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A Business Plan for a Digital and Green Transformation

Negotiations for a traffic light coalition in Germany have begun in a good atmosphere, but they will still be difficult. This is especially true for fiscal policy. Here, the task is something like squaring the circle. The green and digital transformation requires considerable private investment in addition to public investment, and the former will hardly take place without substantial tax incentives. Tax relief on investment is also important to support the increasingly fragile economic recovery. At the same time, the debt brake narrows the scope for public borrowing.

Invest Enough and/or Keep the Debt Brake?

How can this dilemma be overcome? Demands to abolish or soften the debt brake have little chance of being realized. For one thing, the two-thirds majority in parliament needed to amend Germany's Basic Law (*Grundgesetz*) is lacking. For another, there are economic objections. The function of the debt brake is to force policymakers to set priorities and deal with conflicts over the use of scarce resources instead of avoiding them by resorting to debt. The debt brake is also intended to protect the sustainability of public finances. However, sustainability does not only mean limiting public debt; sustainable economic activity can also be jeopardized if public investment is discontinued or private investment is crowded out by excessive tax burdens.

Permanent Secondary Budgets Too Limited

One frequently discussed way out of the conflict between investment needs and the debt brake is to shift debt-financed investments to public enterprises and other secondary budgets. However, this raises two problems. First, there is a risk that this will also finance investments that were previously planned as part of the normal budget, ultimately creating more room for debt-financed public consumption spending. This reduces the sustainability of public finances and could lead to a permanent erosion and circumvention of the debt brake. Second, this only works for classic capital expenditures such as the construction of railroad lines. Support for private investment – for example, subsidies for building insulation or aid for the construction of production facilities for green steel – that would not be competitive without this aid cannot be financed by providing public companies with capital. An alternative to resorting to secondary budgets would be to create a reserve in 2022, the year for which the debt brake is to remain suspended due to the crisis, to finance these plans. In all fairness, this is also a kind of secondary budget. But at least this would be a one-off operation that cannot be easily repeated. The deficit limits of the debt brake would be met again from 2023 onward. Even with this approach, there is a risk that public investments that have already been financed differently will be shifted to reserve financing in order to gain leeway for consumption spending. In addition, the healthy pressure to examine whether existing expenditures in the state budget are truly indispensable is reduced.

Three-Point Plan for Targeted Reserves

To address these concerns, coalition leaders could link the reserve solution to the following plan. First, it spells out which public investments and which subsidies for private investments – for example, accelerated depreciation for the green and digital transformation of production facilities or subsidies for building insulation and new heating systems – will be financed by the reserve in the coming years. Second, it is explained and confirmed, for example by the Federal Audit Office, that these are not investments whose financing was already planned through the normal budget. Third, existing spending, including existing tax breaks, is examined in a spending review with the aim of making a growing and clearly defined contribution to financing priority tasks in the coming years by cutting or freezing government spending. These savings reduce the required credit-financed reserve.

Business Plan for a Green and Digital Transformation

This would ensure that the new government handles public funds carefully and that the credit-financed reserve in government spending does not unleash a flood of spending. The whole package would be something like a business plan for a digital and green transformation that the new coalition presents to the citizens. The transformation task will be financed, but there will be no tax increases, no uncontrolled expansion of government spending, and the debt brake will remain in place as a framework for medium-term fiscal policy. This plan should be acceptable to all parties involved in the traffic light coalition.

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