REPORT ON THE ECONOMIC SITUATION

02/2025

Election for economic turnaround?

Exclusive report for ACATIS Investment: Prof. Dr. Dr. h.c. Lars P. Feld, University Freiburg and Walter Eucken Institute

The German Bundestag elections will be held on 23 February. Germany is once again facing big challenges. Foreign policy, security and defence policy are big issues. Not since German reunification and the supposed "End of History" (Francis Fukuyama's description of how Western liberal democracies overcame socialist dictatorships) has it been so apparent that the world is in the midst of a great power struggle: The authoritarian states of the East are facing off against the liberal democracies of the West. None of these blocks is very cohesive. That is particularly true for the countries in the Western block.

This is the most important task for the new government. It has to renew the transatlantic partnership, and it must ensure greater solidarity between the US and the EU - both in terms of security and trade policy. This is not an easy undertaking with a Trump administration, which does not appear to distinguish between friend and foe. But perhaps Europeans should also ask themselves whether we are being fair to the US. In any case, Germany will have to build up its military and change its security strategy.

Secondly, the new government must chart a new course with regard to economic policy. The German economy is probably in its fourth year of stagnation - an unprecedented situation in the post-war period. A careful analysis of the data invariably leads to the conclusion that Germany is in the midst of a serious structural crisis. Companies that are supposed to invest in Germany must be given better investment conditions. Otherwise, investments will suffer. Investment conditions cannot be improved when governments pick and choose companies and industries to receive (time-limited) subsidies for engaging in activities that are deemed beautiful and good. Costs must be reduced across the board.

To this end, regulatory intensity must be decreased. Data protection is too strict, environmental and climate protection regulations are excessive, and building laws are too far-reaching and complicated. The same applies to labour laws. All of these areas must be deregulated. Moreover, energy costs are also too high. This requires market economic reforms in the electricity and wider energy supply market. When it comes to the electricity market, fragmented and pseudo-market auctions by capacity markets that are regulated by the state are the wrong way to go. Nodal pricing and regionally differential prices are required.

Not least, the tax burden is also too high. Soon, the US will reduce its corporate tax rate to 15 percent, which is half of the German rate for incorporated companies (corporate and trade tax plus solidarity surcharge). A minimum five percent reduction (similar to the level in France) is required to avoid being left behind completely. On the other hand, the also discussed investment premium, which is limited to five years (depending on the election programme) and that would also be provided to non-profitable companies, belongs in the category of selective tax breaks, which was the dominant policy of the current legislative period that is nearing its end. Since this premium is akin to a special write-down that exceeds the actual wear and tear, and that would also be provided to companies generating losses, it corresponds to a general subsidy for companies that invest in Germany. As a result, it is threatened by EU state aid legislation, and justifiably so. Moreover, this approach already reveals the selective character of this particular measure - particularly when one considers the suggestion made by the German Trade Union Confederation (DGB), namely that this premium should only be provided to companies that are subject to a regional collective agreement. This would only continue the nonsensical course of controlling investments.

Third, the new government must focus on stability. While inflation is now within range of the ECB's target value, it is still above that value, and it is not certain that price pressures will continue to ease this year. Price stability is the ECB's mandate. But fiscal policy plays an important role in inflation. In view of the high debt levels in the US and the EU, the federal government should continue to focus on solid financial policies in the context of the debt brake (Schuldenbremse). Bond markets are already nervous enough.

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