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CENTRE FOR EASTERN STUDIES 5.09.2023 www.osw.waw.pl

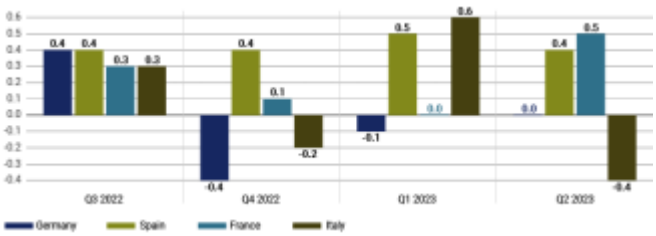
The Meseberg arrangements: the German government is tackling the crisis

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The deteriorating economic situation in Germany has forced the SPD-Greens-FDP government coalition to present a plan to combat the crisis. The measures proposed to improve the situation include tax reliefs for businesses, and in a slightly longer perspective cutting red tape and stepping up the digitisation of the country. However, the package of governmental measures announced in Meseberg is too small and comes too late to significantly boost growth and avoid a recession this year. It is rather an intermediate stage in the process of preparing a more extensive economic reform strategy, which may be announced this autumn.

On 29–30 August, the federal government held an external meeting at Meseberg Castle in Brandenburg (*Kabinettsklausur*). It was intended to calm the situation inside a coalition which has recently been shaken by disputes over electricity prices for industry and over tax and social policy. The manifestation of unity was accompanied by the announcement of plans to combat the economic crisis which the general public is increasingly concerned about. In the latest Infratest dimap survey, 28% of respondents indicated the state of the economy as the most important social problem in Germany. This means an increase of 21 points compared to the results recorded in April this year.

Chart. Germany's GDP dynamics between Q3 2022 and Q2 2023 compared to the leading eurozone economies (relative to the previous quarter)



Source: Eurostat.

Combating the crisis

Since autumn 2022, the German economy has been in a stagflationary drift, with quarterly declines in GDP of up to 0.4% and fairly high inflation, over 6%. No change for the better should be expected given the preliminary estimates for Q3 2023, which is why increasing numbers of research institutes and economic organisations are predicting an in overall

recessive year. For example, the International Monetary Fund estimates that Germany's GDP will fall by 0.3% y/y. What raises more concern than prolonged stagnation, however, is the obvious structural problems that are independent of the economic situation. The problems Germany is finding hard to cope with include high energy costs, digitisation, excessive red tape and labour shortages. In condition of intensifying global competition and the technological race, the EU's largest economy is facing the risk of a permanent slowdown in growth and the migration of its leading industrial companies to other locations, such as the USA. The government, which in late spring was building its narrative around Olaf Scholz's slogan of the "new economic miracle", has been forced to replace it with "combating the crisis".

The tax cuts

The main effect of the Meseberg meeting is the compromise on the 'Growth Opportunities Act' (*Wachstumschancengesetz*, WChG), which until recently was blocked due to the political dispute within the coalition. The Green Party's Lisa Paus, the Minister for Family Affairs, announced that consent for adopting this act would be granted on condition that the Ministry of Finance led by Christian Lindner from the FDP made concessions regarding a new benefit for children (*Kindergrundsicherung*). Lindner did not want to accept the scale of spending for this purpose proposed by Paus. Eventually a compromise was reached, which also opened the way to adopting the WChG in the formula preferred by the FDP which provides for numerous tax reliefs and write-offs for companies. Around €7 billion annually until 2028 (inclusive) will be made available as an incentive for companies to boost investments.

The most important proposals contained in the act include support for the construction sector, which is experiencing a real collapse this year. Projects launched between September 2023 and October 2029 will be eligible for tax breaks totalling €540 million. Incentives in the form of tax deductions are also planned for investments aimed at protecting the climate and stepping up digitisation: up to 15% of the value, up to a maximum of €30 million. Other incentives offered to companies, which are more appealing financially, include: the depreciation of purchased machinery, equipment and vehicles; and the deduction of 25% of the costs of research projects (up to €1 million). It was a great success for Mr Lindner to convince his coalition partners to allow business to offset 80% of their current losses against the profits achieved over the next four years. As a result, they will pay up to €1.6 billion less in taxes. However, reliefs offered to medium-sized and smaller companies may translate into financial problems for local budgets as their revenues depend on taxes paid by companies.

Less red tape, more AI

The second package of anti-crisis measures, which is more structural than cyclical in nature, concerns bureaucracy. In Meseberg, 28 changes were adopted which had been developed as a result of consultations which the ministries of economy and justice held with business organisations. They are expected to bring up to €2.8 billion in savings per year. The draft of the relevant act should be presented in December. As announced, it will include the abolition of the registration obligation for German citizens, which will reduce the strain on the hospitality industry, which is obliged to collect, organise and store these data. Another significant change is the possibility of the 'digital' termination of contracts by sending a

photo of the relevant statement. A similar method will be available to apartment owners who have the obligation to send tenants information about additional costs (such as electricity consumption). The intention to phase out printed documentation is also visible in the proposals to introduce a digital passport and a public procurement procedure based on electronic documents. The announcements of shortening the period of mandatory storage for accounting documents from 10 to 8 years and limiting information obligations, for example in the field of energy, export or retail trade, would be appealing to companies. The ministries of justice and economy have also declared that they will come up with a legislative initiative at the EU level to reduce bureaucracy in European economy. The document is to be prepared jointly with France.

The announcements of the complete introduction of electronic medical prescriptions in 2024 and digital patient records in the healthcare system in 2025 have been slightly overshadowed by plans concerning taxes and the reduction of bureaucracy. Due to these, procedures will be streamlined and it will also be easier to avoid mistakes, such as the duplication of medical examinations. During the meeting in Meseberg, the government also addressed the digitisation challenge. Legal and technical rules for the use of artificial intelligence in administration are to be developed within two years. At the same time, it is possible to develop a German-language model that will compete with the offers of American corporations available on the market.

The first step

Most economists believe that the government's plan is heading in the right direction, but no breakthrough should be expected as regards combating the crisis. The plan's financial dimension is too modest and too slow to significantly affect the current trajectory of GDP. In addition, business chambers are concerned whether the government will have enough determination to complete all the projects, as many assumptions may change in the legislative process.

These concerns are justified inasmuch as the 'Meseberg peace' between the coalition partners may turn out to be short-lived. The FDP and the Greens are divided by a fundamental disagreement over how to stimulate economic growth, not tactical differences. The FDP is in favour of lowering taxes, while Robert Habeck's party would prefer to opt for targeted subsidies. There will be plenty of opportunities for this conflict to flare up again. For example, the discussion on electricity prices for companies is entering a new phase: the FDP is seeking to reduce the excise tax, while the Greens want to guarantee prices for specific industries. There will also be a difference of opinion as regards investment support. Ricarda Lang, the leader of the Greens, proposes financing them through off-budget agencies, while Lindner prefers tax incentives. The SPD is trying to maintain the role of arbiter in these disputes, but it will definitely prefer interventionist measures to the liberalism of the FDP. The intensifying protest of the regional governments against the WChG is an additional source of uncertainty. They point out that two thirds of the costs of the fiscal solutions adopted by the federal government have been transferred to the federal states and municipalities. Therefore, the coalition cannot count on a straightforward vote on the bill in the Bundesrat.

The scenario that the situation inside the coalition will only temporarily calm down and that the disputes will imminently return does not bode well for Germany. However, this it is not

the only possible scenario. There are many arguments that the government can no longer ignore the crisis and must push through deep economic reforms. Their development and publication would also be an opportunity for a new political start, providing a chance to improve the cabinet's ratings. Some members of the coalition expected it to be initiated already in Meseberg as the '10-point plan' (*10-Punkte-Plan*). Apparently, however, the option to prepare a more refined strategy and announce it at a more convenient time than the end of the holiday season has prevailed.