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Advice from across the Ocean

It is not surprising that German politics is attracting much international interest. Germany is the largest economy in the EU, and the country has overcome the Covid crisis with some success. Above all, it is striking that German politics is characterized by moderation. Germany held an election in which moderate parties won an overwhelming majority. Populists from the right and left were able to score points at most in the new federal states, otherwise they did not play a major role.

For a world scarred by the polarizing 2020 US election, for a Britain that must choose between Boris Johnson and Jeremy Corbyn, Germany's stability seems unique - perhaps even strange or mysterious. It is therefore tempting for outsiders to assume that there must be a flaw, a worm gnawing at the heart of Germany's constitutional apple.

Government Formation in Germany Seen from the Perspective of U.S. Economists

That seems to have motivated Joseph Stiglitz and Adam Tooze to intervene in the coalition negotiations with a brash personal attack. They have identified what they consider poison in the German political system. One man, Christian Lindner, the message from New York, is dangerous. Trouble looms if he becomes finance minister, they say, because his fiscal agenda is "antediluvian". Surprisingly, they already trust him to lead a digital ministry. The message seems to be: let the little bad boy play with computers, but don't give him any money. Instead, the finance ministry needs "imaginative leadership".

What does this imaginative leadership consist of? Stiglitz and Tooze make two points: Germany's international influence in an increasingly uncertain and tense world, and budget rules and fiscal orthodoxy.

The two Lindner critics outline a scenario in which a less restrictive German finance minister would change world politics, especially the debates in the World Bank or the IMF. He would be on par with the US administration, which would finally be satisfied with German fiscal policy. This speculation grotesquely overestimates Germany's weight in the world community. If Germany is to be effective, it can only do so together with its European partners, for example through unified European representation in the World Bank and the IMF. So far, however, this has not failed because of Germany.

An Outdated Picture of the Euro Area

Criticism of German fiscal policy often starts with the debt crisis in the euro area. Many American thinkers saw it as a confirmation of their earlier skepticism about monetary union. Joseph Stiglitz was a prominent voice. "Europe's problem is the euro" he lamented. The euro, he said, had been a fatal mistake; with the austerity policies supported by Germany, monetary union could not endure. A colossal misinterpretation - in fact, the eurozone economy has recovered.

In their article, he and Tooze should have traced the stages by which Europe approached a solution after 2012, with reforms such as the banking union and ESM policies that were successful in many countries. Instead, they seem to believe that the bailout only came when Olaf Scholz took office in the German finance ministry in 2018. They underestimate the extent to which Olaf Scholz built on the legacy of his predecessor Wolfgang Schäuble, whom they demonize. Olaf Scholz also insisted that German fiscal policy created margins for unforeseen recessions, such as Covid brought in 2020. Using these margins in the crisis was a cross-party consensus.

It is true that the eurozone needs reforms. The Covid crisis is not over yet either. The problems of environmental degradation come on top of that. But there is currently too much talk of a new consensus for economic policy to replace the discredited "Washington Consensus". Some have dubbed it the "Cornwall Consensus" after the uninspiring G7 summit in June 2021. Such phrases about a supposedly fundamental shift in economic policy thinking stand in the way of real progress.

Expansion of Public Spending at any Price?

These phrases include the demand for a massive expansion of government spending. Convincing arguments for this are lacking, and they are in no way backed up by successful vaccine development. Nor is the current policy of the US government a model - it is more likely to teach us what NOT to do. Joe Biden tying a sensible infrastructure spending bill to a bloated $3.5+ trillion other spending program was a mistake.

Fiscal support for aggregate demand can make sense when production capacities are lying idle. At the moment, however, the problems lie elsewhere. During the covid crisis, entire sectors could not operate because of the risk of infection. Ports were closed, ships housed in the wrong places. Demand for products such as electronic chips skyrocketed as a result of the digitalization push. Economic stimulus packages were partly aimed at bridging periods of closure, but partly they also fuelled the already strong demand for consumer durables, often via online retailing; this reinforced the asymmetric effect of the crisis.

At present, supply shortages of intermediate goods are holding back growth. Here, too, we do not need demand support, but a targeted response to the bottlenecks, which will primarily come from the private sector and will inevitably take some time.

The same reasoning applies to decarbonisation. Here, the main issue is to set CO_2 prices in such a way that emissions fall. For many private households and companies, this is associated with high costs, while others tend to benefit. That is why compensatory measures are needed. But they have to be targeted, not blanket. The new energy supply requires a suitable infrastructure. These investments must be organized intelligently. They often require private, not public, spending. A fiscal policy that suggests it is only about removing restrictions on a debt-financed government spending boom will only lead to scarce capacity being misallocated.

Necessary Reforms for the Euro Area

That is why appropriate fiscal institutions are crucial for the euro area. The Maastricht rules are indeed in need of reform. What is needed, however, is not just more room for manoeuvre on debt. What is needed is a balance between fiscal flexibility and solidarity on the one hand and discipline and tough budget restrictions on the other. This includes insurance mechanisms to cushion major economic shocks such as the Covid crisis, but also capital backing for large portfolios of domestic sovereign debt held by banks. The rules must take into account that the eurozone is a monetary union of fiscally sovereign member states. If spending by individual countries must ultimately be paid for by the taxpayers of other countries that could not influence that spending, this monetary union will not work. The old lessons repeated after every crisis are more than conservative clichés. They are necessary reality checks.

The new German finance minister - whoever he or she may be - should understand this complexity. In a world dominated by political support for more lax fiscal rules, a critical fiscal hawk as Germany's finance minister can play a useful, balancing role. The world, and not just Germany, needs to get its priorities right when it comes to government tasks, rather than just expanding them further and further.

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