REPORT ON THE ECONOMIC SITUATION

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A fall season of decisions?

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

Following the state elections in Brandenburg, Thuringia and Saxony, some in the federal government said that decisions will have to be made in the fall if the present government is supposed to last until the regularly scheduled federal Bundestag elections in September 2025. Accordingly, many are speculating about a premature end to the current government coalition. However, these announcements were rather vague; which decisions are they talking about?

Now that Germany's minister for economic affairs Habeck has submitted the government's fall projections, which include a 0.5% downward adjustment in the GDP growth rate for the current year (to -0.2%), and a slight upward correction for economic growth in 2025 (to 1.1%), there are now calls for an economic programme. Indeed, 2024 will be the second year in a row when Germany's GDP actually shrank. The last time this happened in the post-war period was in 2002 and 2003, after 9/11. What needs to be done to get the German economy back on a solid footing?

An analysis of the current situation illustrates that stimulating the economy for the purpose of stabilising demand does not make a lot of sense. Reticence on the part of consumers and weakness in corporate investments are primarily due to economic uncertainty, to which the federal government has also contributed. It would be too simple to say that this is just due to the in-fighting between the coalition partners. Because the real problem is that economic policy is manoeuvring between controlling investments and a social market economy. Private consumption and investments will return once policies are clearly on a market-oriented course.

Which brings us back to the decisions that need to be made in the fall. By the end of the year, the federal government, Bundestag and Bundesrat have to decide on the 2025 federal budget, a growth package, a pension package and labour market measures. Some of these decisions have to be approved by the federal states in the Bundesrat. In addition, the Bundestag factions of the current government coalition are openly questioning these legislative initiatives.

Even though everyone should know what needs to be done to get the German economy back on course: Improving the cost situation for companies. Labour, energy and regulatory costs, as well as taxes, are too high. The growth package addresses this situation in several ways. However, there is disagreement between the federal government and the federal states, particularly with regard to the tax-related measures. Individual changes to tax laws, such as tax relief for foreign employees, have already been dismissed for political reasons. The left wings of the Social Democrats and Greens do not want to see more restrictions applied to the Bürgergeld. The Wage Loyalty Law (Tariftreuegesetz) would tighten rather than ease existing labour laws. The FDP has taken a very critical view of this initiative, and the so-called hold line in the statutory pension insurance scheme. Another thing the SPD and Greens want to see in the 2025 budget is the removal, easing or at minimum suspension of the debt brake (Schuldenbremse).

The 2025 federal budget allows for the implementation of the growth package and the associated reduction in revenue, and it shifts the focus of consumption expenditures to public investments, without violating the requirements under the debt brake. This approach is correct per se in terms of supply policy. However, the growth package is just a small step, even if it is approved by the Bundesrat with only minor changes. Particularly with regard to energy and climate policies, companies still do not know what they have to prepare for. Permanent subsidies such as an industrial electricity price do not help in this context. The real issue is securing future energy supplies at reasonable prices. There are still questions surrounding the design of the electricity market and the supply of alternatives to coal and gas.

In terms of labour market and social policies, some in the federal government still want to expand benefits and increase regulations. The hold line in statutory pension insurance cannot be implemented in its current version if the system is to remain financially affordable. Ideally, the Wage Loyalty Act should not be passed. It would undo the progress that has been made in reducing red tape by regulatory easing.

A fall season of decisions? It must result in a shift in economic and financial policies, a policy oriented towards a market economy, a strengthening of market forces instead of higher government expenditures based on debt. In the early 2000s, when the GDP fell after 9/11, the federal government responded with Agenda 2010. The current coalition government does not have a lot of time to return the economy to a market-oriented course.

Sincerely yours

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