

Stagflation, de-industrialisation and supply policies

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In view of the negative economic news, and despite it being the height of summer, the German public continues to argue about the right economic and financial policy - whereby opinion sometimes takes precedence over facts. For example, there are claims that the federal government is reducing the funds available for digitisation, even though they are only being moved from the budget of the ministry of the interior to other government departments. What is the real situation of the German economy?

I hardly dare to repeat the word that has already been mentioned so often in this column: The German economy finds itself in a stagflationary environment, i.e. a combination of weak GDP growth and high inflation. Weak growth – that implies a growth level approximating zero. Whether the actual figure is +0.3% or -0.3% is largely irrelevant in this context. Or put another way: The German economy is languishing.

Particularly monetary policy plays an important role in this regard. Inflation in the Eurozone and in Germany is still high, despite gradually declining rates. Which means that monetary policy continues to be restrictive, and rightly so. In the remaining months of 2023, it may raise interest rates by another 25 basis points, or it may accelerate the reduction of bonds on its balance sheet. In any case, this monetary policy will put a damper on total economic demand, and it will also put pressure on economic growth. This effect is intentional.

The impact vectors of monetary policy are varied. While it does affect inflation expectations, it also directly affects the investment environment. In that regard, it is not surprising that the construction industry, which is highly sensitive to interest rates, is very reluctant to invest at the moment. Similarly, other industry sectors are also scaling back investments as financing conditions change. In addition, monetary policy also affects private consumption by making it more attractive to save rather than spend.

In this situation, future economic and financial policies must be supply-oriented, i.e. they must improve incentives for investors and workers. It must become more worthwhile to work, to invest and take on risks. In terms of financial policy, this means that the level of expansion must be reduced in order to

avoid getting into a conflict with monetary policy. Accelerated write-downs for the construction industry would be exactly that, namely counter-productive.

What the current discussion about economic and financial policy lacks is the realization that this will require a less expansive financial policy. Every measure in the federal government's draft budget that takes someone away from one interest group is criticised loudly. The modified criteria for receiving the parental benefit - a threat to the policy of equality; cuts at the Bundesagentur für Arbeit - a setback for continuing education; a return to the normal VAT rate in the restaurant industry - will lead to restaurants closing; the removal of the peak load equalisation for the electricity tax - accelerates de-industrialisation, industrial electricity price as the solution.

Supply policies aim to reduce the cost of taking up an economic activity. But subsidising industry via a lower industrial electricity price is the wrong approach. Electricity prices in Germany will remain high, which means that the industrial electricity price would become an expensive and permanent subsidy. Against the background of climate protection and demographic developments, it will be difficult to achieve a significant reduction in energy and labour costs. If higher CO₂ prices are compensated with the removal of the electricity tax, the electricity price as a whole will not decrease to any significant extent.

In his time, Ronald Reagan characterised the attitude of politicians to economic activity as follows: "If it moves, tax it; if it keeps moving, regulate it; if it stops moving, subsidize it." The current discussion in Germany is all about this last step. Supply policy focuses on the first two steps - a reduction in the tax burden and the regulatory costs.

Sincerely yours



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