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Major Tasks of German Economic Policy

In West Germany a new parliament assembles this month. The old SPD/FDP coalition will form also the new Federal Government. Which are the challenges facing economic policy in the next legislative period?

Structural Questions to the Fore

by Professor Dr Gerhard Zeitel, Mannheim *

The main thrust of economic policy in the next legislative period is predetermined by the problems which have come into being in the recent past. Their ultimate cause on the national level is that the supreme aims of economic activity — full employment, economic growth and stable prices — have not been accomplished in sufficient measure. The course of economic development in our country is besides significantly influenced by specific difficulties in the financing of the public services, in the fulfillment of sectoral tasks especially in construction and housing, transport and power supply, and in constraints operating more particularly on the development of the self-employed middle class. That cyclical and structural factors overlap may be considered the distinctive feature of the present economic trend. Structural questions are coming to the fore and will be a much stronger determinant of economic policy in the next years than they were in previous phases.

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On the international level the persistent inflationary tendencies in the world and the consequent instability of the balances of payments and foreign exchange positions of many countries including several at an advanced state of development will emerge as factors of special gravity. Another important element are the efforts, especially by the developing countries, which are concentrating on the commodity markets and international financial relations, to establish a new "international economic order". A third factor which cannot be ignored is that the European integration has come to a stop. There are even signs of disintegration in some fields. The conjuncture of national and international circumstances is such that the economic policy in the next legislative period will be faced with a concurrence of tasks which cannot easily be resolved. The early days of the Federal Republic are perhaps the only period in the past with which the present can be compared. But our time, unlike those early days, has to cope with wide-ranging additional problems

because the population is now shrinking.

Need for Dynamic Growth

The solution of the principal tasks of economic policy calls for something more than a short-term approach with cyclical considerations in mind. More attention must be given to policies concerned with the economic order and structure and thus to the medium and long term. Such being the situation, it would be wrong to expect the indicated difficulties to be solved by the tendencies towards a cyclical upswing. There is all the less reason for such expectations because the "inflation socle" has not been demolished, the investment propensity is still unsatisfactory and unemployment — swelled by the high birth rate of the post-war age-groups now entering working life — shows evidence of becoming intractable.

It must therefore be the predominant objective of economic policy in the next years to find the way back to the path of persistent dynamic growth. This does certainly not imply similarly

high growth rates as were recorded in the fifties and sixties but points to an average real growth rate for the national product of 4–5 p.c. a year. Without a dynamic growth process of this dimension it will probably not prove possible to combat the underemployment and more especially the politically portentous unemployment among the young. The latter cannot be tackled by emergency programmes alone. In the final analysis the underemployment cannot be overcome by means of special work procurement programmes. It must be seen primarily as a challenge to a dynamic growth policy based on increased investment activity. Steady economic growth would also play a crucial part in restoring the health of the public finances and consolidating the social security system. Social stability and economic growth are at the present juncture very closely interlinked.

As for the future of investment activity, it would be a mistake to assume that the cyclical upswing perceptible at present will bring about the desired growth by itself. There is a need for greater continuity in the methods of economic policy. Blowing hot and cold, as happened in recent years with the investment tax and the investment premium, does not make for such continuity. And new costly reform schemes creating more uncertainty about our economic system would not help but hinder. On the other hand, it cannot be expected that the increased investments needed for a continual growth process will come forth if economic policy does not create better profit chances.

Less Scope for Redistribution

An assured and adequate profit margin is especially important for the smaller and medium-sized firms. Their internal capital accumulation leaves them with-

out an adequate base for expanding investments since their vertical margin has in recent years gone down to approximately 20 p.c. The tax burden has in this sector reached a level which makes special tax relief measures imperative in order to ensure greater economic growth. The imposition of additional burdens whether direct or indirect would be as detrimental to the aim of growth as further cuts in public investments.

In this respect there is less scope for a redistribution policy. The major monetary task of restoring a greater measure of price stability can hardly be achieved if increases in productivity are anticipated by wage increases as happened in recent years. It is because of the conflict potential inherent in this incomes distribution trend that flanking measures deserve more attention in incomes policy. Primary consideration should be given to more active encouragement of capital formation in the hands of employees.

While this is a task of primary importance for our economic order, the general financial and economic situation probably rules out a "grand solution" for it. It would not however be a satisfactory step in the desired direction merely to increase the benefits of the so-called DM 624 law. Specific inducements would have to be offered for profit participation of employees in smaller and medium-sized firms. In general there is little point in accumulating capital in the hands of employees by processes which because of their particular nature become a fixed item in the cost calculations of the firms concerned and leave the great differences in the economic development of individual industries out of account.

The income and property tax burdens on medium incomes which have risen by leaps and

bounds require consideration among flanking elements of the incomes policy. That the relief promised by the tax reform is largely nullified if incomes are dilated by inflation has already been apparent in the current year. The jump in the tax rate at a certain income level under the present system has the effect that if the annual income rises above DM 16,000 for single persons or DM 32,000 for married couples, the total burden including the social insurance contributions rises relatively quickly to 50 p.c. and more. Such heavy imposts – and other charges are rising constantly as well – are unlikely to be ignored in wage calculations. They conduce to excessive wage demands and create uncertainties for the cyclical and growth policy.

In the economic situation as it is developing at present this special interrelation of wages and profits is certainly making it particularly difficult to restore the health of the public finances as ought to be done, the more so as there is a structural gap estimated at DM 30 bn. It is of equal importance for the Federal Government, the *Länder* and the local authorities to return to sound finance. Further increases in direct taxation do not promise a way out. The same must be said of the indirect taxation, especially the turnover tax, in view of the present uptrend of prices. Raising the turnover tax would not only trigger a new price hoist and exacerbate the situation with regard to incomes distribution but hamper, if not block, steps towards tax harmonization in the EC. An example is the trade tax which cannot be harmonized and must be replaced. If the burden of taxes and imposts were to rise further in line with a continuing expansion of public expenditure, the consequence for the economic development of the Federal Republic

would not just be a modification of the distribution ratio between public and private sector but a sudden transmutation of the economic system. And further recourse to loan issues for the financing of special tasks would certainly be the worst possible solution.

Return to Sound Public Finance

If the economic recovery gathers speed, there is no justification on either financial or monetary grounds for a persistently high level of public indebtedness which the local authorities would be least able to bear. From the point of view of public finance the technical problem of finding "accommodation" for a larger debt volume in the capital market would be less of a worry than the further narrowing-down of the scope for public investments. Under monetary aspects a persistently high indebtedness would aggravate the inflationary tendencies and thereby put the central bank in a position where it is forced to take one-sided and structurally unsuitable action. In view of the tax levels reached in recent years a restoration of public financial health should therefore be sought through limits on the expansion of public expenditure on consumption, certainly an onerous task, and that in all the spheres of public spending.

This is a task which must certainly be pursued beyond the next legislative session, but it should be tackled resolutely. Simply to apply the "red pencil" to certain items of expenditure to bring them into line with the revenue is not good enough. There is a need for greater efficiency, to be obtained chiefly by cutting down subsidies. Housing and transport and the education and social sectors should be considered first. Apart from education where there is now evidence of espe-

cially costly misdirection of investment funds (over-academization), these fields offer a chance to return some activities to the sphere of private business and welfare.

Consolidating the Social Insurance

The consolidation of the public retirement and sickness insurance, which is closely linked with the management of the public finances, depends to an essential extent upon the employment situation and the services provided. To raise the contributions further would be wrong.

Apart from the reasons mentioned already, the ratio of social benefits to earned incomes has in many cases reached a critical point. It will probably be well-nigh impossible to keep up the present social security system over the whole of the legislative session without amending the benefits adjustment to economic growth and re-examining the public services in certain fields (e.g. costs of hospitalization and retraining methods).

Problems of Sectoral Structure

The structural problems in certain sectors to which reference has been made here have, like the social security policy, a close connection with the rehabilitation of the public finances. A reorientation of the construction and housebuilding industry is overdue in view of the evident saturation of the demand for rented accommodation on the one hand and of the longer-term owner-occupier requirements on the other. The tendency to put more stress on encouragement of the subject rather than the object which was the usual practice until now will make it easier to hold down subsidies in the longer term. In reducing them in transport, and especially on the Federal rail-

ways and in short-distance traffic, new approaches to sound finance should be searched for. The balance should not be restored by simply closing down certain routes but by facilitating more private competition, for instance on the general cargo and short-distance services.

For our energy supplies we still depend too much on oil. New capacities which do not depend upon oil must be provided for adequate economic growth, and this requires measures to encourage the enormous capital accumulations needed and also speedier licensing procedures which would dispose of the uncertainties felt by industry in keeping to appropriate safety regulations.

A solution of these structural problems in some sectors is more essential than ever for a successful cyclical and growth policy. The great problems of economic policy in the next legislative period cannot be overcome without greater coordination of the divisions of economic policy concerned with the business cycle and the structure and order of the economy.

The preservation of an efficient middle class must be an important element of economic policy insofar as it is concerned with the economic order. Enterprises of small and medium size are playing a fundamental role in maintaining a competitive economy, and this has not been sufficiently appreciated in recent years. In the fifties and sixties the middle class sector of the economy was carried forward by the dynamic growth of the whole economy which enabled it to develop vigorously. It was sufficiently profitable for constant adjustment to changing conditions. The great cost increases at a time when economic progress was largely halted have impaired its adaptability and

regrettably started a process of contraction. The middle class policy will therefore need stressing in the next legislative session. It must not be confined to credit assistance and anti-cartel legislation but aim at eliminating actual competitive disadvantages, for instance in regard to taxation and social policy. The issue in regard to middle class policy should no longer be conservation but activation, and this must include the occupational orientation of young people.

International Ramifications

The economic developments in the Federal Republic are more and more intertwined with international relations, especially with the European Economic Community. All the expressions of lofty sentiments cannot hide the fact that the integration has stalled, and this puts the cardinal features of the integration policy pursued hitherto, such as the agricultural market order, at risk. The integration process cannot be advanced by palliatives in the shape of mutual assistance with

finance and credits. Integration must be given a forward thrust through efforts for greater harmonization, especially in financial, taxation and social policies. This is an arduous undertaking but the only one which promises success. A movement towards conditions closer to those pertaining in a domestic market may also be expected to induce action in the fields of cyclical and incomes policy where national features have until now been predominant. Coordination "from above" cannot be equally effective. And in the absence of a more active integration policy it is hardly possible to provide stronger defences against disruptive international influences.

This all the more so because the international prices are likely to continue on an upward trend even though the primary need for stable money is now mentioned more frequently. But such designs for a new international order as can yet be discerned seem to point in another direction, especially in regard to the commodity markets. The Federal

Republic will do justice to its role in the web of international relations only if it proves itself willing to give direct aid to individual developing countries and at the same time resists attempts to impose on it more indirect obligations without any assurance about the maintenance of free world trade and international monetary stability. Since monetary stability ranks so high, the international ramifications require greater powers for the central bank to act at any time as required to hold off undesirable disruptive influences. Whether the instruments used for this purpose in the past — for instance in regard to interest-induced capital movements — are adequate has to be examined in this context.

Economic policy will face difficult problems in the next legislative period. They can be successfully resolved only if the quintessential features of our economic order are not put in question and our policies concerning this economic order and its processes are based on one concept.

The Priority Task: Making Sure of the Cyclical Uptrend

by Professor Dr Hans G. Schachtschabel, Mannheim *

The Federal Republic of Germany has coped much better with the effects of the worst worldwide economic crisis since the thirties than most of the other industrial states. Although the crisis has at this moment not yet been fully overcome, the evidence of recent economic indicators proves that the Federal Government together with the *Bundesbank* has pursued a consistent economic and cyclical policy, leading the way to an economic upswing without causing the price front to break.

The real gross national product will have risen by 6 p.c. this year. The trend of consumer prices is improving steadily; the inflation rate in October was 3.8 p.c. — on the international scale the lowest after Switzerland. The D-Mark is one of the most stable currencies: in the first nine months of 1976 it improved against the other currencies by an average of 13.5 p.c. The foreign trade volume has expanded strongly; exports increased by 25 p.c. over the corresponding month of last year,

to DM 19.1 bn, and imports by as much as 31 p.c. to DM 18.0 bn. Finally, the unemployment rate, at the beginning of the year still at 5.9 p.c., was in October down to 3.9 p.c.

The demand for industrial goods shows a strong improvement compared with the preceding year. While the gains of the individual branches of industry varied (e.g., investment goods + 40 p.c., consumer goods + 15.5 p.c., basic and producer

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