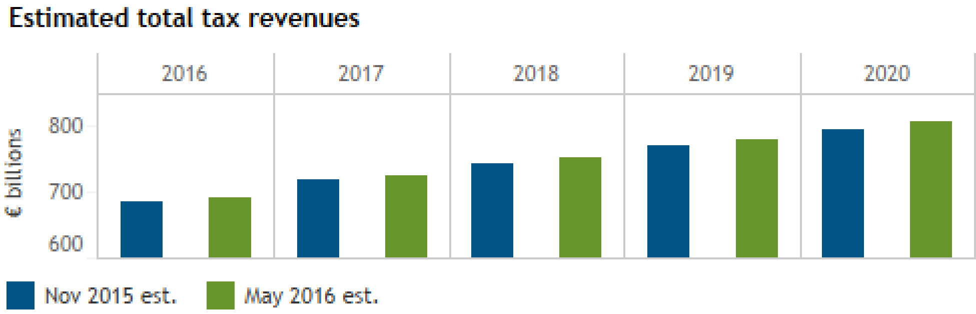
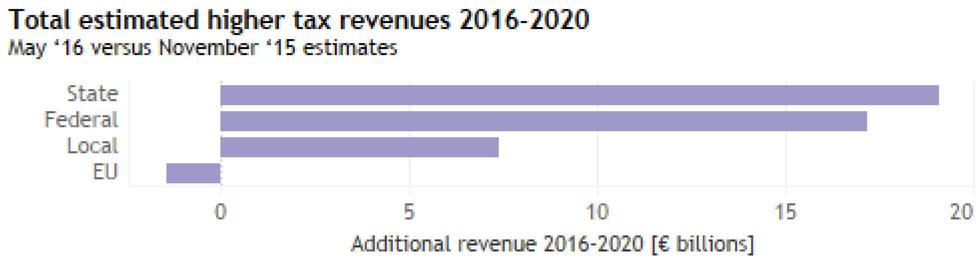
Less taxation for… more representation

Blog post by Associate Adviser Thomas Gratowski, 14 October 2016

The German federal election is less than a year away and strategists in the two large coalition parties are both preparing to answer the same question: how to change the subject from migration. This week hinted at the likely answer, and it is not a particularly novel one: money.

Finance Minister Schäuble announced €6 billion in tax reductions this week. This is almost certainly just a sign of more to come. The plan, which stretches the tax relief over the next two years, largely fulfils legal requirements imposed by the Constitutional Court to guarantee a level of basic income. The tax-free income band has been raised and support for children will basically increase in line with inflation. Steps to tackle the 'cold progression' where inflation-adjustments to incomes lead to higher tax rates and in turn to lower net income, are also included.





Source: German Federal Ministry of Finance

These are small increases but that should not necessarily be taken as a sign of Schäuble's usual fiscal prudence. The Grand Coalition has simply agreed to leave some fiscal space for tax cuts for the next government to fill. This is an opportunity deferred, not declined for tax cuts. Indeed, good news about Germany's public finances this year has whet the appetite for compensating Germans for the pains they went through over the last 18 months and to remind them of their good economic situation. The last estimates from May showed tax revenues would be €42.2 billion higher until 2020 than estimated in November last year. The federal government alone could spend €17.2 billion more without giving up on a balanced budget. In August, statisticians showed the German state had achieved an unforeseen surplus of €18.5 billion during the first half of 2016 – and this is despite the often cited costs of absorbing a large number of refugees.

There are some obvious questions on what the remaining fiscal space will actually be – and how it will be used. The federal government plans to spend almost €94 billion on refugees and integration measures until 2020. That will take a large piece of it. The next tax estimate is expected in November and could paint a materially different picture.

Nonetheless, Volker Kauder, the CDU/CSU leader in the Bundestag, said in August the tax burden should be reduced by €15 billion annually during the next term. The pro-business group in the CDU/CSU is also pushing for a wider tax reform and CSU party leader Horst Seehofer announced in late September the “largest tax reduction of all times”. Discussions in the SPD about tax cuts for smaller and medium incomes are also heating up as party leader Sigmar Gabriel plans a campaign for the ‘working middle class’. Who wins and loses in this bid for votes will be one of the big issues of 2017.