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BULLETIN

Back to Growth: Germany's Third Support Programme for the Economy

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In the next phase to counter the effects of the COVID-19 pandemic, Germany focuses on a quick recovery of demand. This is to be achieved, among others, by the reduction of VAT, support for families with children, and incentives for companies to invest. Given the size and connections of the German economy, the programme may ease the way out of the crisis for the entire European Union. However, it may increase the asymmetries, too: few countries can afford the same level of support for their own economies.

After the outbreak of the pandemic, Germany took several measures to protect companies against liquidity troubles and to protect jobs from being eliminated. In March 2020, the government announced two massive financial shields that give hope for a milder recession than in other euro area countries (-6.5% vs. -7.7% in 2020, according to European Commission forecasts). As the number of infections began to decrease significantly at the end of May, Angela Merkel's government proceeded to the next stage of action: reviving growth and making up for the losses suffered during the closure of the economy. In the first days of June, the leaders of the grand coalition agreed on a €130 billion boosting programme.

Strengthening Demand. The government's plan includes a variety of tools, of which the primary goal is to increase spending in the economy. The central place is taken by the VAT reduction from 19% to 16% (or from 7% to 5% of the reduced rate) in the period from July 2020 to the end of the year. It is supposed to encourage consumers to make purchases they had delayed during the crisis, fearing for the stability of their jobs and income. This is particularly the case for less-well-off households: a group that allocates the largest part of the budget to current consumption. An incentive to increase expenses is the one-time child benefit of €300, easier access to social benefits, financial protection against possible increases in electricity prices, or a brake on a rise in social contributions. These activities are intended to send a signal that the level of income at the disposal of households will be protected so they can spend more boldly.

The addressees of the plan are also companies. To encourage them to increase investment, the government will expand the possibility of lowering the tax burden by accounting for pre-crisis profits with current losses. Depreciation charges will be increased, additional incentives offered to invest in research and development, as well as—in the case of households—protection against higher electricity prices. Significant funds of up to €25 billion are planned for the protection of small and medium-sized companies in sectors that still face restrictions of operations such as event organisation and trade fairs. Part of the package is also addressed to municipalities that lost tax revenues during the pandemic and therefore announced the suspension of public investment. The federal budget will also relieve them financially of the costs of social policy and support local public transport.

Political Consensus. The coalition partners struggled to avoid major disputes and protracted negotiations. The serious issues concerned the premium for the purchase of cars, which was demanded by the automotive industry and related Länder. Finally, it was decided to increase the subsidy for the purchase of electric and hybrid cars from €3,000 to €6,000 (with a maximum value of the car to €40,000) and to expand the infrastructure for electromobility. Therefore, combustion-powered cars were excluded from the support but buyers of such cars—which facilitated the compromise—can benefit from reduced VAT. During the negotiations, other controversies arose, for example, about the duration of the tax breaks and the distribution of the costs of planned activities between the federal budget and the budgets of the Länder and municipalities. Acceptable solutions were achieved relatively quickly in these areas.

This would not have been possible without a more general change in German politics: moving away from the dominant restrictions in public finance in recent years towards spectacular expenditures. There are many indications that Merkel's determination is behind it. The German chancellor, who since March has polled with remarkably high public support, decided to use the crisis to initiate a new political course. It is flanked by the evolution of views among German economists: in recent years, the influence of supporters of Ordoliberalism and a principled approach to budget balance has faded in favour of post-Keynesian ideas. The coalition, therefore, was easier to switch to—to use the formulation of Minister of Finance Olaf Scholz—"classic, social democratic fiscal policy", the essence of which is to massively increase spending in times of crisis. It is worth emphasizing, however, that the implementation of this policy would be much more difficult today if not for the austerity, black-zero policy of the past decade and the monetary expansion of the European Central Bank (ECB), which significantly makes it easier for governments to incur debt and increase spending.

Controversies. The programme presented by the CDU/CSU and SPD coalition, although it raises high hopes for stimulating growth, is not without weakness. For example, there is no certainty that a €20 billion reduction in VAT will support consumer demand at the expected scale. It may well be used by companies to increase margins instead of lowering prices, including in very profitable industries such as online trading, which do not need support. The duration of the reduction is also disputed. If it is withdrawn by the end of the year, the economic recovery may quickly lose momentum.

Some economists believe that a better effect than vague manipulation of tax rates would bring more support to poorer households and selected areas of the economy. These include, for example, public transport, which has been painfully affected by the effects of the pandemic, and the education and childcare sectors. The restrictions still in force mean high costs for schools and kindergartens, and there are not enough funds to increase employment in these facilities and to adapt housing options. Meanwhile, without returning children to institutions and releasing parents from educational and caring responsibilities, it may take longer for the economy to return to full production capacity than the programme originators assume.

Perspectives: European Policy. The implementation of the growth-boosting plan will be of great regional importance. The billions of euros in newly generated demand make Germany the EU's economic "locomotive" and can have a significant impact on the pace of post-crisis recovery throughout the integration area. This is even more important because the markets still have uncertainty related to the risk of a "second wave" of pandemics, but also other threats, such as the failure of talks on trade rules with the UK, the escalation of the economic disputes between the U.S. and China, or social tensions in America. Anti-crisis measures in Germany are particularly important for Poland, primarily due to trade links. Although the pandemic caused a decrease in trade turnover (according to DESTATIS data, a 6.5% drop in exports from Poland and a decline of 1.5% in imports from January to April 2020), but at the same time Poland has become a more important trade partner for Germany (€38.9 billion) than Italy (€37.0 billion) and the United Kingdom (€36.3 billion). Chances for a post-crisis rally in mutual exchange are high.

At the European policy level, Germany's departure from the austerity bias is of great importance, emphasized with satisfaction especially in France and the southern countries. Compromises on enhancing the role of common fiscal policy in economic recovery may be easier to achieve than ever before. On the other hand, there is concern in European capitals that record-breaking rescue plans applied in Germany may deepen differences in the EU and disturb competition on the single market. Few countries can afford a similar scale of support for their own companies, jobs, and social infrastructure. As a consequence, the asymmetry between the fast-recovering German economy and the less prosperous countries, which will suffer much longer due to the pandemic crash, may increase.

Therefore, debates can be launched in the EU like in the previous crisis of 2008-2012 about the political consequences of Germany's growing economic strength relative to other countries. The federal government will argue that the European Commission's €750 billion "renewal fund", which grew actually from a joint idea of Chancellor Merkel and President Macron, will reduce the potential asymmetries. A test of Germany's determination, however, will be its commitment to creating stable and autonomous sources of EU income, for example, a common digital, environment, or capital-transaction tax. With them, the community could generate its own programmes to respond to economic crises and they would be large enough to level the differences in the fiscal potential of Member States.