FAZ
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Deficit spending unwarranted for Germany

by Michael Heise

Critics both at home and abroad have pounced on the German government's plan to once again achieve a balanced budget (known here as the "black zero") in 2016 as *the* main drag on growth. Germany could and should take on more debt, it is said, to improve its public infrastructure and education system, step up integration measures for refugees and cushion any potential impact on the German population. That would boost demand and reduce the huge foreign trade surplus that weighs on the world economy. Providently, in its latest monthly bulletin the ECB has calculated the positive (short-term) effects of additional, debt-financed public spending for Germany and the rest of the eurozone.

But banging on about perceived German austerity policies misses the point. The balanced budget in Germany since 2012 has been achieved despite substantial increases in public spending. Expenditures were flat only in the years 2011 and 2012 when the major stimulus packages enacted during the financial crisis expired. From 2012 to 2015 government spending rose again by EUR 106bn (+8.7%), mainly on the back of rising welfare outlays (e.g. pension top-ups for mothers, early retirement and nursing care reform). Spending will continue to rise in 2016, and by no means solely due to the additional outlays for refugees (around EUR 10bn). Expansionary fiscal measures to the tune of another EUR 10bn have also been penciled in, so the fiscal boost in 2016 will amount to around EUR 20bn – or around 0.6% of GDP.

This additional government spending feeds into an economy running at normal capacity, with growth fueled by sliding oil prices, negative interest rates, immigration and the relatively soft euro. In this situation, additional stimuli via credit-financed spending programs would be counterproductive. They would reinforce the cyclical expansion in demand and substantially increase the risk of overheating, not only in the housing sector. The current wage round, with wage demands of up to 6% (metal industry 5.0%, construction 5,9%, public sector 6.0%), is already a clear warning sign.

Economic and fiscal policy should be geared not to short-term stimuli but to the fostering of longer-term growth. In the face of extremely weak productivity gains and low investment, the growth potential of the German economy is much too low to safeguard the welfare systems and public finances in the long run. Precious little has been done on this front in recent years. Fiscal policy could substantially improve the growth potential by channeling additional spending more into investment and innovation-related areas and not exclusively into public consumption. Since 2012 government consumption has risen by EUR 64bn and monetary welfare benefits by EUR 40bn – whereas outlays on public investment rose by only around EUR 3bn. Had the increase in consumption spending (including transfers) since 2012 been "only" 2% instead of 3% a year, it would have been possible to ratchet up public investment by no less than almost 15% a year without extra borrowing. That would have been a sustained and perceptible contribution to sprucing up infrastructure and bolstering long-run growth.

Of course, it's not just about doling out more money on public investment; the right priorities need to be set. Within the categories of investment and consumption-related spending (think education/training budgets) there are elements with a greater or lesser impact on growth. Moreover, fiscal policy needs to improve the framework for higher private investment in Germany. Given burgeoning tax revenues, talk about further tax hikes – discussed with respect to the flat-rate withholding tax, the inheritance tax or a wealth tax – is certainly not going to stimulate private investment. The focus should be on promoting investment and performance incentives. The tax system needs to be more pro-growth, for instance by lowering the overall tax burden on low and middle incomes and by putting debt and equity-financed corporate investments on an equal tax footing. With German companies currently swimming in cash, the latter could swiftly unleash a surge in investment, providing a long-term boost to growth.

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