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Suspend the debt brake again in 2023

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Concerns about government solvency are greatly exaggerated

Germany is lurching into recession. LBBW Research forecasts a 1% contraction in GDP for 2023. And that does not even include the assumption that Russia could soon cut off its gas supplies completely. Then the economic slump would get really serious.

A recession can affect us all. Companies and households alike will face new challenges. It will not leave public finances unscathed either.

A recession in 2023 will put a strain on public finances

Inflation is currently giving tax revenues a boost

Figures from the Federal Ministry of Finance show that tax revenues (excluding municipal taxes) increased by almost 17% in the second quarter compared to a year earlier. With the expected decline in demand and inflation, this positive development is likely to come to an end and turn into the opposite. If so, the commitment to balanced budgets is likely to become obsolete. After all, it seems rather wishful thinking that the coalition will be able to agree on an offsetting cut in spending. After all, the growing challenges of digitization, as well as the energy and climate crises all call for a ramping up of public investment.

Currently, high inflation inflates tax revenue

The coalition agreement obliges the government to scrutinize all spending categories to snuff out dispensable expenditure. International experience suggests that the government is unlikely to identify and implement the necessary spending cuts, even if we assume that the government were willing to initiate a procyclical austerity process during a recession. In any case, large sums could only be found in the social budget. There is no less conducive backdrop for curtailing social spending than a recession. Do not hold your breath.

Squaring the circle

The fiscal policy guidelines of the coalition agreement (compliance with the debt brake prescribing balanced budgets, no tax increases and the expansion of public investment) are unlikely to be compatible at the best of times. When a recession strikes they become outright contradictory.

Given the many simultaneous shocks currently facing the economy, the renewed suspension of the debt brake in 2023 would therefore be a responsible step.

Germany does not have a debt problem

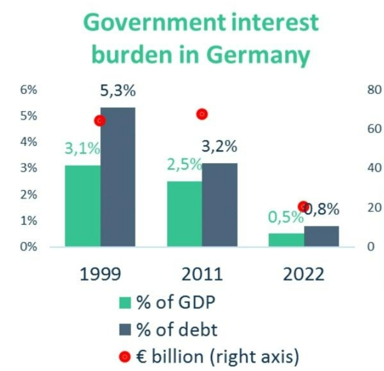
The Federal Minister of Finance has repeatedly expressed his public opposition to this. Germany could not afford higher debts. Fortunately, this thesis is hardly accurate. Capital markets and rating agencies do not see it that way either. For good reason. General government debt is only about 70%.

In any case, the amount of debt is of secondary importance. Debt sustainability is the relevant concept. If we measure Germany's debt bearing capacity by the government's interest burden, it is currently the stronger than it has been in decades (see chart).

It is correct that in the medium term the interest burden will rise again somewhat as the era of negative interest rates is over (and also in the short term because of the temporarily inflated cost of inflation-indexed federal bonds).

It is also correct that demographic change will bring considerable additional burdens over the next ten years. This will require sustainable structural solutions.

Insisting on procyclically applying the debt brake in 2023, never mind the coming economic slump, is no such structural solution. Better to suspend the debt break for another year.



Source: European Commission

Not a good idea: procyclical consolidation in a recession