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SAFE Finance Blog

A plea against “black zero”

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Saving has become an end in itself: Neither the German debt brake nor the European Fiscal Pact are well-thought-out concepts. They are politically difficult to implement anyway



For several years, German fiscal policy has been following an obsession that needs to be described as increasingly harmful from an economic perspective: The avoidance of any new government debt is a key goal, whose achievement is celebrated as a proof for sound public finances. This is a mistake and it is time

to abandon this austerity policy. Instead, we should use fiscal leeway for much-needed investment and tax relief.

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The debt brake has been anchored in the Basic Law since 2009. Since 2019, it has limited the Federal Government's cyclically-adjusted borrowing to 0.35 percent of gross domestic product (GDP). Most EU states have adopted the debt brake with a deficit limit of 0.5 percent of GDP within the framework of the European Fiscal Pact.

Recently, there has been increasing criticism of these strict goals, not only from the opposition but also from economists. The critics just referred to the negative long-term nominal interest rates: ten years later, the German state currently has to repay only about 96 cents for every euro of credit – this is a business opportunity that should be exploited!

Yet both this hint and, above all, no new debt itself are subject to a trap of thought, namely the money illusion. For every saver and borrower, neither the monetary value of the debt nor the nominal interest rate to be paid in euros is decisive. It is rather the real value of the debt – i.e. the equivalent of the goods and services of the liabilities – as well as the real interest rate, thus the nominal interest rate adjusted for inflation.

We should abandon this corset

This distinction has important consequences: Assuming an annual inflation rate of 1.5 percent, the real value of government debt automatically falls by exactly this 1.5 percent every year. If the debt level is to remain constant in real terms, Germany could currently borrow around 30 billion euros, which would be 18 billion euros more than the debt brake would allow.

On the other hand, if the debt ratio is to remain stable, i.e. the ratio of debt to GDP, an even higher deficit is permissible. If the German economy grows at an annual rate of one percent, the state could afford a current deficit of around 50 billion euros without jeopardizing the Maastricht criterion of a debt ratio of 60 percent. In principle, this is independent of the interest rate level, but low-interest rates allow much greater fiscal leeway.

These are conservative estimates based on the assumption of low growth and inflation rates. Conversely, that means that permanently avoiding any new debt leads to an annual decline in the debt ratio of around 2.5 percent. Of course, this can be a politically motivated decision. However, the German government does not communicate it in this way.

Neither the German debt brake nor the derived European Fiscal Pact represent convincingly thought-out concepts. Apart from that, several European states disregard the Fiscal Pact anyway, as debt limits are politically difficult to enforce.

We should abandon this corset, which is questionable from a financial and political-economic point of view, so as to be able to meet the most important political challenges appropriately. For years, government investment spending and public spending on education have been below the OECD average. A lack of investments in education and infrastructure endanger the country's prospects. Regarding the climate goals, investments in local and long-distance public transport would be particularly necessary. On the revenue side, the first step should be a noticeable reduction in taxes and social security contributions for low-income earners. This would also be a reasonable reaction to the sharp rise in housing costs in recent years. A refund of the real estate transfer tax for the purchase of a private home would benefit the insufficient accumulation of wealth by private households and at the same time reduce the particularly unequal distribution of wealth in Germany.

Leo Kaas (<https://www.wiwi.uni-frankfurt.de/en/departments/money-and-macroeconomics/professors/prof-dr-leo-kaas/prof-dr-leo-kaas.html>) is Professor of Macroeconomics at Goethe University Frankfurt.

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Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080

Fax: +49 69 798 30077

Email: info@safe-frankfurt.de

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