As the German budget deficit soars

Government parties plan drastic austerity measures

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Following this year's federal election the parties in the German grand coalition—Social Democratic Party (SPD), Christian Democratic Union/Christian Social Union (CDU/CSU)—are all determined to unload the consequences of the world economic crisis and the billions of euros awarded to the banks onto the backs of the electorate. This is the unmistakable message from the medium-term budget plan presented on Wednesday by Finance Minister Peer Steinbrück (SPD).

Germany will be heavily indebted at both the federal and state level for years to come and the government is seeking to recover these debts in a short period of time at the expense of ordinary people. The social consequences of the necessary cuts and savings will be devastating. "Irrespective of what parties form the next government after September 27—there will be considerable conflicts over economic resources," Steinbrück told the *FAZ* newspaper in an interview.

New debts taken out at a federal level will amount to €86 billion in 2010 alone and by 2013 new debts will add up to €310 billion. This figure does not even include the money made available to German banks as part of the government's banking rescue plan, which Steinbrück has outsourced into a subsidiary budget. If one includes this latter amount then the level of new debt will rise to over €100 billion in 2010—a figure that is two-and-a-half times bigger than the former past record in 1996.

The situation is similar at a state level. Following years of drastic cuts, state budgets on average were in the black in 2008. Now, in the wake of the financial crisis, the Federal Bank predicts a total deficit of €30 billion by states.

Even bigger are the risks to state budgets coming from the huge sums in the form of cash infusions or endorsements made available to rescue ailing state banks and/or major companies. The rescue of the Bavarian Landesbank has cost the state of Bavaria €7 billion in the first four months of this year. Hamburg and Schleswig-Holstein have made 13 and 18 percent of their entire annual budgets available to the HSH Nordbank in the form of a cash infusion. Hesse has increased its financial endorsement package for companies from €300 million to €3 billion, while Baden-Württemberg increased its own fund from €150 million to €2.2 billion. Should this money not be repaid, the states confront bankruptcy.

The government parties are intent on recouping these sums through drastic savings measures. Fearful of the reaction from the electorate, they are refraining from putting forward any concrete proposals until the federal election to the Bundestag. In utterly cynical fashion, Steinbrück told the press conference earlier this week: "I will not make any announcement here that could bring turmoil into politics before September 27."

The grand coalition, however, had already agreed at the end of May to write a "brake on debt" into the German constitution. The measure compels any future government to carry out strict austerity measures. From 2016 the government can only acquire new debt at a maximum of 0.35 percent of the country's gross domestic product—i.e., a sum amounting to €8.5 billion—while states are not allowed to acquire any new debt after the year 2020.

Huge cuts and savings will be made in the coming years to achieve these goals. Steinbrück plans cuts totaling €37 billion from 2011 to 2013, with cuts to be made in all areas of spending—with the exception of debt and interest repayment. Steinbrück told the *Tagesspiegel* newspaper that the next government would have to concentrate fully on complying with the terms laid down by the "brake on debt" and on returning to a balanced budget.

"One does not have to be a trained political economist to know that with sums of such a magnitude only two possibilities remain," the *Süddeutsche Zeitung* commented, "Either to drastically cut social expenditure or drastically increase taxes." The *Süddeutsche Zeitung* concluded, "Due to the financial situation the next electoral period will be characterized by a struggle over resources that the country has not seen for a long time."

By anchoring the debt brake in the constitution the grand coalition has stripped itself of any room for maneuvering with regard to financial policy. Necessary investments in vital social areas such as education or infrastructure are made impossible. The debt brake serves above all a political purpose, supplying the pretext for implementing a radical austerity course against mass opposition. The policies that are promised by the SPD and conservative parties in the course of the election campaign will be abruptly junked after the election on the basis of their incompatibility with the debt brake.

Steinbrück admitted this openly. “It is not possible to do without such disciplining action. This has been shown by experience. I am glad that there is the new debt rule,” he said. He avoided, however, any comment on how the budget gaps will be filled. It is the duty of the next government to decide on income and expenditure, as well as the priorities afforded to specific areas, he declared. Refusing to be tied down, he stated, “Anything and everything is possible.” And this despite the fact that he wants to remain finance minister should the election result in a continuation of the current grand coalition.

Behind the scenes, however, the debate has already begun about where the cuts should take place. The *Bild* newspaper reported on proposals from the CDU-CSU Bundestag faction for an increase in the country’s reduced rate of value added tax (VAT) from 7 to 19 percent—a measure that would bring in around €14 billion. Such a measure would hit low-income earners hardest. The reduced tax rate is valid, among other things, for food, which forms a far higher proportion of the budget of poorer social layers.

The general secretary of the CDU, Ronald Profalla, subsequently disclaimed the report, which he described as “nonsense.” But following the election of 2005 the grand coalition increased VAT from 16 to 19 percent, although during the election campaign the SPD had strictly ruled out any increase, while the CDU had proposed a maximum increase of 2 percent.

Economics experts are convinced that an increase in VAT is inevitable. The president of the German Institute for Economic Research (DIW), Klaus Zimmermann, told the *Münchner Merkur*: “I am certain: In the medium term the government will not be able to avoid an increase in value added tax.” He suggested an increase to 19-25 percent.

Another economist, Udo Ludwig, told the television program “MDR aktuell”: “Possibilities for austerity programs are limited, they are difficult to implement, so that eventually the path chosen to fill the holes in budgets is likely to be tax increases.” For his part Wolfgang Franz, the chairman of the panel of economic experts that advise the government, told the *Berliner Zeitung*: “Because cuts to subsidies will be insufficient, there is no way around tax increases.”

In addition to an increase in VAT, which would immediately adversely affect the living standards of broad layers of the population, probable areas for cuts are pensions and social expenditure. In a comment on the budget deficits, the *FAZ* noted, “The permanent sources of debt in the budget are—apart from increasing interest charges—the subsidies to the chronically indebted social insurance funds, in particular pension insurance. It devours a total of €81 billion—in the meantime, a quarter of Federal expenditure.”

According to *Bild*, the conservative Union faction is considering saving billions of euros by introducing lump sums for the rents paid by those receiving Hartz IV welfare payments. At the moment, they receive the full costs of their rent. The introduction of such a lump sum would force innumerable Hartz IV recipients into moving to cheaper accommodation.

Against a background of soaring unemployment and declining incomes the renewed budget cuts will dramatically intensify the country’s social crisis. According to estimates by the Economic Research Institute RWI real wages will sink this year by an average of 1.5 percent. And the recent forecast of the OECD assumes that the number of unemployed in Germany will rise from the current level of 3.5 million to 5.1 million by the end of 2010. That corresponds to a 12 percent jobless rate.

While the population is beginning to feel the full effects of the crisis, the banks that unleashed the crisis are already returning to profitability. Only this week the European Central Bank offered to make credits available to the banks with no top ceiling, a one-year running time and at an interest rate of just 1 percent. Over 1,110 banks responded to the offer and have already received a total of €442 billion. “We are drowning in money,” was the comment by one stock broker.

The banks have not, however, passed this low interest rate onto their customers and are continuing to demand high interest rates for credits and mortgages—marking up the difference for their profit margins. The owners of private banks accounts are required to pay double-digit interest rates for overdrafts, while small businesses have great trouble receiving credit in the first place.

The government parties are intent on keeping their future policy options under lock and key until the election on Sunday, on September 27. But afterwards—irrespective of the composition of the new government—the gloves will be off. For their part, the main opposition parties—the free-market Free Democratic Party, the Greens and the Left Party—have also made clear they are ready to support a radical cuts program should they have a chance to enter government.

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