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Economic Insight

Germany's debt brake – a lucky break

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Table of contents

Debt brake forces prioritisation	1
It's ultimately about freedom	1
Politicians prioritise consumption over investment	1
Investments up to a certain level can only be exempted from the debt brake, ...	2
... if the definition of investment is written into the constitution	2

Germany's debt brake is unpopular with many politicians. I will analyse why the debt brake is nevertheless helpful and under what conditions a reform could make sense.

Due to the political difficulties in France investors have been looking at the highly indebted country's bonds for weeks. Instead of appreciating comparatively low level of German public debt, some German politicians are criticizing the constitutional debt brake, even though it is largely responsible for the relative soundness of German public finances. After all, Germany is the only major member state of the monetary union whose debt relative to gross domestic product is close to the Maastricht Treaty's requirements (chart).

Debt brake forces prioritisation

Even if the Berlin coalition wants to comply with the debt brake regarding the 2025 budget, it remains unpopular with many politicians because it restricts spending. But this restriction is beneficial. It forces politicians to weigh up different spending options and ideally decide in favour of those that are best for the citizens. Getting the best out of given resources is the core of all economic activity.

It's ultimately about freedom

Without a spending restriction, however, there is no prioritisation of expenditure. The state would spend a lot of money on things that are not important. The floodgates would be opened and waste would be inevitable. The state would draw more and more resources, which it would ultimately have to finance with higher taxes. The economic space for manoeuvre for entrepreneurs and employees would shrink – and with it their freedom. It's not just about money.

Politicians prioritise consumption over investment

Critics argue that the debt brake would prevent the state from investing. In fact, in many years government investment did not even cover depreciation, which is why the infrastructure in Germany is in a poor state. However, this is not due to the debt brake, but to the fact that many politicians prefer to spend money for consumption rather for investments, even in times of abundant tax revenue, as the benefits of investments are not realised immediately but spread over many years and often result in protests from citizens.

Important disclosure Information at the end of the document



Investments up to a certain level can only be exempted from the debt brake, ...

In order to correct this political distortion at the expense of investments, net investments that go beyond the mere replacement of depreciation could be exempted from the debt brake. But there should also be an upper limit for this. After all, not all conceivable government investments are equally useful. This is why it is important to prioritise investments, as with all government spending.

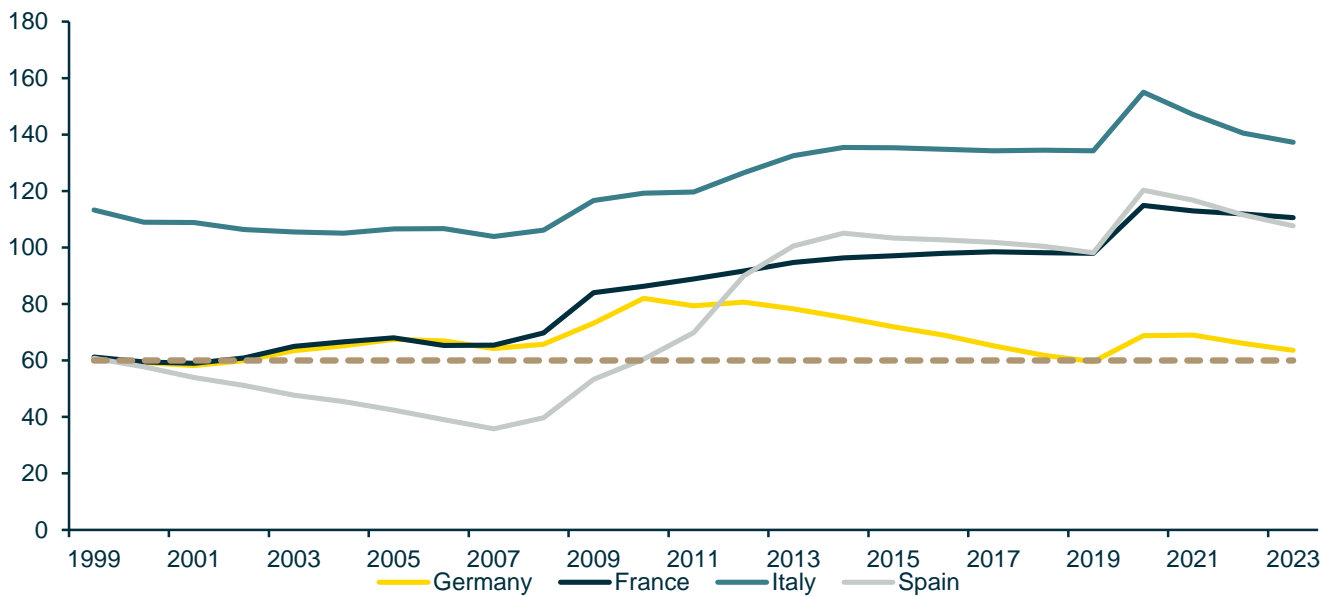
... if the definition of investment is written into the constitution

In addition, the constitution ("Grundgesetz") should stipulate that only genuine physical investments, for example in roads or buildings, are exempt from the debt brake. Many politicians, however, use the term investment in an inflationary way - for example even for mere transfer payments.

Instead of always trying to undermine the debt brake, we should finally learn to appreciate it

Chart 1 - Only Germany stayed close to the 60% debt threshold

Government debt in % of GDP. Dashed line: Maastricht debt limit of 60%



Source: Eurostat, Commerzbank Research



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