



# What helps the “ka-boom”? Five elements of a sound economic stimulus programme for Germany

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Political plans aimed at kick-starting national economies have been introduced in many countries worldwide. The German Bundestag and Bundesrat passed a Coronavirus Tax Relief Act on 29 June 2020 that involves the first key elements of a large scale recovery programme. It is designed to get the German economy out of the crisis “with a ka-boom” as Germany’s Finance Minister Olaf Scholz put it. Some thoughts on the Government’s programme by IAB Director Bernd Fitzenberger.

The German stimulus package is heading in the right direction. It ensures short-term stabilisation of the economic situation, while at the same time focusing on future investments. Nonetheless, on a number of issues, there is still room for improvement.

Germany is in the middle of its deepest economic recession since the end of World War II. The dramatic pace of its spread and the combination of weak demand and the resulting supply shocks – both further aggravated by the lockdown – are unprecedented. Numerous industries non-typical for the beginning of a recession have been massively affected like

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travel and transportation, hotel, restaurants and tourism, entertainment, or the retail industry.

In the short run, it was appropriate that economic policy measures focussed on stabilizing existing enterprises and securing employment. To prevent an economic downward spiral, the German Federal Government agreed upon a large scale [stimulus package](#) on 3 June 2020, which amounts to a volume of 130 billion Euros. The package proposed includes numerous elements which are appropriate in the current situation, such as temporary reduction in value added tax (from 19 % to 16 % for the regular rate, and from 7 % to 5 % for the reduced rate), a focus on future investments, the promotion of in-company vocational training, and balancing the coronavirus-related excess expenditures and/or revenue shortfalls of municipalities, in order to enable them to undertake their planned expenditures. All in all, the stimulus package ensures the much-needed short-term economic stabilisation and is future-oriented at the same time. And yet, some improvement is well worth considering in relation to a number of issues.

In view of the present economic situation, it seems to make sense to implement a stimulus programme which, as a passive governmental measure, does not enact any expenditure cuts until mid-2021. This would be a typical reaction to foreseeable losses of tax revenue in a normal situation. During the current crisis, however, refraining from expenditure cuts on all state levels has the important function of an automatic stabiliser. Apart from that, a sound economic stimulus programme features four active elements. These will be discussed below.

## **A phased reduction in value added tax would prevent an end-of-year rally and even boost demand in 2021 as well**

As the first active element, the package rightly entails quick and extensive stabilisation of demand, since – despite the lockdown easing – the consumer climate in Germany in May 2020 hit a historic low. To support an industry that – admittedly – has been particularly badly affected by the crisis, the politics reacted very quickly with a reduction in value added tax on restaurant meals until mid-2021. Yet, instead of an industry-specific reduction, a temporary general cut in value added tax rates as proposed by the German Federal Government is to be preferred, since it relieves all industries. As compared to other measures of demand stimulation, a general reduction in value added tax has two notable advantages: On the one hand, it has an immediate effect. On the other hand, consumers themselves decide what goods and services they choose to purchase – which prevents a distorting effect of measures

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in favour of individual industries. However, instead of the reduction in the regular value added tax rate by three percentage points limited until the end of 2020 as intended by the Government, a uniform reduction in both value added tax rates by two percentage points until the end of 2020, and additional partial continuation of the reduction for the first half of 2021 by one percentage point would make more sense. The worry that the value added tax reduction will not be passed on to the consumers is not generally justified – the intense competition in numerous markets will ensure that consumers benefit from the tax reduction. However, in comparison to the proposed Government-policy, a phased reduction until mid-2021 would prevent a year-end rally in consumption that may potentially lead to price hikes at the end of the year – thus reducing the demand effect. In addition, a phased reduction accounts for the likely event that the recession will not be over by the end of 2020.

## **Future technologies should be promoted only in the areas where no capacity bottlenecks exist**

Secondly, the promotion of future technologies is a positive element within the Government's proposal. This includes, for instance, investments in digital infrastructure and in the digital competitiveness of enterprises – but also investments in the environmental sustainability of the economy (e.g. the installation of wind turbines). Incentives for purchasing environmentally compatible goods and services (e.g. electric cars and services around them) in order to support their production and sales is also reasonable. In order to ensure that the measures have a short-term economic effect, they should, however, be used only in markets free from capacity bottlenecks, since otherwise state support will just result in price increases without fostering production (this risk seems high for large-scale construction projects to be implemented in the short run).

## **Governmental and private measures to ensure health protection should receive more support**

In the third element, governmental measures to ensure health protection will receive broader and more comprehensive financing as compared to the current state of affairs – the stimulus package of the Federal Government involves no further initiatives in this regard. Installations of health protection in public spaces and public institutions, as well as the promotion and uptake of the [app for infection tracking](#), and the implementation of large-scale testing for COVID-19 are worth mentioning in this context. Private action regarding health protection should receive financial support as well. Tax relief limited to the year 2020 can also be considered for enterprises and employees that spend money on health protection – even up

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to subsidies for companies that make working from home available to those at risk in 2020, or convert their production in order to manufacture health protection-relevant materials. Limited measures of this kind improve the financial situation of the enterprises that make specific investments in health protection and therefore make sure that the German economy is well-prepared for a potential second wave of COVID-19. This would be reasonable from an economic vantage point despite possible [deadweight effects](#), since the profitability of these enterprises has deteriorated due to the crisis. While designing the measures it shall be considered that these need to be administratively practicable and quick to implement.

## **Apprenticeship training needs to be better protected**

The fourth active element of the stimulus package includes financial protection of [dual vocational \(apprenticeship\) training](#) and the transition from training into the labour market. This is also where some improvement is called for. Long-term disadvantages for the age groups making the transition from school-education to the labour market need to be prevented. Going beyond the Government's proposal, it would be advantageous if enterprises were to receive a vocational training bonus for all apprentices employed, as well as financial assistance if they employ graduates of school-based or vocational training courses – again limited until mid-2021.

## **Conclusion**

To prevent the economy from sliding into a deep and persistent recession, quick and resolute action by the government is required that would be inappropriate under normal economic circumstances. The measures suggested should therefore be strictly time-limited. Furthermore, value added tax reduction should not expire at once, but rather in a phased manner. The suggestions made here complement the stimulus package proposed by the German Government. Overcoming this crisis with a bang is a huge challenge. The danger that the recession in Germany and around the globe may still persist by the end of the year must be particularly taken into account. The measures should therefore already now be scheduled until mid-2021 in order to ensure higher planning-certainty for both firms and consumers.

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