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Germany's September 09 elections against the background of the economic crisis – how will voters react?

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CHECK AGAINST DELIVERY

The economic crisis has seriously affected Germany's economy and by extension Germany's society. "Before Lehman", in summer 2008, things looked relatively fine for the so called "black and red" grand coalition, the Merkel/Steinmeier government, which took over from the "red green" coalition, the Schröder/Fischer government, in 2005.

Growth rates were well over 2 percent, the combined state budget was pretty much balanced, employment was high and inflation was low. This performance was at least in part a result of the structural reforms of the previous red green government, reforms which included corporate tax reliefs, deregulation and a streamlining of transfer payments.

When in fall 2008 the world's financial markets began to collapse and the real economy became more and more affected, the grand coalition had maybe something called a "Schrecksekunde" in German. But, like others, our government rose to the challenge and did what had to be done to limit the damage. This included state guarantees for deposits, guarantees for inter bank lending and bank credits, fiscal stimulus programs etc – the whole package .

Since the crisis was in a number of ways unprecedented, most observers believe that in general terms the government's response was adequate. However, criticism comes from two sides, and I trust that the analysis of these criticisms will bring us a step closer to understanding how voters might react in September.

For simplification, I will talk about a procedural criticism and a substantial criticism.

The procedural criticism is very much about communication, coordination and ultimately leadership in the EU and international context, and it can be heard in Stockholm, in Brussels but also inside Germany. As an example we could take Joschka Fischer's article that was published in Dagens Nyheter a couple of days ago, called "Germany's drift from Europe". In this article Joschka Fischer claims that Germany is "openly refusing to lead" and is objectively pursuing a national approach to the crisis.

The headline over the second criticism, the substantial criticism, is clearly "too little too late". It can be heard in the US, Paul Krugman being just one example (also: this week's "Economist"), and it can be heard from the German opposition, from the Greens, the Left - and when it comes to tax cuts even from the Liberals.

Is the first, the procedural criticism correct? I think it is not. Germany's agenda has in fact been, and will continue to be, fully coordinated with and embedded in the larger agendas of the EU, the G 20 and other important actors, with utmost engagement of the chancellor and other government actors.

In any case, I think this type of criticism has no significant impact on the German voters.

With the second, the "too little too late" criticism, it's different. This argument, undoubtedly, has an impact on voters.

It is applied in principle to all three sets of policy tools at hand to cope with the crisis, namely monetary policy, regulation and deficit spending.

I will mainly focus now on deficit spending, where voter concerns are very tangible.

But of course it would also be interesting to discuss what "too little too late" means when it comes to monetary policy or regulation.

For example, with regard to monetary policy, we would probably find greatly diverging views when it comes to the role of the Fed in the past *and* now, which is not so good: if we can't agree on the diagnosis, how can we agree on therapy demands from the "too little to late" group? Let me add here that in my view the ECB deserves a lot of credit for its steadfast, *rule based* monetary policy before and after the crisis, after all: this monetary policy did not produce bubbles in asset prices (exception real estate market in Spain). Maybe that in itself could be a reason for SWE to join the Eurozone?

But let me get back to the fiscal version of the "too little too late" argument which goes like this: if we all agree that deficit spending is the way out of the recession, then more deficit spending is better than less deficit spending, "think big".

However, both in the international as well as in the national arena we have witnessed that attempts to go too far in the direction of ever more deficit spending and state debt have met resistance.

In the international arena this was particularly true before the G 20 summit in London at the beginning of April, when there was pressure that Germany, and other EU states, should "do much more" in terms of spending.

As you know this was refused, not least since we were all able to show that our stimulus in GNP percentage terms was not so far from the US stimulus if you account for the so called automatic stabilizers that stem from our comprehensive social systems and if, for example, you bring elements like guarantees into the picture. In my recollection, the Swedish government was one of the first to point this out, and it is no coincidence that now the Swedish EU Presidency will insist on identifying an adequate exit strategy.

"Doing much more" was also refused because we were able to reconvince partners that recovery is not only about spending more, but also, and maybe much more so, about conducting better monetary policies and about regulating better, let alone staying credible (as in creditworthy).

This, by the way, is a fine example that the German government, together with its partners, was actually exercising leadership in critical times. This is why I suspect that the procedural criticism is, at least partly, a substantial criticism in disguise – what the critics really mean is not so much that Germany is not leading enough, but that Germany is not doing enough.

In the national arena we have also witnessed that attempts to go too far in the direction of more and more deficit spending and state debt have met resistance.

If we look at recent opinion polls or at the results of the European Parliament elections in Germany (approx figures), it looks like voters seem to fear that the pendulum is swinging too far in the direction of big public deficits, resulting sooner or later in tax increases and worse.

Of course this trend to more conservative answers to the crisis has something to do with the German trauma of hyperinflation, but it has much more to do with

now 60 years of success with an open society in general and an open market economy in particular, of course in its German social market economy version.

What is also an interesting feature is that voters seem to be very sensitive not only to the quantity of deficit spending, but also to the quality. Many people have indeed come to understand the difference between structural and cyclical deficits (I think President Sarkozy recently called the former bad and the latter good) and in this context they have come to understand the difference between investment and consumption spending; I find it amazing how such topics have entered the world of higher end talk shows.

And it does not stop there: where people tend to prefer state investment over state consumption, they also care about the type of investment, in particular they want to see "Green Recovery" investment for renewable energies and less emissions. Germany will fully support the Swedish EU Presidency when it comes to ambitious goals for the post Kyoto conference in Copenhagen in December.

By the way, I do admit that it can be disputed just how green the German "Abwrackprämie" is...

Let me turn to another interesting feature which is emerging: voters are obviously and rightly very concerned about jobs, but they are increasingly sceptical when it comes to state interventions to "save" jobs. You might have heard about Germany's new minister for the economy, who went on record against the current Opel trusteeship solution and benefitted from this in the polls.

And then of course there is an issue that is more and more hotly disputed as parties present their elections programs now, and that is the tax policy in the light of huge budget deficits, deficits that could go up to 6% of GNP.

The Christian Democrats CDU and their Bavarian sister party CSU and much more so the FDP, the Liberals, continue to promise certain income tax cuts and vow not to increase VAT. The Social Democrats SPD and the Greens say that promising across the board taxcuts is not responsible and that balancing the budget is key; they want to increase taxes inter alia for "the rich", but like their opponents they also offer cuts in the lowest segment of the income tax tariff.

And now the question is: what does it mean, when we say that for the time being voters seem to be - in economic terms - in a more conservative mood? Who will they believe?

According to a recent poll, 88% believe that taxes will increase in the next period, regardless of political colors, only 7% believe that taxes will be lower.

But does that automatically mean that the Social Democrats and the Greens would benefit because they would be perceived as more credible?

Not necessarily. At the core of this debate are some very fundamental questions on how the economy functions.

If the tax cut proponents are able to make a convincing argument that even credit financed tax cuts can stimulate growth and eventually finance themselves (that the economy is not a zero sum game), people might still vote for them, despite their scepticism. The same goes for the Social Democrats and the Greens, but vice versa. (I am not speaking about Die Linke here, not for lack of respect, but their program is not really comparable).

In any case, I think I have presented the key questions and the key trends when it comes to how voters, German voters, will react to the crisis. If we extrapolate current trends, we could see a conservative / liberal government come 27 September. But the game is still open, as the most recent debate on the role of tax cuts clearly shows.

In this context a final remark. As you might have read, just a few days ago the grand coalition parties, with the support of the opposition Liberals, have approved a law that changes the German constitution and imposes very strict "brakes" on incurring debt at the different levels of government no later than 2020. I am talking about the famous "debt brake". Looking at the current situation, observers have compared this to the Alcoholic who is gulping up a huge bottle, staunchly staying that "this s going to be my last one". I do not share that comparison, of course.