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# Germany's "Jamaica" Coalition and Its Economic Policy\*

The recent Bundestag elections have transformed the political landscape in Germany. The grand coalition has been kicked out and the extreme right-wing Alternative für Deutschland (AfD), which often peddles provocative populist slogans, is now present in Germany's parliament. This is causing quite a commotion, overshadowing the fact the AfD actually only won 13 percent of votes, and will not participate in government. It is time for politics to focus on the question of how a new government can be formed and what needs to be done for Germany to master the challenges ahead and effectively exploit opportunities in the future.

If the CSU/CDU, FDP and die Grünen (the Green Party) want to form a government, they will need to bridge major differences. It will be particularly difficult for them to agree on a future immigration policy. At the moment the main bone of contention between the CSU and the Green Party is the question of capping the number of refugees allowed into Germany. Like the Green Party, Angela Merkel rejects the idea of a cap. Which solution would make sense? The new coalition will hardly be able to ignore one of voters' messages: they never again want to get the impression that the German state has lost control over refugee immigration. The widespread assertion – made to reassure the public – that taking in refugees will also give Germany an economic boost also created mistrust among German citizens. All this does not mean that the new coalition will ditch existing asylum rights and humanitarian support for refugees; or that Germany should close its borders to immigrants. On the contrary, Germany should actively seek to encourage immigration of skilled workers or investors and offer those refugees who successfully complete training courses or have found employment the prospect of remaining in the country. In the future, however, immigration should be restructured in a new law on refugees. Ultimately, the population needs to have faith that the German state can control who is coming into Germany from non-EU countries. This law does not need to feature a cap on the number of immigrants or refugees. At the same time, it has to be clear that this is also a law to limit immigration.

The parties trying to form a government will struggle to agree on climate policy too. They all believe that Germany needs to honour its pledges to reduce CO<sub>2</sub> emissions, but disagree over the best way of doing so. The Green Party, for example, would like to ban cars with combustion engines as of 2030. In this case the Green Party should reconsider its position. In combustion engines in particular there is a very dynamic development towards low-emission or emissions-free technologies. The extent to which electric motors can work as a blanket solution is currently unclear. The drive technology with which climate goals can be achieved needs to emerge in a competitive process that clearly links individual technologies with the environmental damage that they cause. This can be achieved by involving

transport in emissions certificate trading. Climate policy will only meet with social acceptance if it avoids unnecessary costs.

In terms of European policy the CSU/CDU, FDP and the Greens Party agree that Germany has a vested interest in stabilising and further developing the European Union. It is also clear that the EU should deepen its internal market and seek closer cooperation in areas like European defence and security policy and development aid. Closer European cooperation in the procurement of weapons could provide significant efficiency gains and relief for national government budgets.

A stumbling block for the Jamaica coalition will be its European Monetary Union policy. In its electoral campaign the Green Party reproached the then-government for skimping on the EU budget and insisting on austerity policies while denying debt relief for Greece, Eurobonds and public investments; and accused it of deepening the rifts in Europe as a result. Accordingly, the Green Party demands more funding for EU coffers and a European unemployment insurance system. The FDP, by contrast, insists that EU member states should abide by rules on debt and proposes procedures for state insolvencies and orderly exiting the Eurozone, whereby exiting countries can remain EU members. The CSU/CDU adopts a middle-of-the-road position: it rules out collective liability for debt and wants to create a European currency union, which should supervise European debt rules more closely than the European Commission has done to date.

It is deeply important to the future of the Eurozone that banks hold fewer of their own countries government bonds and more equity. Instead of a comprehensive procedure for state insolvencies, accountability bonds should be introduced. These are subordinate bonds that countries would have to use to finance the share of their current budget deficit that exceeds the agreed cap of 0.5 percent (cyclically-adjusted) of gross domestic product. That would strengthen incentives to implement a solid financial policy and protect taxpayers more effectively from liability for the excessive debts of other euro countries. At the same time, it would prevent the destabilisation of countries that have accrued high debts in the past. These reforms should be acceptable to all coalition partners.

The various parties also have very different ideas in the field of taxation policy. To remain competitive as a business location, Germany will have to reform its corporate taxation system. Donald Trump wants to reduce the US tax rate on corporate profits from 25 percent to 20 percent. The French President Emmanuel Macron has announced plans to abolish the wealth tax and to cut taxes on corporate profits significantly. The governments of Britain and Sweden have also announced tax relief for investments.

Germany will not be able to avoid this tax competition, whether its political leaders like it or not. While the FDP emphasizes the competitiveness of the taxation system, the Green Party tends to focus on the battle against tax avoidance. In fact, future reforms should not only offer tax relief, but should also prevent certain sectors – and especially companies in the digital economy – from escaping taxation altogether.

The key issue of digitalisation is less conflictual. At the moment Germany oscillates between excessive enthusiasm for a nationwide roll-out of a fibre-optic network and concerns over the power wielded by new internet companies like Uber and Airbnb. It is important to avoid making any mistakes here. A nationwide fibre optic network rollout would be expensive and inefficient. Such infrastructure should only be built in places where it is clearly needed. As for regulating the digital economy, this should be aimed at preventing abuses, and not obstructing new business models.

Moreover, there is a widespread fear that digitalisation and automation could lead to job losses. There are regular calls for the introduction of an unconditional basic income, perhaps combined with a robot tax, to respond to this threat. That would be a terrible mistake and a capitulation to the challenges ahead. Instead of giving up on a tier of the population and making it dependent on transfers earned by others, the goal should be to offer individuals training in newly emerging careers.

There is also a lot of common ground between the Jamaica coalition partners when it comes to pension policy. They all recognise that demographic change will place a heavy burden on public finances, and especially on pensions. Here it is important to look beyond 2030. During their election campaigns the SPD and the CDU/CSU ruled out any raising of the retirement age to 70, although there are very good reasons for doing so in the medium term. As a measure for disburdening the statutory pension scheme, a higher retirement scheme is often denounced as unfair, because people with physically challenging jobs are often unable to carry on working until the age of 70. That is an important problem, but it should be addressed with higher wages and disability insurance, not pension insurance. It should also be possible to take retirement early, but with corresponding markdowns.

If the Jamaica coalition partners are ready to make constructive compromises, they have an opportunity to provide a fresh impetus and to help Germany and Europe to take a big step forward.

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