

Ambitious plans for Scholz and his government

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After 16 years with Angela Merkel as chancellor, the German voters opted for a change at the last federal election. The new coalition will start its term early December. Olaf Scholz, vice chancellor and Minister of Finance of the outgoing government, will then head a coalition of his Social Democrats, the Greens and the Free Democrats.

The motto of the coalition contract “Daring more progress” is very appropriate as big societal challenges wait: demography, digitization, decarbonization. The main focus is on the transition to a green economy. The plan is nothing less than the transformation of the German social market economy into a socio-ecological market economy to put Germany on the path towards the 1.5 degree goal. The parties plan to phase out coal use “ideally” by 2030 and thus 8 years earlier than scheduled. Also by 2030, they want 15 million electric cars on German roads and 80% of electricity from renewable energy, mostly from wind and solar power. Germany wants to be climate neutral by 2045. So the direction is clear, the detailed steps however less so. With the initiative for an international climate club, the parties account for the global character of the climate crisis. Overall, the green transition requires large public investments in infrastructure beside subsidies to private companies and transfers to consumers. More digitization, less red tape and faster approval procedures will help in the process. But clearly, a lot of public money will be needed.

There are also ambitious social plans: the minimum wage, which is 9,50 Euro right now, will rise to 12 Euro, and the basic transfer system will be reformed. 100,000 new social homes are planned each year together with further 300,000 new apartments to tackle Germany’s tight housing market. But the coalition contract is relatively silent when it comes to demographic change. On the contrary, for the next 4 years it rules out cuts of the public pay-as-you-go pension and contribution rates above 20%. Furthermore, there will be no increase in the statutory retirement age beyond 67. This leaves an almost empty toolbox. To stabilize the public pension system in the long-run, albeit not in the short-run, partial funding will be introduced. To this end, the parties agreed to inject a capital stock of 10 billion euros into the German public pension scheme in 2022. This is however only a drop in the ocean and a lot of questions remain with regard to further financing. Already today, the public pension system receives transfers of 100 billion euros from the public budget. These transfers will rise in the next years when the baby-boomers retire. In addition, the public health insurance and the long-term care insurance feel the demographic pressure and the pressure due to rising costs.

The financing need for the green transformation plus the rising burden of the social insurance systems have to be reconciled with the promise not to raise taxes. More importantly, the coalition contract contains a clear commitment to the German debt brake enshrined in the constitution. It has been relaxed during the pandemic, but the parties plan to put it back into force in 2023. This is a particularly challenging task as the coalition contract avoids putting prices to most of the plans. At the same time, the contract explores different options of increasing the financial leeway. Reducing subsidies, reprioritizing public expenditures and making tax evasion more difficult might help; the recent more optimistic tax projections are also welcome. But this is by far not enough. The new government plans to redirect unused corona-credits to the Energy and Climate Fund if the constitutional court does not object to this. The publicly owned KfW bank might play an important role in providing funding to the private sector. Furthermore, part of the infrastructure investments might be shifted to public companies like the German Railroad AG or moved to extra budgets. However, this all must not undermine trust in the financial solidity of

Germany. There will also be an interesting debate on the European level about the EU's fiscal rules. The new German stance seems to both acknowledge the flexibility of the current rules and point out possible scope for developing them further.

Despite all enthusiasm, the start of the new government will not be as easy as hoped for not least because of the COVID-19 pandemic, which strikes Germany with great force. The first 100 days will be a demanding period for Olaf Scholz and his ministers.