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Neodirigism

Bank failures, economic inequality, populism, train delays, lack of housing, pollution – all this is laid at the feet of neoliberalism. Neoliberal policies are often named as a cause of social and economic grievances. The term actually refers to a historical school of thought that, in response to the world economic crisis of the late 1920s and early 1930s, demanded not less but rather more government action to establish conditions that would improve the functioning of the economy. However, people who use the term nowadays are usually referring to a disproportionate faith in the market and the state's withdrawal from areas where it is actually needed.

In Germany, there is little to be seen of a state stepping back from the economy. The International Monetary Fund reports that in 2018, the government's revenue-to-GDP ratio was 46.4 percent. That was the highest figure since reunification, with the exception of 1999 when it briefly reached 46.5 percent. And according to the Fraser Institute, which every year looks at several countries to determine their degree of economic freedom, Germany's economic freedom peaked in 2000 before declining slightly. The significance of such indicators is limited, but the general impression is certainly not one of the state withdrawing from the economy.

“Neodirigism” – A New Political (Mis)Guiding Light

Such inflationary use of the term “neoliberalism” is paradoxical, as the political debate in Germany is increasingly marked by a position that is the opposite of (neo)liberal and can be dubbed “neodirigism.” This term describes an approach to economic policy with the following characteristics: first, a low level of confidence in the ability of markets, price mechanisms, and competition to solve economic problems. Instead, government intervention in economic affairs is trusted to achieve better results. Second, neodirigism includes the idea that economic incentives do not play a central role in economic decisions of households and firms. This in turn leads to the third characteristic, namely, that the idea that the government can redistribute income through price regulations, transfers, or taxes without having to worry about distortions of economic behavior or other harmful side effects. The overall position harkens back to the economic dirigisme of the 1970s.

Misguided Management of Environmental and Climate Policy

Neodirigist ideas can be seen most clearly in Germany's environmental and climate policy. To avoid unnecessary costs while protecting the environment, price signals are indispensable. They ensure that pollution is avoided where the costs of such avoidance are lowest. For decades, German climate policy has hesitated to introduce a uniform CO₂ price. Policymakers have instead relied on a hodgepodge of uncoordinated and expensive measures, and Germany has still failed to achieve its climate goals. In the meantime, decision-makers have agreed to work toward a uniform CO₂ price.

The positive effects of this instrument, however, will be eclipsed by a multitude of supplementary state interventions. For example, in the presence of a uniform CO₂ price, it is counterproductive to set fleet-wide emission targets for automotive manufacturers, as is the case with the EU regulation on vehicle CO₂ emissions. This regulation stipulates that between 2021 and 2030 the CO₂ emissions of new cars have to be reduced by 37.5 percent. But the whole idea of a uniform CO₂ price is for competition to highlight where CO₂ emissions can be cut at the least cost. If the massive reduction of vehicle emissions is the most economically efficient way of achieving the targets, then this will happen even without regulation. But it is certainly conceivable that reducing CO₂ emissions in other sectors, such as building heating, will incur lower costs. In that case, the CO₂ regulation for vehicles will make achieving climate goals unnecessarily more expensive, without contributing anything to more climate protection.

Subsidies Are Not the Way to Go

Subsidizing solar collectors and wind turbines – essentially setting expansion targets for individual technologies – in addition to introducing a CO₂ price is not helpful either. The CO₂ price alone already grants a cost advantage to zero-emission energy sources, and renewables should also compete with each other. Any additional promotion or political steering of the expansion of individual renewables similarly increases the costs of climate protection.

It is often argued that additional measures such as subsidies for renewable energy would encourage the public to accept higher CO₂ prices and thus promote climate protection, but this line of reasoning has its flaws. Such interventions distort the use of climate-friendly energy sources, making climate protection more expensive, and ultimately undercut the purpose of climate policy. Another consideration is that the extent of the CO₂ emissions reduction for Germany and Europe is already set out in international obligations. Support should focus on researching and developing new technologies, not on providing sweeping subsidies for the expansion of known technology.

None of this leads to the conclusion that a CO₂ price alone is enough to efficiently achieve climate targets. Additional intervention, however, must be carefully thought through and coordinated with the CO₂ price. It is needed for cases where the CO₂ price is not effective. For example, improved thermal insulation in buildings lowers heating costs for renters. But if rental regulations make it impossible for the costs of that insulation to be recouped fully through rental payments, forcing landlords to bear some of the cost, then increasing the CO₂ price will not ensure that buildings are properly insulated. This is because the landlords will incur high costs from thermal insulation but no corresponding benefit. If no one is willing to change these rental regulations, it may make sense to offer landlords additional financial incentives to encourage them to invest in proper insulation.

Intelligent Use of Market Mechanisms Produces Better Results

Unnecessary dirigism has a harmful effect on other areas of environmental policy as well, such as the limitation of fine particulate emissions in city centers. Intelligent use of market mechanisms leads to better results. Instead of demanding bans, authorities should opt for flexible toll systems. In areas with high levels of fine particulates, rising tolls ensure that the only people who drive cars into the city are those for whom not driving their car would result in higher costs. After all, installers who deliver major kitchen appliances can hardly be expected to do without their delivery van, but someone who wants to go to the movies in the city can switch to public transport. However, many politicians prefer to impose driving bans. The drawback of such bans is that they do not distinguish between the widely differing ramifications for individual drivers – which makes curbing fine particulate emissions much more expensive than necessary for the economy as a whole.

Is the State an All-Knowing Distributor of Resources?

Another example of dirigism is the debate over investment in Germany. Here, too, state decisions about the use of resources are given priority over private ones and the effects of economic incentives are ignored. While there are loud calls for expanding public investment, private investments go largely unnoticed – even though the volume of the latter is roughly nine times that of the former. It is perfectly possible to hold the opinion that public investment, which has already risen over the past few years, should be increased further; but this would not change the fact that Germany's economic future will be decided primarily in the realm of private investment. Better conditions are required to make progress here. Limits on loss compensation mean that corporate taxation currently favors less risky investments over risky ones; compared to other countries, the tax burden in Germany is too high. In addition, industry requires a reliable and affordable supply of energy.

Rather than improving conditions for private investment, additional taxes are being discussed and then justified by arguing that they further redistribution efforts. Corporate taxation reform or reductions to income tax are rejected as “gifts to the rich”. Instead, there are calls to introduce a net wealth tax. This approach denies the related economic disincentives. Lower corporate taxes, so runs the argument, would not lead to more investment in Germany, and a wealth tax would not result in capital flight. Many studies have indicated the opposite, but this fact is ignored. Simply because taxes have negative side effects does not mean that they should be cut or that they need not be levied in the first place. But these effects have to be taken seriously when weighing up the costs and benefits of financial policy reforms.

An Extreme Example – Berlin's Rent Cap

One particularly salient example of dirigist policy is the rent cap in Berlin. This approach assumes that rental payments can be reduced through regulation without impacting the supply of housing for rent. In fact, experience with rental regulations show that they scare off housing construction investors and make housing more scarce. Criticism of the rent cap should by no means be taken as a recommendation for politicians to leave the housing market completely alone. Political decisions, such as permits for building construction zones or the establishment of standards for new construction, already offer a way for the state to influence the housing market. But housing allowances and construction of social housing are better instruments than a rent cap. They make more housing available whereas rent caps limit the housing supply. Ultimately, the rent cap discriminates against people in search of housing and redistributes wealth to those who already have a place to live.

In the field of social and labor market policy, the call for “overcoming” the Agenda 2010 reforms is another feature typical of dirigism. But this, too, denies the role played by the effects of economic incentives. Dirigists reject as unreasonable the notion that recipients of Hartz IV benefits should be required to look for work; they believe that incentives for looking for employment are not needed. They hold that going beyond supporting the unemployed and requiring them to put effort into their job search is a step too far. After a full decade and in a changed labor market, it is absolutely correct to question whether the rules that apply to low-wage jobs are still appropriate. However, the focus needs to be on how to further improve incentives for finding work and better support people in this labor market segment. A core problem in this area is that the various transfers and contributions have not been coordinated with one another and so lead to disincentives for extra work as well as a kind of part-time-job trap.

Dirigist intervention is gaining support in industrial policy, too. Many gaze in wonder at the “Made in China 2025” strategy, in which the Chinese government named ten sectors where it aimed to be the global leader by 2049. Germany and Europe are often exhorted to advance an industrial policy with similarly clear objectives and bolster existing major companies so as to create “European champions.” Yet this neglects to acknowledge that China is a country that still has some catching up to do in industrial manufacturing. In their situation, imitation could be eminently sensible, even if there is doubt as to whether China has correctly estimated its own comparative advantages with the ten sectors for its Made in China 2025 strategy. Germany, by contrast, is at the forefront of technological development. In this case, there is much more potential in broad support of innovation without stipulating certain sectors or technologies.

Market-Economy Processes Have a Bad Reputation

Defending the market economy system against dirigist intervention is not particularly popular among the general public, opinion polls show. In 2018, only 32 percent of the German population supported the statement that the state should stay out of the economy, whereas more than 50 percent disagreed. Little and, over time, declining support for a liberal economic system was also revealed in opinions on the statement that socialism was fundamentally a good idea, just poorly executed. In 1991, 39 percent of West Germans agreed with this statement, though that was shortly after the collapse of communism in eastern Europe. In 2018, that figure was 49 percent. Eastern Germany's agreement with the statement holds constant at over 70 percent. The significance of such polls should not be overstated. However, they stand in opposition to a crucial fact: to date, only market economies have achieved environmental protection and prosperity for large portions of their populations.

Neo-Dirigism Entails Major Risks

There is consensus that social security, including redistributive management, and correction of market failures are key tasks of the state. What this means in specific cases is where the disagreements arise. The danger inherent in neodirigism is that ideologically motivated intervention that does more than establish the conditions for markets to function properly can undermine not just growth and employment but also the achievement of environmental policy goals. It puts Germany at risk of paying unnecessarily high costs to meet its climate change obligations or even failing to meet them at all. The attempt to directly specify market results – such as legally requiring rent reductions – in a bid to pursue distribution objectives will actually exacerbate the housing shortage instead of easing it. Policymakers and the public in Germany need more openness so they can make shrewd use of markets and competition in combination with government regulations as they strive for economic, social, and environmental goals.

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