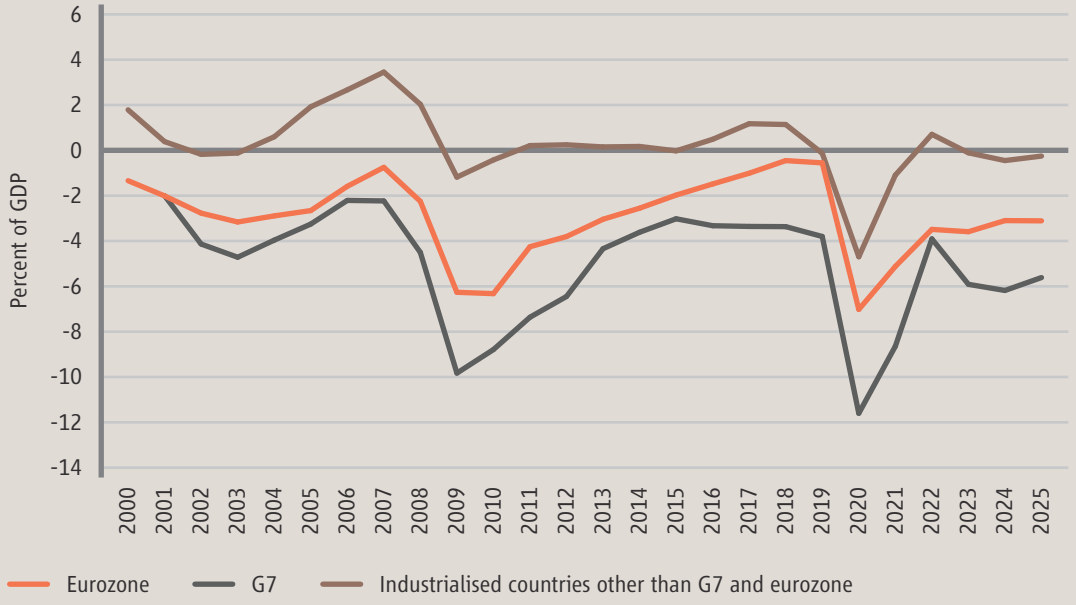


Source: IMF WEO October 2024, estimates from 2024. The group of industrialised countries other than the G7 and the eurozone consists of: Andorra, Australia, Czech Republic, Denmark, Hong Kong, Iceland, Israel, South Korea, Macao, New Zealand, Norway, Puerto Rico, San Marino, Singapore, Sweden, Switzerland and Taiwan.

The lasting increase in debt ratios cannot be justified by the economic functions of government debt explained in section 2. These functions can explain why government debt increases in times of crisis. In subsequent years, however, the debt ratios are expected to decrease again. The fact that debt continues to grow can be explained by economic policy arguments that point to deficiencies in political decision-making processes. Most notably, there appear to be incentives for key players in the political decision-making process to use borrowing to conceal the true level of public spending or to shift the burden onto future generations. This is an important reason why many countries are trying to limit government debt in the medium to long term by means of fiscal rules.

Figure 2 provides a supplementary overview of how budget deficits have changed over time. Government debt ratios can rise either because new debt is taken on in large measure or because GDP growth is low. This shows that higher new debt is an important factor behind the sharper increase in the debt ratios of the eurozone and the G7 countries.

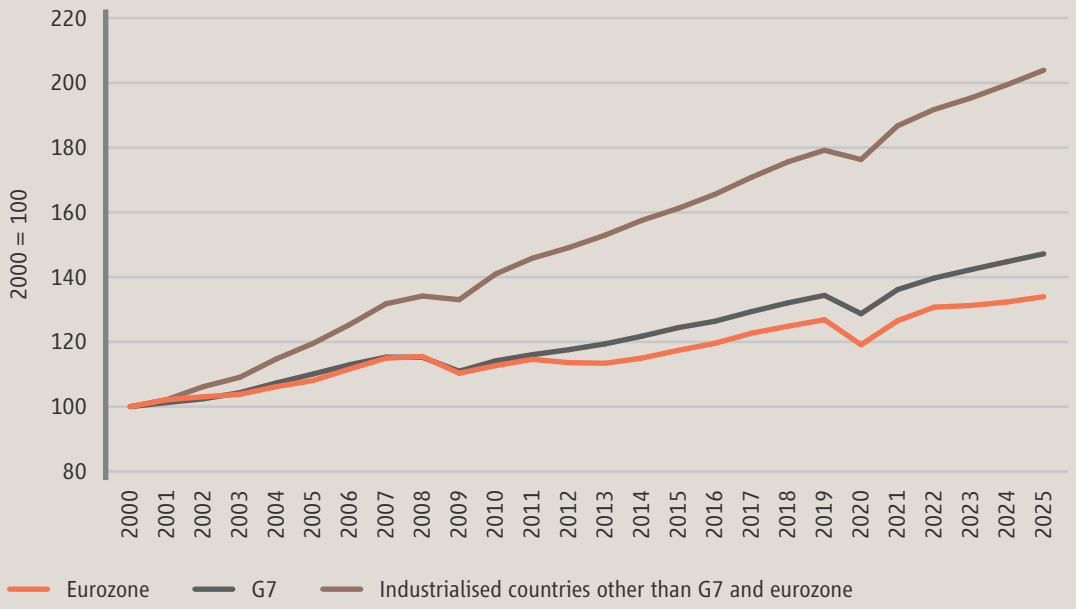
Figure 2: Ongoing government budget deficits



Source: IMF WEO October 2024, estimates from 2024.

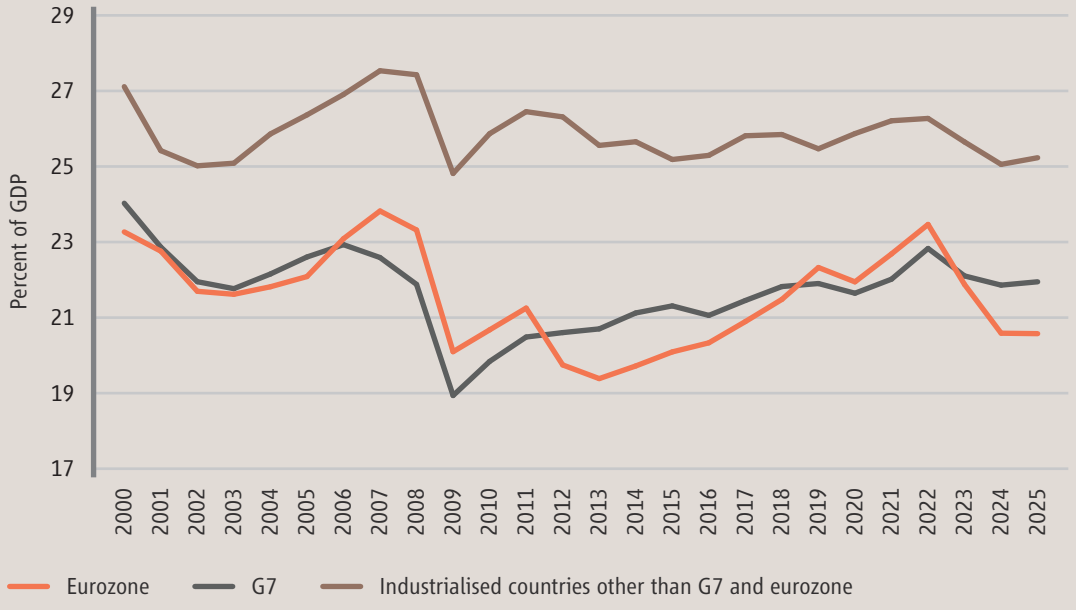
In this context, it should be noted that growth and budget deficits influence each other insofar as slumps in growth have consequences for budget balances simply due to the automatic stabilisers. In the case of permanent differences in growth rates, however, stabilisation policy can hardly account for different debt ratios. Given the current budget deficits, however, differences in growth rates mean that the debt ratios develop differently. Figure 3 shows how GDP has changed over time for the three groups of countries. Over the last 25 years, non-eurozone and non-G7 countries have grown significantly faster. In addition to the divergent budget deficits, this is an important additional reason for the different trajectories of the debt ratios.

Figure 3: Indexed GDP growth



Source: IMF WEO October 2024, estimates from 2024.

Figure 4: Investment



Source: IMF WEO October 2024, estimates from 2024.

In principle, it is also conceivable that different levels of investment explain divergent debt levels. This applies primarily to public investment, which will be examined in more detail below for some eurozone countries. However, in terms of total investment (see Fig. 4), the investment rates in the group outside the eurozone and the G7

group were significantly higher.

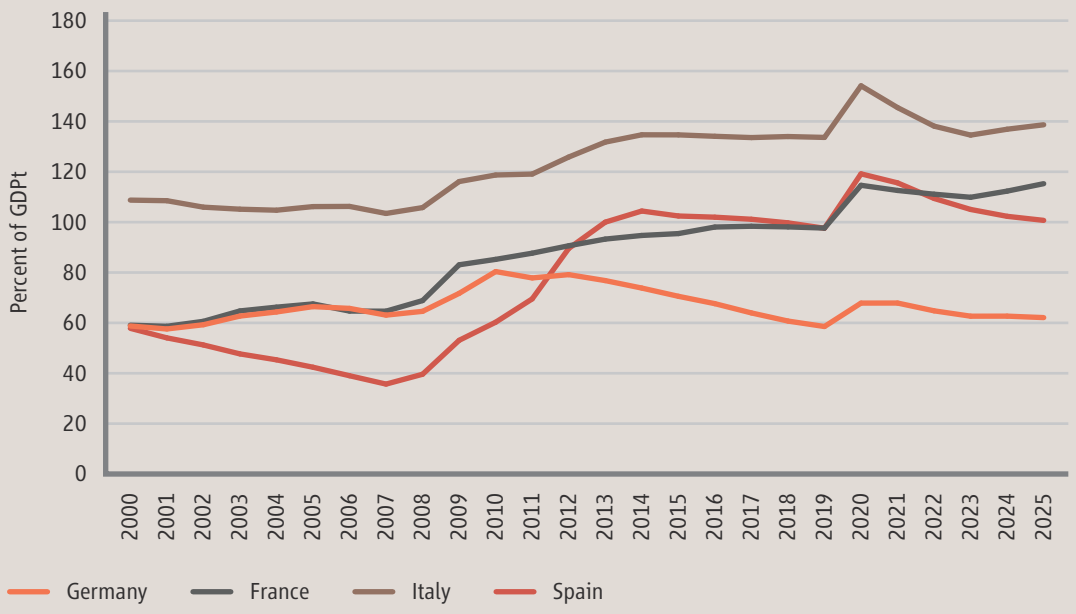
In this respect, the higher levels of government debt in the eurozone and the G7 cannot be justified or explained by the fact that public or private investment has been promoted or financed on a larger scale there.

2. Government debt in eurozone countries

The growth of government debt in the eurozone as a whole should be viewed in the context of the fact that individual EU member states are responsible for their own debt. The fact that excessive debt in individual member states can have serious consequences for the other members justifies the coordination and monitoring of national fiscal policies, but this does not alter the fact that decision-making power over fiscal policy lies at the national level.

Figure 5 shows how the debt ratios in the large EU countries of Germany, France, Italy and Spain have changed over time. At the time of the introduction of the euro in 2000, France, Spain and Germany had similar government debt ratios. They stood at 60 percent, in line with the upper limit agreed by governments as part of fiscal policy coordination. Italy was well above the limit, but was nevertheless accepted into the EMU for "political reasons". This was justified, among other reasons, by the fact that Italy had reduced its debt ratio by approximately ten percentage points in the five years prior to the crisis.

Figure 5: Government debt ratios in the eurozone



Source: IMF WEO October 2024, estimates from 2024.

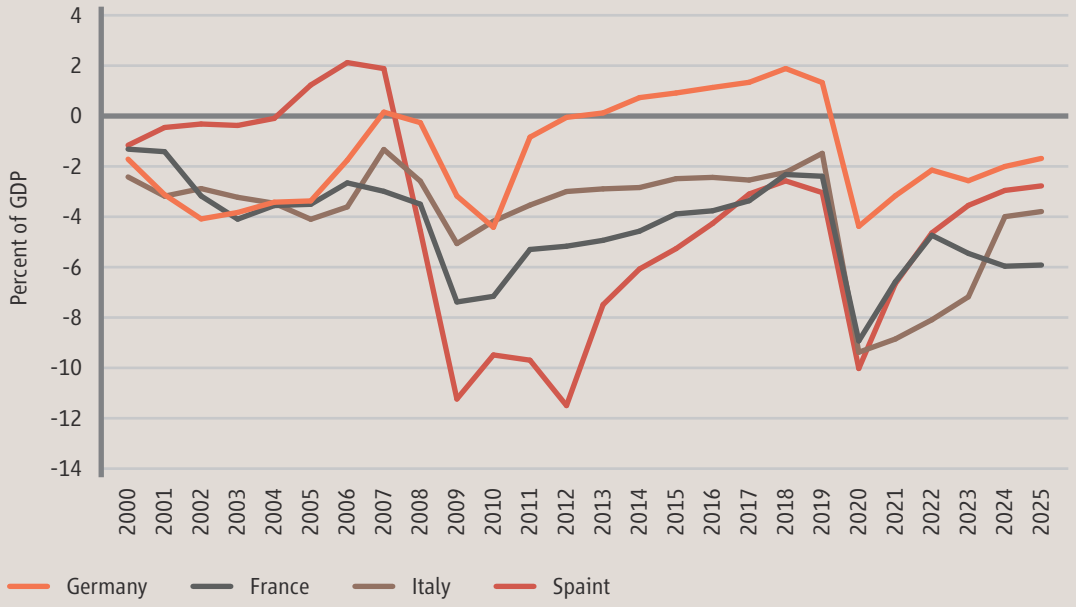
After the establishment of the EMU, government debt in many member states developed differently than hoped and intended. In Italy, the debt ratio's downward trend came to an end, although falling interest rates had opened up considerable additional financial leeway. The first massive increase in government debt then occurred in the context of the global financial crisis, which began in Spain in 2007 with the end of the real estate boom. Since then, however, the trend in government debt has diverged. While Germany managed to push the debt ratio back down following the financial crisis to roughly the level it was at at the inception of

the EMU, debt in the other member states continued to rise. This is why France, Italy and Spain were in a much weaker financial position at the outbreak of the COVID-19 pandemic than they were at the outbreak of the global financial crisis. In light of this, a decision was taken to try to avert a loss of confidence in the short-term financial stability of the highly indebted member states by jointly borrowing within the framework of the NGEU crisis fund, which ultimately proved successful. However, the need for this intervention showed that the coordination and supervision of fiscal policy in the eurozone has not achieved its objectives in its attempt to ensure the stability of national public finances.

Figure 6 shows how the budget balances of the eurozone countries considered here have changed over time. Between 2001 and 2005, the German budget deficit exceeded the agreed upper limit of 3 percent of GDP; this was also the case in France from 2002 to 2005. By jointly preventing the sanctions that should have been imposed from being carried out, the German and French governments effectively undermined the fiscal rules at the very beginning of the EMU. Despite exemplary public finances, Spain has been plunged into serious economic difficulties by the private debt crisis that erupted in 2007, triggered by the end of the real estate boom. Fiscal policy coordination and supervision in the eurozone was, and still is, not adequately prepared for such cases.

In Italy, budget deficits were higher than in Germany, but in most years lower than in France, especially in the years following the global financial crisis. The fact that the debt ratio did not fall despite this fact can be explained by the extremely low economic growth in the period under review. In the two decades following the turn of the millennium, the Italian economy was trapped in stagnation. More recently, the situation has improved, but this is at least partly due to the transfers from the EU's NGEU fund that the country is receiving. Whether the country's return to growth will last remains to be seen. What's remarkable about the developments in France is the dramatic deterioration in budget discipline of late. Deficits in the region of six percent are incompatible with the country's obligations under the European Stability and Growth Pact.

Figure 6: Budget balances in the eurozone

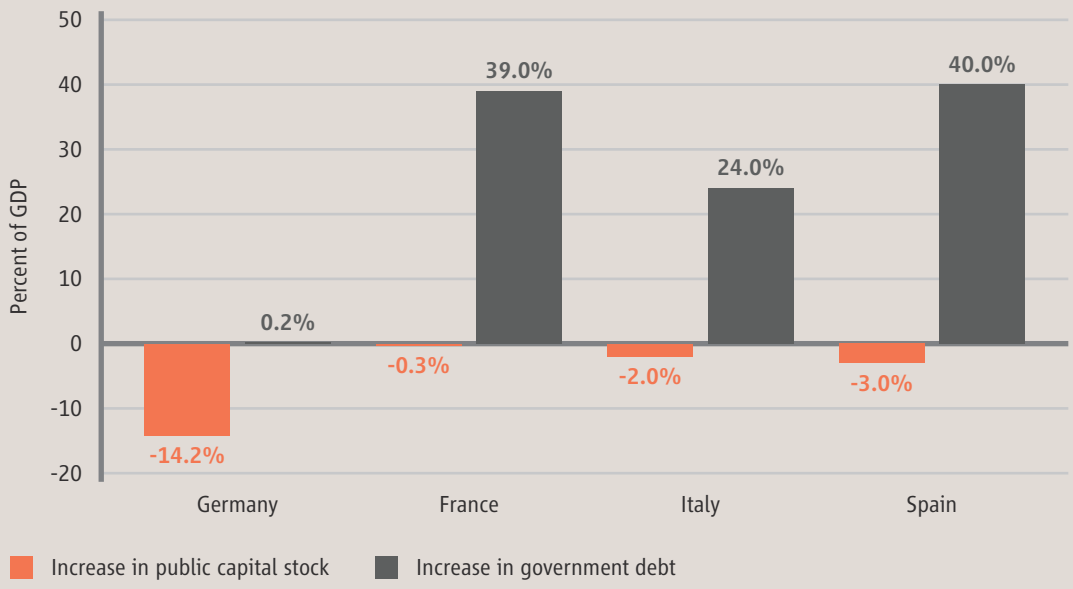


Source: IMF WEO October 2024, estimates from 2024.

Occasionally, there are also calls to allow higher government debt in Germany, as this would be the only way to finance the urgently needed public investments. But the low level of investment reflects the prioritisation of consumer spending in the political process, and it is unclear why even greater scope for borrowing would change this. A simple comparison of the development of debt and public capital stock in the four eurozone countries considered here reveals that more debt does not necessarily lead to higher investment.

Figure 7 shows how the debt ratios and public capital stock, measured as a percentage of GDP, changed over the period from 2000 to 2019 in each of the four countries. In Germany, the debt ratio remained stable and the capital stock shrank by roughly 15 percentage points. In France, Italy and Spain, the debt ratio increased by between 20 and 40 percentage points, but the funds did not flow into an increase in the public capital stock. In none of the countries did it rise as a percentage of GDP. The increase in government debt in these three countries was channelled entirely into consumption. One can certainly criticise Germany for pursuing an unsustainable policy on the expenditure side, in that the ratio of public capital stock to economic output has fallen. It may have been advantageous to increase public investment, even if it had been debt-financed. However, it is simply naive to think that if we just allow more debt, then public investment will follow, as the examples of Italy, France and Spain illustrate.

Figure 7: Public capital stock and government debt



Sources: IMF Investment and Capital Stock Dataset, 1960-2019. IMF WEO Oct 2024. Own calculations.

IV. The coordination and monitoring of fiscal policy in Europe and the reform of the Stability and Growth Pact

1. The Stability and Growth Pact and compliance with its rules

The Stability and Growth Pact (SGP) is the set of rules introduced to maintain stable public finances in the eurozone. It is used to monitor and coordinate national fiscal policies in the EU. In 1992, the Maastricht Treaty established the economic convergence criteria for joining the eurozone. It set targets for the development of various macroeconomic variables, including the inflation rate, interest rates and exchange rates. It also included upper limits for both the new borrowing and the government debt level of the accession candidates. The upper limit for the total debt level was set at 60 percent of GDP, and the limit for the annual deficit at 3 percent of GDP.

The SGP was established in 1997 to ensure sound public finances even after a country's accession. The purpose of the SGP was to ensure the permanent coordination and monitoring of the fiscal policies of EU member states. The "Maastricht criteria" of 60 percent for the government debt level and 3 percent for running deficits became part of the Stability and Growth Pact (SGP). These limits are, in principle, still in force today. Yet many member states were already in breach of these limits upon joining the EMU. Since the introduction of the euro, the limits have been frequently violated. Particularly when it comes to debt, many member states are well above the 60 percent mark; even Germany currently sits above this mark, albeit only slightly.[3]

The SGP is composed of two elements: the preventive arm and the corrective arm. The preventive arm (EU Regulation (EU) 2024/1263) is primarily designed to prevent excessive budget deficits from occurring in the first place. In the event that a member state does run up an excessive deficit, the corrective arm comes into play. Its legal basis is Regulation (EC) 1467/97. At the centre of this is the excessive deficit procedure. This procedure aims to help member states to correct excessive budget deficits or levels of debt, but it is also intended to exert a certain amount of political pressure. There is, however, no way to force the member states to change course.

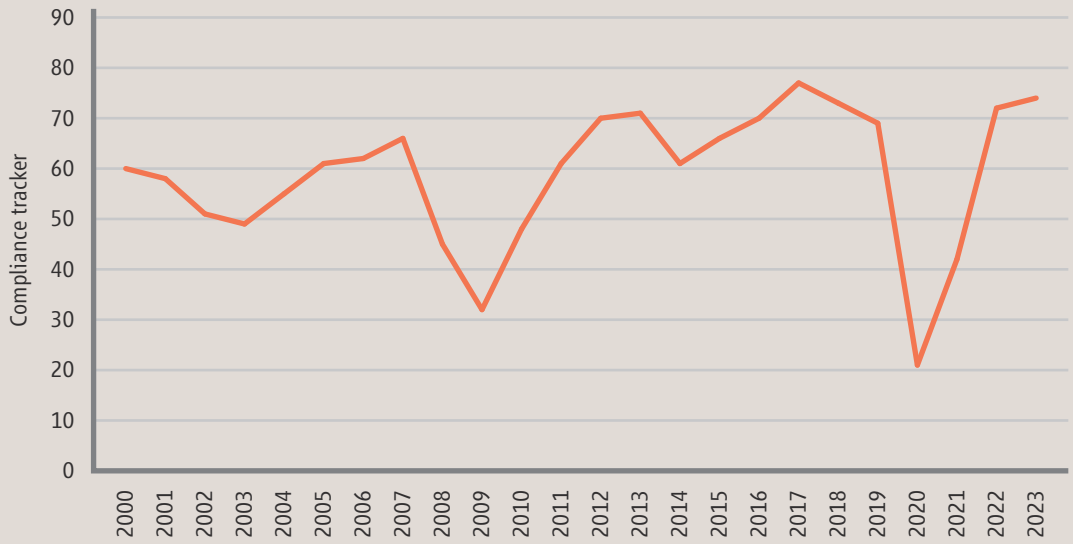
Compliance with the requirements of the SGP is the subject of ongoing debates between the member states and the European Commission. The experience with the Pact shows that while the SGP provides an important frame of reference, it does not change the fact that the decision-making power over fiscal and debt policy ultimately lies with the member states, and that they simply do not follow EU rules if they do not want to.[4] Figure 8 presents data on compliance with the SGP provided by the European Commission as part of its Compliance Tracker.

It shows that compliance with the requirements of the SGP is particularly weak in times of economic crisis. This suggests that the preventive arm of the SGP in particular is not having a sufficient effect. Measures to consolidate public finances must be implemented when the economy is doing well so as not to have a procyclical effect. The fact that this is not happening may explain why compliance with the SGP in economically worse times is so severely compromised.

3 Critics of the debt limits like to point out that there is no sound economic justification for capping the debt ratio at 60 percent or the deficit at 3 percent of GDP. That is true, but it applies to many political compromises of this kind.

4 This is discussed in detail in Becker and Fuest (2018).

Figure 8: Compliance with the SGP rules



The indicator analysed here achieves a value of 108 if the rules are fully complied with in all member states (27 member states, 4 criteria: budget deficit, debt level, structural deficit, expenditure) and a value of zero if all criteria are violated in all member states.

Source: European Commission, own calculations.

2. The latest reform of the SGP

The SGP has been reformed on various occasions, most recently in 2024.[5] In future, the focus of the preventive arm will be on the plans that the member states are obliged to present, outlining trends in the national budget, economic policy reform plans and investment targets over a period of four to five years. The multi-year planning horizon should make it possible to take into account developments that extend beyond the period of one year and entail fiscal risks. These include, for example, the impact of demographic change on the social security systems, which entail risks as regards the sustainability of public finances.

The requirements to be met when developing the national budget include, in particular, net expenditure paths with binding upper limits. The starting point for this calculation will be the net primary expenditure of the member state concerned. In future, this is to serve as the most important indicator for coordinating and monitoring fiscal policy. Net primary expenditure is the country's total government expenditure minus interest expenditure. Some adjustments to this figure will also be made. For example, expenditure on EU programmes will be excluded if it is fully financed by revenue from EU funds. National expenditure on the co-financing of EU programmes will also be excluded. The same goes for cyclical spending on unemployment benefits. Finally, the expenditure figure is also adjusted for one-off and other temporary measures as well as for discretionary revenue measures. For example, if a country reduces tax rates, the expected resulting shortfall in revenue is treated the same as an increase in expenditure.

Before the member states' plans are finalised, the European Commission will send the member states whose budget deficit exceeds the 3 percent limit or whose national debt exceeds the 60 percent of GDP limit a fiscal path for the country's net primary expenditure.

5 For the following, see German Federal Ministry of Finance (2024).

This will include adjustments to ensure the sustainability of the country's public finances. The fiscal path covers an adjustment period of four years. The member state may request an extension of the fiscal adjustment period up to a maximum of seven years, justifying it with reform and investment projects that in turn must fulfil certain criteria.

These criteria include the stipulations that the planned measures "promote growth and resilience, support the sustainability of public finances and address the country-specific recommendations from the European Semester as well as the common EU priorities."[6]

The expenditure paths are linked to the still relevant upper limits on the budget deficit and the debt level of 3 and 60 percent of GDP, respectively, as follows: During the adjustment period, the budget deficit must fall below the 3 percent threshold and be kept there. Furthermore, the debt ratio must be reduced or maintained at a level below the 60 percent threshold.

As regards the development of the debt ratio, it must fall by a minimum amount per annum during the consolidation period. This minimum amount corresponds to 1 percentage point of GDP when the debt ratio is above 90 percent. In the range between 60 and 90 percent of GDP, the minimum amount drops to 0.5 percentage points of GDP.

A further element is what has been termed the deficit resilience safeguard. Its aim is to prevent the deficit ceiling of 3 percent from being exceeded again in the next normal economic downturn. To ensure this, fiscal consolidation should continue until the budget deficit is well below the 3 percent limit in structural terms, i.e. 1.5 percent of GDP. The annual improvement in the structural primary balance required to achieve this target has also been defined: it should be 0.4 percentage points of GDP, or 0.25 percentage points if the adjustment period has been extended.

The corrective arm of the SGP has also been reformed, although the changes are less far-reaching. Procedures can be initiated and course corrections demanded because of a budget deficit or a level of debt that is too high. For the EU as a whole, as well as for individual member states, escape clauses can be activated in the event of severe economic downturns.

3. Economic assessment of the reform

The SGP reform attempts to incorporate various legitimate concerns into the SGP. The key role of an expenditure rule recognises that it is easier for a government to control primary spending than the deficit, which is a residual figure that can fluctuate, for example, if interest rates rise suddenly.[7] Furthermore, it is true that sustainable fiscal policy should take a medium-term view and factor in foreseeable risks as early as possible.

What is less convincing is the fact that, under the expenditure rule, expenditure by member states on the co-financing of EU programmes is not taken into account. Yet there is no reason to treat this expenditure differently from other government spending when it comes to ensuring the sustainability of public finances. This results in a shift of power in favour of the European Union, which is willing to accept an impairment of the SGP. The central function of the fiscal rules, namely to ensure sound public finances, is thus weakened.[8]

Furthermore, the considerable discretionary scope that the Pact provides is also problematic. The rules contain a large number of vague legal terms. There is considerable leeway for interpretation when assessing whether promised reforms and investments "promote growth and resilience", for example. One can easily imagine

6 German Federal Ministry of Finance (2024), p 10.

7 The proposal of an expenditure rule with this rationale can be found in various reform concepts for the eurozone, including Bénassy-Quéré et al. (2018).

8 See also Kronberger Kreis (2024).

that, in future, it will be even easier than before for member states that want to postpone consolidation indefinitely to actually do so.

Now, the counterargument to this is that the previous rules have already had little binding force. But the reform of the SGP was an opportunity to increase this binding force. Measures should have been included to improve the incentives for consolidation during periods of economic prosperity. At the same time, one shortcoming of the previous rules applicable to times of crisis was that, in the event of severe crises, debt limits were not simply extended, but instead removed altogether. In this case, it would have been possible to maintain a certain degree of coordination and monitoring of debt policies even in crises by adding corresponding levels to the escape clauses. Another missed opportunity was the chance to tighten fiscal policy discipline through the capital markets, for example by introducing capital adequacy requirements for government bond portfolios at banks or by introducing the concept of accountability bonds, i.e. the obligation to finance government debt in excess of agreed debt limits with subordinated bonds.[9]

V. New debts at the EU level?

In the EU, the instrument of government debt is, in principle, exclusively reserved for the individual member states. The EU itself has no legal basis to take on debt, and the EU budget must be balanced without incurring debt. In the past, there have been various exceptions to these principles, but their volume was quite limited (see Claeys et al. (2023)). This changed during the COVID-19 pandemic, when EU member states decided to take on EUR 429 billion in debt through 2027 to finance transfers to member states through the NGEU fund. There is further debt beyond this, however, which is passed on to the member states in the form of loans.[10]

Although NGEU was intended to be a one-off emergency measure, i.e. an exception that would confirm the rule of the prohibition of debt at the European level, there are increasing calls for new EU debt funds.

1. A new EU debt fund to boost competitiveness?

Among various proposals for new debt funds at the EU level, the proposal in the context of the report on the future of European competitiveness led by Mario Draghi (known as the Draghi report)[11] has received the most public attention. The report identifies three areas for action to increase the EU's economic competitiveness. The first of these is the EU's ability to innovate. The second area addresses the link between competitiveness and decarbonisation. The third area of focus is security and reducing economic dependencies. In all of these areas, substantial investments are deemed necessary. The report puts the amount needed at EUR 750 to 800 billion per annum. This corresponds to 4.4 to 4.7 percent of the EU's total GDP in 2023[12]. According to the report, a large proportion of this investment would come from the private sector, with the figure quoted as 4 percent of GDP. The remaining amount would come from the public sector. According to the analysis in the report, private capital costs would have to fall by around

9 For more on the concept of accountability bonds, see Fuest and Heinemann (2017). The proposal is part of the reform concept outlined in Bénassy-Quéré et al. (2018).

10 For an economic justification of NGEU, see Dorn and Fuest (2021).

11 See Draghi (2024).

12 See Draghi (2024), p. 59.

250 basis points for this private investment to take place. This would require appropriate state-financed incentives such as investment bonuses. Given a total private investment volume of EUR 680 billion, this would mean EUR 17 billion in investment grants in the first year, EUR 34 billion in the second year, and so on. Even if one were to hope that some of the reduction in financing costs would be realised through the creation of a European Capital Markets Union, the amounts involved are still high. What's more, they would come on top of the EUR 120 billion of public investment that the report calls for every year.

Over a period of seven years, these measures would result in additional public expenditure of EUR 1.316 trillion. Financing through EU debt would therefore require a fund whose volume exceeds that of the NGEU crisis fund of EUR 750 billion (in 2019 prices) by around 75 percent.

The call for a new EU debt fund was immediately rejected by member states such as Germany and the Netherlands. Mario Draghi himself has pointed out, however, that the financing through a new EU debt fund is not essential and, in his view, not necessary for the implementation of the recommendations in the report.[13] Without an EU debt fund, however, public investment and the promotion of private investment would have to be financed at the member state level. Germany accounts for approximately 25 percent of the EU's GDP. Accordingly, an additional EUR 30 billion of public investment would be required from Germany, along with an initial EUR 4.25 billion in grants to private investment, followed by an annual increase in these grants by the same amount.

2. Economic assessment

The establishment of a new EU debt fund, as called for or at least suggested in the report on competitiveness, is not in and of itself a suitable solution to the EU's economic problems, for a number of reasons. As the report convincingly shows, the EU's lack of competitiveness is not the result of a lack of investment. On the contrary, a lack of investment is itself a symptom of a lack of competitiveness and a lack of prospects for an improvement in the economic situation in Europe. The report describes a series of actions that would be needed to increase competitiveness, growth prospects and thus also the attractiveness of the EU as an investment location. Many of these actions do not cost any money initially. One example of this is the call to reduce reporting obligations by 25 percent for all companies, and implement a further reduction for small and medium-sized enterprises of up to 50 percent. This point is also particularly important to family businesses, as many of these are SMEs that are particularly affected by excessive bureaucracy.[14] In the event that a new debt fund is established, policymakers' attention would immediately focus on how the funds are used, as well as on conflicts over how the funds are distributed among the member states. Politically challenging issues such as reducing bureaucracy and other structural reforms would likely get pushed to the back burner.

To achieve a lasting improvement in the competitiveness of the EU member states, far-reaching structural reforms are needed that primarily require action at the member state level. The Draghi report (Draghi (2024)) emphasises the need to give more weight to the principle of subsidiarity. At the same time, it emphasises that it is important to create more European competences in areas where doing so will create added value – but only there. Examples of this include the defence industry and the management of critical dependencies, for example

13 "I have to say, as much as I love this concept, it is not the main thing in the report," the former ECB president said, adding, "There are many good reasons for having it, [but] it is not an essential ingredient." https://www.euractiv.com/section/economy-jobs/news/common-debt-not-essential-for-eu-competitiveness-says-draghi/

14 See also the Foundation for Family Businesses (2024).

in the supply of raw materials. The report also states that, in the area of investment, the key problem is not the quantity but the quality of the investments. This particularly applies to the important area of research and development (Fuest et al. (2024)).

What would be needed, then, is a process in which the EU, including the member states, agrees on a coherent strategy for improving its competitiveness. In this context, the focus must be on reforms at the level of the member states. The role of the EU level is to coordinate or take action where the actions of the member states lead to inefficiencies, for example because the policies in question have significant cross-border effects. Part of the concept developed in this way would also have to be rolling back EU legislation that proves to be unnecessary or counter-productive. This applies, among other things, to the area of reporting obligations that has gotten out of hand, but also to requirements that are substantively flawed, such as those in the Energy Efficiency Directive.

Any assessment of the need for new forms of EU-level financing must be based on a fully developed concept for improving competitiveness. If such needs arise, proportional debt financing should not be ruled out. However, the extent to which these needs can initially be covered by reallocating expenditure must be examined. Furthermore, member states must be prevented from failing to implement unpopular but necessary reforms and consolidation measures at the national level because debt at the EU level creates the leeway for such measures, thus absorbing national failures at the expense of other member states.

VI. Conclusions

The government debt of the eurozone's member states has been on a steady upward trajectory since the establishment of the EMU. The increase in debt occurs primarily in times of economic crisis. These increases are, to a certain extent, unavoidable, but the debt must be reduced in economically better times. This has not been the case.

Particularly those member states whose debt has reached extremely high levels are now a cause for concern. In addition to Italy, this includes France, which is currently running budget deficits of almost 6 percent of its gross domestic product, without an economic downturn that could justify such deficits.

The coordination and surveillance of national debt as part of the European Stability Pact has not been able to prevent a wide range of violations of the agreed rules. Furthermore, it was not possible to prevent many countries from exceeding the agreed maximum government debt levels by a long margin for a long time.

In the context of this analysis, the following recommendations can be made for the further development of fiscal policy instruments in Europe:

1. The latest reform of the Stability and Growth Pact has the advantage of taking into account multi-year fiscal developments, paying more attention to the role of expenditure trends and considering the interaction between economic policy reforms and debt trends. However, the rules have been amended to allow member states to run higher deficits when spending more on EU programmes. While this strengthens the political power of the EU institutions, it undermines the SGP's function of ensuring stable public finances. This should be rescinded.

2. Furthermore, the new rules contain a large number of exceptions and vague legal terms, meaning that the surveillance and coordination of fiscal policy in Europe is not expected to become more effective. Above all, there was missed opportunity to strengthen elements of market discipline. Proposals

for steps to increase market discipline without risking destabilisation have been put forward. In banking regulation, this includes the introduction of a capital adequacy requirement, at least for individual member states with concentrated portfolios of government bonds. Compliance with the rules of the SGP could also be significantly reinforced if subordinated bonds (accountability bonds) had to be issued for national debts that exceed the agreed ceilings. Their terms would include a provision that they would be cancelled if the issuing country were to run into financial difficulties and have to request the eurozone community for assistance under an ESM programme.

3. The current debate on the financing of new government spending through additional debt at the EU level is problematic. During the COVID-19 pandemic, the NGEU fund was used to take on government debt at the European level on a large scale for the first time. This was a sensible decision in order to stabilise a situation that was both acute and characterised by a high degree of uncertainty. However, it was agreed at the time that this should be a one-off measure. To some extent, such an agreement is inherently contradictory, because if you believe that such debt was helpful, then it is not credible to announce that you would not take the same course of action again.

4. Meanwhile, however, there are now repeated calls for further debt funds to be established for all kinds of purposes, including outside of acute crises. One example is the proposal for new EU debt that came out of the report on the future competitiveness of the EU (Draghi (2024)). There may well be urgent cases requiring urgent financing of European public goods, in which joint borrowing can be considered as an emergency solution if there is a risk of excessive delays without debt financing. One example would be extensive military aid for Ukraine to avert the country's defeat in its war with Russia. In principle, however, demands for new EU debt funds carry a great risk that the costs of failures of national economic and financial policy will be shifted to the community of member states and that necessary structural reforms will be put off or not implemented at all.

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Single market of freedom: Legal basis and new perspectives

by Prof. Dr. Dr. Udo Di Fabio

I. The integration of Europe with the powerful lever of the single market

At the beginning, the later political community of the European Union (EU) was designed as a defence community. After its failure, it was reborn as an economic community. From the ruins of the European Defence Community (EDC), vetoed by France in 1954, and the incomplete European Coal and Steel Community (ECSC), a European Economic Community (EEC) was formed under the Treaty of Rome, the centrepiece of which was the common market based on the four fundamental freedoms and a ban on discrimination.[1] The aim of this economic community was to create a single customs territory, a customs union,[2] [3] and a cross-border area in which goods, services, capital and labour should be able to move freely. But the common market was intended to be more than just a free trade area. The aim was to gradually remove the obstacles imposed by the member states and to reduce their protectionist political control through subsidies, aid and state-owned enterprises, or to control them jointly through a "high authority", through the Commission, on the basis of fair competition.

In European legal studies, this centrepiece of European integration was also seen as a convergence of ordoliberal concepts and a fundamental decision under primary law (the treaties).[4] A policy-oriented steering and planning authority such as the Commission was in line with French ideas of "planification" dating back to *Jean Monnet*.[5] The common market as an organisational framework for the development of market forces, as well as for the freedom to conduct a business, corresponded to German and Dutch ideas at a time when the social market economy was successfully establishing itself as a model, particularly in the young Federal Republic of Germany. In the wake of the economic boom in post-war Western Europe, free trade and the four fundamental freedoms were intended to strengthen market forces, but also to channel their dynamic energy and potential towards political integration. The idea was to increase prosperity through a knowledge-based system of market freedoms, which would reduce national differences and amplify common interests: prosperity as a clever technique of governance.[6]

Despite all the different notions of what this would ultimately entail, the one thing upon which everyone agreed was that there would be a functional convergence of markets. The hope was that this would provide a strong

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1 *Schorkopf, F.* (2023) *Die unentschiedene Macht: Verfassungsgeschichte der Europäischen Union [The undecided power: Constitutional history of the European Union]*, 1948–2007. p. 73; *Faig, H. D.* (2020) *Genealogie der Grundfreiheiten [Genealogy of fundamental freedoms]*. pp. 73 ff.

2 *Herrmann, C.* (2024) "Zur Bedeutung und Funktionsweise der Zollunion für den Binnenmarkt" ["On the importance and functioning of the customs union for the single market"], in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU*, 83rd edn, July 2024, TFEU Article 28, para. 9. *Issing, O.* (2022) "Der 1959 eingeleitete Prozess des innergemeinschaftlichen Zollabbaus war bereits 1968 abgeschlossen" ["The process of reducing customs duties within the community, which began in 1959, was completed by 1968"], in Hufeld, U. and Ohler, C. (eds.) *Europäische Wirtschafts- und Währungsunion* [*European Economic and Monetary Union*], section 1 (34).

3 *Schorkopf, F.* (2023) *Die unentschiedene Macht: Verfassungsgeschichte der Europäischen Union [The undecided power: Constitutional history of the European Union]*, 1948–2007. p. 78.

4 *Steinbach, A.* (2022) "Marktwirtschaft und Systementscheidungen im Recht der WWU" ["Market economy and system decisions in EMU law"], in Hufeld, U. and Ohler, C. (eds.) *Europäische Wirtschafts- und Währungsunion*, section 6 (10).

5 *Massé, P.* (1962) "La planification français", *Communication & Languages*, pp. 83 ff.; *Issing, O.* (2022) in Hufeld, U. and Ohler, C. (eds.) *Europäische Wirtschafts- und Währungsunion* [*European Economic and Monetary Union*], section 1 (43).

6 *Di Fabio, U.* (2022) "Die Selbstbehauptung Europas als Idee" ["The self-assertion of Europe as an idea"], in Di Fabio, U. (ed.) *Die Selbstbehauptung Europas* [*The self-assertion of Europe*], pp. 1, 3 f.

foundation for the desired political and cultural unification of Europe. Those who, like the European constitutionalists, had even fewer intentions of creating a true political union when the EEC was established in 1958, at least wanted to see this common market as a project for peace and democracy. This was because the new economic imbalances or customs barriers between Western European states emerging after 1945 would – it was feared – sooner or later result in a return of the old disastrous European power struggles and allow economic disparities or conflicting interests to develop into politically dangerous competition once more.

II. Political union and the single market

The economic community has long since become a political union on the threshold of nationhood, even if this threshold has not yet been crossed.[7] At its core, political union means expanding the area of economic competence in the direction of an overarching political entity.[8] Since the late 1980s, a common foreign policy, a common judicial and home affairs policy, the management of the asylum system, environmental and climate action, research and development, and socio-political initiatives have increasingly come to the fore and led to a change in priorities.[9] The Commission no longer based its legislative proposals solely on the removal of trade barriers within the single market, but also pursued independent policy objectives, including those that restricted economic freedom of movement and the freedom to conduct a business. In place of the member states, whose powers in terms of integration policy were severely curtailed, the Union itself now emerged as a decisive force for the common good in many cases. In the beginning, as with European standardisation, there was a strategy of harmonisation that involved business organisations and tried to win over trade and industry to the political goals of the EU through cautiously implemented legal acts.[10] Meanwhile, however, somewhat market-critical tendencies have also emerged within the EU's organisational system, as evidenced by its increased surveillance and political control ambitions. Furthermore, climate policy specifically has moved in an interventionist direction because fixed targets for reducing climate-damaging emissions have been adapted at the European level in the course of the global climate action process.

However, the initial seemingly ordoliberal model is still just as valid as a guiding principle as ever before, as evidenced by the wording of the treaties, and is more than just a mere undertone.[11] Article 3 of the Treaty on European Union establishes the social market economy as the basis for economic and constitutional law, as it were. The treaty governing how the EU operates ties economic policy to this model of the social market economy by means of Article 120 TFEU. This provision obliges the member states and the Union to act "in accordance with the principle of an open market economy

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7 Germany's Federal Constitutional Court does not yet regard the union of states as having a character *similar to that of a sovereign nation* according to the state of development of the Treaty of Lisbon, Federal Constitutional Court, *Official Digest* 123, 267 (para. 278).

8 On the motives discussed in the mid-1980s: *Nickel, D.* (1985) "Der Entwurf des Europäischen Parlaments für einen Vertrag zur Gründung der Europäischen Union" ["The European Parliament's draft Treaty on European Union"], *Integration*, 8, pp. 11 ff.

9 The corresponding ideas came from the meeting of the European Council on 28 June 1985 and were implemented in several reform steps via the Single European Act and the Treaty of Amsterdam up to the Treaty of Lisbon.
Schorkopf, F. (2023) *Die unentschiedene Macht: Verfassungsgeschichte der Europäischen Union [The undecided power: Constitutional history of the European Union]*, 1948–2007. p. 214 ff.

10 *Foundation for Family Businesses (ed.)* (2025): Implementative Steuerung als politische Lenkung der Unternehmerfreiheit – Eine verfassungsrechtliche Analyse am Beipsiel aktueller ESG-Regulierungen [Implementative Control as Political Steering of Entrepreneurial Freedom – A Constitutional Analysis Using Current ESG Regulations as an Example], Prof. Dr. Dr. Udo Di Fabio, München.

11 *Steinbach, A.* (2022) "Marktwirtschaft und Systementscheidungen im Recht der WWU" ["Market economy and system decisions in EMU law"], in Hufeld, U. and Ohler, C. (eds.) *Europäische Wirtschafts- und Währungsunion*, section 6 (11).

with free competition".

The subjective rights of economic actors have played an important role ever since the single market was created, especially within the dynamic development of integration. The fundamental freedoms have been placed in the hands of companies that produce goods, offer services and employ workers who engage in economic activity, and of investors who use capital or foreign exchange across borders, as a lever to fill the common market with life; this common market was then further developed into a single market precisely because of these fundamental freedoms. This lever was applied in the jurisdiction of the member states, which, through the submission procedure, allowed the European Court of Justice (ECJ) to become a driving force behind integration. In this way, the community project was repeatedly strengthened in the legally defined everyday life of the member states.

The fundamental freedoms became an instrument for creating a new institutional reality, but, at the same time, they were more than that. In the value system of both Germany's Basic Law and the European treaties, the individual is at the centre of the legal system and may never be made into a mere object or instrument of a collective plan. On the contrary, the individual must always be perceived and taken seriously as a subject in their own right, with their own value and independent claim to self-determination. In this respect, the fundamental freedoms have never served the functional unification of Europe alone, but always also fundamental self-determination in the economic sphere. The functionality of the market and the economic self-determination of the individual or a company are inextricably linked. If the economically autonomous freedom of individuals to act is reduced, the functionality of the market also suffers. If the market is distorted, either inherently or as a result of external influences, the institutional scope necessary for economic freedom to flourish is lost, both legally and in practice.

The relevant fundamental economic rights were initially only enshrined in the constitutional traditions common to the member states and in the European Convention on Human Rights (ECHR) and were only made binding upon the European Communities and later the European Union by way of adaptation. It was only with the Treaty of Lisbon that fundamental rights, and with them the economic freedoms enshrined in them, were given independent legal standing in the Union's primary law through the contractual implementation of the European Charter of Fundamental Rights.[12]

III. Fundamental freedoms and fundamental rights

Fundamental freedoms and fundamental economic rights currently coexist as primary law on an equal footing.[13] In Europe, the *fundamental freedoms* are the free movement of goods (Article 28 et seq. TFEU), the free movement of workers (Article 45 TFEU), freedom of establishment (Article 49 TFEU), freedom to provide services (Article 56 TFEU) and the free movement of capital (Article 64 TFEU). The *fundamental rights* of the freedom to conduct a business (Article 16 EU Charter) and the right to property (Article 17 EU Charter) point in the same protective direction. The fundamental freedoms can be understood as underpinned by fundamental rights, in the sense that they serve as a supporting structure:

12 *Rengeling, H.-W.* (2004) "Die wirtschaftsbezogenen Grundrechte in der Europäischen Grundrechtscharta" ["The fundamental economic rights in the European Charter of Fundamental Rights"], *DVBl*, pp. 453. *Wolff, D.* in Burgi, M. and Habersack, M. (eds.) *Handbuch Öffentliches Recht des Unternehmens*, section 6 (7 f) of the Protection of private-sector undertakings in European Union law (Schutz des privatwirtschaftlichen Unternehmens im Recht der Europäischen Union).

13 *Jarass, H. D.* (2013) "Zum Verhältnis von Grundrechtecharta und sonstigem Recht" ["On the relationship between the Charter of Fundamental Rights and other law"], *EuR*, pp. 29 (30).

"The activities covered by the individual fundamental freedoms are protected in relation to the Community and the member states by the fundamental economic rights (freedom of occupation, competition and trade) in the sense of a fundamental prohibition of restriction. The fundamental freedoms therefore have a constitutional underpinning that requires their interpretation to be in conformity with fundamental rights. This means that even non-discriminatory restrictions on the freedom to conduct a business are subject to the requirement of justification, which is consistent with the understanding of fundamental freedoms as general prohibitions on restriction."[14]

During the functional era of establishing the single market, the ECJ initially treated the fundamental freedoms as practically paramount – even in the event of a conflict with fundamental rights such as freedom of association and freedom of assembly. In its rulings on private-autonomous collective rules, the ECJ has already recognised, since the Walrave and Koch case, that EU citizens' rights of access to the market may not be overridden by non-state collective systems either. This was confirmed by the Bosman ruling and had a far-reaching effect[15], since in this case a collective system in professional football was declared inadmissible, which was aimed at preventing a (transnational) change of employer.[16] The weight of the fundamental freedoms, even when weighed against conflicting fundamental rights, is strengthened by the functional argument behind the objective of the single market. "The special nature of the fundamental freedoms to establish cross-border private autonomy arises from the overwhelming weight of the single market objective for all Community law in the competitive relationship between the two forms of guarantee."[17]

However, the functional primacy of the fundamental freedoms over fundamental rights was only so pronounced in case law as long as the member states (and the corporate associations operating within them) were still developing traditional national regulatory powers and were thus significant opponents of the completion of the single market. To the extent that the EU itself adopted an increasingly dense network of harmonising economic regulations, the fundamental freedoms were no longer seen as a legal lever for enforcing Community law against the member states. Today, there is likely to be consensus that the fundamental freedoms are reinforced by corresponding fundamental economic rights, while the fundamental freedoms do not take precedence over conflicting fundamental rights positions, and at the same time, conversely, fundamental social or participatory rights cannot claim precedence over fundamental economic rights:

"Neither do fundamental social rights take precedence over fundamental economic freedoms, nor do fundamental freedoms take precedence. Neither of the two guarantees – fundamental social rights, in particular the right to collective action, and freedom of establishing a business or providing services – overrides the other. In a social market economy (Article 3 III EUV), which is committed to competition and fundamental social rights, such as the European Union, this simply cannot be otherwise."[18]

Where a situation exists that requires a balancing of multiple interests, which is common in the doctrine of fundamental rights, the leverage of the fundamental freedoms also loses some of its force. The single market today no longer emerges more or less naturally from the application of anti-discrimination laws and

14 *Kluth, W.* (2022) in Calliess, C. and Ruffert, M. (eds.) *EUV/AEUV* [*TEU/TFEU*], 6th ed., TFEU Art. 57, para. 62.

15 CJEU (1995) *Bosman*, C-415/93, judgement of 15 December 1995; CJEU (2010) *Bernard*, C-325/08, judgement of 16 March 2010.

16 *Löwisch, M. and Rieble, V.* (2017) *Tarifvertragsgesetz* [*German Collective Labour Agreement Act*], 4th ed., section 1 TVG, (676). *Bachmann*, G., (2010) "On the conflict between national private law and the fundamental freedoms" ["Nationales Privatrecht im Spannungsfeld der Grundfreiheiten"], *AcP*, 210, pp. 465 ff.

17 *Ruffert, M.* (2024) in BeckOK German Basic Law, 59th ed., 15 September 2024, German Basic Law Art. 12, para. 6.

18 *Franzen, M.* (2024) in Franzen, M., Gallner, I. and Oetker, H. (eds.) *Kommentar zum europäischen Arbeitsrecht (EuArbRK)* [*Commentary on European Labour Law (EuArbRK)*], 5th ed., TFEU Art. 151, para. 40.

the preservation of the principle of undistorted competition,[19] but requires additional coherent policies that are geared towards open competition in a social market economy and counteract the tendency towards political interventionism and an increasing regulation of companies' freedom to conduct business.

IV. The single market between ordoliberalism and control

According to the legal definition in Article 26 TFEU, the internal market comprises an economic area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. The formula is that the internal market creates *internal freedom and external unity*. This is accompanied by a structural and investment policy that promotes competitiveness, as well as a common trade policy (Article 206, 207 TFEU).[20] However, the phrase "completing the single market"[21], which was successfully put into circulation by Commission President *Jaques Delors* in particular, has created the impression that the single market already exists, is an unalterable fact and therefore does not require any further action. Such a view does not correspond with reality when comparing large internal markets such as the US market, which features significant economies of scale, with the reality of the European market situation. This is well known in European legal scholarship:

"Nevertheless, it has long been recognised that the single market objective cannot be easily achieved, but that the establishment of the single market is an ongoing task."[22]

The previous understanding of the single market policy follows the allocation of competences under Article 114 TFEU and thus reacts "primarily to distortions of competition and comparable restrictions of market freedoms (hence the term: 'reactive legal harmonisation')".[23] When "completion" was mentioned, it was only in terms of four main areas where liberalisation, simplification and cost reduction should be carried out. The issues at stake were the elimination of border controls, technical standardisation and uniform market access rules, public procurement, and licensing restrictions on services, including the free movement of capital.[24] With the creation of a single currency area, it became clear – if it wasn't clear already – that the single market required a coordinated economic, labour market and social policy, which could hardly be managed in a satisfactory way in the heterogeneous environment of the Union, which had grown considerably in size.

It is precisely here that there is also a subtle but significant conceptual conflict between the French and German approaches to regulatory policy. The French view is more statist and influenced by industrial policy, while the German guiding principle was ordoliberal and more transatlantic. Within the monetary union, the euro crisis revealed how heavily the success of a single currency and political stability depended on the different national economies becoming competitive

19 *Issing, O.* (2022) in Hufeld, U. and Ohler, C. (eds.) *Europäische Wirtschafts- und Währungsunion* [*European Economic and Monetary Union*], section 1 (42).

20 *Terhechte, J. P.* (2024) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU* [*The Law of the European Union*], 83rd ed., July 2024, TEU Art. 3, para. 39.

21 *European Commission* (1989) *Report on the completion of the single market* ("Delors report"). Brussels: European Commission.

22 *Terhechte, J. P.* (2024) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU* [*The Law of the European Union*], 83rd ed., July 2024, TEU Art. 3, para. 38.

23 *Hess, B.* (2024) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU* [*The Law of the European Union*], 83rd ed., July 2024, Art. 81 TFEU, para. 10, with reference to EC], 5 October 2000, Case C-376/98, *Germany v. Parliament and Council*, ECR 2000 I-8419.

24 *Kühne, K.* (1989) "Chancen und Risiken der Vollendung des Binnenmarktes" ["Opportunities and risks of completing the single market"], *GMH*, 6, pp. 321 (328); https://library.fes.de/gmh/main/pdf-files/gmh/1989/1989-06-a-321.pdf

in international competition. Germany in particular felt that the crisis had vindicated its approach. After all, the country had originally regained lost ground in terms of international competitiveness by implementing reforms under the Agenda 2010 programme, and therefore saw the problems as lying mainly in the south of the European Union, but also in France. As long as Germany benefited from a favourable international environment, its strong middle class, the well-established network of industry, trade and services in co-operation with scientific and technical centres of excellence, and from globalisation in particular, it also seemed to hold the key to setting the agenda for the economic and fiscal policy coordination of European partner countries. But after the invasion of Ukraine and the virtual halt of Russian gas supplies to Germany, the threat of trade conflicts with the US, the significant decline in exports to China, combined with growing competition in the market as a supplier of mechanical engineering, automotive and chemical products, the EU's strongest economy is essentially standing before the ruins of an all too careless extrapolation of existing competitive advantages into the future.

Germany has strayed quite a distance from its original economic policy concept with the idea of an open and social market economy, as laid down in the European treaties, because it is relying more heavily on interventionism in the sense of state economic control, not only in the energy sector but also in other areas defined as important in terms of industrial or climate policy. The earlier deregulatory impact of the single market project has faded. Today, it is interpreted by many as a neo-liberal episode, basically as a political aberration, although it also always served as the actual functional engine of integration to prevent political and economic conglomerates of interests in the member states from hindering integration. In the current geopolitical situation, however, it is not only a matter of internal obstacles to integration, but also of the EU's self-assertion as an innovative, economically successful and internationally competitive region of the world.

In a statement on the Draghi report, Commission President *von der Leyen* formulated the following as a programme: "This is why we need to act on all the principal levers that are at our disposal: bringing down energy prices; mobilising public and private investment; improving the business environment; and cutting unnecessary red tape."[25] The report had just blamed a lack of competitiveness on the shortcomings of the single market:

"The clean tech sector is suffering from the same barriers to innovation, commercialisation and scaling up in Europe that afflict the digital sector: a total of 43 percent and 55 percent of medium and large companies, respectively, cite consistent regulation within the single market as the main way to foster commercialisation, while 43 percent of small companies identify lack of finance as an obstacle to growth. As in the digital sector, the lower capacity of EU clean tech companies to scale up leads to a gap between the EU and US in later-stage funding."[26]

"Scaling up" cannot simply be prescribed. A digital platform architecture with extensive data availability, international networks, artificial intelligence, private venture capital willing to take risks, a mobile and performance-motivated labour market, a legal system that is friendly to innovation and affordable energy costs are all conducive to achieving a large consumer base. Have the EU and Germany created the right conditions in this regard? Or are we faced with a long-standing patchwork of technological and economic ambition coupled with a lack of trust in the market and an all too paternalistic approach to setting targets, surveillance and documentation?

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25 Statement by President *von der Leyen* at the joint press conference with *Mario Draghi* on the report on the future of EU competitiveness, 9 September 2024, https://ec.europa.eu/commission/presscorner/api/files/document/print/en/statement_24_4601/STATEMENT_24_4601_EN.pdf

26 *Draghi, M.* (2024) *The Future of European Competitiveness, Part A: A Competitiveness Strategy for Europe*. September 2024, p. 46.

Germany, in particular, has so far failed to recognise the significance of the challenges posed the environmental transformation and the shifts in power caused by demographics, population changes and the new geopolitical landscape. In so doing, it relied excessively on the past performance of its strong medium-sized business sector, the high level of education and training of its workforce, and the traditional industrial core competencies that form a solid economic foundation and a healthy economic and fiscal base. Energy costs are high throughout the EU, and in Germany they are more than twice as high as in the United States. Labour costs, tax burdens and social security contributions are extremely high by international standards.[27] German energy policy seems to be just as ill-conceived – in terms of global competition – as the political decisions regarding the labour market and the sustainable development of the social security system. Regulatory requirements under EU law and additional or premature national regulations have created substantial bureaucratic burdens for companies, impacting their flexibility and ability to innovate. Confidence in the freedom to conduct a business and in the creative power of private initiative is dwindling, if not in favour of confidence in the steering power of political decisions, then at least in favour of a fatalistic attitude towards the necessity of political intervention in the face of signs of global neo-protectionism.

In this respect, one of the new EU Commission's tasks is precisely to develop a coherent concept for the further development of a competitive single market, one that is based on trust in the freedom to conduct a business and a change of direction in terms of regulation, while still taking into account the necessities of trade and climate policy. The Draghi report rightly assigns responsibility to the Commission for developing a strategy to simplify and promote an internationally competitive single market. It doesn't have to be labelled disruption, but it is a regulatory and political change of direction. The realisation of environmental and social goals is critically dependent on whether the ability to create value, especially industrial and digital value, develops successfully in Europe. Today, the single market is a project in which the freedom to conduct a business and the productive use of capital must benefit from a significantly improved political and legal framework.

V. Capital market

A functioning capital market is one of the cornerstones of a competitive single market that has been strengthened in an internationally changing environment. In the wake of the eurozone crisis, attention was focused on strengthening fiscal resilience and a capital markets union was seen, in part, as a mutually stabilising union in the banking sector or a common means of financing sovereign debt. However, in order to regain or establish the competitiveness of the single market, today it is crucial that private capital be mobilised for both investment and innovation. Here, too, regulation of the financial market to date has been largely reactive, focusing primarily on stability risks or consumer protection, or on compliance with convergence criteria.

"Particularly in response to the global financial crisis of 2007/2008, the EU has significantly expanded both the personnel dedicated to the regulation of its financial and capital markets as well as the scope of said regulation, with particular emphasis being placed on protecting individual property rights. On the one hand, this more developed legal sub-system of the EU aims to maintain the stability of the financial and capital markets, including safeguarding the capacity of the financial and capital markets to function. The latter includes protecting the ability of the market to fulfil

27 *Nettesheim, M.* (2022) "Selbstbehauptung der EU durch Schutz des impliziten sozialen Kontrakts" ["The EU's self-assertion through protection of the implicit social contract"], in Di Fabio, U. (ed.) *Die Selbstbehauptung Europas* [*The self-assertion of Europe*], pp. 23 (42 n. 44).

its allocative, institutional and operational functions. Furthermore, this regulation aims to protect the EU's economic and competitive order, given the importance of the regulated stakeholders in an open market economy with free competition. Thirdly, regulation aims to maintain the member states' long-term capacity to take action, including compliance with the convergence criteria of the Economic and Monetary Union (EMU), by avoiding further bailouts in favour of financial market stakeholders deemed to be systemically important. Finally, regulation is increasingly aimed at protecting customers, particularly in the form of investor, depositor, saver and consumer protection."[28]

The observation is correct that European lawmakers use equality rules, specifically in the form of discrimination bans, to control and limit the economic power of financial market players by balancing the interests of various stakeholders.[29] However, in view of the immense shifts in both digital and industrial value creation in the international economic landscape, such protective measures have not been able to keep pace with the new challenges. The aim is not so much to curb the market power of European financial market players as it is to strengthen it and to promote venture and investment capital, either from the resources within the single market or to make non-European investments in the single market lucrative.

The European Commission's proposals for an EU-wide legal framework governing cryptocurrency assets and the action plan for the completion of the capital markets union[30] do not sufficiently address the new mobilisation objectives of promoting investment. The EU taxonomy, which is motivated by climate and social policy, is designed to be reactive rather than suitable for quickly and unbureaucratically providing a sufficient volume of investment capital throughout Europe. It is quite telling that the taxonomy primarily focuses on new reporting obligations.[31]

VI. Completing and revitalising the single market

The approaches taken so far to restore a dynamic and internationally competitive single market have fallen short in a number of areas. A new commission will have to follow in the footsteps of Jacques Delors here, with a much larger task in view of the new challenges that have arisen. A leading representative of European legal studies such as *Martin Nettesheim* has called for a "return to the essentials" and reminded us that democratic systems are based on an "implicit social contract": they owe their existence and stability to the fulfilment of a promise to their citizens "to enable a good life in a (prosperity-securing) market".[32] The unprecedented success story of European integration is based on the conviction that democracy and peace cannot be achieved without an open and social market economy and that a modern democracy has never existed without a market. Democratic decision-making, the legitimacy of state power and economic prosperity are interdependent. This leads to the demand that the real mission as regards the creation of a European single market is not to mistrust

28 *Ukrow, J. and Ress, G.* (2024) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU* [*The Law of the European Union*], 83rd ed., July 2024, TFEU Art. 63, para. 424.

29 *Ukrow, J. and Ress, G.* (2024) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der EU* [*The Law of the European Union*], 83rd ed., July 2024, TFEU Art. 63, para. 426.

30 *Schmidt, J.* (2020) "Capital markets union: CMU Action Plan II & crypto assets", *EuZW*, pp. 828.

31 *Pföhler, M.* (2024) "Die Nachhaltigkeitsberichterstattung nach der EU-Taxonomie und nach den Vorgaben von CSRD und ESRS" ["Sustainability reporting in accordance with the EU taxonomy and the CSRD and ESRS guidelines"], *WPg*, pp. 1052 ff.

32 *Nettesheim, M.* (2022) "Selbstbehauptung der EU durch Schutz des impliziten sozialen Kontrakts" ["The EU's self-assertion through protection of the implicit social contract"], in Di Fabio, U. (ed.) *Die Selbstbehauptung Europas* [*The self-assertion of Europe*], pp. 23 (37).

the market, but to maintain the "grand bargain".[33] Democratic rule and markets represent two different, but complementary, intertwined democratic processes. The European single market must be internationally competitive, promote innovation and value creation, and encourage and reward entrepreneurial initiative. At the same time, it must be open, offering fair opportunities to every market participant as an employee, consumer or entrepreneur, and must be inclusive, not dominated by oligopolies or monopolies or distorted by excessive state intervention.

1. The European Commission, with its legislative initiative, the European Parliament and the Council are called upon to revitalise the single market as the centrepiece of integration and as a functional expression of the implicit social contract. The purpose of this is to protect the ability of the member states' democracies to function and to make the European social model strong and successful in a global environment that is becoming increasingly robust.

2. Strong signals are needed to switch from mistrust to trust, and to decisively reduce bureaucracy in economic and social life.

3. Economic rights and freedoms deserve to be strengthened, because added value grows out of professional and market freedom, while excessive state intervention leads to higher costs and weakens the power of initiative.

4. Where the economic structures of member states are (still) strong in terms of international competition, they need more regulatory consideration and protection. Where they need to become stronger, they also require intelligent support, in particular in the form of incentives for private investment.

5. The stability of the eurozone depends on limiting government debt and on enabling a strong European capital market geared towards investment in growth-generating companies.

6. The completion of the single market is far from being a reality in either the energy supply or electricity generation sectors. Similar to the armed forces' defence needs, there is a considerable need for coordination and investment here.

7. It is the responsibility of the new EU Commission to incorporate the necessities of trade and climate policy into a coherent concept for the further development of a competitive single market. A much-needed regulatory change of direction can only succeed if there is more trust in the value-adding power of entrepreneurial and private autonomy.

33 *Nettesheim, M.* (2022) "Selbstbehauptung der EU durch Schutz des impliziten sozialen Kontrakts" ["The EU's self-assertion through protection of the implicit social contract"], in Di Fabio, U. (ed.) *Die Selbstbehauptung Europas* [*The self-assertion of Europe*], pp. 23 (41).

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German energy policy: Out of balance and out of control[1]

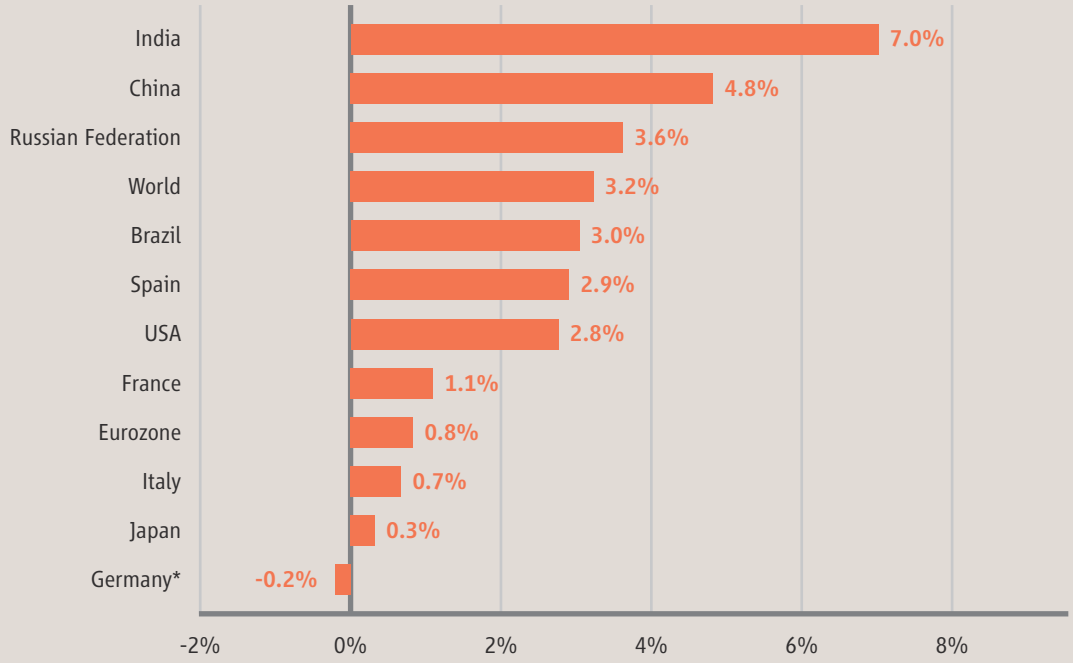
by Prof. em. Dr. Dr. h.c. mult. Hans-Werner Sinn

I. Germany: Back of the pack

Germany is doing poorly. The many factory closures and the crisis in the industrial and construction sectors have generally spread uncertainty as to whether the current economic policy was the right course. What went wrong, what needs to be changed and what can be changed? This essay argues that a number of bad decisions have been made, particularly in climate and energy policy, and that these urgently need to be corrected.

Some politicians are still arguing that Germany's economic problems are only temporary and will soon blow over. But the problems run much deeper. The crisis gripping the country is not just cyclical in nature, but has structural causes that are dragging down Germany's economy more so than those of other countries.

Figure 1: Comparison of real GDP growth rates in 2024



*According to Germany's Federal Statistical Office, gross domestic product fell by 0.2 percent in 2024. All other figures shown are IMF forecasts prepared later in the year.

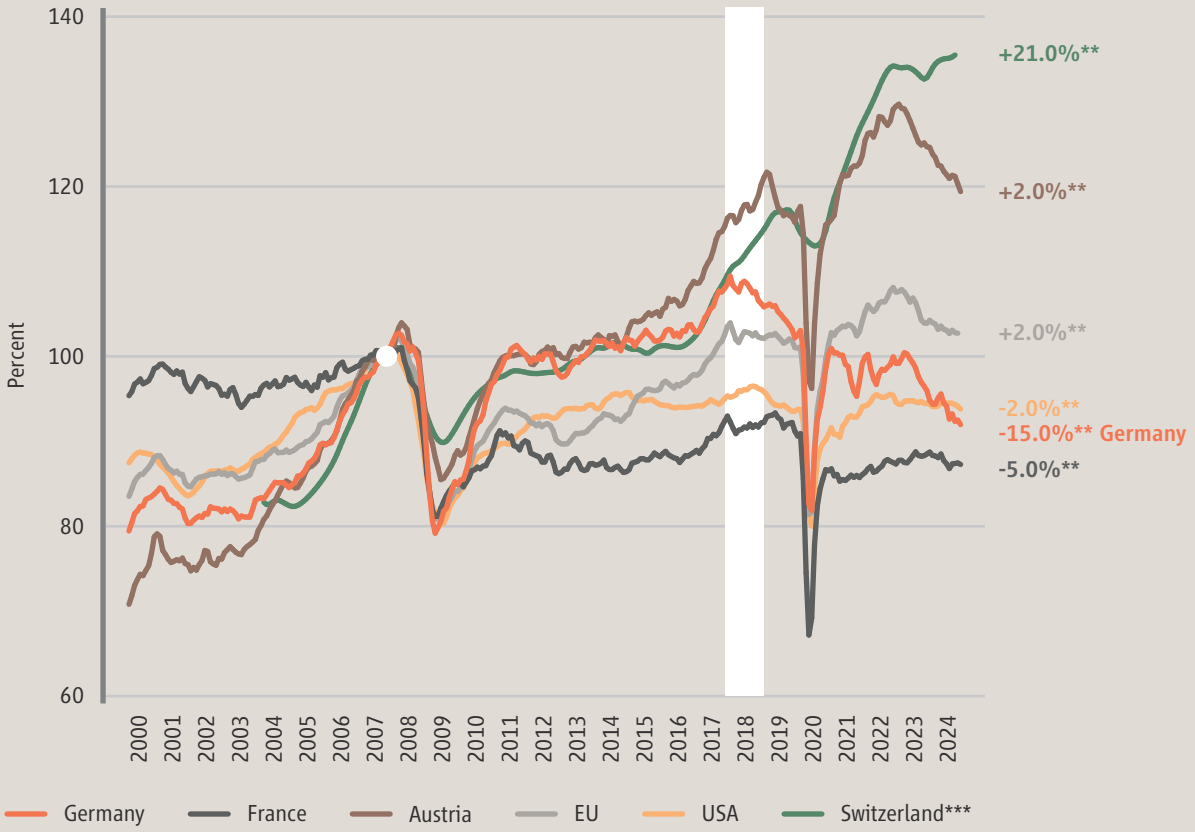
Sources: IMF (2024), German Federal Statistical Office (2025).

1 This article is based on a large number of research papers and lectures by the author since his monograph *The green paradox* (Sinn, 2008) and further expands on them: Essay in EER entitled "Buffering Volatility" on calculating possible storage solutions (Sinn, 2017); Christmas lectures at LMU Munich (Sinn, 2013 and 2019) entitled "Energy transition to nowhere" and "How do we save the climate and how not?"; lecture at the University of Osnabrück (Sinn, 2024a) entitled "The German crisis and the necessary revision of European climate policy"; lecture at the University of Lucerne (Sinn, 2023b) entitled "Extremism in energy policy based on the example of Germany and the EU"; and his article in the *Frankfurter Allgemeine Zeitung* entitled "Wir Geisterfahrer" ["Us wrong-way drivers"] (Sinn, 2024b). The author would like to thank Anja Hülsewig for her expert support in researching the literature and creating the graphics.

As was the case at the time of the reforms introduced by the Schröder government twenty years ago, Germany is at the back of the pack in terms of international growth. This can be seen in Figure 1, which shows the growth in real gross domestic product in 2024 for a selected group of countries. While other countries of importance to Germany grew, Germany shrank by 0.2 percent.[2]

Needless to say, the list of countries shown in the diagram is not exhaustive. It also only covers one year. However, little changes when other OECD countries are included or when a longer period is considered. Such extended comparisons show that Germany's growth trend started to decline in 2018. Even then, Germany had decoupled itself from the international supply train. Measured by the extent and depth of the downturn, the crisis is the most severe in post-war German history, aside from the steady decline of the GDR.

Figure 2: Production in the manufacturing industry, index curves (Q3/2007 = 100, through November 2024)*



*Manufacture of food products and animal feeds, manufacture of chemical and pharmaceutical products, metal production and processing, manufacture of data processing equipment, electronic and optical products, mechanical engineering, manufacture of motor vehicles and motor vehicle parts. **The percentages at the end of the curves are calculated from 2018 onwards, as described in Table 1 below. ***Until September 2024.

Source: "Christmas lectures" by the author since 2019, available in the form of YouTube videos, prepared from data from Eurostat and national statistics offices. A list can be found at: https://www.hanswernersinn.de/de/politik/weihnachtsvorlesungen.

2 See German Federal Statistical Office (2025).

Germany's decoupling is particularly evident in industrial production, specifically the decline in manufacturing output, as shown in Figure 2. The figure shows index curves of real production volumes in various countries, in which all values are normalised so that they correspond to 100 in the third quarter of 2007, one year before the bankruptcy of Lehman Brothers and the ensuing 2008 financial crisis. It shows the growth of production over time, but not the absolute level, which is irrelevant when comparing countries of different sizes.

The collapse of Lehman Brothers in 2008 and the start of the COVID-19 crisis in 2020 are both clearly visible. What is remarkable is that although Germany was able to recover from the 2008 financial crisis faster than many other countries and catch up with the EU average by 2018, things went downhill from there. Obviously, 2018 was the turning point. Compared to most of the European countries shown, but also to the United States, German industry lost ground. At the same time, as is clearly evident, the US itself had considerable problems getting back on its feet in the years following the global financial crisis, which was one of the reasons for Donald Trump's electoral success.

A comparison with Germany's German-speaking neighbours, Austria and Switzerland, is also alarming, because while Germany's own industries were shrinking, those of these countries grew strongly for quite some time. Austria is only just faltering a little at present. Meanwhile, Switzerland is jumping from one production record to the next, although one would think that the massive appreciation of the Swiss franc in recent years should have hit the country hard.

Of the countries in question, only France has apparently had more serious problems than Germany so far. For decades, French industry had been shrinking in comparison to other sectors because France had always indulged in state-controlled mercantilism, which has not worked at all. Its performance since the 2008 financial crisis has also been extremely disappointing. In this context, it should be emphasised once again that the diagram does not show the absolute levels of production, but only the relative change since the third quarter of 2007, meaning that everything is artificially equated because of this indexing. In fact, the value added by French industry relative to total economic output in France is only half that of Germany.

Now, there are some people who say that industry is not important in today's world; that growth in other sectors of the economy could compensate for the decline in industry. But anyone who puts forward this argument fails to recognise the central role that internationally traded industrial goods play in a country's prosperity compared to its domestic goods. Because industrial goods face global competition and have to hold their own in terms of wages, productivity and product quality, industry defines the real wage level to which domestic sectors ultimately have to and are able to adapt. The productivity and competitiveness of industry therefore also largely explain the standard of living of those sections of the population who are employed in domestic sectors. Again, this standard of living depends largely on how many imported goods, from tourism to mobile phones to bananas, an economy can acquire in exchange for its export goods. In economics, this correlation is used in what is known as the Balassa-Samuelson effect to explain the persistent increase in the prices of domestic goods in relation to export goods.[3] The leading role of industrial goods as a factor in the development of prosperity also applies, in turn, to other goods, such as software products, which are defined as services but are nevertheless traded internationally. But it does not apply to household services or construction services, which have to contend with ever-increasing wages that are defined elsewhere. In this sense, the decline in German industrial production, as shown in Figure 2, is a highly problematic event for the prosperity of the German population.

3 According to Balassa (1964); Samuelson (1964). See also Sinn and Reutter (2000).

The sectors that explain the decline in industrial production are shown in Table 1 below, which presents the growth rates of the individual sectors from 2018 to the most recent data in November 2024. It is clearly evident that the minus signs are piling up. Particularly important sectors for Germany are the automotive industry, the chemical industry and mechanical engineering. Production in these sectors has fallen by 18 to 22 percent. But other sectors appear to be in a similarly dire state. The data processing equipment, electronic products and optical products sectors, however, have fared better.

Table 1: Growth or decline in production in selected sectors from 2018 to November 2024

	Production
Data processing equipment, electronic products and optical products	+6%
Electrical equipment	-19%
Pharmaceutical industry	-14%
Machines and equipment	-18%
Metal industry	-19%
Automotive industry	-20%
Chemical industry	-22%

Note 1: Calculation based on monthly data as three-month moving averages to eliminate the random nature of monthly fluctuations. The initial value used to calculate the percentage corresponds to the average monthly production in 2018. The final value is the average value for the months of September, October and November 2024.

Note 2: Experts occasionally point out that the official figures for real value added suggest a less problematic trend than real production itself. However, this is an artefact resulting from the deflation of companies' intermediate inputs using a different price index than that used for turnover. It does not make sense to calculate a difference between real quantities deflated with different price indices, however, because the percentage change of this difference depends on the arbitrarily chosen base period for these price indices. Moreover, it is both unusual and misleading to eliminate relative price changes from the calculation of real variables through deflation. In fact, recent years have seen not only a collapse in companies' real turnover but also a deterioration in margins, as intermediate inputs have become relatively more expensive than the products sold. This disadvantage is obscured by using a separate price index for intermediate inputs. If all components of nominal value-added – turnover and intermediate inputs – are deflated using the same price index (for example, the producer price index), the percentage change in real value-added from 2018 to the current period closely mirrors that of real production. In this case, two effects applicable to imported intermediate inputs offset each other: their relative price increase and the substitution of imports by domestic products.

Source: Eurostat (2025a).

The much-discussed de-industrialisation is therefore not just a future doomsday scenario, but has already been in full swing for seven years. The announcements of lay-offs in industry, which are currently flooding the newspapers, are real phenomena explained by the dramatic declines in industrial production.

II. The politically driven de-industrialisation of Europe and Germany

So, what are the reasons for this de-industrialisation? One explanation, of course, is the disruption of trade with Russia due to the war, and in particular the interruption of energy supplies. And the demographic distortions resulting from the low birth rate among Germans are contributing to the crisis just as much as the ever-worsening standards of education among young people, as documented by the PISA studies. The expensive expansion of the welfare state is one of the explanations, as is the fact that the welfare state acts as a powerful competitor to the private economy in the labour markets.

Since the crisis is concentrated in the metal-processing industry, including the automotive industry, and in the chemical industry, the view must be directed primarily to climate and energy policy, because at its core this is a policy that deprives the economy of energy and prohibits profitable production in a market economy. The bans apply not only to Germany, but are also partly based on requirements set by the EU, which, with its Green Deal, wants to present itself as spearheading the global fight against climate change.[4] This is the list of restrictions and production bans that have been imposed on the economies of the EU:

- From 2018: Formula for calculating carbon emissions from manufacturers' vehicle fleets became much stricter
- 2019 Green Deal: phase out combustion engines by 2035
- 2019: ESG legislation[5]
- 2023 Energy Efficiency Act: 45 percent reduction in energy consumption from 2008 to 2045
- From 2024: Ban on oil heating following the creation of municipal heating plans
- From 2035: "Combustion engine ban"
- 2030 to 2038: Coal phase-out
- Natural gas phase-out by 2045
- 2024: Green Paper on the dismantling and conversion of gas networks

Much of what was decided concerns restrictions on the consumption of fossil fuels and can therefore be explained by the hope of avoiding or at least reducing global warming due to the growing concentration of carbon dioxide in the atmosphere. However, not all of the measures can be explained in this way.

The ESG legislation, for example, is a planned economy hodgepodge of reporting obligations for monitoring and evaluating a company's ethical, social and environmentally relevant activities, as well as those of all its domestic and foreign suppliers. These obligations are only partly related to issues of environmental sustainability, but they do impose significant restrictions on companies.[6] From an economic point of view, this is a control element of a centrally planned economy that stands in stark contradiction to the systemic rules of the market economy and can significantly disrupt the European and German economy, to the point of companies completely leaving the area. The elimination of this legislation without replacement should be considered.

Germany's Energy Efficiency Act adopted in 2023 is also particularly noteworthy.[7] Contrary to what one might initially think given the many explicit references to climate change in the wording of the law, it is not limited to reducing the use of "dirty" fossil fuels. In the decisive section 4, which quantifies the emission reduction, there is no such restriction. Even if it were possible to generate all of the energy required in a

4 See European Commission (2019).

5 Environmental, social and governance (ESG) principles within the framework of the EU taxonomy.

6 ifo Institut (2020). See also Zeitler und Wolf (2020).

7 Energy Efficiency Act (2023).

carbon-neutral manner, energy consumption would still have to be reduced by almost half of the 2008 level by 2045. This legal requirement is economically incomprehensible, even if one takes into account the need to take environmentally harmful activities into consideration. The law actually has nothing to do with climate action; it only slows down economic activity itself. The Energy Efficiency Act is a de-industrialisation act.

And Germany is not using this law to get itself in shape for the digital economy either, as is often demanded by those who campaign for the eradication of "dirty" industries. Especially if artificial intelligence (AI) triggers the anticipated revolution in the labour market and replaces human intelligence in the same way that combustion engines replaced human labour, enormous amounts of energy will be needed. Intelligence requires energy, after all, regardless of whether the source is biological or artificial. The human brain consumes one-fifth of the total energy used by our body. And it's a similar story for the supercomputers that AI requires. Seen in this light, Germany's Energy Efficiency Act, despite its euphonious name, is tantamount to a modernisation blockade.

III. The nuclear phase-out

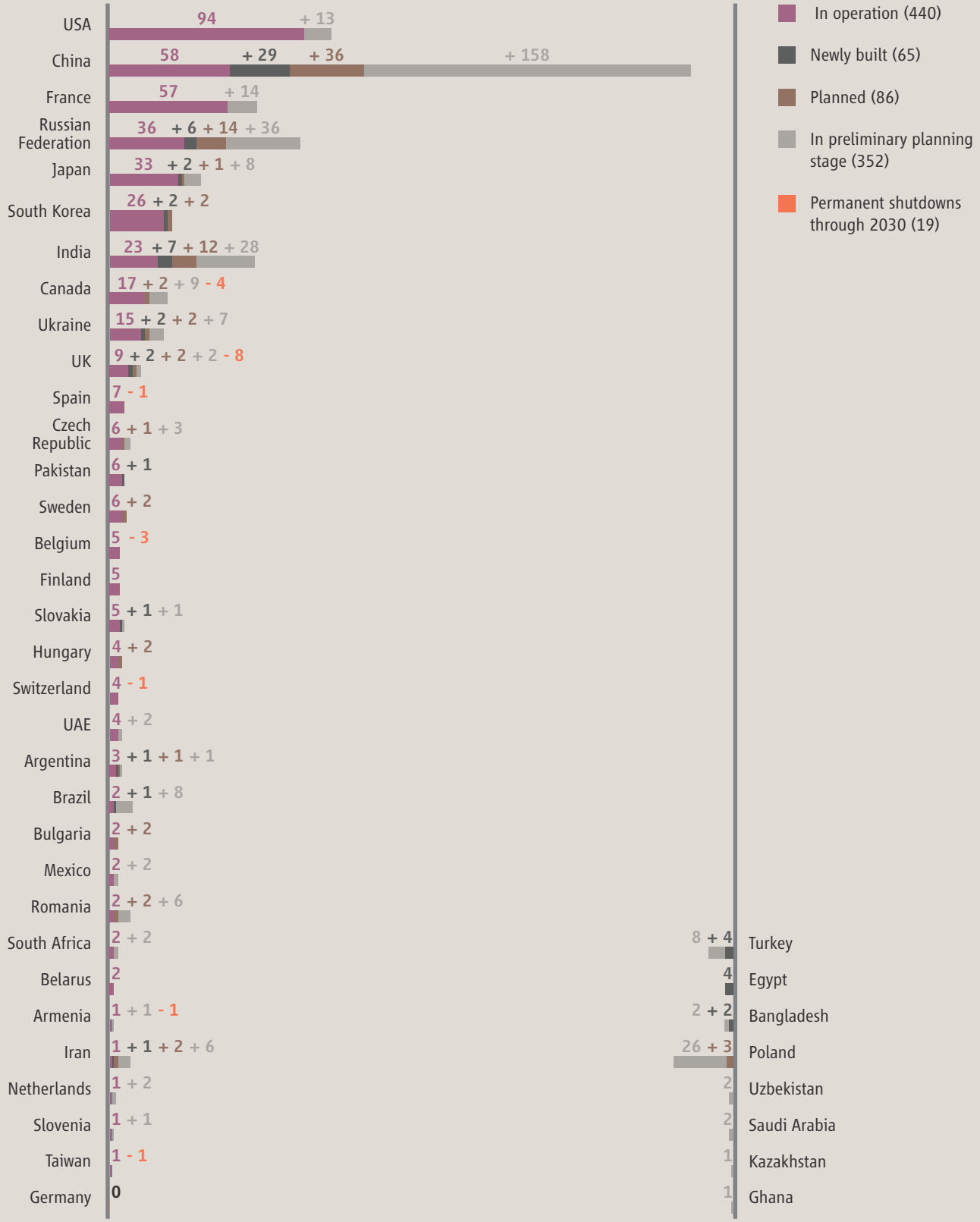
Germany's nuclear phase-out is perhaps the clearest manifestation of the looming blockade. Figure 3 below, which is based on publications by the World Nuclear Association (WNA), shows the current state of the global nuclear industry. It shows that there are currently 440 nuclear power plants in the world, most of which are located in the United States, followed by China with 58 and France with 57 plants.

A total of 19 nuclear power plants have been scheduled for closure by 2030. There are technical reasons for the closures, mostly due to the approaching end of their normal life cycle. However, with the exception of Taiwan, which plans to shut down its nuclear power plant in May 2025, the plant closures will not lead to a complete phase-out of nuclear power. There have been such total phase-outs before, however, in Lithuania and Italy. Lithuania had to promise the EU that it would shut down its two Chernobyl-type graphite reactor power plants, which were built in the 1970s, before it was allowed to join the EU. And Italy, in the year following the Chernobyl disaster of 1986, held a referendum followed by a shutdown of its plants. Austria had started building a power plant in the 1970s, but never completed the project by connecting it to the grid. Furthermore, there have been many research reactors that were used and then decommissioned. And of course many countries in the world, especially in the developing world, do not have nuclear power plants simply because they do not have the technical means to operate them.

Sweden was the first country to decide to phase out nuclear power after the Three Mile Island accident near Harrisburg, Pennsylvania, in 1981. However, this decision was never implemented. In 2023, Sweden decided to build new power plants, partly under pressure from green politicians.

Overall, in view of the growing dangers of global warming due to carbon emissions from burning fossil fuels, the threat to gas supplies from Russia and the energy demands of AI, nuclear power has seen a revival in recent years. In France, President Macron announced the construction of another eight power plants after considering phasing out nuclear power during his first term in office. And even Japan has unequivocally reaffirmed its commitment to nuclear power after the Fukushima accident in 2011 and the subsequent overhaul of all its power plants.

Figure 3: Nuclear power plants and phase-outs after the Fukushima disaster. As of January 2025, according to the World Nuclear Association (WNA)



Note on the 352 in the preliminary planning stage: According to the World Nuclear Association, 344 plants are in the preliminary planning stage. France is currently considering the construction of a further 8 plants in addition to the 6 already planned. See Tagesschau.de (2022).

Sources: Own illustration according to World Nuclear Association (2025). The data on plant shutdowns are based on research conducted on Wikipedia (2025) and on the website of the Gesellschaft für Anlagen- und Reaktorsicherheit (2024).

In contrast to Germany, nuclear power is experiencing a renaissance worldwide. A total of 65 new nuclear power plants are being built around the world, 86 more are already firmly planned, and preliminary plans exist for 352 others. And that's without counting the many projects involving new reactor types that are being researched worldwide. For example, the Swedish press reports that ten more power plants, including small-scale plants, are planned by 2045.[8]

Meanwhile, the tech giants are investing billions in the development of such mini power plants, in part to provide a reliable energy supply for the supercomputers used for AI. There are more than half a dozen well-financed start-ups worldwide that have set themselves the goal of producing small nuclear power plants on an industrial scale, almost like on an assembly line, in order to avoid the expected shortage of controllable, continuously available electricity. This involves, on the one hand, small traditional pressurised water reactors, such as those used on nuclear submarines, and, on the other hand, the new type of liquid salt reactor, in which the fuel for the nuclear reaction is always present in a molten state combined with liquid salt. Since core meltdown is the normal operating state in these power plants, they cannot be threatened by a core meltdown, unlike conventional power plants. They are also inherently safe because the nuclear reaction is extinguished due to physical reasons if anything goes wrong. One of the projects is a dual-fluid reactor developed by the Berlin-based non-profit organisation IFK mbH. It is now operated by Dual Fluid Energy Inc. in Canada.

Of the countries in the sphere of influence of Western alliances, only Germany took the decision to shut down all its nuclear power plants after the Fukushima disaster. It's the wrong-way driver on the motorway.

IV. Utopian targets

The economic policy of recent years has also been unusual, not to say utopian, in other respects. Among other things, the reason for this can be seen from the targets for the timing of the carbon emissions reductions that Germany has legally committed itself to. An EU regulation from 2021,[9] which Germany itself had agreed to, had already forced the country to reduce its carbon emissions to zero by 2050. However, in 2024, the German parliament itself passed a law requiring Germany to achieve this goal by 2045.[10] Furthermore, Germany has committed itself, on the basis of EU requirements and its own resolutions, to achieving interim targets that are defined as percentage reductions in carbon emissions compared to 1990.[11] The year 1990, in other words one year after the fall of the Iron Curtain, is also the reference year for the targets set at the Paris Climate Conference. Figure 4 illustrates the legally prescribed targets for the reduction of carbon emissions in the form of a curve that starts at 100 percent in 1990 and ends at zero percent in 2045.

Furthermore, Figure 4 shows the actual decline in carbon emissions since 1990. This decrease is impressive, because Germany not only reached the target of a 40 percent reduction by 2020, but achieved a further reduction of 43 percent by 2023, signalling continued compliance with the requirements in the future.

The declines are, of course, not only due to intentional plans to green the energy supply. In view of the fact

8 See Gesellschaft für Anlagen- und Reaktorsicherheit (2024).

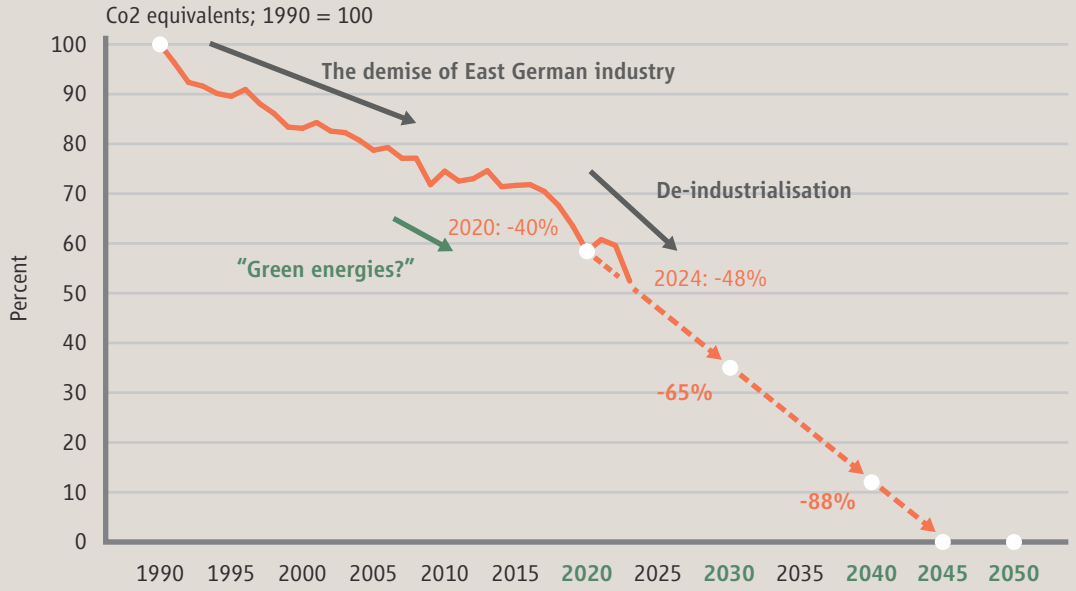
9 European Commission (2021).

10 See Germany's Federal Climate Change Act (2019 and 2024).

11 Ibid.

that these plans have so far essentially only applied to the electricity sector, which itself only accounts for a fifth of primary energy, this can hardly have been the dominant factor. There are also other factors at play that have helped policymakers to meet their targets without being emphasised or acknowledged in public discourse. On the one hand, the demise of the GDR has made itself felt, whose dirty industries were soon closed down after reunification by the *Treuhandanstalt*, which was responsible for privatising the former state-owned enterprises of the GDR. On the other hand, the declines are the result of the de-industrialisation already described above, which led to the reversal of the trend in German economic development in 2018.

Figure 4: Actual and statutory targets for the reduction of German carbon emissions compared to 1990



Sources: Data through 2021: United Nations (2025). For 2022 and 2023: European Environment Agency (2025). For 2024: Agora Energiewende (2025).

This is problematic because, although de-industrialisation was already in the offing as a result of the Energy Efficiency Act, as explained above, the politicians responsible never mentioned it publicly. On the contrary, they painted a rosy picture of the future, in which Germany would take a leading global position in the commercialisation of green technologies thanks to the wise foresight of its politicians. The basic message was that the county could kill two birds with one stone: investing in climate action while strengthening the economy and thereby improving the population's standard of living.

As absurd as it may seem to economists to think that economic growth can be generated by a mixture of production bans and energy price increases, the media, which plays a significant role in shaping public opinion, has embraced this view. As recently as 2023, German Chancellor Olaf Scholz evoked the possibility of green policies generating growth rates like those seen during the German *Wirtschaftswunder* (the period of rapid economic growth in West Germany after the Second World War).[12] Later, he even spoke of the "turbocharged growth" that green policies could ignite.[13]

12 See Greive and Olk (2023).

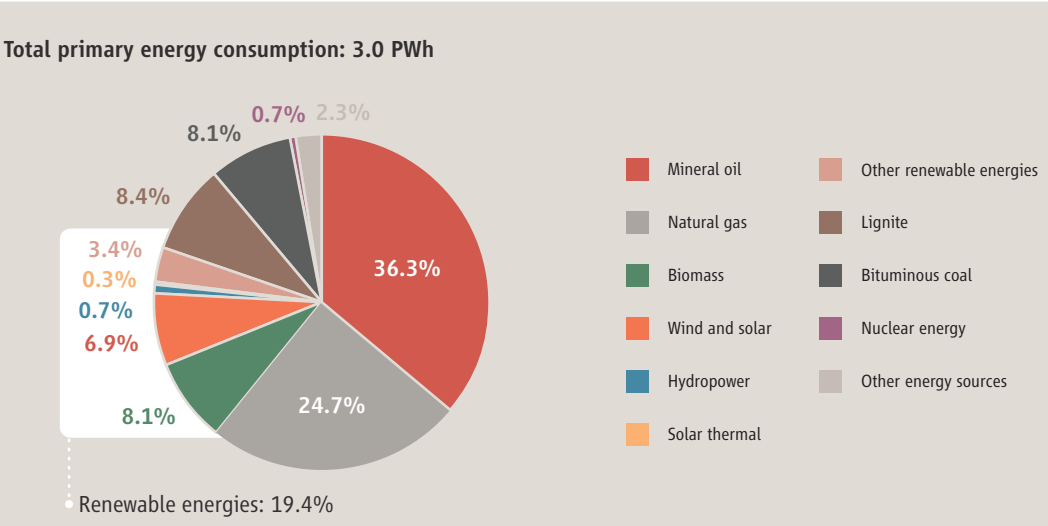
13 See Süßmann (2024).

The fact is, it will be absolutely impossible to achieve the legally prescribed targets, which have now even been enshrined in the rulings of the German Constitutional Court,[14] without the further de-industrialisation of the country. It took 33 years to reduce carbon emissions by 43 percent below 1990 levels. That was 1.3 percentage points per year. Subsequently, in the period through 2045, i.e. in only a further 22 years, achieving the remaining 57 percentage points would mean progressing at an average rate of 2.6 percentage points per year, in other words at double the speed. This is simply mission impossible, because all the low-hanging fruit has already been picked, unless another industry collapse is accepted or even intended. To reach the target in time, the country – after already having dismantled GDR industry – would now have to dismantle West German industry too. Politicians who are willing to take that risk will not be allowed to stay in office by the electorate, which has already realised what absurd promises it has been taken for a ride on.

It is incomprehensible how legislation that can only be described as utopian was able to pass through the German parliament and convince the Constitutional Court.

The fact that the German path is not feasible is also evident from the planned expansion of wind and solar power, which is supposed to cover almost the entire adjustment burden. However, as shown in Figure 5, according to the official data from AG Energiebilanzen e. V., in 2023 it only accounted for just under seven percent of primary energy consumption in the Federal Republic of Germany, while green energy as a whole accounted for 19 percent. This means that the share of wind and solar power would have to be increased from seven percent to 81 percent by 2045 due to a lack of expansion options in the field of bioenergy or hydroelectric dams – which is also proof of the utopian ideas that have been sold to the German public as realisable policies.

Figure 5: Energy mix in Germany in 2023 according to AG Energiebilanzen e. V. (share of primary energy consumption)



Source: AG Energiebilanzen e. V. (2024a).

14 See German Federal Constitutional Court (2021).

And the fact that wind and solar power only accounted for seven percent of electricity generation in 2023 will certainly come as a surprise to many readers. However, it should be noted that the percentage refers to total energy consumption, including energy used in heating, production processes and combustion engines. Electricity, which is usually chosen as the reference base, itself only accounts for one fifth of the total energy consumed in Germany.

Heat pumps can, of course, get us some of the way. When used for simple heating, they may perhaps generate three times the amount of electrical energy consumed over the course of a year. Hydrogen produced in the world's deserts from sunlight could also be used if it were to become available at competitive prices at some point. Either way, the distance it would need to travel is so extremely long that no amount of technological advances in green technology could possibly make it happen in twenty years. It would result in more than an elevenfold increase in its percentage share.

But, of course, Germany always has the option of further increasing its percentage share in the near term by accelerating the de-industrialisation through more and more bans. There may even be idealists out there who would applaud it.

V. Fair-weather power

The endeavour to force Germany to abandon fossil fuels in just twenty years with the combined might of the state is utopian, not least because wind and solar power are unsteady, fair-weather energy sources, and Germany cannot survive on them alone. The electricity is sometimes available and sometimes not, depending on the weather. And it is difficult to control it in order to adapt it to the constantly changing needs of the economy, which fluctuate on an hourly, daily and weekly basis and, above all, with the seasons. Wind and solar power absolutely require conventional, controllable electricity alongside them, which then not only has the job of matching the fluctuations in demand, but also of balancing out the fluctuations in green electricity itself by means of countervailing variation.

Back when there were only a few solar panels and wind turbines installed in Germany, it wasn't a problem because the conventional power plants were easily able to cushion the little bit of additional volatility with the help of the existing power lines. Meanwhile, however, the problems are mounting, because these forms of energy now already account for a large share of the total electricity supply. At the same time, however, not only have the easily controllable nuclear power plants been disconnected from the grid, but many of the gas- and coal-fired power plants that would otherwise have been used to cushion the green imbalance are also no longer in operation.

According to data from AG Energiebilanzen e. V., wind and solar power already accounted for 43 percent of total electricity generation in Germany in 2024.[15] At the same time, no fewer than 33 coal- and gas-fired power plants were decommissioned in 2024, as if the multitude of wind and solar power plants could reliably cover the electricity demand.[16] In reality, however, this is not the case, because when the sun is not shining and the wind is not blowing, i.e. in periods of a renewable drought, achieving high market shares is of no use because it simply means more and more wind and solar plants are available. This is because the electricity they produce in large quantities during favourable periods, some of which is then exported, is not available during

15 See AG Energiebilanzen e. V. (2024b).

16 See German Federal Network Agency (2025).

dark, windless periods, nor can it be stored over the seasons.

Battery storage systems like those used in cars are not nearly enough. They cannot even be "filled up" in summer with the electricity that the cars themselves need in winter. Battery storage is useful for recurring intra-day storage tasks, but any attempt to store energy for more than a day or two is where they no longer prove cost-effective. And the pumped hydroelectric energy storage that we have in Germany would be just enough to cover a general power outage for seven to eight hours.[17] These types of storage are purely short-term storage options. They do not offer a solution for the seasonal storage problem. One possible solution would be to use a system with hydrogen storage tanks. However, these are also extremely expensive, uneconomical and far from being viable on a large-scale practical basis. This applies both to hydrogen produced in the summer months from local electricity for use in the winter, and to hydrogen produced in the deserts and then transported to Germany by tankers or pipelines. The technical feasibility of this, which was already demonstrated by Bölkow back in the 1960s, is still a long way from being economically viable.

Due to green power's large share of total electricity generation, Germany is already suffering from dramatically increasing electricity prices during the dark, windless periods that often occur during the Advent and Christmas season and sometimes last for several days. Cloudy skies and no wind are typical of this time of year. This is also reflected in the hourly electricity prices quoted on the electricity exchanges, where, depending on the weather forecasts, electricity supply and demand are balanced one day in advance. On 12 December 2024, the electricity price there rose to 94 cents per kWh, and customers with a variable tariff even had to pay up to EUR 1.30 per kWh on that day.[18] If it had not been possible to import French nuclear power, the excessive dismantling of conventional capacities in recent years would have made a blackout a distinct possibility. This is also what prompted Germany's Federal Court of Audit to describe the calculations from Germany's Federal Ministry for Economic Affairs (which is also responsible for energy) as an "unlikely best case" and "fanciful" in 2024.[19]

For the path to volatile green power to work at all, there needs to be a sufficiently high conventional power plant capacity. Conventional electricity as such does not have to flow all that often if there are enough solar panels and wind turbines available. But the conventional power plants have to be on standby, ready for use when the sun and wind are not enough. The conventional capacity must be calculated with a fairly large grain of salt, in an amount that would be necessary without green power, because it must be possible to cover the entire electricity demand for days on end, if necessary, during periods of darkness and low wind. Seen in this light, wind and solar power do reduce the need for conventional fuels, but not for the conventional power plants themselves. The fixed costs of these plants in the form of wages, plant financing, depreciation and the necessary repairs cannot be saved.

The road to green fair-weather electricity means double the fixed costs: on the one hand for the new wind turbines and solar panels and on the other for maintaining the old power stations. These two-fold fixed costs are the main reason for the extremely high electricity costs in international comparison.

Figure 6 shows the development of German electricity prices paid by private households in an international comparison. The diagram clearly shows how these costs have increased steadily over time and now stand at the top of the list internationally. In 2024, German

17 Sinn (2017), p. 136.

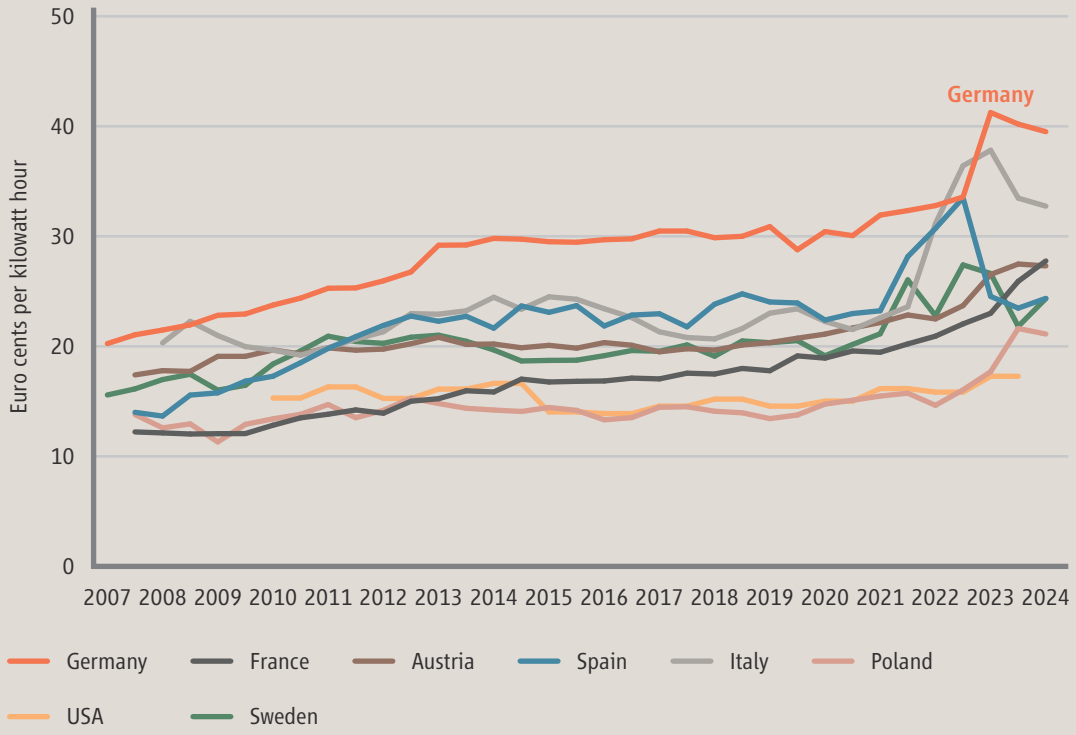
18 See Zinke (2024).

19 See German Federal Court of Audit (2024), p. 8.

households had to pay an average of EUR 0.41 per kWh for their electricity. There is no other country in the world that comes close to matching this figure.

And the electricity costs billed to customers do not even include all the costs, because the green electricity industry receives billions in subsidies from tax revenues each year to compensate for the elimination of the EEG surcharge in 2023. The EEG surcharge was levied on electricity customers in order to guarantee high electricity prices for green plants and at the same time to grant them the right to feed their electricity into the grid as a priority despite these prices. Today, the taxpayer is being burdened instead. In the years prior to its abolishment, the EEG surcharge was usually around 6 cents per kWh. The current subsidy for green electricity, which represents a hidden electricity cost, is likely to remain at roughly the same level. If the electricity tax, which is around 2 cents per kWh, is deducted from the subsidy, one comes to the conclusion that the true economic cost of electricity borne by private households in Germany in 2024 will not have been "just" 41 cents per kWh on average, but around 45 cents per kWh. This puts Germany even further ahead of all other countries in terms of electricity costs.

*Figure 6: International comparison of private household electricity prices**



*Existing customers with an annual consumption of between 2.5 and 5 MWh. Prices incl. taxes and duties. Until the first half of 2024; USA until the end of 2023.

Quelle: Eurostat (2025b). USA: U.S. Energy Information Administration (2025).

While it is true that, as the journalist Franz Alt once said, the sun doesn't send a bill, the people who operate green energy systems, the operators of the conventional power plants that are still needed, and the tax authorities are sending citizens three bills at once.

However, it is not only the measures to compensate for the possible periods of little or no sunshine and wind

that are driving up prices; the sometimes excessive feed-ins of wind and/or solar power when weather conditions are favourable are doing so as well. Sometimes, the production of green energy increases so rapidly that conventional power plants cannot be powered down quickly enough. Grid operators then often have to dispose of the electricity abroad for a fee. In fact, the electricity price on the day-ahead market was zero or negative for 532 hours during 2024. That was an average of one and a half hours a day over the course of the year.[20]

The electricity supplied to neighbouring countries at negative prices was usually treated as if it had been used in Germany when calculating the share of green electricity in the relevant celebratory statistics. In other statistics, it was treated as a profitable export. In reality, it was a matter of disposing waste abroad and also being charged for it. And these disposal fees are also factored into the German electricity prices.

If gas-fired power plants are used to balance out fluctuations in wind and solar power, the problem of negative electricity prices is less significant than it is with coal or nuclear power plants, because they are more flexible and can even balance out fluctuations that occur over the course of a day. They can prevent blackouts during times when the sun is not shining and the wind is not blowing, and avoid the need to purchase expensive electricity from abroad to cover for the shortfall. And since they don't use boilers that take a long time to heat up or cool down, they can be shut down more quickly if the weather suddenly improves.

Unfortunately, the expansion of gas-fired power plants has been very slow. On 11 September 2024, Germany's Federal Ministry for Economic Affairs finally managed to agree to put out to tender 12.5 GW of gas-fired power plant capacity, although according to the Federal Network Agency and the four transmission system operators, at least 20 to 25 GW are needed.[21]

However, a solid long-term solution is not guaranteed even with gas-fired power plants, because the continued addition of new wind and solar installations will lead to more and more cases in which the production of green power will exceed electricity consumption. In this case, it will not make any difference if flexible gas-fired power plants are used, because they cannot produce less than nothing. This is a completely new problem that has only recently begun to emerge, because the excess electricity spikes have been rare so far. However, the problem will progressively become more acute as the share of wind and solar power continues to grow.[22] Gas-fired power plants can buffer phases with rapidly fluctuating electricity production and periods when there is no daylight or wind at all, but they do not help prevent electricity peaks that occur when more green electricity is being generated than is being consumed. The problem of negative electricity prices will therefore become more pressing in the years to come if the expansion of green energies continues, forcing grid operators to shut down more and more green plants, which will further reduce their private-sector and overall macroeconomic profitability.

Another problem implicit in the forced expansion of green electricity is the fact that, without a huge expansion of the structure and volume of domestic and international transmission capacities, it will become increasingly difficult to find a balance between the abundant wind power in the north in autumn and spring and the abundant solar power in the south in summer. When the respective green energy types are only fed into the grid in small amounts, this balancing act is easy to perform because the grid operators can still find free transmission capacity. However, as their market share grows, it will become increasingly difficult because the

20 European Energy Exchange (2025).

21 See Consentec (2024).

22 A detailed discussion and warning with explicit calculations based on hourly feed-in data for Germany can be found in Sinn (2017), sections 6–8, in particular Figure 8.

lines would first have to be expanded.

Meanwhile, the expansion of wind and solar power capacities is leading to absurd developments through what are known as redispatch measures by grid operators. Redispatching means that grid operators pay conventional power plant operators to supply more electricity than would otherwise be profitable for them at prevailing electricity prices in order to avoid the localised overloading of power lines.

If, for example, wind picks up in the north without more sun shining in the south at the same time, a voltage gradient will result, leading to an overload on the north-south power lines because electricity always flows to areas with low voltage. At the same time, electricity prices also fall in southern Germany, even though the wind power generated in the north is not transmitted to the south because regional price differentiation is prohibited in Germany. This causes the operators of conventional power plants in the south to reduce their output in the north due to the wind power, although the additional wind power from the north cannot be transmitted south due to the weak lines. The result is a further increase in the voltage gradient, which further increases the risk of the line fuses blowing. To prevent this from happening, grid operators have to pay the power plants in the south to artificially increase the voltage in the south, and to do so to such an extent that it avoids both the primary voltage gradient due to the increased wind power in the north and the secondary gradient due to the shutdown of conventional power plants in the south. Not only are these redispatch measures expensive for electricity customers, they also mean that, on balance, an increase in wind power in the north can trigger an increase in conventional power generation in the south. On days like these, this puts additional pressure on electricity prices, while at the same time the annual average electricity price rises due to the expensive redispatch measures. The inverse happens when there is suddenly more sunshine in the south, while wind conditions remain normal in the north. The electricity then wants to flow to the north for technical reasons and has to be prevented from doing so by conventional power plants in the north, which generate a counter-voltage. The mutual self-reinforcing effect of redispatching could have contributed to the reasons for the many days with negative electricity prices in 2024.

The extent of the necessary redispatch measures and the corresponding costs for grid operators and consumers could be reduced if, as Grimm and Ockenfels (2024) suggest, Germany were divided into different electricity price zones. In that case, prices would only fall in the part of the country where favourable weather conditions were benefiting green power production, and in the other part of the country, operators of conventional power plants would have less reason to take their plants off the grid. Accordingly, fewer conventional power plants would have to be prompted to increase production via redispatching. However, it would not be possible to avoid redispatching altogether, because it is still necessary for technical reasons to block the primary effect of an asymmetrical voltage increase on the north-south lines.

All this shows how difficult it is to convert an economy's electricity supply to wind and solar energy. Taming the fair-weather power is a task whose sheer dimensions the responsible politicians probably did not realise at the time.[23]

23 In the lecture '"Energy transition to nowhere", the author already discussed the issue of volatility: Sinn (2013). See also the essay by Sinn (2017) that builds on this.

VI. A possible path forward

Regardless of the difficulties of the energy transition, Germany has now invested hundreds of billions of euros in the development of a green electricity infrastructure, on both a large and small scale – at the household level. These are now sunk costs, just like the costs of old nuclear power plants or old coal-fired power plants. Consequently, we have to start from the situation in which the country finds itself today.

If one form of energy is going to be expanded at the expense of another, then from a business perspective, this expansion will only be profitable if its average costs (including fixed costs) are lower than the marginal costs of the other form that it is replacing. This initially argues against decommissioning existing plants, because in economic terms, what is already there has the advantage that past costs, which cannot be changed, no longer need to be taken into account. Refraining from using existing fossil coal-fired power plants, existing green plants and recommissioning existing nuclear power plants seems equally misguided.

But it is not only these narrower business considerations that need to be taken into account; overarching economic effects must also be considered. In this respect, it is important that green energy has the advantage of being generated domestically. The wind and sun that it uses are available in this country, and they will remain available even in the biggest international crisis. This is a security aspect that should not be dismissed. Although conventional power plants will be needed to buffer this electricity, at least it will be possible to reduce the import of fuels, which is prone to disruption and are transported on supply routes that cannot be controlled. Due to the ability to store these fuels, it is possible to produce electricity without a continuous supply. The more wind and solar power is generated, whether it is fed into the grid or used for personal needs, the longer the storable stocks of such fuels, be they coal, gas or uranium, will last if global supply chains are interrupted.

And if, by means of intelligent control systems and the use of battery storage, private consumption can be synchronised with the availability of self-generated wind and solar power, at least for a short time, the grid will be stabilised at the short frequencies during the load change.

The economic aspects also include, in particular, the potential to reduce carbon emissions, which was the primary aim of the green revolution. According to climate scientists' current knowledge, carbon emissions intensify climate change and cause the universally feared secondary effects on nature, including more frequent storms, flood disasters, rising sea levels due to the melting of the Greenland ice sheet, and the shifting of the habitable parts of the planet, which causes migratory movements that sow discord. We must not lose sight of these key advantages of wind and solar energy. They fundamentally support the case for maintaining and, if possible, further expanding green energy as far as technically and economically feasible.

However, the expansion should be carried out with a sense of proportion and a steady hand, in such a way that the new structures are built up first and only then, once they are actually functioning properly, are the old ones dismantled afterwards. The headlong rush to destroy the existing system that has characterised Green Party policy in recent years is the hallmark of a hasty revolution, but not of a clever and well-considered transformation strategy that maintains a sense of proportion and balance.

Furthermore, the expansion should be carried out together with all European states, the other major countries of the world, particularly the United States, China, India and Brazil, so that those countries that care about the global climate are not left behind while the others continue unchanged on a course that is advantageous for them.

If such coordinated action is not successful, then the question arises as to whether the unilateral renunciation of the use of fossil fuels, as practised by the EU and above all by Germany, is of any use at all, when these fuels are not extracted on European territory but have to be imported. At the very least, it seems reasonable to suspect that such a renunciation could lead to these fuels being consumed and burned elsewhere in the world at decreasing prices. In this case, the danger of de-industrialisation would not be offset by any benefit to the climate. Germany, which is putting its existence as a globally active industrial nation at risk through:

- the accelerated expansion of wind and solar power
- the phasing out of nuclear power
- the suppression of combustion engines
- the phasing out of coal power

and, in future, also through

- the dismantling of its gas networks

has strangely never publicly discussed this most important of all questions; instead, it has avoided discussing the supply-side issues of climate policy by using a mixture of superficial semantics in public and technical enthusiasm in private. The fact that this essay also does not address the question of where the carbon quantities saved by climate policy in Europe ultimately remain – in the ground or in the furnaces of other parts of the world – should not be taken as a sign of contempt. In fact, it is only an attempt to outline a sensible policy at the national and European level for the hypothetical case of global cooperation. The author has commented elsewhere on the question of what could otherwise be done (2008, 2022, 2023a).

VII. Conclusions

These are the conclusions of this short essay:

1. Germany's growth trend turned negative in 2018. As a result, Germany came in last among the OECD countries in terms of growth in recent years.

2. Since the trend reversal in 2018, Germany has been in a structural phase of de-industrialisation that has affected almost all industrial sectors, but is particularly pronounced in the automotive, chemical and mechanical engineering industries. Neighbouring countries such as Switzerland and Austria are less affected, despite also having strong industries. EU industry as a whole is also faring better than German industry.

3. De-industrialisation was induced by an orgy of power plant shutdowns, which, in the long term, aims to eliminate all fossil fuels and combustion engines in the country over the next twenty years.

4. De-industrialisation has also been forced upon the country by the Energy Efficiency Act, which demands that energy consumption be cut in half, regardless of whether the energy is green or fossil fuel-based. Under this law, companies no longer have the option of replacing fossil fuels with green energy. The Energy Efficiency Act is in fact a de-industrialisation act.

5. When it comes to phasing out nuclear power, Germany is the lone wrong-way driver on the motorway. With the possible exception of Taiwan on the other side of the world, no other country is following suit. In many countries around the world, however, nuclear power is experiencing a renaissance because it generates controllable and carbon emission-free electricity and has got a grip on the safety issues. Many start-ups are in the process of developing

modular small reactors that produce electricity in the immediate vicinity of the consumer.

6. Germany wants to completely ban the use of fossil fuels by 2045, in just twenty years, apparently because it has high hopes for wind and solar power. But in 2023, wind and solar power only accounted for seven percent of Germany's total primary energy consumption, with the remaining green energy making up about twelve percent. This means that wind and solar power would have to increase their share of total electricity consumption elevenfold between 2023 and 2045. This is a utopian vision, unless, after the demise of GDR industry, an equally drastic de-industrialisation of the West is now also to be accepted.

7. Green energy from wind and sunlight is a fair-weather power source and cannot be used in this form alone. Since electricity storage is not available to compensate for seasonal weather fluctuations, the only option is to use conventional electricity as a buffer. Conventional power plants will be required to permanently balance the volatility of green electricity and cover periods without sunlight or wind. The resulting and unavoidable duplication of energy systems led to a duplication of the systems' fixed costs and made Germany the world leader in electricity costs incurred by private households. The notion, propagated for years at the highest levels, that the path to green energy would reduce electricity costs and, in Germany, also generate new economic growth, proved to be a pipe dream.

8. As the market share of these energy sources increases, the problem of power peaks, where generated green power temporarily exceeds demand, will arise as a new problem for the electricity supply. Such peaks, which occur at weekends when there is high wind pressure and bright sunshine, cannot be meaningfully utilised as long as long-term forms of storage are lacking. Functioning and reasonably priced long-term storage on the scale needed is nowhere in sight.[24] Just last year, in 2024, Germany experienced a daily average of one and a half hours of negative electricity prices or prices of EUR 0 per kWh because conventional power plants could not be shut down quickly enough on sunny and windy days. This problem will be dramatically exacerbated by power peaks that exceed consumption as wind and solar power continue to expand. The path to a green electricity supply will reach its natural limits.

9. Notwithstanding all of the above, the potential environmental benefits and, in particular, the increased protection against an interruption to the energy supply in the event of a crisis, which green electricity is able to offer, must be recognised. The non-subsidised, private-sector generation of green electricity for personal consumption therefore remains a sensible part of the energy transition, especially if it is supplemented with private funds for short-term storage to bridge short-term weather fluctuations.

10. The green strategy implies huge erratic criss-crossing power flows within Germany and also to the border regions of neighbouring countries due to green power's dependence on the weather. These power flows have little to do with the old power flows during the time of conventional power plants and therefore need different lines for the most part. Until these are built, the inevitable isolated grid overloads will have to be absorbed with costly and sometimes environmentally nonsensical redispatch measures. These measures are therefore not only necessary to compensate for dark and windless periods, but also increasingly to counteract high electricity feed-ins at certain points in order to protect against grid overloads. These have to be generated by conventional power plants. In order to make sensible use of the regionally excessive supply of

24 See Sinn (2017).

green electricity, significant investment is needed to reinforce the domestic German electricity grid and the grids on both sides of the country's borders.

11. When it comes to its energy transition, Germany has lost all sense of balance and moderation. The country has abandoned the rational foundation of climate policy and spiralled into ideological heights that threaten total economic collapse. Politicians should carefully consider whether they really want to maintain in this rigid form the energy policy exit scenarios that they, in conjunction with the EU, enacted during the Merkel era and the time of the red–green coalition government. In any case, they should immediately stop the further destruction of functioning infrastructure in the energy sector and test out new ways of reducing carbon emissions before letting the entire nation continue down the path to an uncertain future.

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Family businesses and the EU – a shared responsibility for Europe's future

by Prof. Dr. Kay Windthorst

The European Union (EU) is currently caught in a maelstrom of various forces that threaten the peace, security and prosperity of its citizens. Russia's war of aggression against Ukraine, which has now been going on for three years, the wave of immigration perceived as threatening by large sections of the population, the rivalry between the USA and China and the unpredictable effects of Donald Trump's renewed presidency are creating a highly volatile situation with major, almost incalculable risks. These external threats are colliding with an economy in Germany that has fallen into recession, not least due to an undeniable backlog of reforms and indecisive political leadership. In this situation, it is important to join forces and take decisive action together. In the economic sphere, this appeal is directed above all towards family businesses and the EU, as they bear a special responsibility here as key players with different roles. Will they be able to fulfil this task? This will be examined below. In this context, the aim is also to determine which measures are necessary to better fulfil this responsibility in the future.

I. The role of family businesses in the Union

The role of family businesses is determined by their responsibilities and significance. Before that can be discussed, however, it is necessary to clarify what is meant by a family business in the national and European context.

1. The term "family business"

The widespread use of the term "family business", which is seemingly taken for granted, should not obscure the fact that a generally recognised definition of this term has not yet been established.[1] This is not absolutely necessary either, because a common understanding of the essential characteristics of a family business has emerged at the national and EU level that allows this type of company to be defined and differentiated from other types.

a) Constituent characteristics of a family business

According to this, a family business is characterised by the fact that at least one family, due to its voting rights and/or majority share in the company, either manages the company itself through family members[2] or at least monitors and controls the management of the company through non-family members (external parties).[3] In contrast, turnover, number of employees, legal form and capital market orientation are not relevant to a company's classification as a family business.[4] What is much more crucial is the inextricable link between the subsystems of "family", "owners" and "company".[5]

The EU also takes this structural approach and relies on the "ultimate owner model", i.e. sole or at least majority decision-making rights. However, in the case

1 See, *Gregorič, A., Rapp, M. S. and Requejo, I.* (2022) *Listed family firms in Europe: Relevance, characteristics and performance*, p. 6 with footnote 12, which makes reference to almost 200 definitions.

2 In this context, one speaks of owner-operated family businesses, *Windthorst, K.* (2021) *Die Krisenresilienz des Familienunternehmens: Der Beitrag der Corporate und Family Governance* [*The family business' resilience in times of crisis: the role of corporate and family governance*], pp. 25 f.

3 See *Windthorst, K.* (footnote 2), p. 26 f.

4 *Windthorst, K.* (footnote 2), p. 23 f.

5 Thus, based on the three-circle model by Tagiuri and Davis *Gregorič A., Rapp, M. S. and Requejo, I.* (footnote 1), p. 6.

of listed companies, a threshold of 25 percent of the decision-making rights based on the company's shares is deemed to be sufficient.[6] This distinction is not relevant to this analysis, however, as it does not challenge the fundamental approach to defining the characteristics that determine what classifies a company as a family business.

b) Difference to SMEs

The abbreviation SME is used to refer to micro, small and medium-sized enterprises. According to the EU definition, these are companies that employ fewer than 250 people and that either have an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million.[7] The definition of SMEs is based solely on these employee and financial figures. In contrast, the defining feature of a family business is the controlling influence of the business-owning family over the family business, which arises from their ownership position.[8] In view of these different points of reference, classification as an SME and as a family business are not mutually exclusive. Rather, many family businesses are also SMEs and vice versa.[9] However, they are subject to different challenges, which arise in family businesses from the inextricable link between business and family governance.[10]

2. Economic significance in Europe

The central question of how the EU and family businesses can work together to shape the future of Europe was raised by family businesses in Germany. However, it also includes family businesses from individual EU member states in order to avoid a one-dimensional perspective with limited informative value.

According to a 2014 survey, more than 85 percent of all European companies are family businesses, providing 60 percent of private-sector jobs.[11] These enterprises continue to play a major role in the economy of the Union, although there are significant differences between member states[12] in terms of the number of people these businesses employ and the economic sectors in which they operate.[13] The Union recognises that family businesses have contributed greatly to Europe's economic recovery in the past. They play an important role in terms of economic growth and social development, and are therefore also important in socio-political terms, over and above their economic significance.[14]

However, the lack of a legally binding, specific, simple and harmonised definition of the term "family business" at the European level hinders the collection of reliable and comparable data. This makes it more difficult to identify the particular situation, specific

6 *European Commission*, *Final report from the expert group on family businesses*, November 2019, p. 10.

7 Article 2(1) of the appendix to Commission Recommendation 2003/361/EC of 6 May 2003 (OJ EC No. L 124/36); by contrast, the Institut für Mittelstandsforschung (IfM – Institute for SME Research) in Bonn bases its definition of SMEs on the unity of ownership and management; see *Bartuschka, W. The integration of compliance in the systems of corporate governance – an SME approach*, CB 2017, 30; within the SME sector, a distinction can be made between micro-enterprises (up to 9 employees/up to 2 million in turnover and balance sheet total), small enterprises (up to 49 employees/up to 10 million in turnover and balance sheet total) and medium-sized enterprises (up to 249 employees/up to 50 million in turnover/up to 43 million in balance sheet total).

8 *Uffmann, K.*also emphasises the decisive influence on the business, "Family Business Governance – Rule Making in the Shadow of Law and Love", *ZIP* 2015, 2411 (2444).

9 On this, see *Windthorst, K.* (footnote 2), p. 25, 30 f.

10 *Windthorst, K.* (footnote 2), p. 24.

11 Recital C of the European Parliament resolution of 8 September 2015 on family businesses in Europe (2014/2210(INI)), OJ EU 2017/C 316/5/57.

12 See I. 4. below.

13 *Centre for European Economic Research (ZEW)* (2023) *Familienunternehmen in Deutschland und Italien – Zur Bedeutung des Unternehmenstyps im Vergleich mit ausgewählten europäischen Staaten* [*Family businesses in Germany and Italy – A comparison of the significance of this type of company in selected European countries*]. Foundation for Family Businesses (ed.) pp. 44 ff.

14 European Parliament resolution (footnote 11), recitals B. and M.

needs and challenges, and economic performance of family businesses. And this, in turn, hampers or delays necessary measures at the level of the Union and the member states to prevent and counteract undesirable developments in relation to these undertakings.[15]

Such recommendations and measures require a nuanced view of the structure and prevalence of family businesses in the EU, which should be taken on an individual member state basis. In addition to Germany, suitable candidates for this purpose include France, Italy and Poland, in view of the size of their economies and with a view to achieving a geographical balance within the Union. Key comparative parameters here include the structure and the prevalence of family businesses.

3. Structure of family businesses in individual member states

The criteria used to determine the structure of a company are its legal form (see a) below) and the influence of its owner (see b) below). They create the basis on which a comparative assessment of family businesses in Europe can be made. That is because family businesses can always be assigned to these categories, which can be found in all member states in varying degrees. Only this will enable reliable statements to be made about their structure and their degree of distribution in Europe, which are crucial for assessing their significance in the Union and their interaction with the Union.

a) Differentiation according to the legal form

The structure of a family business is determined primarily by its legal form. It is therefore also an important distinguishing feature as regards the classification of family businesses in Europe. This is because the legal form category is relevant to central aspects of business governance[16], for example the shareholders, equity, liability and management.[17]

There are three types of company that can be distinguished in all member states of the Union according to their legal form: sole proprietorships, partnerships and corporations. For the purposes of this comparative analysis, sole proprietorships are defined as companies that have only one natural person as a shareholder, i.e. the sole owner. In contrast, partnerships have at least two natural or legal persons as partners, without themselves acquiring full legal capacity. Examples of this in Germany are the civil-law partnership (GbR), the general partnership (OHG) and the limited partnership (KG). In contrast, a corporation is a legal entity under private law that has at least one natural or legal person as a shareholder. This applies, for example, to the limited liability company (such as the GmbH in Germany), the public limited company (such as the German AG) and the Societas Europaea (a public company registered in accordance with the corporate law of the European Union, abbreviated SE).[18]

b) Differentiation based on the owner's level of influence

As regards family businesses, the influence of the owner on the management of the company is taken into account in addition to the legal form. This aspect not only plays a significant role in business governance, but also in family governance[19], which has its own conditions, logic and rules. According to the definition of a family

15 See European Parliament resolution (footnote 11), recital L.

16 The subject of business governance, which is also sometimes referred to as corporate governance (see, for example, *Papesch, M.* (2010) *Corporate Governance in Familienunternehmen: Eine Analyse zur Sicherung der Unternehmensnachfolge* [Corporate governance in family businesses: an analysis of how to ensure a successful company succession], p. 11.), is the organisation of the company and the actions of the senior management. *Windthorst, K.* (footnote 2), p. 29.

17 See *ZEW* (footnote 13), p. 8.

18 For a comparative view, see *ZEW* (footnote 13), pp. 8 ff., ibid. including with further examples.

19 Family governance can be defined as a system of rules and controls relating to the family that owns a family business, with a focus on the organisation of the family and the conduct of family members as regards this business, *K. Windthorst* (footnote 2), p. 28.

business, it must be family-controlled due to the right of the owning family to make the final decisions.[20] This requirement therefore applies to all family businesses.

In contrast to this, in an *owner-operated* family business, the management of the company is also exclusively or at least predominantly in the hands of one or more persons who are also the owners of the company and members of the owner family.[21] If, on the other hand, the company is managed exclusively or primarily by people who do not hold shares in the company as members of the owning family, it is referred to as an *externally managed* family business. The family then exercises decisive influence over the management of the company through controlling bodies, such as a shareholders' committee, and through rights of veto.[22]

c) Combination of criteria

A model can be developed by combining the categories of legal form and influence of the owning family: in the case of sole proprietorships, the owner also usually manages the company, provided that they do not appoint an external managing director. Sole proprietorships with more than one owner are treated as partnerships. They can be categorised as owner-managed due to the unity of ownership and management if the company has no more than three general partners.[23] In the case of corporations, the decisive factor determining whether they can be classified as owner-managed is whether the management of the family business is exclusively or predominantly in the hands of members of the owning family.

4. Prevalence of family businesses in individual member states

This structural model is neither mandatory nor generally recognised. However, it does allow empirical statements to be made about the prevalence of family businesses in the selected member states. The starting point in this context is the realisation that family businesses can be found throughout the entire Union. This general observation can be further substantiated on the basis of the legal form.

a) Differentiation according to the legal form

According to Orbis data for 2019, which covers companies with at least five employees, sole proprietorships account for 10 percent of companies in Germany and Italy. By contrast, their share in Poland is significantly higher at 44 percent.[24] If we look at partnerships according to the definition developed for this purpose[25], the rate breaks down as follows: Germany: 17 percent; Poland: 11 percent; Italy: 7 percent; France: 3 percent. In this respect, too, a different degree of prevalence can be observed, but it is less pronounced than in the case of sole proprietorships. By contrast, there is a significant disparity as regards corporations. In France, the vast majority of companies (97 percent) take this form, whereas in Poland, fewer than half (45 percent) do so. Germany and Italy lie between these two extremes, at 73 percent and 83 percent, respectively.[26]

b) Differentiation based on the owner's level of influence

Family businesses can be further categorised according to the owner's level of influence. The analysis of the

20 See I. 1. above.

21 These individuals do not have to be the sole or majority owners of the family business; it is sufficient if they hold shares in the business, provided that the family as a whole can exercise a controlling influence over the business based on their ownership of it, *K. Windthorst* (footnote 2), p. 33 f.; thus, family businesses run by their owners are a special form of family-controlled businesses, see *ZEW*(footnote 13), p. 6.

22 *Windthorst, K.* (footnote 2), p. 34.

23 See *ZEW* (footnote 13), p. 6.

24 See *ZEW* (footnote 13), p. 20; for France, in the approach taken in this analysis, no companies are categorised as sole proprietorships.

25 For more details, see I. 3. a) above.

26 See in detail *ZEW* (footnote 13), p. 20.

Orbis data for 2019 is limited to corporations because of their particular importance to the economies of the respective member states. Family businesses account for 84 percent of incorporated companies with at least five employees in Italy, 82 percent in Poland, 76 percent in Germany and 54 percent in France. Of these companies, 71 percent in Italy, 62 percent in Poland, 69 percent in Germany and 39 percent in France are owner-managed.[27]

These figures suggest the following conclusions: Germany and Italy have a large proportion of family businesses that are organised as corporations and managed by their owners. In France, on the other hand, there are a large number of corporations, but only just over half of these can be categorised as family businesses, and most of them are owner-managed. Poland has a large number of sole proprietorships, but comparatively few corporations. Approximately four-fifths of these are family-owned and roughly three-fifths are owner-managed.

5. Preliminary result

Family businesses, especially owner-managed corporations, play an important role in and for the EU. This applies not only in economic terms, but also in terms of social and structural policy, as well as in terms of education and social cohesion as an important factor for the resilience of democracy in the member states.[28] Family businesses thus bear a great responsibility for the stability and future direction of Europe. Does the EU recognise this and act accordingly, or do its policies hinder rather than help family businesses thrive and grow? And conversely, how do family businesses view the work of the Union – as a support or a burden? This is also and especially a question of each side's perception of the other.

II. How the EU and family businesses view each other

The starting point for assessing and, if necessary, recalibrating the interaction between the EU and family businesses is how they each perceive the other. In addition to objective factors, the subjective experiences of the respective stakeholders also play a crucial role in this regard.

1. The Union's view

a) Focus on listed companies and SMEs

The EU's view of family businesses was initially focused primarily on listed companies. In addition to their size and public profile, the fact that these companies are already subject to extensive disclosure requirements and regulatory provisions has also contributed to this. They are therefore familiar with regulation and, as such, are fundamentally suitable as subjects.

The EU later expanded this approach and provided for differentiations for small and medium-sized enterprises, granting them certain exemptions. However, these were not specifically tailored to family businesses, but to SMEs in general.[29] What was not considered, however, was that although these types of company often overlap, family businesses are subject to specific conditions, logic and rules.[30] This led to accusations that the EU tended to be "blind to family businesses". Even if one does not share this view, it is only from 2010 onwards that greater consideration of the special needs of family businesses began to emerge.

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27 See *ZEW* (footnote 13), p. 22.

28 See European Parliament resolution (footnote 11), recitals B., I. and M.

29 For example, the European Parliament resolution (footnote 11), C 316/59 calls on the Commission, in relation to SMEs, to apply the "Think small first" principle.

30 See I. 3. b) above.

In this context, the European Parliament resolution of 8 September 2015 on family businesses in Europe[31] and the final report of the Commission expert group on family businesses are particularly noteworthy. Unfortunately, however, the findings and demands were not put into practice, or were implemented only to a small extent.[32] In any case, there was no paradigm shift in the way family businesses in the EU were viewed. The main reasons for this are the lack of a generally recognised definition of family businesses in the Union, and the differences in the structure and prevalence of family businesses in the member states, as noted above.

b) One-dimensional view of family businesses

Insofar as the EU is concerned with family businesses, the concepts and actions are focused on business governance. By contrast, family governance remains largely ignored. This one-dimensional view makes it more difficult to develop targeted solutions. This is because, in order to understand family businesses in all their complexity and with all their unique characteristics, it is essential to take appropriate account not only of business governance, but also of family governance and the way these governance systems are intertwined. At EU level, at best, only tentative steps have been taken in this direction.[33]

When looking for the reasons for this deficit, the lack of a uniform definition of family businesses and their diversity in the member states once again come to light.[34] These factors make it difficult to develop a consistent EU policy on family businesses. In addition, there are also conditions relating to legal competence. The competences assigned to the Union in the treaties often have a final structure, i.e. they aim to achieve certain objectives. This is demonstrated, for example, by the exclusive competence for establishing the competition rules necessary for the functioning of the single market (Article 3(1)(b) TFEU) and the shared competence for consumer protection (Article 4(2)(f) TFEU). The relevant implementation measures address business governance and are not aimed at a specific type of company. Conversely, important family governance issues, such as direct taxation, inheritance law and the succession of family businesses, fall within the competence of the member states. They are therefore beyond the Union's control.[35]

c) Discrepancy between demands and actions

The far-reaching demands at the EU level to promote family businesses have not been bundled into a consistent, effective concept and implemented through concrete action; instead, they have often remained mere declarations of intent and announcements. The European Parliament is aware of this. In its resolution on family businesses in Europe from 2015, the European Parliament also emphasised that "the work of the Commission's Expert Group on Family Businesses has been completed for more than five years and no new European initiative has been launched at EU level since then".[36]

However, the European Parliament's initiative has not led to any fundamental change in EU policy towards family businesses. Their importance is recognised, but insufficient practical steps are being taken to support these companies in a way that is commensurate with their relevance. An important step in this direction would be to establish a regular, open and constructive dialogue between representatives of family businesses,

31 Footnote 11.

32 For more detail, see II below. 1 c).

33 See the resolution of the European Parliament (footnote 11), C 316/58, recital H., which points out the high level of integrity and values of family businesses that determine their business activities and emphasises the high standards of social responsibility towards employees and the environment; this reflects the link between family governance and business governance.

34 On this point, see I. 1. above.

35 See the European Parliament resolution (footnote 11), C 316/58, recital G and C 317/61, point 21.

36 See footnote 11, OJ C 316/58, recital J.

the EU and the member states. Such a dialogue has not yet been established, however. This is also due to the fact that "not all 28 EU member states have associations or other structures of interest groups that specifically address the concerns of family businesses."[37]

2. The family businesses' view

The perceived deficits on the part of the EU in the way it deals with family businesses are also recognised as such by the latter. This particularly applies to the lack of consideration given to the specific concerns of family businesses and the inadequate dialogue between family businesses and the Union. The other points of criticism mainly reflect the view of family businesses in Germany; however, they are in principle also shared by family businesses in other EU member states.

a) The EU as a major cause of regulatory burdens

aa) The purpose of regulation

The economic system in Germany is a social market economy, in which sustainability issues are becoming increasingly relevant.[38] A functional regulatory framework is necessary to ensure the stability and efficiency of such an economic system.[39] The aim is to strike a fair balance between the freedom to conduct a business and the interests of third parties, such as competitors, producers and consumers. Sensible regulation thus includes rules to ensure open and fair competition, to safeguard quality standards, to protect consumers and to promote sustainability issues.[40]

In this context, regulation must, on the one hand, create the necessary legal certainty. But, on the other hand, it must also be flexible enough to allow companies to react quickly to changes in (external) conditions. Regulation must not become an excessive, one-sided means of control,[41] but must seek to achieve a proportionate balance between the aspects mentioned. It must not become an end in itself, but must always remain a means to an end.[42]

bb) Regulatory effort and bureaucratic burdens

Regulatory requirements, mostly in the form of standards set at the European and national level, need to be enforced, which regularly occurs at the state and local level. Regulation results in additional work and costs for both the regulating and the regulated parties, especially when it comes to companies. This regulatory effort occurs in a bureaucratic system[43] and is therefore also referred to as a bureaucratic effort or as bureaucratic burdens – or bureaucracy, for short. Regulation and bureaucracy are thus closely related. More regulation means more bureaucracy, which has a negative impact on businesses and the economy.

cc) Increasing regulation and bureaucracy

Businesses (and family businesses in particular) view bureaucratic compliance activities as a significant burden. The amount of work involved has once again increased significantly since 2021 and has almost tripled compared to 2020.[44] One of the main reasons for this undesirable trend is the EU's regulatory activity, which is becoming increasingly extensive and dense.

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37 European Parliament resolution (footnote 11), C 316/58, recital N.

38 On this, see *K. Windthorst* (2024) "Securing prosperity through family businesses", in: Foundation for Family Businesses (ed.): *How to secure Germany's prosperity – Annual bulletin of the Advisory Board of the Foundation for Family Businesses*, p. 51 (56 f.).

39 Foundation for Family Businesses (ed.) (2024) *Bureaucracy as a barrier to growth: inventory and reform approaches – Annual Monitor of the Foundation for Family Businesses*, p. 1.

40 Foundation for Family Businesses (footnote 39), p. 1.

41 "Neo-interventionism" is a form of this misguided regulation, see *C. Fuest* (2022) "Economic policy beyond the coronavirus crisis: the rise of neo-interventionism", in: Foundation for Family Businesses (ed.), *Free enterprise and state control – Annual Bulletin of the Advisory Board of the Foundation for Family Businesses*, p. 1, ibid. on the characteristics of this form of interventionism.

42 See Foundation for Family Businesses (footnote 39), p. 1.

43 For the characteristics of a bureaucratic system, see Gablers Wirtschaftslexikon, https://wirtschaftslexikon.gabler.de/definition/buerokratie-29945/version-253540, last accessed on 15 February 2025.

44 See Foundation for Family Businesses (footnote 39), p. 3.

The EU's competences, such as the single market or consumer protection,[45] which are geared towards specific objectives, and thus their final structure, allow for excessive regulation at the Union level, against which the principle of subsidiarity enshrined in Article 5(3) TEU offers only insufficient protection in practice. It is hardly surprising, then, that approximately one third of regulatory laws have their origin in the Union.[46]

This trend is having a particularly adverse effect on the German economy, especially since Germany also has an extremely high level of its own regulation compared to other member states.[47] Furthermore, the bureaucratic burdens in Germany mainly affect large companies with more than 250 employees, which have seen the greatest increase.[48] In view of the importance of these companies for the labour market and the economy, the negative consequences of this development are particularly significant.

dd) Consequences of this trend

The companies primarily criticise the following adverse effects of this trend, which are partly contingent on and overlap with one another:[49]

- Long and complicated approval procedures;
- High reporting costs; these arise primarily from the necessary internal human and external consulting resources, for example for ESG reporting;
- Less investment as a result of these resources being tied up and the financial resources required for this;
- Declining competitiveness;
- Declining attractiveness of Germany as a business location for foreign investment in a European and international comparison;
- Increasing relocation of business activities abroad;
- Fewer new companies being founded in Germany.

ee) The specific burden on family businesses

These consequences of excessive regulation and bureaucracy affect family businesses particularly severely and are therefore criticised by them accordingly. This is because they have a negative impact on three factors that contribute significantly to the competitiveness of these companies: quick decisions based on short decision-making processes, consistent implementation of decisions, and a high degree of adaptability to changing circumstances.[50] This agility, decisiveness and flexibility are particularly evident in owner-managed family businesses[51] and are rooted in their governance. They contribute to the resilience of these companies.[52]

b) Constraints on innovation and competitiveness

From the perspective of many family businesses, the high level of regulation, which is mainly due to the requirements of the EU, restricts companies' freedom to make their own decisions, slows down the decision-making process and ties up resources that are needed elsewhere. This applies in particular to adapting existing processes to new challenges and to the necessary innovation in the context of research and development.

Added to this are legal restrictions, for example for data protection reasons under the EU's General Data

45 These shared competences are enshrined in Article 4(2)(a) and (f) TFEU and, in accordance with the first sentence of Article 2(2) TFEU, enable the Union to take primary action to regulate these areas; the competences of the member states are superseded in this respect, in accordance with the second sentence of Article 2(2) TFEU.

46 Foundation for Family Businesses (ed.) (2019) *Economic policy for a strong EU – Annual Monitor of the Foundation for Family Businesses*, p. 7.

47 In an international comparison, Germany is among the lowest-ranking countries in the regulatory index, see Foundation for Family Businesses (footnote 39), p. 2.

48 See Foundation for Family Businesses (footnote 39), p. 14.

49 See in detail Foundation for Family Businesses (footnote 39), p. 34 ff.

50 See Foundation for Family Businesses (ed.) (2025), *Country Index for Family Businesses*, p. 35.

51 For the definition of these family businesses, see I. 1. above.

52 On the contribution of corporate and family governance to the crisis resilience of family businesses, see *Windthorst, K.* (footnote 2), pp. 59 ff., 102 ff.

Protection Regulation. To avoid any misunderstandings: the necessity of adequate data protection is generally recognised. But excessive data protection can hinder or even prevent business models that have the potential to better address pressing challenges in future. This is particularly evident in the field of artificial intelligence. The innovations made possible by technical progress require a review and, if necessary, a re-evaluation of the regulation on the basis of an overall assessment of all relevant circumstances. This includes data protection, but also the ability of companies (including family businesses) to innovate and compete.

c) Lack of transparency in decision-making processes

A common criticism is that the decision-making processes in the EU are perceived as lacking transparency. This applies less to the information on the results of the decisions that the Union makes available on digital platforms. Rather, the criticism is directed against the influence of various stakeholders and interest groups in the context of the complex decision-making processes, which is difficult to assess and evaluate from the outside. This lack of transparency breeds mistrust,[53] which is further fuelled by decisions that do not take the concerns of family businesses into account, or do so only to an insufficient extent.[54]

In addition to the lack of transparency, the communication between representatives of the Union and family businesses is perceived as inadequate. The situation as regards municipal administration in Germany is different. The proportion of family businesses that rate their working relationship with local authorities as positive is 42.6 percent.[55] The proportion of companies that have frequent and occasional contact with local politicians is 62.4 percent. By contrast, the principle of institutional and procedural autonomy of the member states, according to which the member states are generally responsible for executing Union law, means that as a matter of principle, there is only limited scope for businesses to work collaboratively with the Union directly.

Developing a mutual understanding of the respective needs of companies (including family businesses) and the EU is impeded by the fact that 77.9 percent of companies never have any contact with MEPs, while 15.4 percent only rarely do so and 5.1 percent occasionally.[56] Regular, fair and open dialogue is essential to fostering this understanding. If this is absent, it makes it more difficult to develop trust. The relationship between companies (including family businesses) and the Union is suffering as a result. After all, trust is an essential component of effective co-operation. To make matters worse, this deficit is not compensated for by effective representation of companies' interests at the political level in Europe. This is because an organisation that specifically represents the interests of family businesses does not exist. It is therefore not surprising that only 10.5 percent of all companies in Germany see their interests being best served at the European level.[57]

d) Neglect of the specific needs of family businesses

The Union's focus on listed companies and SMEs, as well as its one-dimensional view of family businesses, largely ignores family governance[58] and neglects the specific concerns of family businesses. These include the

53 On the connection between transparency and trust, see *Windthorst, K.* (2019) "Transparency for family businesses – transparency in family businesses", in Foundation for Family Businesses (ed.) *Aspects of corporate transparency – Annual Bulletin of the Advisory Board of the Foundation for Family Businesses*, p. 77.

54 For more details, see IV. 2. f) below.

55 9.2 percent of family businesses in Germany are highly satisfied with their relationship with the municipal or local government, while 33.4 percent are satisfied with this relationship; among non-family businesses, 7.4 percent are highly satisfied and 36.3 percent are satisfied. Foundation for Family Businesses (footnote 39), p. 18.

56 Foundation for Family Businesses (footnote 46), p. 9.

57 See Foundation for Family Businesses (footnote 46), p. 8.

58 See II. 1. b) above.

inextricable link between business and family governance,[59] the often difficult access to financing,[60] the (digital) infrastructure in rural areas, where family businesses are often located,[61] the challenge of finding suitable successors,[62] and the burden on family shareholders due to inheritance and gift tax.[63] This runs counter to the important role played by family businesses in Europe, a fact that is also recognised by the EU.[64]

Many family businesses also perceive that their special concerns are not being given enough consideration. It is therefore common for these companies to take a critical view of the EU's actions. However, it would be going too far to blame all these deficits on the EU. This is because they fall partly within the jurisdiction of the member states. This applies, for example, to the provision of an adequate infrastructure and to inheritance and gift tax. If one is looking for ways to improve the relationship between the EU and family businesses, these limitations in terms of legal competence must be observed.[65]

3. Preliminary result

This analysis highlights the deficits and problems that exist in the way the EU and family businesses view each other. It seems as if the stakeholders are working at cross purposes and that the EU is not taking the specific needs of family businesses adequately into account, but is instead placing an increasing burden on these companies through extensive regulation. This adversely affects the co-operation between the Union and family businesses. If the protagonists continue along this path, it will jeopardise efforts to shape the future of Europe together. In this regard, the Union and family businesses bear joint responsibility. It is high time that they became aware of this responsibility and developed a new form of co-operation.

III. A return to shared responsibility

The fact that the EU and family businesses share responsibility for the future of Europe is not self-evident, but requires substantiation.

1. Localisation in different domains

This is because the stakeholders operate in different domains – the exercise of sovereignty on the one hand, and the exercise of the freedom to conduct a business on the other. Thus, they are subject to different conditions, logics and rules. The Union acts in accordance with the principle of conferral (Article 5(1) sentence 1, 5(2) TEU) on the basis of and within the limits of the transfer of sovereignty by the member states. When taking action, it is bound by this allocation of competences and by the further provisions set out in the TEU, TFEU and the Charter of Fundamental Rights of the European Union. In contrast, family businesses operate in the exercise of their inherent freedom to conduct a business, which is protected by EU law (Article 16 of the

59 See most recently *Windthorst, K.* (footnote 38), p. 60.

60 On this aspect, under the aspect of crisis resilience, see *Windthorst, K.* (footnote 2), p. 82 ff.

61 For more on this phenomenon, see Foundation for Family Businesses (ed.) (2023) *The importance of family businesses for rural areas – contribution to prosperity and cohesio*n, p. 7 ff.

62 On this, see *Windthorst K.* (2020) "Family governance as the interface between business practice and academia", in ibid. (ed.) *Challenges for family businesses – digitalisation, internationalisation, governance*, pp. 95 (103 f.).

63 For an international comparison of inheritance tax rates, see Foundation for Family Businesses (ed.) (2024) *An international comparison of inheritance taxes – special study for the Country Index for Family Businesses*, pp. 49 ff., 67 ff.

64 See I. 3. above.

65 See IV. 2. below.

EU Charter of Fundamental Rights) and constitutional law (in particular Article 12(1) and Article 2(1) of the Basic Law for the Federal Republic of Germany.[66]

2. Connection via the market

Despite the fact that the Union and family businesses operate in different domains – the legally-bound exercise of sovereignty in the case of the former, and the pursuit of individual freedom in the economic sphere in the case of the latter – they are linked by various commonalities. In this context, the market is particularly noteworthy. It is described as a both an institutional precondition for, and simultaneously the product of, private autonomy and economic freedom.[67]

Businesses depend on an open, functioning market to offer their goods and services. Individuals, i.e. consumers, but also suppliers, need access to this market in order to satisfy their needs by acquiring the goods and services they require according to their ideas and desires.[68] In this context, it is overwhelmingly recognised that an open market economy with free competition does not automatically follow from the free interrelation of supply and demand, but must be safeguarded and promoted by regulation.[69] This responsibility is vested in the authority of the State, that is to say the member states and the Union. The main objectives in fulfilling this function are fair competition, protection of employees and their social interests, appropriate consumer protection and ensuring that sustainability concerns are addressed.[70]

3. Preliminary result

Businesses are "necessary intermediaries to efficiently organise the economy."[71] The Union, in conjunction with the member states, provides the regulatory framework for this economic model through regulation. The Union and the companies are bound together by this interaction within the framework of a social market economy.[72] Although they play different roles, they share a common responsibility.[73] This extends beyond the economic and social sphere and also has structural, political, social, ecological and democratic dimensions. These primarily relate to ensuring an equivalent standard of living, social cohesion, climate action and environmental protection, and the resilience of democracy itself.[74]

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66 On this, see *Di Fabio, U.* (2022) "Dirigismus und Verfassung: Wie viel staatliche Lenkung verträgt die unternehmerische Freiheit?" ["Interventionism and the constitution: How much state control can the freedom to conduct a business tolerate?", in Foundation for Family Businesses (ed.) *Free enterprise and state control – Annual bulletin of the Advisory Board of the Foundation for Family Businesses*, pp. 27 (35).

67 According to *Di Fabio, U.* (footnote 66), p. 36.

68 This differs from the advocates of radical market economy ideas, who take a laissez-faire approach, as can currently be observed in the case of President *Milei* in Argentina; this model should not be equated with neo-liberalism; on this distinction, see *Fuest, C.* (footnote 41), p. 2.

69 See II. 2. a) above.

70 On this, see *Di Fabio, U.* (footnote 66), pp. 36 ff.

71 *Di Fabio, U.* (footnote 66), p. 35 f.

72 On this economic model, see *Windthorst, K.* (footnote 38), pp. 56 f.

73 On the interaction of private and public stakeholders in securing prosperity, see *Windthorst, K.* (footnote 38), p. 53.

74 For more details, see IV. 1. ee).

IV. Developing a new form of collaboration

To fulfil this shared responsibility for the future of Europe, the EU and family businesses must continue to improve the way they work together. The guiding principles here are, on the one hand, moving away from antagonistic behaviour that attempts to expand one's own position unilaterally, and on the other hand, developing a mutual understanding of the needs of the other party[75] and, finally, establishing more constructive cooperation than has been the case so far.

1. Focus on shared values and goals

a) Laying the groundwork for the new collaboration

To lay the groundwork for this new form of collaboration, the Union and family businesses will need to return to the shared values and goals that have shaped and guided them. These values and objectives are based on different sources – as regards the Union, they arise from applicable law, in particular from the founding treaties. In contrast, in the case of family businesses, they are an essential component of the traditional values of the owning family, which are also fundamental to the management and strategy of the company.[76] However, this does not change the fact that these values and goals often coincide. Although the Union and family businesses operate at different levels, they ultimately work towards the same overarching goals.

b) Key values and goals shared by the Union and family businesses

aa) Compliance with the law

Both requiring and fostering legally compliant behaviour is an indispensable condition for an orderly community. For the Union, it arises from its obligation to provide an area of justice under Article 3(2) TEU and is specifically defined for companies by compliance requirements.[77] For companies, the imperative of law-abiding behaviour results from their obligation to comply with the relevant legal requirements and, more generally, from the guiding principle of the honourable merchant, which shapes many family businesses' set of values.[78]

bb) Free and fair competition

The necessity of free and fair competition is enshrined in EU law, among others, in Article 120 sentence 2 TFEU. It is further delineated by the establishment of a single market under Article 26 TFEU and its protection by the fundamental freedoms of Article 28 ff. TFEU and the competition rules in Article 101 ff. TFEU. For companies, such competition is essential to successfully sell their goods and services on the market.[79]

cc) Social and societal responsibility

Article 3(3), sub-paragraphs 1 and 2 and Article 3(5) TEU emphasises the Union's responsibility for creating a social market economy aimed at full employment and social progress, combating social exclusion and promoting social justice. For family businesses, supporting

75 Regarding the relevant deficits, see II. above.

76 These guiding principles are often not codified, but may be contained in a family charter. On this, see *Windthorst, K.* (footnote 2), p. 159 ff., ibid., p. 81, on the importance of the controlling family's values for the management from the point of view of crisis resilience.

77 On compliance requirements for family businesses, see *Windthorst, K.* (2021) "Compliance-Herausforderungen in Familienunternehmen" ["Compliance challenges in family businesses"], in Bochmann, J., Scheller, H. and Prütting, H. (eds.) *Munich Handbook of Corporate Law*, vol. 9: *Law of Family Businesses*, 6th ed., sec. 14, paras. 42 ff.

78 On the important role of the honourable merchant in family businesses, see *Hipp, S.* (2020) "Der ehrbare Kaufmann" ["The honourable merchant"], in Windthorst, K. (ed.) *Herausforderungen für Familienunternehmen – Digitalisierung, Internationalisierung, Governance* [*Challenges for Family Businesses – Digitalisation, Internationalisation, Governance*], pp. 85 ff.

79 *Di Fabio, U.* (footnote 66), p. 36 f. describes the protection of an open market and free competition as the first stage of economic intervention.

employees and contributing to the local community are essential elements of the family's values as well as those of the company's management.[80]

dd) Ensuring an equal standard of living

For the Union, preventing significant disparities in the standards of living across member states is included in the requirement under Article 3(3) sub-paragraph 3 TEU, which is defined in more detail in Article 174 ff. TFEU. Family businesses play an important role in ensuring an equal standard of living because they are often based in rural areas and stabilise these areas primarily as employers, but also through vocational training. The key factors in this regard are the loyalty of these companies to their location and their employee retention programmes.[81]

ee) Promoting environmental sustainability

Under Article 191 (1) TFEU, preserving, protecting and improving the quality of the environment, along with the rational utilisation of natural resources, are listed as key aims of Union policy on the environment.[82] The Green Deal announced by the Commission in December 2019 is intended to be a central lever for driving the desired ecological transformation of the economy.[83] However, its implementation has stalled, not least due to the coronavirus pandemic and Russia's war of aggression against Ukraine. At present, it is not possible to say whether the Green Deal will actually be realised.[84]

The principle of sustainability plays a crucial role for family businesses. However, a distinction must be made between environmental sustainability and sustainability as it applies to family businesses. *Environmental sustainability* relates to consequences for the climate, for the environment and for resources. It is concerned with protecting these valuable goods in the long term for future generations. For the economy, environmental sustainability means economic activity that helps to protect rather than endanger the climate and environment, and that makes careful and sparing use of natural resources.[85]

In contrast, *sustainability specific to family businesses* is characterised by management that is focused on long-term strategies and activities; a long-term increase in the value of the company rather than short-term profit maximisation; reinvestment; high equity capital; high employee retention; and a particular loyalty to the company's location.[86] However, both environmental sustainability and sustainability as it applies to family businesses share the fact that they are geared towards the long term, thus implying long-term action and a desire to fulfil a special responsibility for future generations.[87]

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80 See *Windthorst, K.* (footnote 2), p. 134, ibid., p. 89 ff. including on employee retention; on the community involvement of family businesses, see Foundation for Family Businesses (ed.) (2020) *Das gesellschaftliche Engagement von Familienunternehmen* [*How family businesses give back to the community*], pp. 15 ff.

81 On this, see *Windthorst, K.*. (2020) "Die Bedeutung von Familienunternehmen für die Gleichwertigkeit der Lebensverhältnisse in Deutschland" ["The importance of family businesses in ensuring an equivalent standard of living in Germany"], in Foundation for Family Businesses (ed.) *Industriepolitik in Deutschland und der EU* [*Industrial policy in Germany and the EU*], pp. 97 (108 f.).

82 *Windthorst, K.* (2021) "Die ökologische Transformation der Wirtschaft aus der Perspektive der Familienunternehmen – Vom politischen Ziel zur praktischen Umsetzung" ["The environmental transformation of the economy from the perspective of family businesses – from political goal to practical implementation"], in Foundation for Family Businesses (ed.) *Chancen und Risiken in der Politik des Green Deal* [*Opportunities and risks in the policies of the Green Deal*], pp. 73 (82).

83 Communication from the European Commission, 11 December 2019: The European Green Deal (COM[2019] 640 final), pp. 4 ff.

84 A critical view can be found in *Di Fabio, U.* (2021) "Green Recovery: Rechtsmaßstäbe für den ökologischen Umbau der Wirtschaft" ["Green recovery: legal standards for the environmental restructuring of the economy"], in Foundation for Family Businesses (ed.) *Chancen und Risiken in der Politik des Green Deal* [*Opportunities and risks in the policies of the Green Deal*], pp. 1 (13 ff.).; on the conflicting objectives of environmental transformation and securing prosperity, see *Di Fabio, U.* (2024) "Wohlstand und Verfassung" ["Prosperity and the constitution"], in: Foundation for Family Businesses (ed.): *How to secure Germany's prosperity – Annual bulletin of the Advisory Board of the Foundation for Family Businesses*, p. 1 (7 ff.).

85 See *Windthorst, K.* (footnote 82), p. 91, also on the significance of this sustainability for family governance.

86 *Windthorst, K.* (footnote 82), p. 90.

87 According to *Windthorst, K.* (footnote 82), p. 90.

ff) Strengthening the resilience of democracy

Democracy, together with liberty, the rule of law, respect for human dignity, equality and respect for human rights, as enshrined in Article 3(1) TEU, are among the core values upon which the Union is founded. All Union bodies are obliged under Article 3(1) TEU to promote these values. When it comes to democracy, the Union and family businesses also share a common vision. Admittedly, these companies are not subject to any standardised obligation to promote democracy, as they act on the basis of their freedom to conduct a business. In doing so, however, they are effectively promoting the resilience of democracy.

This is because, particularly in rural areas, family businesses play an important role as employers and training centres in ensuring an equivalent standard of living and stabilising the community.[88] If these companies relocate by moving their production to urban centres with better infrastructure or abroad to take advantage of lower labour costs,[89] it often results in a portion of the younger generation moving away because they can no longer find adequate work. The region is then at serious risk of depopulation and an ageing population. The "vacuums" that are created are then often filled by radical political forces. Family businesses thus strengthen the resilience of democracy.

2. Recalibrating responsibilities

Refocusing attention on the common values and goals of the Union and family businesses makes it clear that they share an immense responsibility for the future of Europe. The Union, in particular, has not always lived up to this insight.

a) Key questions when defining responsibilities

To change this in future, it will be necessary to recalibrate each side's respective responsibilities. This process should be based on two guiding questions:

- Which areas are covered by the freedom to conduct a business, and where does the state have to intervene through regulation?
- How are competences divided between the Union and the member states in terms of exercising sovereignty?

b) The freedom to conduct a business as the starting point

The freedom of a company to conduct business must be the starting point for the recalibration of responsibilities.[90] This is already evident from the constitutional protection of economic freedom and the freedom to conduct a business. This original freedom is not granted by the state, but rather it is recognised by the state through the guarantee of fundamental rights. It is essential for functioning competition and an open market economy based on it.[91] This freedom is not unlimited, however; rather, can be restricted by the state. "However, this does not change the fundamental principle that the provision of goods and services must primarily be carried out by private entities."[92]

c) Complementary function of state regulation

The freedom to conduct a business is the starting point, and it is complemented by the regulatory function of the state. However, the use of the state's authority to restrict companies' economic freedom requires a sufficiently important objective reason. Furthermore, this must be done in accordance with the principle of proportionality.[93] One such justification is to safeguard the model of a social market economy, which is established

88 See IV. 1. dd) above.

89 Regarding this trend, see II. 2. dd) above.

90 On securing prosperity, see *Windthorst, K.* (footnote 38), pp. 53 ff.

91 See III. 2. above.

92 *Windthorst, K.* (footnote 38), p. 58.

93 See *Windthorst, K.* (footnote 38), pp. 54, 58; also see Article 52(1) sentence 2 EU Charter of Fundamental Rights.

and recognised in Germany and the Union.[94] They have to set a regulatory framework that maintains the conditions necessary for the market economy to function.

These are, in particular, "a market driven by supply and demand with fundamentally unregulated pricing, open and functioning competition, privately owned means of production, a free labour market and social security systems."[95] The necessary complementary social element in the legal design of the economic order is reflected in the attribute "social" in the term social market economy. It requires government action to protect employees[96] and their social concerns.[97] In addition, the guarantees of the welfare state and the protection afforded by fundamental rights oblige the state to intervene if this is "necessary to protect the weaker, for example in emergencies, i.e. for social reasons."[98]

In contrast, the question of whether regulation is also permissible on grounds of environmental sustainability is disputed. Although it is widely recognised that the social market economy must be further transformed into a social and sustainable market economy, in this context, "sustainable" is understood primarily as environmentally sustainable, i.e. protective of the environment and active in mitigating climate change.[99] However, there is much debate as regards the means by which the state can realise this goal. The differences of opinion centre primarily on the questions of whether an environmental transformation of the economy can be enforced by government regulation of companies and, if so, which measures are permissible.[100] This will not be discussed further here. In any case, regulation must be limited to proportionate restrictions on companies' economic freedom and leave them the necessary scope to manage their own affairs as they see fit, for example by means of practical exceptions.

d) Reducing regulatory burdens

When recalibrating the responsibilities of the EU and family businesses, the issue of how to minimise the resulting compliance costs for companies comes to the fore, alongside the permissible type and scope of regulation. The following measures, among others, have been proposed to reduce these regulatory burdens, with the aim of improving the implementation of regulatory requirements:

- A stronger focus on user needs in public administration;
- Expansion of the digitalisation of public administration.[101]

94 This is covered in IV. 1. b) cc) above.

95 According to *Windthorst, K.* (footnote 38), p. 56.

96 Occupational safety regulations are a good example of this.

97 According to Article 3(3) sub-paragraphs 1 and 2 TEU, these include full employment, social progress, the fight against social discrimination, and the promotion of social justice and protection.

98 According to *Windthorst, K.* (footnote 38), p. 56.

99 Environmental sustainability focuses on mitigating climate change, protecting the environment and conserving natural resources for future generations. As it pertains to the economy, this means that economic activity must not exacerbate climate change or environmental degradation, but must instead protect them and use natural resources carefully and sparingly. *Windthorst, K.* (footnote 82), p. 90, ibid. also on other aspects of the concept of sustainability.

100 On this, see *Windthorst, K.* (footnote 82), p. 80 ff.

101 When it comes to dealing with external bureaucratic matters digitally, there are significant differences between family businesses and non-family businesses in Germany. "While approximately one fifth of non-family businesses take care of more than 60 percent of external bureaucratic matters digitally, the figure for family businesses is only 15.7 percent," see Foundation for Family Businesses (footnote 39), p. 28.

e) Greater consideration of the specific needs of family businesses

Regulation should take greater account of family businesses' specific concerns.[102] As regards business governance, this particularly means facilitating access to financing options and providing an efficient infrastructure, especially in rural areas.[103] In terms of family governance, it would be an important first step if its significance were to be recognised and given due consideration in the regulatory framework. In particular, the specific measures should simplify succession. One important means of achieving this would be for the member states to structure their inheritance and gift taxes in a way that takes into account the importance and special concerns of family businesses.

f) Stricter observance of the principle of subsidiarity

The principle of subsidiarity enshrined in Article 5(3) TEU must be observed when the Union and the member states exercise their competences. According to this principle, in areas which do not fall within its exclusive competence, the Union shall act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the member states, neither at a central level nor at a regional or local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at the Union level.[104]

From the perspective of family businesses, Union competence is indispensable, particularly as regards trade policy, i.e. the representation of economic interests in an international context.[105] This necessity is legally supported by the Union's exclusive competence for a common trade policy (Article 3(1)(e) TFEU). It also meets practical needs in view of the competitive relationship between the US, China and the Union, which is increasingly taking on the character of an economic confrontation.[106] The companies also favour EU-level competence in financial market and banking supervision, as well as in competition policy.[107] By contrast, they consider national competence in social systems and fiscal as well as economic policy to be sensible.[108]

The key here is that the principle of subsidiarity be more strictly observed and enforced in practice. Ultimately, this is also in the interest of the Union. This is because its extensive regulatory activity, which is constantly moving into new areas and also increasing the density of regulation, is not only viewed critically by many companies – including family businesses – but is also a major reason for the growing distance or even rejection of the Union. In view of these pressing issues, it is imperative that both the Union and family businesses establish a new form of co-operation in fulfilling their shared responsibility for the future of Europe. At its core, it should be characterised by the outlined division of responsibilities and an open culture of dialogue.

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102 Regarding the reasons for this necessity, see I. 3. above; to determine this specific impact, Habersack proposes introducing a family business test as an element of regulatory impact assessment, see *Habersack M.* (2020) in Foundation for Family Businesses (ed.) *Gesetzesfolgen für Familienunternehmen abschätzen – Ein Familienunternehmen-Test für Deutschland und die EU* [*Assessing the impact of legislation on family businesses – A family business test for Germany and the EU*], pp. 1 ff.

103 This demand is particularly aimed at the family business' transport connections and access to a fast internet connection.

104 On the interpretation of this principle, see *Bast, J.* (2023) in Grabitz, E., Hilf, M. and Nettesheim, M. (eds.) *Das Recht der Europäischen Union* [The law of the European Union], 80th supplement, Article 5 TEU, paras. 49 ff.; on its judicial enforcement, ibid., para. 58 f.

105 Foundation for Family Businesses (footnote 46), p. 18; 86.5 percent of the companies surveyed demand this.

106 The (punitive) tariffs currently imposed and threatened by US President Trump are an expression of this confrontation.

107 This is supported by 80.2 percent and 77.7 percent of the companies surveyed, see Foundation for Family Businesses (footnote 46), p. 18.

108 On these issues, the agreement rate is 81.9 and 51.9 percent, see Foundation for Family Businesses (footnote 46), p. 18.

V. Summary of the main results

1. There is no generally recognised standardised definition of family businesses at the EU level. This makes it difficult to identify the specific needs of these companies and to develop adequate measures to counteract undesirable developments in relation to them.

2. There are considerable differences in the structure and prevalence of family businesses across the member states. Germany and Italy have a large proportion of family businesses that are organised as corporations and managed by their owners. In France, on the other hand, there are a large number of corporations, but only just over half of these can be categorised as family businesses. Those that can are predominantly owner-managed. Poland has a large number of sole proprietorships, but comparatively few corporations. Approximately four-fifths of these are family-owned and roughly three-fifths are owner-managed.

3. The EU's focus is primarily on listed companies and SMEs. In contrast, family businesses play only a minor role that does not do justice to their importance and largely neglects family governance.

4. From the perspective of family businesses, the EU's regulatory policy is a major cause of the significant bureaucratic compliance burden, which has once again increased sharply since 2021. This trend is having a particularly adverse effect on the German economy, especially since Germany also has an extremely high level of its own regulation compared to other member states.

5. Negative consequences of this runaway regulation include long, costly approval procedures, high reporting costs, less investment due to resources, including the necessary financial resources, being tied up, declining competitiveness, Germany becoming a less attractive business location for foreign investment, and a growing trend towards relocating business operations abroad.

6. Family businesses are especially affected because their competitiveness is based, in particular, on quick decisions thanks to short decision-making processes, consistent implementation of decisions, and a high degree of adaptability to changing circumstances.

7. Deficits in the way the Union and family businesses view each other make it more difficult to solve these problems. It seems as if the two sides are working at cross purposes and that the EU is not taking the specific needs of family businesses adequately into account. This adversely affects the co-operation between the Union and family businesses.

8. This has far-reaching consequences because the Union and family businesses bear a shared responsibility for the future of Europe. To fulfil this responsibility, a different form of co-operation is needed. The groundwork for this will be laid by returning to the shared values and goals that characterise and guide the behaviour of the Union and family businesses.

9. These values and goals stem from different sources. For the Union, they are based on applicable law, in particular from the founding treaties. In contrast, in the case of family businesses, they are an essential component of the traditional values of the owning family, which are also fundamental to the management and strategy of the company. However, this does not change the fact that these values and goals often coincide. Although the Union and family businesses operate at different levels, they ultimately work towards the same overarching goals.

10. Key shared goals and values include compliance with the law, open and fair competition, social

and societal responsibility, ensuring an equivalent standard of living, promoting sustainability, and strengthening the resilience of democracy.

11. This leads to a recalibration of how the Union and family businesses fulfil their respective responsibilities. The starting point for this is each company's freedom to conduct business. This original freedom is not granted by the state, but rather it is recognised by the state through the guarantee of fundamental rights. It is essential for functioning competition and an open market economy based on it.

12. The freedom to conduct a business is complemented by the regulatory function of the state. However, the use of the state's authority to restrict companies' economic freedom requires a sufficiently important objective reason. Furthermore, this must be done in accordance with the principle of proportionality. One such justification is the protection of the regulatory model of a social market economy, which is established and recognised in Germany and the Union.

13. In addition, the guarantees of the welfare state and the protection afforded by fundamental rights oblige the state to intervene if this is "necessary to protect the weaker, for example in emergencies, i.e. for social reasons." In contrast, the question of whether regulation is also permissible on grounds of environmental sustainability is disputed. This primarily applies to the question of whether an environmental transformation of the economy can be enforced via government regulation of companies and, if so, which measures are permissible. In any case, regulation must be limited to proportionate restrictions on companies' economic freedom and leave them the necessary scope to manage their own affairs as they see fit, for example by means of practical exceptions.

14. One important goal in the recalibration of the responsibilities of the EU and companies is the reduction of business compliance burdens resulting from regulation. To this end, a stronger focus on users by public authorities and the expansion of the digitalisation of administrative processes have been called for.

15. In view of these pressing issues, it is imperative that both the Union and family businesses establish a new form of co-operation in fulfilling their shared responsibility for the future of Europe. At its core, it should be characterised by the outlined division of responsibilities and an open culture of dialogue.

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Family, inheritance and tax law obstacles impeding the mobility of the international entrepreneurial family

by Prof. Rainer Kirchdörfer

I. Introduction

Globalisation and Europeanisation have shaped many areas of our lives over the course of decades. In this context, Germany has taken on a prominent role. As the largest economy in Europe and a key player on the global stage, Germany has been and continues to be a driver and beneficiary of the internationalisation of the economy and society.

Germany's strong position in this regard is due in no small part to the international presence of our family businesses. There are no longer any large German family businesses that are not closely interconnected with foreign countries. These larger family businesses are a mainstay of our economy and contribute significantly to its competitiveness. They epitomise innovation, continuity and social responsibility. Their high level of flexibility and the internationalisation of their shareholder base enable them to adapt quickly to global changes.

If you look more closely at the core of family businesses, you will find three dimensions or, in sociological terms, three systems: the family system, the ownership system and the business system. At all these levels, in all these systems, globalisation has been taking place to an ever greater extent, and continues to do so. A real-life example illustrates this:

> *A German business owner with a private residence and the registered office of his parent company on the German side of Lake Constance and a second home on the Arlberg in Austria wants to marry his Austrian fiancée in Switzerland and then move his marital residence to Switzerland. Once married, he ultimately wants to adopt the Austrian son of his new wife, who is of legal age, and prepare him to take over his company after he retires. To this end, he initially wants the son to gain more experience as managing director of a subsidiary in Italy.*

The example clearly shows that not only the ownership and management of the company, but also the internationalising owner family itself has a wide range of points of contact with different countries, thus simultaneously establishing civil law and tax law links to numerous jurisdictions. In the example, these are Germany, Switzerland, Austria and Italy. The different legal systems not only increase the complexity of the circumstances in all three of the aforementioned systems, but also lead to de facto obstacles to the personal mobility of members of the owning family. This sometimes conflicts with the principle of freedom of movement, at least within the European Union.

Part II of this essay summarises the legal challenges faced by the owning family as a result of internationalisation and shows which provisions based on the European treaties have been adopted that (also) contribute to the idea of freedom of movement. Part III deals with the tax challenges faced by a business-owning family in the process of internationalising. The exit tax is considered a prime example of a de facto restriction of the free movement of persons.

II. The role of the European Union in overcoming civil law challenges when a business-owning family internationalises

Organising the relationship between the business and the family is already legally complex for a family that owns a business which operates only within a single country, but this complexity increases significantly when the family goes international. The multitude of legal issues concerning the business-owning family itself and the organisation of the family's relationship with the company requires a great deal of planning, even in a purely national context. In an international environment, the requirements multiply with each additional legal system involved.

1. Challenges in the area of inheritance and family law

If, for example, a German business owner marries a foreign national, the spouses live abroad or the business owner dies abroad, complex issues arise in the areas of inheritance and family law, among others. The same applies if spouses wish to divorce or if a German owner sets up a will abroad in a form that does not correspond to the German form of will. All of this essentially affects non-business owners as well, but in the case of marriages in which one or both parties are business owners, there are additional serious (direct and indirect) effects on the family business.

The above-mentioned life circumstances initially affect "purely individual" legal transactions conducted by owners of family businesses, such as wills, prenuptial agreements or contracts waiving statutory inheritance rights. However, even family business shareholders are regularly compelled by the company's articles of association to act in a certain way in legal transactions. One example is ensuring, through marriage contract and inheritance law provisions, that shares in family businesses remain in family hands in the long term and that no (indirect) economic consequences arise from the participation in the company at its expense when calculating civil law compensation claims (such as a compensation for accrued gains in the event of divorce or a claim to a compulsory portion in the event of death). The purpose of such rules in the articles of association is to ensure the continued existence of the company as a family business.

The complexity of such "private legal transactions" at the intersection of family and business is magnified in an international context by the need to comply with different legal systems. For example, in order to meet the requirements of a (German) partnership agreement when implementing shareholder obligations, family shareholders with an international background must first be clear about which country's law their personal contracts are actually governed by. The respective national material inheritance and family law (known as substantive law) differs considerably between nation states.

In the area of substantive inheritance law, this applies, for example, to the following issues of importance to individuals that own shares in a family business:[1]

- How is intestate succession organised in the country concerned?
- Can succession in the country concerned be influenced (wholly or partly) by a will?
- Are inheritance contracts permissible?
- What is the relationship between several heirs in the country concerned and what is their relationship to a possible "executor"?
- Does the country in question have a forced heirship or a comparable right, and can this right be waived?
- How does moving abroad affect a last will and testament previously made in Germany?

1 See also Wiedemann, A. and Reinhart, F. (2021) *Die internationale Unternehmerfamilie – Wesentliche Aspekte* [*The international business-owning family – key aspects*], p. 33.

In the area of substantive family law, the answers to the following sample questions, which are of importance to business-owning families in the individual countries concerned, also vary greatly:

- Do spouses form joint assets or do they maintain separate assets?
- How are assets equalised in the event of divorce or the death of one of the spouses?
- Can any (post-marital) maintenance claims be waived?
- How does moving abroad affect contracts under family law that were previously concluded in Germany?

If the politically desirable aim were to answer the above questions uniformly, i.e. independently of the country concerned, the substantive law of the (affected) states would have to be standardised. However, this is neither politically nor socially desirable nor enforceable. Instead, there should be agreement between the states as to which substantive law is to be applied in cross-border cases. This question of private international law, which is considered before the substantive law, is accompanied by the procedural question of which court of which country from the group of relevant countries will decide on the applicable law and then on the substantive legal issue in the event of a legal dispute (international civil procedure law).

The answers to the above questions are all the more important for business-owning families because only by asking these questions can the family shareholders obtain certainty as to which law should govern their private contracts and their relationship with the company, and who will make the final decision in the event of a dispute. Ideally, family shareholders can themselves choose the applicable law (choice of law clause) and determine the internationally competent court (choice of court clause).

2. The interface between civil law and the provisions of the European single market

The expansion of the single market was a major factor in Germany's economic growth in recent decades. Its harmonisation established uniform standards, and the enforcement of fundamental freedoms has reduced cross-border obstacles. And yet what the European Commission stated in 2012 in the Single Market Act II still applies:[2] *"The development of the single market is an ongoing process."* It is therefore not surprising that the "establishment of the single market" continues to be enshrined as an objective in the European treaties.

At the same time, cross-border legal uncertainty that extends into matters of civil law effectively hinders the mobility of family business owners and goes against the principle of freedom of movement enshrined in the European treaties. The issues and the existing European solutions are presented below as regards succession (under II.2.a)) and family law (under II.2.b)).

a) Inheritance law

Precise arrangements are needed to determine succession in the ownership or partnership of family businesses. To this end, many business-owning families have agreed on clearly defined rules. The vast majority of family businesses' articles of association stipulate, for example, that shares in the company may only be transferred to descendants, but not to spouses or third parties, upon death. Furthermore, the typical content of articles of association of German family businesses also includes a clause that a shareholder must conclude an agreement with their spouse to limit or exclude the right to a forced share in the event of the shareholder's death, at least to the extent that the value of the company shares would otherwise be included in the calculation of the forced share. Such content of the articles of association must be implemented in accordance with applicable inheritance law (including internationally). Usually, this mandatory provision in the (German) articles

2 Communication from the Commission of 3 October 2012 – Single Market Act II, COM(2012) 573 final, p. 4.

of association is tailored to German law from a legal point of view. It cannot be readily transferred to the substantive inheritance law of other countries, which sometimes differs considerably.[3]

Each family member who also owns a share of the family business must therefore first determine which country's substantive law applies to their own private inheritance arrangements as regards their share of the company.

aa) European Succession Regulation

The European Union is prohibited from harmonising material substantive law. However, the member states have recognised that the proper functioning of the single market requires measures to resolve conflicts of jurisdiction and application of conflicting substantive law. The EU Succession Regulation is therefore part of a legislative programme to harmonise the conflict of laws of the EU member states. The Treaty of Amsterdam created the basis for this for the first time, which continues to apply today in Article 81(2)(c) TFEU. After numerous studies and consultations, the EU Succession Regulation was finally adopted on 4 July 2012.[4]

The problems associated with the various and divergent substantive rights have been partially alleviated by the EU Succession Regulation.[5] The Regulation lays down the substantive law applicable to the succession (inheritance statute), for example after a cross-border move, determines international jurisdiction and sets out rules governing the recognition and enforcement of decisions and documents in matters of succession.[6]

The primary criterion for determining the applicable substantive law is the habitual residence of the deceased at the time of their death (Article 21(1) EU Succession Regulation). However, the testator may, within certain limits, determine the applicable substantive law by means of a choice of law clause in their last will and testament (Article 22 EU Succession Regulation). This applies in particular to the law of their home country (home law).

> *Example: If the German business owner Mr A dies in Switzerland, but included a corresponding choice of law clause in his will in favour of German law, this choice of substantive German law will be recognised by Germany, Italy and Austria on the basis of the EU Succession Regulation. Switzerland would also follow this choice of law because it is permitted under its national law.*

The EU Succession Regulation, on the other hand, does not explicitly permit the testator to select an (international) court of jurisdiction in addition to the application of the relevant law. However, if the deceased did include a respective choice of law clause in their will, the court initially responsible can declare itself incompetent in favour of a court whose law the deceased had chosen.

The EU Succession Regulation also applies to third-country matters,[7] for example, to cross-border matters between Germany and the United States. This does not mean, of course, that a third country not party to the EU Succession Regulation would be (correspondingly) bound by its provisions. In these cases, the law of the third country must always be examined as well. Finally, it should be noted that Denmark and Ireland already reserved the right not to be bound by such provisions when the treaties were concluded. Consequently, they did not sign the EU Succession Regulation either.

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3 On this, see Wiedemann, A. and Reinhart, F., ibid., p. 36 f. and Süß, R. (2025) *Erbrecht in Europa* [Inheritance law in Europe], 5th edn.

4 For a detailed treatment, see Schmidt, J. in: BeckOK EU Succession Regulation (2024), Art. 1 para. 2.

5 Council Regulation (EU) No 650/2012 of 4 July 2012.

6 For a detailed treatment, see Köhler, A. (2024) in Gierl, W., Köhler, A., Kroiß, L. and Wilsch, H *Internationales Erbrecht* [*International inheritance law*], sec. 1, paras. 4 ff.

7 Schmidt, J., ibid., Art. 1 para. 10 ff.; from Germany's point of view, an exception to this applies to states with which overriding treaties have been concluded, including Turkey, Iran and Russia.

bb) Side note: Hague Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions (HCCH 1961 Form of Wills Convention)

Irrespective of the above, a family member who is also part owner of the family business must ensure that a will drawn up or an inheritance contract concluded abroad is also recognised as valid in both their home country and abroad as regards its form. The question of the law governing the admissibility and substantive (formal) validity of a last will and testament (valid execution statute) must therefore be answered independently of the substantive law of succession (inheritance statute). This is another area where the respective national legal systems differ.

The EU Succession Regulation allows the testator in Article 24 ff. to include a choice of law clause in their last will and testament (with a sufficient connection to the relevant state) to determine the national substantive law according to which the admissibility of a certain type of last will and testament (e.g. will, joint will, inheritance contract) and its substantive validity (e.g. testamentary capacity) is to be determined.[8]

However, no such choice of law clause exists for the question of which provisions determine the formal validity of a last will and testament. However, Article 27 of the EU Succession Regulation introduces numerous reference points that lead to formal validity. These include, among other aspects, the law of the state of which the deceased was a national at the time of the valid execution of the will or at the time of their death. It should be noted that the provisions of Article 27 of the EU Succession Regulation may be superseded by the Hague Form of Wills Convention,[9] which takes precedence.[10]

Insofar as countries do not apply the EU Succession Regulation and have also not joined the Hague Convention (e.g. the United States[11]), the individuals concerned are always advised to check the special (formal) requirements governing the valid execution of a last will and testament in this third country and to additionally fulfil them as a precaution. In practice, this is sometimes taken into account by means of separate foreign wills (but with identical content).

Continuing the example: if the German business owner Mr A has drawn up his will in compliance with the formal requirements of German law (and only German law), Austria and Switzerland will also recognise this on the basis of the HCCH 1961 Form of Wills Convention. Italy has not ratified the HCCH 1961 Form of Wills Convention, but would recognise the valid execution of the will on the basis of Article 27 of the EU Succession Regulation.

b) Family law

In family law, a wide range of structurally similar questions arise. In the case of marriages with a cross-border dimension, the substantive family law applicable in a specific case is of material significance for a family member who is a shareholder in a family business. Before one or both spouses move abroad, the effects on a pre- or postnuptial agreement must be examined. From the business point of view, the legal provisions relating to marital property are particularly important because they can indirectly affect the financial structure of the family business. In family law, too, there are significant substantive differences between different national legal systems.

There is a whole catalogue of European regulations on matters of matrimonial and family law that have been adopted by way of enhanced judicial cooperation

8 Loyal (2024) in *BeckOK BGB*, 72nd edn, Art. 24 EU Succession Regulation, para. 8.

9 Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions, German Federal Law Gazette 1965 II, p. 1145.

10 Köhler, ibid., sec. 4, para. 65.

11 See Leithold, S. in: Burandt, W. and Rojahn, D. (2022) *Erbrecht* [*Inheritance law*], 4th edn, USA, para. 21.

(Article 81(2)(c) TFEU) and which relate to international judicial competences, the recognition of court rulings and the determination of the applicable law:

- The Rome III Regulation[12] determines the applicable law in the event of divorce and applies between the member states of Austria, Belgium, Bulgaria, France, Germany, Hungary, Italy, Latvia, Luxembourg, Malta, Portugal, Romania, Slovenia and Spain. Article 5 of the Rome III Regulation initially establishes far-reaching options as regards the choice of law. In the absence of a choice of law, as a general rule, the law of the country of habitual residence of both spouses at the time the court is seized applies.[13]
- The EU Matrimonial Property Regulation[14] and the EU Registered Partnership Regulation[15] are also of particular importance for international business-owning families. They apply in all member states except Denmark and Ireland. Together they determine the applicable substantive law governing the entirety of the property relationships arising from the marriage or registered partnership. The exceptions are alimony and large portions of the maintenance settlement.[16] The regulations allow for a broad choice of law and choice of court of jurisdiction.
- The EU Maintenance Regulation[17] lays down rules on international jurisdiction and the recognition and enforcement of decisions relating to maintenance obligations and, by referring to the Hague Protocol, also rules on the law applicable to such obligations. It also provides for the possibility of an agreement on the choice of court of jurisdiction.
- The Brussels IIb Regulation,[18] which applies in all member states except Denmark, governs the jurisdiction of courts and the recognition of judgements in matters of international custody and cross-border child abduction. In this context, the courts' jurisdiction is primarily based on the child's habitual residence; however, the Regulation does allow for a choice-of-court agreement within certain limits.

As an example, to take account of the provisions in the articles of association of a family business regarding the treatment of the value of the company share when calculating a claim for equalisation of accrued gains in the event of divorce, the German entrepreneur X, who lives in Switzerland, can conclude a marriage contract with his Austrian wife in which the application of German law is stipulated and the claim for equalisation of accrued gains is then modified or excluded. Germany, Italy and Austria recognise such an arrangement on the basis of the EU Matrimonial Property Regulation. Switzerland would also follow this choice of law on the basis of national law.

The multitude of regulations shows that much has already been regulated at the European level in the area of international family law, which significantly increases the cross-border "mobility" of business-owning families. The relevance of a unified system for determining the applicable law and the jurisdiction of the courts, and the problems that arise when there are no such regulations, were recently the subject of intense public scrutiny in the context of a cross-border dispute between Germany and Denmark concerning the custody of the children of a German business-owning family.[19]

12 Council Regulation (EU) No 1259/2010 of 20 December 2010.

13 See Rieck, J. (2024) in Rieck, J. and Lettmaier, S. *Ausländisches Familienrecht* [*Foreign family law*], para. 15.

14 Council Regulation (EU) No 1103/2016 of 24 June 2016.

15 Council Regulation (EU) No 1104/2016 of 24 June 2016.

16 Andrae, M. (2024) in Andrae, M. *Internationales Familienrecht* [*International family law*], sec. 4, para. 1.

17 Council Regulation (EG) No 4/2008 of 18 December 2008.

18 Council Regulation (EU) No 2019/1111 of 25 June 2019.

19 Denmark has not adopted the Brussels IIb Regulation and was therefore not bound by the 2021 decision of the Higher Regional Court of Hamburg; see also Legal Tribune Online, 8 January 2024, *https://www.lto.de/persistent/a_id/53578* (accessed on 14 January 2025).

The Danish example cited also shows, however, that – in particular with regard to the question of recognising a choice of law clause – the conflict of laws of each state must still be examined if that state has not acceded to a multilateral agreement. In this respect, the task of convincing further states to join the collective regulations remains here as well.

III. The role of the European Union in overcoming tax challenges when a business-owning family internationalises

The tax issues faced by international business-owning families are no less complex. This applies, for example, to a member of a business-owning family who is planning to change their place of residence, but also to succession planning for the company.

1. Challenges in the area of tax law

The necessary awareness of the problem is constantly being raised in business-owning families and the family offices of business-owning families, in order to examine the tax consequences in advance of planned changes in the private sphere of the business-owning family and to scrutinise them in the context of the following aspects (among others):

- How does the tax situation change for the family business and/or for a shareholder if the latter moves their place of residence abroad?
- Is a tax liability triggered simply by taking up residence in a foreign country?
- How does it affect German taxes (including corporate income tax) if the managing partner suddenly makes the most important operational and strategic decisions abroad?

These questions arise even when family members are not directly involved in the family business themselves, but simply receive or can receive distributions from a family foundation as beneficiaries, for example, from the income from a foundation's shares in the family business. In such a case, when moving abroad, the following, for example, should be taken into account:

- Is it possible that assets of the German family foundation to which the family member concerned has no legal access may be (directly) attributed to individual family members abroad on the basis of their position as a governing body or as a beneficiary of a family foundation under foreign tax law?
- How are the earnings (distributions) of a German family foundation taxed in the beneficiary's country of residence?
- How does the applicable foreign inheritance law treat the death of the founder or a beneficiary?

With the exception of bilateral double taxation agreements (DTAs), there are hardly any regulations in the area of tax law that would strengthen the cross-border freedom of movement of the business-owning family. Rather, there are many situations based on the tax status quo that are economically equivalent to a "ban on relocation" of family members who own shares in a family business. This fact, although not particularly surprising to the informed reader, is alarming in the context of the present discussion.

2. European law and tax law

That said, the European Union's hands are not necessarily tied. Although the EU treaties do not provide the EU with any inherent legislative powers with respect to tax law – as is also the case for substantive inheritance and family law – this does not prevent the EU from also issuing tax regulations on the basis of its internal market powers (Article 4(2)(a) TFEU). Although Article 4(2)(a) TFEU does not itself constitute an enabling provision, the instrument of harmonisation can be used to remedy

this, which can be applied in the area of direct taxation under the conditions set out in Article 115 TFEU.[20]

The European Union has not remained inactive in this area either, but has repeatedly made use of the enabling powers granted to it. Individual regulations also served to reduce tax obstacles to cross-border business activity. Examples include the Directive on Administrative Co-operation in the field of Taxation[21], the Parent-Subsidiary Directive[22] and the Merger Directive[23].

Over time, however, the institutions of the European Union have given less priority to removing tax barriers to cross-border business activity. Instead, their focus increasingly shifted toward protecting the tax base. This has already become apparent from the adoption of ATAD I[24] and ATAD II[25], as well as the draft of ATAD III. The amending directive on the Directive on Administrative Cooperation (DAC6)[26] with its reporting requirement for cross-border tax arrangements and Pillar II[27] (global minimum taxation) are also relevant in this context.

By contrast, combating intra-EU fiscal obstacles to the single market is less often addressed by the European Commission and is instead, in practice, subject to review on the basis of the fundamental freedoms and thus the lengthy route to the European Court of Justice.

3. Exit tax

The image shown above is particularly exemplified by the example of taxation on the departure of a "material" shareholder of a company to a foreign country. If a family member that owns shares in a family business intends to move across the border, the family is confronted with existential questions (i.e. questions of material importance as regards the family business).

Whether and when a shareholder is deemed to have "relocated" for tax purposes, and what the consequences of this are, depends first of all on the legal form of the company and the nature of its operational activities. The tax regulations differentiate between partnerships (business premises) on the one hand and corporations on the other, and also according to the activity – commercial or asset management – and the composition of the corporate assets. The following few examples should help to illustrate this:

- *If a shareholder in Germany holds at least 1 percent of the shares in a corporation under civil law (directly or indirectly) and these shares are considered to be part of their private assets for tax purposes, there is a risk of an exit tax being imposed if they leave Germany.*
- *The same applies if the shareholder holds the shares in the corporation through an asset-managing partnership or if the shares are not assigned to the partnership's tax operating assets. The legal owner of the shares in the corporation under civil law is then the partnership. For tax purposes, however, the shares in the corporation are attributed to the private assets of the shareholder (if applicable, on a pro-rata basis in accordance with section 39(2)(2) sentence 1 of the German Fiscal Code.*
- *If the shares in the corporation are owned by the shareholder under civil law, but for tax purposes they are assigned to the shareholder's business assets (their sole proprietorship or the special business assets of a commercial partnership), then an exit*

20 Fehling, D. (2020) in Schaumburg, H. and Englisch, J. *Europäisches Steuerrecht* [*European tax law*], paras. 10.20 ff.

21 Council Directive (EEC) 799/1977 of 19 December 1977.

22 Council Directive (EEC) 435/1990 of 23 July 1990.

23 Council Directive (EEC) 434/1990 of 23 July 1990.

24 Council Directive (EU) 1164/2016 of 12 July 2016.

25 Council Directive (EU) 952/2017 of 29 May 2017.

26 Council Directive (EU) 822/2018 of 25 May 2018.

27 Council Directive (EU) 8778/2022 of 25 November 2022.

tax does not apply in the event of their relocation. Instead, however, what is known as "taxation upon leave of tax net" (with similar legal consequences) can be triggered.

- *"Taxation upon leave of tax net" and not an "exit tax" may be imposed in the event of a shareholder moving abroad in certain cases, even if the shares in the corporation belong under civil law to a partnership in which the shareholder has an interest and the shares in the corporation are attributable for tax purposes to the business assets of the commercially active or commercially oriented partnership.*
- *The case is different again if the commercial or commercially-oriented partnership elects to be taxed as a corporation. In this case, the shareholder's shares in the opted partnership are in turn treated as shares in a corporation. If these are categorised as private assets for tax purposes, the shareholder may be subject to exit tax if they relocate abroad.*

In practice, the greatest "challenges" usually arise when shareholders of a corporation plan to relocate, i.e. in the area of the traditional exit tax. Therefore, the equivalent for interests in partnerships, known as "taxation upon leave of tax base" will not be further discussed in this essay.[28] However, the following fundamental statements and considerations can be applied to the taxation upon leave of tax base.

a) What is exit taxation – facts and legal consequences

Put simply, exit tax is the taxation of a notional profit realised by a shareholder that is "exiting" the country by relocating abroad who holds at least one percent of the shares in a corporation. It is of the utmost importance and poses the greatest risk for family members who are shareholders in a family-owned corporation, since shareholders can trigger the conditions not only when they move abroad (which can be planned), but also in numerous other unforeseeable circumstances,[29] and because the tax is incurred independently of any cash inflow.

Specifically, the exit tax covers shares in corporations under German law or comparable foreign legal forms, provided that the relevant ("exiting") shareholder directly or indirectly held at least one percent of the company's share or nominal capital at any time during the last five years (even if only for a short period).[30] Furthermore, the interest must be treated as part of the individual's private assets for tax purposes. Another requirement is that the affected ("exiting") natural person has been subject, without limitation, to unlimited tax liability in Germany for at least seven of the previous twelve years.[31]

The individual's relocation abroad is ultimately what triggers the tax liability. The circumstances under which a person is deemed to have "exited" are outlined in section 6(1) sentence 1 of Germany's External Tax Relations Act. It specifies three "grounds for deeming an individual has exited", namely the termination of unlimited tax liability (no. 1), the transfer without consideration to a person without unlimited tax liability (no. 2), and the exclusion or restriction of Germany's right to tax the individual (no. 3).

The first type of exit (in the narrower sense) requires the termination of unlimited tax liability in Germany, i.e. abandonment of one's German domicile and usual place of residence in Germany.[32]

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28 Layer, B. (2024) "Der 'wegziehende' Mitunternehmer – Steuerliche und ausgewählte sonstige Aspekte" ["The 'relocating' co-owner – tax and other selected aspects"], *DStR*, pp. 1049 ff.

29 Since October 2024, exit taxation has been effectively extended to significant shares of private assets in investment funds by establishing a parallel regulation in Germany's Investment Tax Act; see section 19(3) of the Investment Tax Act.

30 Federal Ministry of Finance (2023) "circular dated 22 December 2023", *German Federal Tax Gazette* I 2023, special issue 1, 2, para. 6.1.3.

31 Pohl, C. (2024) in Brandis, P. and Heuermann, B. *AStG* [*External Tax Relations Act*], sec. 6 External Tax Relations Act., paras. 33 ff.

32 For further points of contention, see Pohl, C., ibid., section 6, para. 44; Benecke,]. (2024) in *BeckOK AStG*, section 6, para. 50.

Variation on the example above: If the business owner Mr A, who has been subject, without limitation, to taxation in Germany for many years, runs his business in the legal form of a corporation, he would trigger the exit tax as a result of moving to Switzerland, giving up his domicile and changing his usual place of residence. As a result, he would have to pay tax on the unrealised gains in the shares in full as if he had sold his shares at market value.

This variation of the tax situation could easily be avoided in practice simply by a family member that owns shares in a family business maintaining a flat (or their usual place of residence) in the country.

The second variation is more difficult to "plan" – in addition to the traditional variation of relocating abroad, exit taxation applies when a family member that owns shares in the family business transfers their shares free of charge to a person who is not subject, without limitation, to taxation in Germany. This includes, on the one hand, the (plannable) act of gifting shares during one's lifetime, but also the (less plannable) transfer in the event of death, insofar as the shares are transferred to persons who neither have a domicile nor their habitual residence in Germany.[33]

Variation on the example above: If the business owner Mr A, who has been subject, without limitation, to taxation in Germany for many years, gifts or bequeaths his shares in the corporation to his new wife's son, who lives in Austria, the exit tax would be triggered when the shares were transferred.

After all, under section 6(1), sentence 1, no. 3 of the External Tax Relations Act, excluding or limiting Germany's right to tax the gain on the disposal of the shares is also sufficient grounds upon which to impose exit taxation. This includes a wide range of situations:

Among them are, for example, the loss of the right to tax due to a change of residence under the terms of a double taxation agreement ("actively leaving the tax net").[34] The basis for this is Article 13(5) of the OECD Model Tax Convention, which assigns the right to tax capital gains from the disposal of shares to the country of residence. While it is possible to retain one's domicile, this applies only to a limited extent to the question of one's "residence" under a DTA. The issue of residence is particularly relevant in cases where one has multiple domiciles in Germany and abroad. If the taxpayer is deemed to be resident in both signatory states under the relevant double taxation agreement and under national law, the taxpayer will henceforth only be deemed to be resident in one of the two states for the purposes of the double taxation agreement. If the taxpayer has a residence in both countries, the taxpayer's centre of vital interests shall henceforth be decisive. While the centre of vital interests must be determined according to objective criteria, it is ultimately a question of circumstances and may change over time between the country from which the person has exited and the country to which the person has moved. The double taxation agreements, which were originally concluded for the sole purpose of avoiding double taxation, suddenly create the risk of a restriction of German tax law and thus the risk of triggering the exit tax.[35]

The taxable event can even be triggered by the destination country entering into a double taxation agreement (after) the individual has exited, which results in the exit country losing its right to tax the individual (known as passively leaving the tax net).

Changing the legal form of a domestic partnership (permanent establishment) into a corporation, which in practice is possible and often occurs even against the will of individual partners, also poses an "exit tax problem" for a partner living abroad.

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33 For a detailed account, see Reinhart, F. (2025) in Oppel, F. et al. *Beck'sches Family Office Handbook* [*Beck's Family Office Handbook*], sec. 4, paras. 1568 ff.; Benecke,]., ibid., sec. 6, paras. 56 ff.

34 See Grützner, H. (2023) in Haase, F. *Wegzugsbesteuerung* [*Exit taxation*], paras. 341 ff.

35 For a detailed account, see Reinhart, F. op. cit., sec. 4 para. 1575 ff.

b) Practical problems related to exit tax for owners of family businesses

The following practical examples illustrate the extent to which the exit tax restricts the mobility of family business owners who plan to move across borders and the "surprises" it holds for the family:

- *A family member that owns shares in a family business with the legal form of a corporation is not operationally active in the family business, but has a management position with a large international corporation. In order to advance further in the management structure, they are offered the opportunity to manage a subsidiary in New York in the United States. The family member has to turn down the offer because their employer cannot guarantee that they will return to Germany in the years to come (within seven years, to be precise). The family member is also not able to provide the security required for a deferral of the exit tax.*
- *Three younger family members that own shares in a family business with the legal form of a corporation are supposed to take over the management of the German parent company and two subsidiaries abroad in the long term. In order to gain management experience in their own company, the three successors are each to take over the management of a foreign subsidiary. Depending on how things go, one of the three family members will end up returning to Germany, while the other two will take on the long-term management of the foreign subsidiaries.*
- *A member of a German family who owns shares in the family business has passed away in Germany. Upon his death, his shares were transferred to his wife, who also lives in Germany. Due to his religious beliefs, the deceased family member expressed the wish to be buried in Israel, where one of his daughters lives. During the funeral in Israel, the deceased's wife, who travelled to Israel for the funeral, has a serious accident and is henceforth in need of care. It is not possible for her to return to Germany; from this point on, the wife will live in a nursing home in Israel, close to her daughter.*
- *A business-owning family wants to gift their children shares in the family business (with the legal form of a corporation) at an early stage. On her 14th birthday, the mother gifts her daughter shares in the family business. At the age of 16, the daughter temporarily moves to a boarding school in England. Following this, she studies at LBS for four years and then wants to work at PwC in London, where her English fiancé is also employed.*
- *A family member who owns shares in the family business with the legal form of a corporation meets his true love, a local Italian woman who owns a hotel, while on holiday in Sardinia. The couple would like to establish their shared centre of vital interests in Italy and run the hotel together.*
- *A father owns a share in the family business in the legal form of a corporation. His daughter has been living in France for a long time, where she runs a museum. The father dies unexpectedly and leaves his daughter a share in the company.*
- *A family member that lives in Switzerland and owns shares in the family business based in Switzerland and in the legal form of a corporation meets his new partner in Germany and moves to Munich to live with her. The relationship lasts 14 years. After the divorce, he moves back to Switzerland.*
- *A family member that owns shares in the family business with the legal form of a corporation moves to Brazil and deliberately retains his apartment in Stuttgart. In the absence of a DTA between Germany and Brazil, there is no restriction on Germany's right of taxation. Some time later, he learns that Germany and Brazil have now signed a model double taxation agreement after all.*
- *A family member who owns a 5 percent share in a German family business with the legal form of a partnership lives in Canada. Against his will, the family business is converted into a stock corporation pursuant to section 1(4) of the German Reorganisation Tax Act (Umwandlungssteuergesetz).*

c) Conflicts of interest and competence in the context of exit tax

When the exit tax was introduced in 1972, legislators initially intended it to (only) close existing or perceived tax loopholes in international situations. Today, the argument of preventing tax avoidance is less frequently used to justify exit taxation. Rather, it is an integral part of the revised and, in various legal provisions, codified concept of leaving the tax net for certain private and business assets.[36] The focus of fiscal interest is on a "fair" allocation of taxation rights between the country the individual is exiting and the country they are moving to.

The interest of the country the taxpayer is exiting in taxing the individual exiting is, by its very nature, contrary to the interest of the exiting family business shareholder, who has not received any liquid funds to finance the exit tax due to the lack of an actual sale. Taxpayers are protected by the ability-to-pay principle, which is enshrined in the constitution and defined in more detail in the area of income tax law by the realisation principle. Accordingly, not every notional increase in value is subject to income tax, but only the gains that have actually been realised (principle of actual ability to pay). Legislators must, as a rule, adhere to this specific manifestation of the ability-to-pay principle (requirement of consistency); any deviation from a consistent taxation framework requires an objective justification capable of legitimizing unequal treatment.[37] Even if a departure from the ability-to-pay principle under income tax law were justifiable in the present case – and the exit tax were therefore constitutionally permissible – it would still constitute a systematic inconsistency within the tax framework. This is because it brings forward the point of taxation to a time prior to the actual disposal of shares, and thus before the gains are in fact realised.

However, the interest of the country the taxpayer is exiting in levying tax also conflicts with the fundamental freedoms enshrined in the European treaties – in particular, the freedom of establishment and the free movement of workers.[38] These two fundamental freedoms also protect individuals from measures by the state the taxpayer is exiting that would make it more difficult for its nationals to establish themselves or take up employment in another member state – for instance, through advance taxation, the requirement to provide a financial guarantee, or even a mere tax filing obligation.[39] However, an interference with the scope of protection afforded by the fundamental freedoms may be justified under Union law if it pursues a legitimate objective and is proportionate – in other words, suitable, necessary, and appropriate. In the present case, the interference with Union law is counterbalanced by legitimate interests of the national legislature – in particular, preserving the allocation of taxing rights between member states and safeguarding tax collection by member states to prevent revenue shortfalls. These grounds have now been established as "overriding requirements of the general interest".[40] However, the adopted provision must likewise satisfy the principle of proportionality. In this context, a particular question arises as to whether preserving the allocation of taxing authority and safeguarding tax collection cannot also be achieved by less severe means, and whether the existing rules go beyond what is necessary to achieve the legitimate interests.[41]

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36 Benecke, J., ibid., sec. 6, introduction.

37 Tischendorf, M. (2024) *IStR*, pp. 713, 714 with further references.

38 CJEU, judgement of 21 December 2016 – C 403/14 (Commission v Portugal); CJEU, judgement of 11 March 2004 – Case C-9/02 (de Lasteyrie du Saillant); on third-country issues and the free movement of capital and persons, see Kudert, S., Hagemann, T. and Kahlenberg, C. (2017) *Die Internationalisierung der Unternehmerfamilie – Reformvorschläge für die Wegzugsbesteuerung* [The internationalisation of the business-owning family – exit taxation reform proposals, p. 51, and CJEU, judgement of 26 February 2019 – C-581/17 (Wächtler); ibid., judgement of 6 September 2023 – I R 35/20.

39 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 51 with further references.

40 CJEU, judgement of 7 September 2006 – C-470/04 (N); ibid. CJEU, judgement of 21 December 2016 – C-503/14 (Commission v Portugal), Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 48 with further references; Schönfeld, J. (2024), *IStR*, 369, 371.

41 See, for example, CJEU judgement of 26 February 2019 – C-581/17 (Wächtler); Schönfeld, J. (2024), *IStR*, 369, 370.

At the international level, the situation is further complicated by the fact that an exit tax levied in the country the taxpayer exits is not automatically taken into account by the country the taxpayer relocates to in the event of a subsequent sale. The exiting shareholder is therefore exposed to the risk of double taxation.

d) Available relief measures, in particular deferment options and instalment payments

Although the exit tax is assessed immediately after leaving the country and is generally immediately payable in full, German legislators have repeatedly revised the regulations and provided for legal relief in response to concerns raised by the CJEU under EU law. The following payment facilities are currently available under the law:

Firstly, there is the option of paying the tax assessed in seven equal annual instalments, without interest, upon application and upon provision of security (section 6(4) External Tax Relations Act).

Furthermore, section 6(3) External Tax Relations Act stipulates that if the absence is only temporary, any exit tax assessed in the meantime will retroactively cease to apply (known as the "repatriates rule").[42] Such temporary absence is deemed to exist if the taxpayer actually returns within a seven-year period.[43] The period can be extended by a further five years to a total of up to twelve years. However, even if the taxpayer returns, the exit tax assessed will only be waived if the German right of taxation with respect to the gain from the disposal of the shares is re-established at least to the extent that it existed at the time the taxpayer left the tax net.

Finally, there is the option of deferring exit tax payment (usually only against provision of security, however) for the period of temporary absence – i.e. up to twelve years. If the exit tax is ultimately not waived in this case, however, interest will be levied (retroactively) for the deferral period. In contrast, the option of an interest-free deferral for an unlimited period of time without the provision of collateral for relocations within the European Economic Area was abolished with effect from 1 January 2022.

Regardless of whether the taxpayer returns or is granted a deferral, the unrealised gains inherent in the shares will be taxed if the shares in the corporation are sold or contributed to business assets after leaving the country. In this case, there is a risk of double taxation if (and because) the destination state does not take the German exit tax into account and taxes the unrealised gains (in full) itself. Under German law, unrealised gains in the shares are also subject to taxation if, following the taxpayer's relocation, profits are distributed that exceed one quarter of the shares' fair market value.

The legislative materials indicate that German legislators consider the revised provisions to be generally consistent with EU law.[44] In the literature, this view is rightly doubted.[45] This is particularly true in view of the recent statements by Germany's Federal Fiscal Court.[46]

e) Criticism of the existing exit tax

In light of the above, the current structure of the exit tax under section 6 External Tax Relations Act continues to be subject to harsh criticism. The complaints centre on violations of EU and constitutional law, distortions in the tax system and the misplaced economic incentives created by the exit tax.

The Simplified Corporate Taxation expert commission,

42 Kraft, G. (2022) "Die reformierte Wegzugsbesteuerung – Ökonomische, verhaltenssteuernde, verfassungsrechtliche und unionsrechtliche Aspekte" ["Exit taxation reform – Economic, behavioural, constitutional and EU law aspects"], pp. 83 ff.; Pohl, C., ibid., sec. 6, paras. 79 ff.; Benecke, J., ibid., sec. 6, paras. 172 ff.

43 See also Seemann, A. and Neckenich, L. (2021), *FuS*, pp. 198 ff.; on EEA matters, see also Reinhart, F., ibid., sec. 4, para. 1595.

44 Bundestag publication (Bundestagsdrucksache, BT-Drs.) 19/28652, p 47.

45 Häck, N. (2020), *ISR*, pp. 17 f.; Pohl, C., ibid., sec. 6, para. 15.

46 Federal Fiscal Court, judgement of 6 September 2023 – I R 35/20; see also Layer, B. and Neckenich, L. (2024), *FuS*, pp. 40, 41 f.

which was tasked by the German Federal Ministry of Finance with developing specific proposals for practical and politically feasible solutions for a modern and innovative tax law, has come to the conclusion that the exit tax constitutes a disproportionate tax sanction on relocation.[47]

Criticism has also been levelled at the fact that exit taxation has a negative impact on the attractiveness of Germany as a business location for established companies and start-ups, in that the exit tax not only affects the mobility of existing shareholders, but also that of (potential) investors, and thus the establishment of new companies in Germany.

In a study carried out on behalf of the Foundation for Family Businesses, Kudert, Hagemann and Kahlenberg (European University Viadrina) already systematically addressed many of the consequences mentioned above in 2017 and also pointed out the constitutional and EU law issues.[48] Even after the latest reform of exit taxation in 2022, a new study by Kraft (Martin Luther University Halle-Wittenberg) comes to the conclusion that parts of the existing regulations can be seen as a "blatant" violation of EU law, in particular the freedom of establishment. In this context, the "impediment to the cross-border mobility of persons" is consciously tolerated.[49]

A comparison with other major economies shows that the exit tax is not a purely German phenomenon. For example, France, Austria and the United States also have comparable exit taxes. Conversely, there are numerous countries within Europe that do not impose an exit tax at all – including Switzerland, Greece, Italy and Luxembourg.[50] With the reform of 1 January 2022, the German exit tax came to be regarded – if not before, then certainly at that point – as one of the most aggressive internationally.

f) Reflections on a sustainable exit tax reform

Against the backdrop of the potential loss of taxing rights associated with a taxpayer's exit – specifically in respect of unrealised gains accrued during the taxpayer's period of residence in the state being exited – a complete abolition of the exit tax is not feasible from a tax policy perspective. Furthermore, EU law does not require the complete abolition of exit taxes either. Thus, in the context of exit taxes, the preservation of an appropriate distribution of taxation powers and the efficiency of tax collection have been established as (unwritten) justifications.[51]

In terms of tax policy and EU law, the aim must therefore be to strike the best possible balance between the conflicting interests – namely the interest in taxation on the part of the country the taxpayer is exiting and the country the taxpayer is entering, as well as the shareholder's interest in freedom of movement. From the perspective of the country the taxpayer is exiting, both the substantive protection and the legal enforceability of its taxing rights must be considered as part of the overall balancing of interests. Any proposed solution must therefore preserve the substantive right of the state the taxpayer is exiting to tax the unrealised gains in the shares of the corporation up to the time of their exit, and ensure that the resulting tax claim can be enforced at any time. Finally, accompanying regulations are needed to avoid double taxation.

In line with regulations already in place in other countries, there are many proposals for reforming the exit tax in Germany.

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47 Expert Commission (2024) *Final report on "simplified corporate taxation"*, p. 146.

48 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., pp. 1 ff.

49 Kraft, G., ibid., p. 114 f.

50 Expert Commission, ibid., p. 147.

51 For a detailed account, see Englisch, J., in: Schaumburg, H. and Englisch, J. (2020) *Europäisches Steuerrecht* [*European tax law*], para. 7.224.; Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 48 f.

If the objective of a proposed solution is to codify measures that are binding on both the state the taxpayer is exiting and the state they are relocating to, then the appropriate starting point must, in principle, be at the level of double taxation agreements (see section III.3.f.aa)).

If such a treaty-based solution is not feasible, the question arises as to how national law might be adjusted to better reflect the interests of taxpayers who own shares in a family business, without jeopardising the legitimate interest of the country the taxpayer is exiting in taxation, as outlined above (see section III.3.f.bb)).

Given that the business owner's right to freedom of movement is also safeguarded by the fundamental freedoms of the European Union, the question arises as to what role the EU can assume in reconciling the competing interests at stake (see III.3.f.cc)).

aa) Treaty solution: reallocation of taxation rights

In most cases, existing double taxation agreements assign the right to tax the profits from the sale of shares in corporations to the destination country if the shareholder moves to the destination country and also becomes resident there under the terms of the agreement (Article 13(5) of the OECD Model Tax Convention). For this reason, the state the taxpayer is exiting asserts its taxing rights at the last possible moment by imposing an exit tax on the unrealised gains in the shareholder's shares in the corporation – despite the fact that the shares have not been disposed of. If the shareholder's interest in freedom of movement is taken into account, then the aim must be to divide the right of taxation in the event of a later sale under the agreement in such a way that the taxation of the increase in value of the shareholder's shares in the corporation remains with the state the taxpayer is exiting until the taxpayer relocates. The tax base currently "secured" by the state the taxpayer is exiting through the applicable exit tax would, in that case, not be lost in substantive terms under the double taxation agreement.

However, the formal enforceability of the tax claim would also need to be ensured through an appropriate administrative cooperation provision within the double taxation agreement.[52]

As a result of such double taxation agreements, the state the taxpayer is exiting could refrain from immediately assessing tax at the time of exit and could tax the unrealised gains at a point in time when the taxpayer actually realises the unrealised gains in the country they relocated to, without running the risk of losing access to the gains in relation to said country.[53] At the time of the shareholder's exit, the value of the unrealised gains in the exiting shareholder's shares in the corporation would have to be ascertained.

The main function of double taxation agreements is, after all, to prevent double taxation. In this context, if the taxing rights are allocated by the DTA in such a way that the state the taxpayer is exiting is granted the exclusive right to tax the increases in value up to the date of exit, the taxing right of the state the taxpayer is relocating to is automatically limited to increases in value from the date of their relocation ("step-up"). This would prevent double taxation from the outset.

Such a solution under treaty law has the following advantages: the tax assessment in the state the taxpayer is exiting would only be performed at the time the taxpayer materially realises the income. Moreover, the mere valuation of the shares – unlike an exit tax that arises and is assessed at the time of exit – would not diminish the taxpayer's creditworthiness with financial institutions. Finally, double taxation of unrealised gains in the shares would be ruled out under such bilateral provisions.

52 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 70.

53 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 42 f.

Example: Business owner Mr A founds his corporation based in Germany as sole shareholder in year 1. The initial outlay amounts to EUR 1 million. In year 10, business owner Mr A relocates to Switzerland, giving up his domicile and usual place of residence in Germany. The market value of the shares in the corporation at this time is EUR 10 million. In year 15, business owner Mr A sells his shares to a third party for EUR 15 million. Germany would continue to have the right to tax the capital gain up to the time of departure (i.e. EUR 9 million). If Switzerland limits its right of taxation to the increases in value from the date the taxpayer relocated to the country, Switzerland would have the right to tax the increase in value of EUR 5 million.

From a tax system perspective, the state the taxpayer is exiting could also take into account any depreciation in the value of the shares in the corporation after the taxpayer relocates; however, this would probably not be mandatory (under European law).

bb) National solution: a tiered model for selecting the least burdensome option

Bilateral negotiations are notoriously protracted. Accordingly, the question arises as to whether and how exit taxation can be structured through purely national law in such a way that the conflicting interests are balanced in the best possible way. One model discussed in the literature involves postponing the point of taxation depending on the legal and economic risk of enforcement.[54]

From the perspective of the shareholder exiting the country, the best option would be to defer taxation until the time the unrealised gains are realised. Similar to the tax treaty model, this idea could initially be taken into account under purely national law by determining only the fair market value at the time of exit and thus the unrealised gains or losses arising in Germany as part of a valuation procedure. The assessment notice would be the basis for the future tax assessment (tax assessment notice).

The tax itself would, however, only be assessed at a later point in time (following the exit) when the capital gain is actually realised, albeit with retroactive effect to the point in time of the exit. According to the prevailing view, such a domestic tax – characterised as a retroactive event triggered by subsequent realisation – would have to be structured as a treaty override, since the taxing right under Article 13(5) of the OECD Model Tax Convention is determined by the point in time at which the tax becomes chargeable, namely the actual realisation of the previously unrealised gain.[55] However, it would amount to a treaty override benefiting the taxpayer — one that could, in fact, be structured as an elective right. In the retroactive tax assessment, there is – in addition to the lack of a binding effect on the taxpayer's new country of residence – a significant difference compared to the solution under the treaty described above.

However, in addition to securing the right of taxation, the German tax authorities would also have to ensure that the tax based on the assessed value could be collected by subsequent tax assessment at the time of the actual sale.[56] Provided that an agreement on administrative cooperation or mutual assistance in the collection of taxes has been concluded with the taxpayer's new nation of residence, the formal enforcement of the tax claim would in principle be assured. However, if the relevant double taxation agreement does not provide any basis for the country the taxpayer is exiting to levy a tax on the unrealised gains accrued in the shares during their period of tax residency, there is a risk that a treaty

54 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 73.

55 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 33.

56 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 73.

override could result in the request for administrative cooperation being rejected.[57]

It is unclear whether Article 13(6) of the German DTA negotiation basis already provides a remedy here. It is true that it codifies the right of the country the taxpayer is exiting to impose an exit tax.[58] The aim of this clause is, on the one hand, to legitimise the exit taxation in the treaty law, and, on the other, to prevent the double taxation of unrealised gains in the event of a future actual sale in the new nation of residence.[59] The wording of Article 13(6) of the German DTA negotiating basis, however, only covers taxation based on a notional disposal at the time of exit.[60] However, the provision does not expressly authorise Germany to defer the tax assessment to the later point in time at which the taxpayer resides in the new country and actually realises the previously unrealised gains there.

In conclusion, however, if enforcement in the taxpayer's new state of residence is possible or the taxpayer still has sufficient assets (e.g. in their former state of residence) that the state they are exiting can lay claim to, a simple valuation at the time of their relocation should suffice. A simple valuation is a less intrusive measure than the immediate assessment and enforcement of taxes.[61] This is because an assessed tax liability, for example, reduces the taxpayer's creditworthiness and places the taxpayer in a less favourable position than they would have been in had the value simply been assessed; a downgraded credit rating therefore has the effect of (additionally) restricting freedom of movement.[62] As a consequence of such a solution, a deferral would not be necessary either. Deferral interest was already ruled out as a matter of course. However, the law would (correctly) have to explicitly exclude interest on the tax claim as a result of the retroactive effect.[63]

If an appropriate agreement on administrative cooperation and mutual assistance in tax collection with the country the taxpayer is relocating to is lacking, or enforcement on the basis of these treaties is excluded, then an assessment of the tax at the time of the taxpayer's exit would be justified. Even then, however, a fiscal policy solution should be pursued that is more balanced and better serves the interests of all parties involved than the current law.

In such cases, the burden on the exiting taxpayer due to the immediate assessment and/or enforcement of the tax and the (factual) restriction of their freedom of movement must be weighed against the risks the country would face in enforcing the tax if payment is deferred. Accordingly, the state the taxpayer is exiting must determine whether there is a specific risk as regards enforcing the tax claim in the state the taxpayer is relocating to.[64] The taxpayer can avert the specific enforcement risk by providing collateral. If there is no risk associated with enforcement, the tax would be deferred interest-free for an unlimited period of time.[65] Finally, the tax can be collected in instalments as the enforcement risk increases. Immediate taxation should

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57 Regarding the request for information under Article 26 OECD Model Tax Convention, see Schaumburg, H. in: Schaumburg, H. (2022) *Internationales Steuerrecht* [*International tax law*], para. 9.35.; something else could apply to the enforcement of the claim under the EU Mutual Assistance Directive for the Recovery of Taxes, since this is specifically intended to protect the neutrality of the internal market, see Förster, J. (2024) in *Steuern in Europa, Amerika und Asien* [*Taxes in Europe, America and Asia*], Allgemeiner Teil [General section], para. 103d.

58 Reimer, E. (2021) in Vogel, K. and Lehner, M. *DBA* [*OECD Model Tax Convention*], Article 13, paras. 225 f.

59 Expert Commission, ibid., p. 148.

60 Reimer, E., ibid., Article 13, para. 304.

61 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., pp. 50 and 74.

62 See CJEU, judgement of 7 September 2006 – C-470/04 N; Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 51 with further references.

63 Otherwise, interest would have to be paid after the due date under current law.

64 Kudert, S., Hagemann, T. and Kahlenberg, C., ibid., p. 74.

65 Similarly, Expert Commission, ibid., p. 151.

be limited to cases in which protecting access to the tax base justifies immediate taxation in a "substantive manner".

As the balancing of interests now pertains to the enforceability of the tax claim against the taxpayer, rather than the assertion of taxing rights against the country the taxpayer is relocating to, individual circumstances relating to the taxpayer – such as the risk of insolvency – may also be factored into the assessment. In the present case, a consideration of reductions in value in the taxpayer's shares in the corporation after exiting the country would be ignored – in line with the tax system – since taxation is applied retroactively to the time of exit.

cc) What else could the European Union regulate?

While the model of a simple valuation at the time of exit could be introduced by each individual member state alone, the binding allocation of taxing rights would be subject to bilateral negotiations between the countries concerned. Experience has shown that the multilateral requirements or proposals in this regard – whether from the OECD or the UN – are subject to a long and tedious negotiation process.

Independently of this, however, the EU legislature could also take action in this context and take binding measures.

(1) Harmonisation competence on the basis of Article 115 TFEU

Although the European Union has no inherent legislative powers in the area of direct taxation, Article 115 TFEU provides an adequate basis for authorising the adoption of measures, including in the area of direct tax law.

Although Article 115 TFEU is situated within the chapter on the "Approximation of Laws" rather than the chapter on "Tax Provisions", and thus does not constitute a legal basis specifically tailored to direct taxation, the competence conferred upon the Council under Article 115 TFEU is not tax-specific. Instead, it represents a general clause aimed at facilitating the internal market through legal approximation (harmonisation).[66]

As a result, the EU may nevertheless act on the basis of Article 115 TFEU – through directives – where a tax provision of a member state exerts a direct and disruptive influence on the functioning of the single market.[67] The impact of the exit tax on the single market is undisputed in terms of the above-mentioned encroachment on the fundamental freedoms, in particular the freedom of establishment (Article 49 TFEU) and the free movement of workers (Article 45 TFEU).[68]

(2) Substantive requirements imposed by the EU through directives

As is clear from the above, the EU is not dependant on the Court of Justice of the European Union to assess the relevant national tax regime in terms of the fundamental freedoms. Rather, the Council could use Union secondary law to advance the harmonisation of laws while preserving the interest in taxation. Since Union secondary law must be directly geared to the functioning of the single market, the corresponding directive could provide for a tiered catalogue aimed at ensuring that the state the taxpayer is exiting applies the least severe means possible to protect its interest – namely safeguarding its taxation powers and enforcing its tax claims. A tiered catalogue in such a directive could include the following, for example:

- Where both the state the taxpayer is exiting and the state the taxpayer is relocating to are bound by the directive, taxing rights upon the realisation of a capital gain are allocated in such a way that the state the taxpayer is exiting may tax the increase in

66 Schaumburg, H. (2020) in Schaumburg, H. and Englisch, J. *Europäisches Steuerrecht* [*European tax law*], para. 11.39.

67 Schaumburg, H., ibid., para. 11.39.

68 Benecke, J., ibid., sec. 6, para. 2.

value accrued up to the time of the taxpayer's exit. The state the taxpayer is relocating to must then take into account the tax burden imposed by the other state, either by limiting its own taxing rights to the increase in value that has occurred after the taxpayer has relocated, or by crediting the tax assessed by the other state against its own tax claim. The EU Mutual Assistance Directive already ensures that the state the taxpayer is exiting can enforce its taxing rights upon realisation of the value increase.

- Insofar as the taxpayer relocates to a third country that is not a party to the directive, but with which the member state concerned has an agreement ensuring the enforcement of the tax claim, the member state may only recognise the increase in value at the time of the taxpayer's relocation. A tax assessment that has a retroactive effect to that date may only be issued upon realisation of the previously unrealised gain.
- If enforcement of the tax claim of the state the taxpayer has exited is not guaranteed at a later point in time, the tax can be assessed, whereby payment in instalments should be made possible depending on the enforcement risk. The taxpayer exiting the country must also be given the option of deferring the tax liability (against the deposit of collateral) without interest until the date of realisation.

Unlike the enforcement of directive requirements vis-à-vis private individuals, the legal effect of the directive would not require transposition into national law. The member states would be the sole parties to the directive in accordance with Article 288(3) TFEU. The directive would thus be binding on the member states.[69]

4. The cross-border tax treatment of foundations

As is well known, (family) foundations play an increasingly important role in the structure of family businesses and business-owning families. In Germany, this is true not least because of the existing exit tax and taxation upon leaving the tax net. The German family foundation is used – in addition to the use of the legal form of a commercial partnership[70] – as a vehicle to enable family members that own shares in a family business and desire to relocate abroad to do so, while at the same time allowing them to retain (indirect) ownership interest in the company without affecting their freedom of movement. The use of a family foundation and its "shielding effect" would be a prerequisite for achieving the desired legal outcome. However, a family foundation is considered a transparent legal entity in many of the countries to which people relocate, depending on the wording of the family foundation's statutes and the composition of its governing bodies. This applies, for example, for purposes of income taxation, and in some cases also for purposes of wealth or capital taxation.

Example: In order to avoid the exit tax when business owner Mr A moves to Switzerland, or when he makes a gift to his son living in Austria, he instead considers contributing the shares in his family corporation to a German family foundation before relocating. The potential beneficiaries of this family foundation should be him, his wife, and their descendants. In this example, it would be necessary to check for each country involved – in this case, Austria and Switzerland – whether the German family foundation would actually have a tax-shielding effect there and/or what tax consequences the establishment of the foundation, the death of a beneficiary and any distributions to the beneficiaries would have in the respective foreign countries.

69 König, D. and Kleinlein, T. (2020) in Schulze, R., Janssen, A. and Kadelbach, S. *Europarecht* [*European law*], sec. 2, para. 57.

70 On this, see Layer, B. (2024) "Der 'wegziehende' Mitunternehmer – Steuerliche und ausgewählte sonstige Aspekte" ["The 'relocating' co-owner – tax and other selected aspects"], *DStR*, pp. 1049 ff.

In the worst case, an heir of the settlor of the foundation who is resident abroad and who is also a beneficiary of the family foundation may have to pay inheritance tax and/or wealth tax on the assets of the family foundation attributed to them. But also for income tax purposes, the income of the family foundation could be attributed to the beneficiaries living abroad, regardless of their distribution, and taxed under foreign income tax law.[71] Problems arise in this respect, for example, in Italy, France, Austria, Denmark and the United States. In conclusion, the family foundation is not a panacea for avoiding the exit tax.

Continuing the example: From an Austrian perspective, there is a risk that the foundation assets will continue to be attributed to business owner Mr A during his lifetime. Whether this can be counteracted through the appropriate wording of the foundation's statutes and the composition of its governing bodies can only be clarified with full legal certainty through corresponding consultation with the tax authorities in Austria.

The attribution of foreign foundation assets to the settlor may also lead to attribution or qualification conflicts between the states concerned, and may result in the rejection of a withholding tax refund claim in Germany.

Continuing the example: If, from Austria's perspective, the foundation assets continue to be attributed to business owner Mr A rather than to the German family foundation, the withholding tax refund claim in Germany is at risk of being rejected in the event of distributions to the son, as beneficiary of the foundation. This is because, from Austria's point of view, such a distribution does not constitute investment income received by the beneficiary from the foundation, but merely a gift from Mr A to the son. If Austria had an inheritance or gift tax, the distribution from the foundation could therefore constitute a taxable gift from Mr A to the son. The same applies if, from an Austrian perspective, the foundation assets may be attributed to a third party or the son after the death of the business owner Mr A due to the structure of the foundation.

Even if a German family foundation is treated as non-transparent abroad, it should be noted that distributions from German foundations are sometimes subject to horrendous tax rates abroad because the respective foreign state often does not recognise corresponding legal entities under its law or questions comparability with domestic foundation structures.

To continue the example: even if Austria regards the German family foundation as non-transparent for tax purposes in this specific case, there is still the risk that it will not regard the German family foundation as comparable to an Austrian private foundation or an Austrian corporation, with the result that, although double taxation will no longer occur, the beneficiary will potentially face taxation of up to 55 percent in Austria itself.

The above findings, which are only briefly presented, on the cross-border treatment of foundations and their beneficiaries are alarming when viewed in the context of the mobility of shareholding family members in German family businesses. Where family businesses involve foundations in their organisation, it is therefore also of particular importance for the future of our family businesses, and it is also in the interest of the member states and the European Union to establish reliable and robust rules to ensure mobility (in this case, the free movement of business owners when foundations are involved). In this context, two points must be distinguished from one another:

71 Layer, B. (2024) "Der 'wegziehende' Mitunternehmer – Steuerliche und ausgewählte sonstige Aspekte" ["The 'relocating' co-owner – tax and other selected aspects"], *DStR*, pp. 1049, 1055; also see Kraft, G. (2025) "Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens" ["Tax issues for family foundations as vehicles for business assets"].

- The first essential step is for the foreign foundations to be recognised as non-transparent legal entities for tax purposes. In this respect, bilateral agreements could serve to recognise and treat foreign assets (for tax purposes). The corresponding rules should be incorporated into the intergovernmental double taxation agreements. Whether, however, relevance to the single market can be established in such a way as to justify the adoption of Union law measures based on Article 115 TFEU is, at the very least, open to question. Consideration must be given to the residual competence clause under Article 352 TFEU. The latter could, in any case, serve as a legal basis[72] for a European supranational foundation, as is also the case in company law. This could be structured in such a way that it is treated as non-transparent for tax purposes across borders.
- Bilateral agreements on the conditions for recognising the lack of fiscal transparency of foreign foundations must ultimately be linked to regulations on the tax treatment of the income of beneficiaries who reside abroad. In this context, the tax treatment of the distribution in the foundation's country of domicile must be decisive for its qualification under the agreement.

  However, since the classification of income under treaty law for the purpose of allocating taxing rights may differ from how the distribution is characterised and taxed under the domestic tax law of the beneficiary's state of residence, there is a need to achieve a consistent classification through bilateral agreements. Within the European Union, this gives rise at the very least to a legal implication under Union law: the tax treatment of foreign foundations must not, by virtue of the principle of equal treatment enshrined in Union law, be less favourable than that of domestic foundations.

IV. Conclusions

In the course of the Europeanisation of the economy, the European Union has, over the past decades, addressed several important issues concerning cross-border business families – reflecting the ongoing internationalisation of such business-owning families. This applies primarily in the area of private international law. However, other aspects that are essential to ensuring the mobility of business-owning families have been neglected to date. This applies above all in the area of tax law, in particular exit tax law. In this context, it is imperative not only to remove direct and indirect obstacles to the flow of goods, but also to those faced by people, particularly business-owning families. The European Union has a number of tools at its disposal for this purpose. It should use them in the interest of advancing the European fundamental freedoms within an economy shaped by family businesses.

In summary, the following can be stated:

1. The free movement of persons within the EU enables EU citizens to move, live, work and run a business anywhere in the EU. Even indirect restrictions can affect the freedom of movement guaranteed by the fundamental freedoms.

2. Families that are "internationalising" have to deal with a wide range of legal and tax issues. If the family owns a company (including a family business), they face a multitude of challenges under civil and

72 See Kalss, S. and Klampfl, C. (2024) in Dauses, M. A. and Ludwigs, M. *EU-Wirtschaftsrecht Handbuch* [*Handbook of EU business law*], Chapter E, para. 554.

tax law. For such business-owning families, significant problems arise in the areas of inheritance law, family law and (exit) tax law.

3. Since harmonisation of substantive law in the areas of inheritance and family law is out of the question, particular importance must be attached to the clarity of the applicable law, and to ensuring that both the choice of applicable law and jurisdiction are, as far as possible, subject to party autonomy. EU law has, for the most part, provided sensible regulation of the issues arising in this context.

4. In the area of exit taxation, however, the free movement of business-owning families has so far been largely ignored. In this regard, the onus is on both national legislators and the European Union to find solutions that will effectively help to establish fundamental freedoms for international business-owning families not only within the EU but also beyond its borders.

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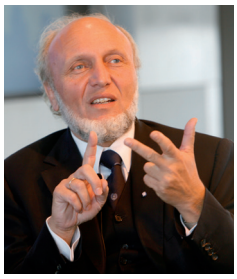

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