FRIEDRICH EBERT STIFTUNG
London Office

October 2008

A protective shield for jobs

Angela Merkel and Peer Steinbrück are rescuing the banks. A protective shield costing almost EUR 500 billion is supposed to prevent collapse on the financial markets. The shield is being paid for by taxpayers. So far, so bad.

Confederation of German Trade Unions (DGB)*

But who is actually protecting jobs from the consequences of the financial crisis? In the crisis, the banks are cutting credit lines and demanding better securities. Credit provision is being cut back. Interest rates are going up. Investment plans are being postponed. Different sectors of the economy are affected in varying degrees. Not all sectors are doing as well as the metal-working and electronics industries. Companies there are swimming in money. High own capital quotas and a high proportion of financial assets protect metal-working and electronics firms from the deterioration in credit conditions. However, in construction, retail and catering, the starting position is considerably worse.

Since this is a global crisis, Germany, as world champion exporter, is threatened with losing important sales markets. The British, Irish and Spaniards have already lost their desire to buy. Now the German economy's pathological dependence on exports is coming home to haunt us. Germany can no longer grow under its own steam. Cash-strapped consumers are not making up for the sinking demand from abroad. Consumers at home are feeling insecure because of the crisis and spending even less money. Added to this, if price rises are taken into account, in recent years wages have actually fallen.

Even a few short weeks ago, the Chancellor did not see any political need to act to protect the economy and ensure growth. The red Finance Minister was scornful about the threat of money going down the tube. Economists were spitting blood. Because according to neoliberal theories, giving the economy a spending boost produces at best a flash in the pan. Its lasting results are

* This article was first published by the Confederation of German Trade Unions (DGB), Federal Executive, Economic and Fiscal Policy Department, in the *Standpunkt*, no.3, 22nd October 2008.

said to be only the ashes of inflation and new debts. Just how far divorced from reality this economic fairytale is, is something the pragmatic Anglo-Saxons have been showing us for decades. The Americans and British, with their active monetary and financial policies, are achieving high growth rates and at times full employment. In Germany this is being totally ignored. German autism is reminiscent of a Beatles hit from the 1970s. “Nothing's gonna change my world", the long-haired ones sang in those days. True to the motto: If it shouldn’t be so, then it can’t be so.

However, a “policy of the steady hand" will in the end cost us dear. Production and demand are collapsing like a house of cards. The economic downturn is thus becoming deeper and will last longer. Our republic can tell you a thing or two about that: A downturn at home lasts on average for 28 tough months. In the USA it lasts for only 11 months. But every additional month of the growth and labour market crisis means millions in lost taxes and contributions. Steinbrück’s dreams of balancing his budget are vanishing into thin air.

It doesn’t have to get that far, if only we take off our ideological blinkers in time. Beyond our national borders, a great deal of work has gone into designing successful programmes to boost the economy and growth. We should now learn from these experiences. The first step must be a quick injection of liquidity into the economy. It must come into effect before a wave of pessimism buries everything in its wake.

Furthermore, the dose has to be sufficient. It should be one per cent of GDP if we really want to stand up to the forces of the downturn successfully. That is round about the size of the latest American economic programme – around US$ 160 billion – which was put into effect this spring. So for Germany this would mean a package of about EUR 25 billion.

The next crucial question is how best to get the economy going again. Should central and state governments and local authorities spend more, or should there be tax cuts for everybody? The lesson of the past is that higher public expenditure is more effective that cutting taxes. According to an estimate by the Munich ifo Institute, each additional euro from the coffers of the state increases GDP by EUR 2.40. However, an extra euro taken off taxes only increases GDP by EUR 1.80. The latest tax cuts of the Bush government – principally for those on higher incomes – were a classic example of how not to do it. The stimulus to the economy, only 30 cents for every euro in tax cuts, was minimal.

The public investment gap is another reason for higher state spending. At only 1.5%, the rate of state investment is about one percentage point lower than the European average. Greater public investment in education, infrastructure and climate protection in the future would combine what is socially necessary with what is economically sensible. This public investment offensive could be augmented by additional investment allowances.

In addition, social transfers could also be raised. A significant increase in the rate for Hartz IV income support would give a boost to consumption. Because low-income households spend each additional cent they receive immediately. Their rate of savings is close to zero.

In an open economy, the additional demand would of course not only benefit German firms.

But the largest European economy would thereby at long last take responsibility for the Single Market. And if Peer Steinbrück would talk to his French, British and Italian colleagues, this could produce a common European show of strength. Not to mention energetic support from the guardians of the European currency.

The fact that such a programme produces new debt in the short run is no disaster. Because one thing is certain: The longer the downturn lasts, the larger the debt mountain will become. In addition, the economic package will to a great extent pay for itself through its positive effects on growth and the labour market. The German central bank estimates the self-financing share at 50%. And higher public investment should in the medium term be financed from taxes anyway. However, anyone who wants to run up as few debts as possible could also use part of the gold reserves. About EUR 50 billion of gold is lying around uselessly in the cellars of Germany's central bankers.

However, the worst thing the politicians could do would be to sit back and do nothing. When supplemented with large wage increases, higher public expenditure can get the growth engine of the economy started again.

Translation: The Language Technology Centre

The views expressed in this article are those of the author and do not necessarily reflect those of the FES London.

A German-language version of this article is available on http://www.aktionintern.de/publikationen/standpunkt/data/standpunkt_3_2008.pdf