Germany Is Finally Ready to Spend

In the long run, the COVID-19 pandemic may change Europe's economy for the better.

People wearing face masks walk in front of a euro sign in Frankfurt am Main, Germany, on April, 24. YANN SCHREIBER/AFP/GETTY IMAGES

Germany's fiscal prudence hasn't made the country popular. Over the past several years, economists have written countless op-eds blaming Germans for sucking demand out of the world economy. For example, the economist Paul Krugman has argued that "the whole world has a Germany problem." The combination of Berlin's "ruinous obsession" with balanced budgets and its considerable exports creates excess savings that need to be invested abroad. That, in turn, creates large trade imbalances with nations that take in the investments. Debtor countries such as France and the United States have thus argued that Berlin needs to loosen its purse strings to address global economic imbalances.

Now, if COVID-19 has done any good, it is that it has put such calls on standby.

On June 3, German Chancellor Angela Merkel's coalition government presented a 130-billion-euro ($145 billion) fiscal stimulus package worth 4 percent of German gross domestic product over two years. Coming on top of direct transfers to companies and employees starting during the lockdown, Germany's fiscal response to the pandemic amounts to a whopping 13.3 percent of GDP. Berlin is finally spending.

Compare Merkel's response this time to her policies during the 2008-2009 financial crisis. In those years, she reluctantly accepted the need for stimulus of under 2 percent of GDP over two years only after the economy had been contracting for three consecutive quarters. In the COVID-19 crisis, by contrast, Berlin has already put forward the second fiscal plan just three months after the first German COVID-19 fatality.

Beyond attempting to right the German economy, the stimulus spending will yield spoils for Germany's EU partners. To see how consider not only the size but also the composition of Berlin's latest national fiscal stimulus package. First, it dwarfs other euro area countries' plans. France's fiscal measures to date amount to mere 3.6 percent of GDP by comparison.

Further, with its focus on consumption incentives and government spending, the German stimulus will have knock-on effects on imports from other European countries. If German households, corporations, and the public sector buy more, demand for foreign goods will also increase. When the EU's largest economy is spending big, not only German boats are lifted. Finland's finance minister, for one, has noted that Helsinki should be "very grateful" for Germany's national fiscal stimulus plan. "This sacrifice by German taxpayers will help us incredibly much," the minister said this month.

What's more, as Berlin taps into debt markets, it will also make it easier for the European Central Bank (ECB) to keep on financing the eurozone's most indebted members. The reason is that the ECB is required to balance its asset purchases of government bonds among the 19 member states of the currency union. If there are more German treasuries on the market, it is easier for the ECB to buy treasuries from other nations.

By spurring imports into Germany and boosting investments, Merkel's stimulus package is also a start to correct some long-standing economic imbalances within the EU. The flip side of Germany's excess savings and export surplus that draws the ire of Washington and Paris is weak consumption and chronic underinvestment. Since the 2000s, investment by the public and the corporate sector as a percentage of GDP has fallen and been much below other eurozone countries.

The fiscal stimulus tries to tackle this structural problem. On the federal level, the plan outlines a public investment initiative to help Germany transition to a more climate-friendly economy, improve its health and education infrastructure, and even spur research in areas from artificial intelligence to quantum computing. At the sub-federal level, Berlin aims to alleviate structural bottlenecks to public investment by taking on the provision of more social benefits that had been paid by the municipalities. This frees up much needed fiscal space in poorer regions that have put off investments in the past.

Berlin's investment priorities are aligned with the EU's strategic sovereignty and climate agenda. Berlin aims to spend more than 7 billion euros ($8 billion) on fifth-generation telecommunications infrastructure and research alone. Another 9 billion euros ($10 billion) is earmarked to fund a hydrogen industry, with $2 billion of that slated for investment abroad. The plan also lifts caps on subsidies for solar energy and increased funding to upgrade shipping of liquefied natural gas. Other priorities are cybersecurity, health, and armaments procurement.

Finally, the stimulus may foreshadow a broader structural shift away from Berlin's focus on Germany's export-oriented businesses. Despite some pressure to do so, Merkel did not yield to business demands for a cut to the corporate tax rate. German corporations are already cash-rich. Profitability is not the problem; underinvestment is.

The chancellor even stood firm against demands for aid to the auto industry in the form of a scrappage scheme for internal combustion-engine cars. In 2009, Berlin helped jump-start car sales by handing out 2,500 euros to buyers that returned their older ones. Her refusal to repeat the scheme is remarkable. Auto executives and trade union leaders have German politicians on speed dial. But environmental concerns, along with a realization that blindly subsidizing Germany Inc. is not the way forward, outweighed vested interests.

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