

The  
Economist

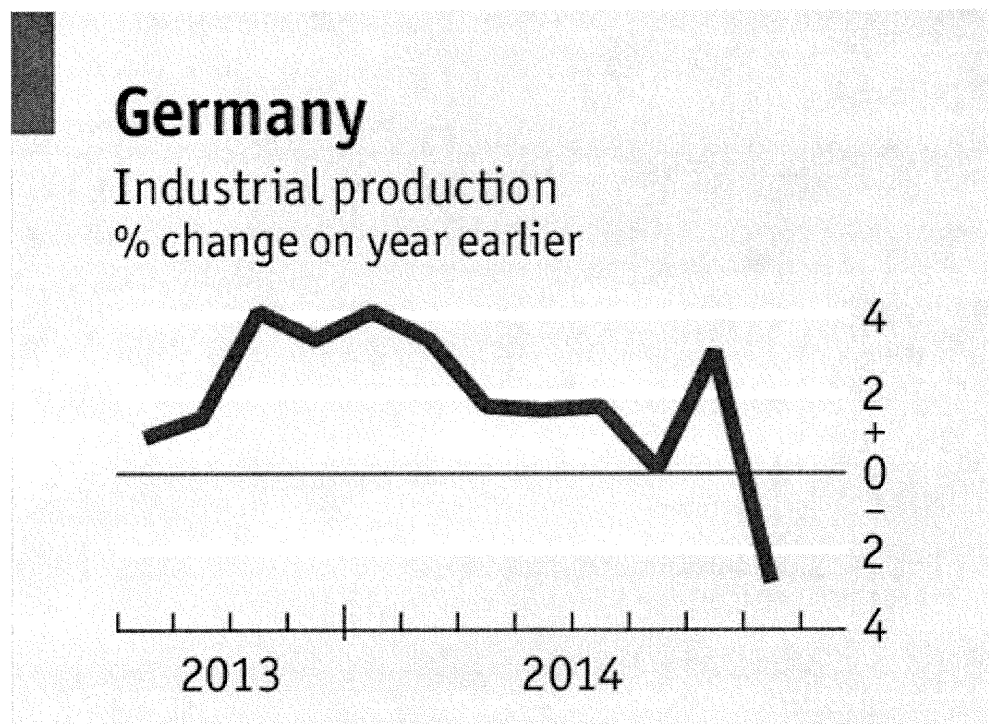
## Germany's flagging economy

# Build some bridges and roads, Mrs Merkel

**The German government should invest money in infrastructure, not worry about balancing its budget**

Oct 18th 2014 | From the print edition

FOR the past few years Germany has been a shining exception to Europe's economic weakness. But suddenly the Teflon Teuton is in trouble. Germany's GDP fell in the second quarter and more recent news has been grimmer still. Industrial output and exports plunged in August. The ZEW index, a measure of investor confidence, has tumbled to its lowest level in almost two years. The economy may well be in recession



This weakness has many outside Germany deeply worried. But inside the country the reaction is one of stoic nonchalance. Even as the government this week slashed its official growth forecasts from 1.8% to 1.2% for 2014, and from 2% to 1.3% for 2015, it argued against any shift from the long-standing goal of balancing the budget next year. "A dip in growth is not a cataclysm," says Sigmar Gabriel, the economy minister; there are "no economic-policy grounds" for changing course.

Good politics, lousy economics

Politically, this position has a certain logic (see article

(<http://www.economist.com/news/europe/21625790-economic-woes-home-are-testing-angela->



merkels-understanding-how-best-use-her) ). The promise of no government borrowing in 2015 was at the heart of Angela Merkel's election campaign. Sticking with it is popular with German voters, who see deficits as dangerous, ineffective and probably immoral.

Economically, the logic is feeble. Obsessing about a balanced budget in the teeth of recession is risky. Fiscal stimulus, focused on infrastructure investment, would leave the country safer in the short term and able to grow faster in the long term. And it would not break the country's fiscal rules.

German politicians are convinced that their slowdown will be modest and temporary. But look around the world economy, and you see lots of danger signals flashing. Share prices, inflation rates and bond yields are all falling (see Buttonwood); the oil price is slumping; China is battling a debt problem (see article (<http://www.economist.com/news/leaders/21625785-its-debt-will-not-drag-down-world-economy-it-risks-zombifying-countrys-financial>) ). These could easily be harbingers of a nasty and prolonged dip. Faced with that possibility, a prudent government should prepare some counter-cyclical defences.

One tool is looser monetary policy. The Germans should be supporting the European Central Bank's big bond-buying scheme, not leading the opposition to it. But the main national tool at Mrs Merkel's disposal is fiscal policy. By increasing spending next year, Germany's government could cushion its economy from weakness elsewhere.

Focusing that spending on infrastructure would also boost Germany's long-term growth prospects. A decade of belt-tightening has starved the country of much-needed investment. Since 2003 public investment has not kept pace with depreciation. Not surprisingly, bridges are creaking and kindergartens overflowing. This scrimping hurts Germany's productivity. It is a false economy, especially when money is so cheap. Bond yields are at a record low of 0.72%, and long-term interest rates are negative in real terms.

On a conservative estimate, the Merkel government could increase infrastructure spending by some 0.7% of GDP in 2015 and 0.5% in 2016 without breaking the debt-brake rules. That money should be used to accelerate "shovel-ready" federal projects, of which there are many, from repairing bridges to completing roads; and to help the cash-strapped states and municipalities that account for two-thirds of government infrastructure spending. This newspaper (which thinks the rules of the debt-brake are excessively rigid) would prefer a bigger plan. But this would be a start. Germany should do it now.

From the print edition: Leaders



Build Some Bridges and roads, Mrs. Merkel

According to the article:

1. Show the changes to Germany GDP: **C**      **I**      **G**      **NX**
2. What factors mentioned in the article could impact the level of I?
3. Which tools is The Economist recommending, and what impact would each have on the Germany economy?
4. "Fiscal stimulus, focused on infrastructure investment, would leave the country safer in the short term and able to grow faster in the long term." Explain using a PPF diagram.
5. If Germany spends more than it receives in taxes, it must borrow the difference. Why do you think The Economist wants Germany to borrow to fund infrastructure spending?

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