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The Coalition Agreement – A Desire for Something New

Angela Merkel was said to be careful to manage expectations. Those who promise little need not fear criticism if nothing is achieved. The traffic light government is acting differently. Its coalition agreement is ambitious. It wants to massively accelerate the digitalization and decarbonization of the economy while preserving prosperity and inclusion.

The plan's charm lies in the fact that it is characterized by a will to shape the future. Beyond the core areas of digitalization and climate protection, however, there are also issues where there is a lack of willingness to reform.

The strength of this coalition agreement lies not only in its willingness to take risks in order to seize opportunities. It also lies in the fact that many of the projects are well thought out and take scientific concepts into account. This applies to important parts of climate policy. The carbon price is to play a central role. All sectors are to be subject to European emissions trading in the medium term.

Technology Openness in Climate Policy

They want to be less dirigiste regarding the technologies used to reduce emissions. The competitiveness of German industry is to be protected by solutions such as a carbon border adjustment. Since climate protection only works globally, a climate club with other countries is being sought. Investments to adapt to climate change play an important role. It will take time to implement these plans, and many questions remain unanswered. But the overall strategy is a step forward compared to the previous rather small-scale climate policy oriented towards sectoral targets and dirigiste interventions.

In energy policy, the plan outlines the path to climate neutrality. Renewables will be expanded, as will power grids and hydrogen pipelines. To ensure security of supply, the plan is to use gas-fired power plants following the phase-out of coal and nuclear power, then later convert these plants to hydrogen. Whether this is economically and technically feasible remains to be seen. To make this switch at all feasible in the time available, the coalition wants to drastically speed up planning procedures.

Cross-Cutting Task of Digitalization

The second defining issue, digitalization, is rightly seen by the traffic light government as a cross-cutting task. The coalition partners promise investments in the digitalization of public administration, schools, and universities as well as an expansion of digital infrastructure. Education and training in digital skills are to be promoted, as are data security and the development of key digital

technologies. Most importantly, access to public and private data for businesses and citizens and data sharing are to be strengthened. This ought to trigger a surge in innovation and start-ups. General government spending on research and development is to increase from 3.2 to 3.5 percent of gross domestic product.

Financing through Restructuring of Debt Partially Unresolved

It is welcome that the traffic light coalition partners aren't limiting themselves to the easy way of debt financing, but also want to reallocate expenditure. However, it remains to be seen to what extent cuts in other areas can help finance the new projects. In the short term, such cuts are difficult; in the medium term, more can be achieved. It therefore makes sense to allow for the contribution from cuts in expenditure to grow over the years.

Financing through more government debt is restricted by the debt brake enshrined in the constitution. However, loans are permitted for subsidiary budgets, for example for public banks such as Kreditanstalt für Wiederaufbau or for Deutsche Bahn. In addition, the debt brake is suspended until 2022 in response to the coronavirus crisis. In the meantime, debt-financed reserves can be formed to finance future investments. Critics complain that indebted subsidiary budgets undermine democratic control of fiscal policy – which is why the coalition wants to expand parliamentary oversight and ensure greater transparency vis-à-vis the public.

How convincing the financing package really is will ultimately be measured by whether the promised spending shifts really make a significant impact.

Comprehensive Reform of the Tax and Transfer System

The willingness to tackle complex economic problems in a way that takes into account insights of science and research is also reflected in the plan to remove obstacles to employment from the existing tax and transfer system. A commission of experts is to propose reforms that will ensure that people who earn a higher gross income through their own work also earn a higher net income. Today, it can happen that their net income actually falls as a result of transfers being withdrawn.

The taxation of spouses is to be reformed in such a way as to create stronger employment incentives for second earners. Strengthening employment incentives is also important because the workforce will shrink in the coming years as the population ages. The coalition partners therefore want to keep older people in employment longer, strengthen training and further education, and lower the barriers to immigration into Germany's labor market.

Open Questions in Pension and Tax Policy

However, the coalition agreement also has weaknesses. Leaving the pay-as-you-go pension system as it is and ruling out a higher retirement age is not sustainable. The ageing of the population will force reforms. Saving a tax-financed capital stock for retirement cannot take the place of changes in the pay-as-you-go part of the pension system.

With regard to tax policy, it is welcome that companies affected by the crisis will be supported by extended loss carrybacks. Accelerated depreciation will strengthen growth. However, it should not be limited to the already heavily subsidized areas of climate protection and digitalization. It would be better to stimulate investment more broadly, even if the intensity of subsidies is then lower. What is missing is a willingness to fundamentally reform income and corporate taxation, which is long overdue. The coalition partners' ideas in this area were probably too different.

Further Development of European Debt Rules

The further development of European debt rules and the banking system also appears to be important in terms of fiscal policy. It is right to demand that banks holding large portfolios of domestic government bonds back them with equity capital. The German government should make this a condition for reforming the sovereign debt rules. Strengthening euro member states' ownership and their private creditors' liability is important. Merely softening debt rules only increases the risk that the costs of individual states' over-indebtedness will be passed on to taxpayers in other countries.

The "Ampel" coalition members write that they have a "desire for something new." This is evident in their program for government. Even if implementing it will inevitably be difficult and the fourth wave of the coronavirus will overshadow the handover of power, the beginning of this government inspires confidence.

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