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Elections in Germany: Economic Policy at a Crossroads

The economic situation in Germany is precarious. Similar to the beginning of this century, Germany has slipped into a long-term phase of stagnation. Growth figures have fluctuated close to zero since the end of the coronavirus pandemic. This is in sharp contrast to most other major economies, which have been able to recover more or less from the impact of the pandemic in recent years. Germany is therefore falling behind. The image of Germany as the “sick man of Europe” is back in fashion.

So what is going on with the German economy? What economic policy measures are political parties promising in the upcoming election campaign to overcome the stubborn economic weakness in what is still the strongest European economy?

The main weakness of the German economy is lack of investment. This applies more or less to all sectors. Public investment, particularly at the local level, has been completely inadequate for years in relation to requirements. The lack of investment has led to a gradual deterioration of infrastructure, which is now taking full effect. At the level of the federal states, investment in the education system and social housing, which has also been lacking for years, has led to noticeable deficiencies in the quality of education and in some cases to massive rent increases, which are putting a heavy strain on the purchasing power of private households. Although the federal government has noticeably increased its investment activity, this is still nowhere near enough to compensate for the deficits of the past, let alone to meet climate policy requirements.

The same can be said of private investment, which has been significantly shrinking recently. This weakness is putting pressure on the model of an economy that is strongly geared towards industry and its exports. Geopolitical conflicts and the Chinese strategy of flooding the export markets with its cheaper industrial products in order to compensate for its own domestic economic weakness are playing a significant role. This is compounded by uncertainty about the future, the potentially conflict-laden foreign trade strategy of the USA, and the lack of clarity about the necessary conversions due to climate policy requirements. However, uncertainty and ambiguity are poison for industrial investment.

Despite all these negative trends, there is a fundamental difference between the stagnation at the beginning of the century and the current state of the economy. While over five million people were unemployed back then, the current figure is “only” about 2.5 million. In this respect, the labour market situation is much better.

Against this generally rather gloomy backdrop, the dispute over economic policy concepts to overcome the miserable economic condition will be a focal point of the election campaign between the parties. Three overlapping areas of conflict are currently emerging between the established parties SPD, CDU, Greens and FDP: fiscal policy, climate policy and social policy.

The current government broke up over fiscal policy. While the FDP and, from the opposition benches, the CDU insisted on strict adherence to the debt brake, the SPD and the

Greens want to relax it for investments and possibly also for military aid for Ukraine. The investments are primarily intended to modernise the dilapidated infrastructure and meet the requirements of climate change. This necessity is disputed by the other parties, at least with regard to climate change, and sheds light on a fundamental dispute over the strategic direction of climate policy. On one side are the CDU and FDP, who essentially see the market as the driver for the necessary investments. In their view, the prerequisites for this have been created with the introduction of levies on CO₂ emissions, which make the use of harmful technologies more and more expensive. This expected increase in the relative prices of emission-prone goods would automatically and efficiently trigger private investment, which over time would bring about the transition to a sustainable production economy. Further public investment or an active industrial policy would be largely superfluous with this approach. These funds could therefore be saved and higher public debt can be avoided.

The SPD and, to a lesser extent, the Greens are pursuing a different strategy. They want to add an active investment and industrial policy to price signals. In this way, the speed of the transition is expected to increase. This should not only improve the carbon footprint more quickly but also create technological advantages, particularly in industry. In this way, the current export model of the German economy could endure in a renewed form. This is also a major departure from the proposal of the other two parties, where the market alone decides whether the current economic model will endure. The hope is that this will result in a sustainable transition without misallocation. The fear is that this could be associated with a significant increase in structural unemployment or a loss of quality in the newly created jobs.

A further conflict exists primarily between the SPD and the other parties over the appropriate social policy in the environment described. For many, the prevailing idea is that a choice must be made between more investment and existing social benefits. Accordingly, there are calls to cut or at least freeze social benefits. The SPD wants both more investment and increased social security during the transition process. This is only consistent if the debt brake is opened up for investment at the same time, which is in fact one of their demands.

In Germany, as in other countries, it is not uncommon that controversial discourses between the established parties are overshadowed by debate with populist parties, especially right-wing populist parties. They deliberately pick-up on weaknesses in the economic situation and blame them on migrants, support for Ukraine, actual or supposed elites and the established parties as a whole. This is how they treat the topics of high rents and dilapidated infrastructure in the public discourse.

Above all, right-wing populist parties have seized on one issue that the other parties have so far only addressed inadequately: inflation, or more specifically, higher prices. Even though the inflationary momentum has largely come to a standstill, prices remain at a significantly higher level. This is particularly the case for food prices, which in Germany are over 30% above the 2021 level. Middle- and lower-income families are particularly affected. Their purchasing power has been noticeably reduced by the price increase. This has not been offset by the compensatory measures taken by the federal government for this group. While the burden of higher food prices was of greater importance for families with low incomes, the tax relief has little effect on them, as they pay little if any taxes. If they are employed on a precarious basis, i.e. without collective wage agreements, they generally do not benefit from the tax-free inflation compensation agreed upon by the collective bargaining parties in many sectors.

This means that broad sections of the population are actually worse off than they were three years ago. It remains to be seen which line of arguments will prevail with voters in February.

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