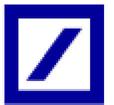
Deutsche Bank Research 

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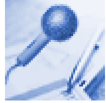

The EU as economic "white-knight" - where's the limit?

December 16, 2008

At their recent summit the EU heads of state and government adopted the European Economic Recovery Plan put forward by the European Commission in late November. The 27 member states aim to raise 1.2% of GDP, or EUR 170 bn, to fight the recession in Europe (another EUR 30 bn will come from the EIB). The member states are free to choose instruments from a fiscal tool box in order to stimulate growth in their (national) economies. The EU has merely a coordinating role. This approach makes sense for two reasons: one is that the economic problems in the member states have quite different starting points. For instance, the United Kingdom and Spain are confronted with a serious crisis in the real estate sector, while Germany has to grapple with a slump in foreign demand. The other reason, though, is that in a single market with close economic ties it is vital that national measures do not cancel out the efforts of other member states and that these other members do not remain idle in hopes of benefiting from the economic policies implemented by their partners.

Various issues remain open. For instance, it is uncertain whether the 1.2% of European GDP is to be raised in equal measures at the national level or whether this is an average value, i.e. with some countries contributing more and others less. There is also the question of whether the measures are to be based on one year or two (2009/2010) and whether only timely, temporary and targeted measures may be credited. It is likely to be very difficult to judge this in the first place, though. In only the rarest of cases do the stimulus programmes put forward by the EU member states follow the principles of balance sheet transparency and veracity; the main priority seems to be to outdo the others in terms of billions pledged. The French include the current investments of state-owned and partially state-owned companies in their list, and the Italians have even factored in the expenditures of the EU Structural Funds in that region in “their” stimulus programme. Moreover, many of the packages involve provisional announcements that still have to go through the political process at home. This is a case where the Commission should have provided clear conceptual guidelines and called for explicit integration in the stability and growth pact.

As Germany is the biggest economy of the Union it is expected to assume the role of growth engine. One of the reasons used to justify this is that Germany enjoys greater fiscal latitude under the 3% budget limit (of the Maastricht Treaty) than its EU partners do. While this is true, it is unthinkable to expect countries that have successfully consolidated their finances in the face of considerable belt-tightening to commit to a new round of deficit spending. This would substantially reduce the incentives for politicians to work towards sustainable, sound fiscal policy. Nevertheless, it is correct that fiscal stimulus in the EU is scarcely likely to feed through if Germany does not make a significant contribution.

In a European comparison, though, Germany is not doing as poorly as the public impression would suggest considering the criticism of some EU partners. While the relief programmes adopted in October and November are only partly geared to stimulating growth, they are nonetheless set to come into timely effect shortly after January 1, 2009. All in all, German policymakers have – according to the stability programme – already launched initiatives for extra spending and tax relief in 2009 and 2010 totalling EUR 31 bn (fiscal stimulus for 2009: around 1% of GDP). The temporary waiving of counterfinancing for the revenue shortfalls arising from the supreme court ruling on the reimbursement of the commuter allowance will boost domestic demand in 2009 by an additional EUR 5 bn. This would already equal the EU target of 1.2% of GDP for national measures.

Nonetheless, it would make economic and political sense if at the beginning of next year Germany were to put another log on the (fiscal) fire in the form of a further targeted stimulus package which would help to stop the downward spiral of pessimism and at least partly cushion the extraordinary slump. The instruments used should link effective short-term fiscal stimuli with mid-term growth-enhancing initiatives. These could include measures to ensure adequate liquidity provision in the economy, a degressive, ecologically-based bonus for buying new cars, a further temporary extension of funding for short-time work, and greater expansion of public investment not only in building projects but also in education, research and development. Further tax relief – no matter how desirable

– unfortunately seems unable at present to find a political majority. One key aspect in all these considerations is that decisions are reached swiftly without being discussed to death in public discourse. Any other approach will only fuel the wait-and-see attitude among consumers and industry and further feed the downward spiral.

It would be particularly clever if together with the stimulus package the government could enact the regulations on a debt cap already long under debate in the Federalism Commission. This would send a clear signal to the nation and the business community that the expansion of national deficit spending is only temporary in nature, having been triggered by the exceptional situation facing the economy. This would no doubt lead to greater acceptance and thus efficacy of the measures, stabilising the future confidence of citizens and business alike. There is no question that they realise only too well that the debts of today are the taxes of tomorrow.

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