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After corona is before the Depression?

Economist Gustav Horn on how to strengthen Germany's economy — and why stimulus package at European level is essential

Read this article in German.

The storm of the corona pandemic has brought global economic activity to a standstill. It is true that stabilisation programmes of varying degrees are being implemented almost everywhere in an attempt to keep the economy alive, in an artificial coma as it were. But the resources available in some countries are very limited. On the other hand, the uncertainty caused by this unprecedentedly severe pandemic is very high. It therefore remains to be seen what state the global economy will really be in once the infection wave has subsided.

Probably in a deep global recession. Its precise extent will depend crucially on the degree to which companies are still willing to invest and on whether private households are prepared to consume as much as they did before the crisis began. It is to be feared that in this uncertain economic climate both companies and households will be so insecure overall that they will reduce their spending noticeably. They expect bad times and they will hold on to their money. While this is perfectly understandable from an individual or microeconomic point of view, it is a serious problem from a macroeconomic perspective. Because if this happens, macroeconomic demand collapses and the economy is stuck in a recession. Given the global nature of this crisis, it is also unlikely that export markets will come to the rescue. The slump is happening all around the world.

This slump will not correct itself, at least not within a time frame that is economically and politically acceptable. If nothing else is done, all the national economies are heading into a wall of high unemployment. The political upheavals that may follow don’t need to be described in detail.

The three or four Ts

So it's time to do something to boost the economy; at the very least, we should start planning. It is true that the German government has provided support for the domestic economy with massive aid programmes, so the level of uncertainty is likely to remain comparatively low in Germany. But even here, the realisation will spread that export markets have largely collapsed. This is likely to have a huge negative impact on companies' propensity to invest. So in this country, too, it is time to start thinking about appropriate economic stimulus packages.

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The general requirements for these consist of the so-called 'three (or four) Ts'. They stipulate that economic stimulus packages should be *timely*, *targeted* and *temporary*. The fourth 't', which is often added as a further requirement from an ecological perspective, is *transformative*. This means that the stimulus programmes should also make a contribution to the ecological transformation of the economy.

The requirement for timeliness is self-explanatory. Measures should be planned at least before the economic depression takes hold and becomes entrenched. Targeted demand stimulation should be applied precisely there where the losses are most severe. In contrast to standard economic crises, in this instance this does not include the construction sector, for example. It is primarily the sectors associated with social consumption, such as personal services, cultural events and catering, which have been hit hardest. Industry belongs to the next group of sectors, those affected primarily through the slump in exports and secondarily through the internal restrictions on social contact. The financial and banking sector has so far only been affected by the knock-on effects of reduced creditworthiness. However, these have so far been kept within manageable limits by the government's ongoing stabilisation measures.

The right targeting

Correctly targeting the programmes is anything but a trivial matter because of the very different degrees to which individual economic sectors are affected. For an economic stimulus programme to be properly targeted, it is important to check, even before it is implemented, whether demand in those sectors that have been hit particularly hard will not recover of its own accord, at least partially, as restrictions are gradually eased. If private households, during the period of the contact restrictions, have saved a larger proportion of their income than before, and if they

then spend it once the restrictions have been relaxed – in other words, if their savings rate falls again – then the demand for personal services may pick up again by itself.

There is one difference to be noted in the current situation. The impact on the domestic economy is of a different nature from that on export markets. In the domestic economy, the recession was a direct result of measures taken for medical purposes; in the export markets, it is a knock-on effect. Each should therefore be addressed with a different kind of programme.

With this in mind, a stimulus package focused on the supply side should be put in place, one which also weighs up priorities. The highest priority should be given to those sectors where social consumption has been massively curtailed and where the loss of income will be difficult to compensate for later. This should be followed by all those sectors where such compensation is possible. Last come those sectors that only suffer from the knock-on effects.

Group by group

For the first group, classical demand stimulation will not help. In the catering industry, it is not possible simply to make up for meals that have not been eaten. What is more, as long as the danger from the virus continues to smoulder, capacity will have to remain strictly limited. The same applies to cultural events. It therefore makes sense to support the supply rather than the demand side for these sectors. So cutting VAT is the right thing to do. However, in this instance this should not lead to price cuts, but should widen profit margins so as to compensate for lost profits. Wage subsidies can be used in a similar way in these industries.

For the second group – where a compensatory increase in demand is possible – consumer vouchers could be helpful. This could generate additional demand. Clothes shops, bookstores and similar businesses could be considered for this.

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The final group can only be helped by stimulating aggregate demand. This group is also where the requirement to transform the economy comes into play. The additional government spending aimed at stimulating aggregate demand should flow into areas which are crucial for sustainable production and for the resilience of the economy. As recently proposed by two economic research institutes –

the IMK, which is close to trade unions, and the IW, which is close to employers – these funds should go into health, housing, renewable energy, low-emission transport infrastructure, digital infrastructure and education. This is where added value that equips us for the future is created. At the same time, a quantitative and qualitative leap forward in digitalisation and in the health and education sectors will strengthen the resilience of the economy in the face of global crises such as the pandemic.

No small feat

In this way, domestic demand can be strengthened. And ultimately, all sectors of the economy, with one exception, benefit from this. The exception is the export sector, which is so important for Germany. It is not possible to access this sector by means of such a programme. This is why a complementary economic stimulus package at European level is essential, so that Germany's direct export markets at the very least are strengthened. This programme, too, should be targeted and transformative. It should aim to support and develop European public goods such as fast and environment-friendly transport links, clean energy and state-of-the-art digital infrastructure. In the end, all European markets will benefit from the increased expenditure associated with these projects.

The last remaining requirement for an economic stimulus package is crucial. All the proposals mentioned must be time-limited a priori, that means from the planning stage already. This applies to tax measures and consumer vouchers as well as to expenditure programmes. Only with the aid of the necessary time pressure can spending be increased during the downturn – in other words, precisely when the stimulus is needed.

Such a differentiated approach should make it possible to swiftly reboot economic activity both at home and in direct European export markets. This might succeed in preventing a significant increase in unemployment in spite of the historic scale of the corona crisis. That would be no small feat.



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