The Ifo Viewpoints 2001

- Save Our Coal!
- Chancellor Schröder's "Steady Hand" Must Act Now
- Whither Systems Competition?
- Economies, Businesses and Economists
- The Japanese Disease
- In Defence of the Free Movement of Labour
- Back to Nature
- Socialisation of Human Capital
- Thank You, England!
- Social Welfare Reform

30

Save Our Coal![*]

In Germany coal is at a depth of 700 to 1500 metres, and the seams are 1.6 metres thick. In the United States hard coal can be open mined (e.g. in Montana and Wyoming) and the beds are as thick as 30 metres. It is no wonder that the coal Germany imports from the US only costs DM 82 per tonne, only a quarter of the cost-covering price at which coal can be extracted in Germany and half the price at which coal is actually sold in Germany thanks to state subsidies. Currently, ca 3.7 billion euros of public funds are spent on coal mining and artificially prop up the competitiveness of some 66,000 jobs. The replacement of the Kohlepfennig, a hidden tax to subsidize German coal, by a tax-financed subsidy for the producers necessitated by the October 1994 decision of the German Constitutional Court, has done little to change the material importance of subsidies for the industry. Without an infusion from the government, the German coal industry would have long since been carried to its grave.

The slogan used during the past decades in support of subsidy policies at reduced volumes has been “Save our coal (industry)”, using the protection of jobs and the cushioning of structural change as arguments. The coal industry should be kept alive to provide a livelihood for the miners and to prevent social hardships.

There is no justification for these subsidies since they preserve a sector that provides such a minimal contribution to the economy that the beneficiaries are not prepared to pay the industry’s workers enough to compensate them for the burden of their labour and their loss of leisure-time. Taxpayers’ money is needed to make the coal industry viable. Such an intervention in the market process is not justifiable since it negates the basic selection property of markets according to which from the numerous technically possible products only those are realised that unambiguously pass the compensation test: a good is produced only if the money that the beneficiary is prepared to pay for it is sufficient to compensate all those who suffer disadvantages in the production, be it in the form of loss of time or health or in the form of a loss due to profits not realised from having employed the capital in other ways. The fact that not everything is produced that engineers could produce if they were allowed to is the true accomplishment of the market economy. It chooses what is sensible and bans the nonsensical to the drawers of its designers.

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[*] November 23, 2001.

Coal is not the only sector that is kept alive by subsidies. In Germany a total of between 100 and 200 billion euros of public subsidies are paid to enterprises, a gigantic amount that not only costs the taxpayers a lot of money, preserving not only the wrong industry structures but also bringing new ones into being which otherwise would not have existed, thus creating permanent damage. In eastern Germany, the industrial ruins outside the cities bear testimony to this effect. Even so, subsidies for the coal industry break all records. Per worker and year, the state contributes some 56 thousand euros. If the mines were all closed, the subsides saved could go to letting the dismissed workers live in luxury hotels with generous daily allowances.

The argument that structural change must be cushioned since it would be unfair or unsocial to ask the affected workers to change industries and jobs has been unsound ever since justifications were made for supporting the grandfathers of today's miners. For the children and grandchildren, let alone their Turkish colleagues, who have been hired for hard work in the mines, it is absurd. In all these years there were ample opportunities to bring about structural change – without the social hardships that accompany dismissals – merely by not employing new miners.

A particularly strange argument for present policies is safeguarding Germany's energy supply, since these policies lead to the extraction and burning of coal, not its preservation. We live in a time when OPEC countries are induced to an excessively rapid extraction of their resources as a result of uncertain political conditions. Guided by the goal of selling off the natural resources they have and depositing the profits in Swiss bank accounts before new political forces do the same, so much oil as possible is pumped from the ground. The reserves are thus being depleted too rapidly, the prices are too low, and too few natural resources will be left for future generations. In this situation, any stable country with natural energy resources that gives greater priority to its future generations than to OPEC should think twice before extracting its resources today. This holds not only for the United States, England and Norway but also for Germany. The motto we need today is: "Save our coal, leave it in the ground".

29

Chancellor Schröder's "Steady Hand" Must Act Now*

How the economy would react to September 11 and the war in Afghanistan was at first a matter of speculation, because, although the danger of an economic downturn was obvious, the evidence was lacking. Time was needed to see how some of the regularly compiled economic indicators would react. Even the German economic research institutes in their recent economic analysis and forecast had to rely largely on plausible suppositions.

Now, week after week, the "hard" facts are emerging, and they do not bode well. In the US, the Consumer Confidence Index registered its lowest reading since 1994, the unemployment rate rose from 4.9 to 5.4 percent from September to October and the survey of existing home sales showed the strongest plunge from August to September since the the index was recorded. In the third quarter the American economy failed to grow for the first time in years. The UK CBI economic indicator showed the strongest decline in 17 years. Similar downturns have been recently reported in Sweden, Belgium and Italy. For Germany the results of the Ifo Business Survey of 7000 German firms, conducted during the first half of October, are now available. The indicator took the biggest one-month drop since the first oil crisis in 1973.

The bad news is indicative of a storm that is brewing. The silver lining on the horizon that could be seen – with some imagination – in various economic indicators last summer, has totally disappeared. In their autumn forecast the German economic research institutes see Germany already on the brink of recession, and they forecast economic growth of just 0.7 percent this year and 1.3 percent in 2002. In the meantime, the dangers have become even greater.

Especially at risk is the German manufacturing industry. After 6.4 percent growth in 2000, only 0.8 percent is expected for this year. Besides weak demand, rapidly rising inventories make a quick turnaround in production unlikely. Especially hard hit are the sectors close to construction. Construction spending will decline by 5 percent this year and by more than 1 percent in 2002. An end to its shrinking is not likely until 2003.

Signs of a looming recession have grown so clearly that politicians must now respond energetically. In the United States demand-stimulating measures have been taken that

* Published as "Des Kanzlers ruhige Hand muss zupacken," *Handelsblatt*, no. 213, November 5, 2001, p. 10.

will lead to a budget deficit of about 1.5 percent of GDP. German tax reform was implemented just in time, since it will allow the deficit-to-GDP ratio to increase from the 1.5 percent called for in the Stability Programme to 2.5 percent this year and from 1 to 2 percent in 2002. This, however, will not eliminate the danger of recession.

For this reason, the economic research institutes have recommended that the government advance the next phase of tax reform by one year. This is easily done if the German Länder agree, and will not exceed the 3 percent limit of the deficit-to-GDP ratio established in the Stability Pact. It would raise the budget deficit for 2002 by an additional 0.3 percent of GDP, and by stimulating consumption would raise growth by an additional 0.5 percent.

During the next boom, even more energetic efforts should be made to reduce the deficit. The risk of not eliminating the budget deficit by 2006, as called for in the Stability Pact, is not great. In all probability, an economic upswing will set in before, that will allow the state to intensify its consolidation efforts.

The government could of course argue that it should continue to gather more information before taking steps to stimulate the economy, and of course the indicators will calm down somewhat in the weeks ahead. But further hesitation will cost the economy dearly since production once lost can never be recovered. The time for demand-supporting measures has come. Consumers and investors need encouraging, forward-looking signals.

The European Central Bank's failure to lower interest rates at its last meeting, although U.S. rates are now below those in Europe, was very disappointing. Is the boom in Ireland and Finland so important for Europe that it prevents battling recession in the heart of the Continent? Where is the much-touted responsibility of every individual member of the Central Bank for the whole, for the sake of which Germany contented itself with only half of the voting strength of these two countries even though it is nine times as large?

And why has the German government taken cover? What good is Chancellor Schröder's "steady hand" metaphor when energetic action is needed? Is the American government displaying a "shaky hand" in implementing a massive Keynesian economic programme?

The time has also come to apply the 1967 Stability and Growth Act, the Magna Charta of stability policies. This law obligates the federal and Länder governments to take the requirements of macroeconomic balance into consideration in their economic and fiscal-policy measures. Accordingly they must not be guided solely by the goal of

rapid budget consolidation, since balancing the economy is not less important than balancing the books of the Ministry of Finance.

Since economic balance is now clearly upset by a demand deficiency, the federal and Länder governments should implement the measures for stimulating demand that are contained in the Stability and Growth Act. This includes the granting of an investment premium of 7.5 percent to private investors and municipalities as well as lowering the income tax by up to 10 percent. These measures could be implemented immediately by a simple executive order, since the measures were designed for rapid deployment in emergency situations. The emergency is upon us.

28

Whither Systems Competition?*

The old systems competition between East and West aimed at military superiority and has, meanwhile, been decided. Globalisation and European integration, however, are producing a new systems competition, whose outcome is yet unknown. The new systems competition aims at improving a location's attraction for potential tax payers and at repelling the state's boarders, and it follows completely different laws than the old one.

The consequences of the new systems competition are drastic reforms of regulation and taxation systems in many countries, improving competitiveness from a national point of view. Germany, too, must make great efforts to introduce long overdue reforms in order not to fall behind even further. Economists largely agree on the nature of these reforms.

Quite another problem arises if system competition is not viewed from the vantage point of an individual country; but rather if the consequences are considered which follow for all countries together if they are successively subject to systems competition in ever new rounds of reforms. The historical processes are still largely understood which unfold over decades, but then bring forth even greater changes. How far do the analogies go between private competition and the competition of states? May we expect that systems competition works as well as the competition in private markets?

Theoretical analyses show that the answer to this question is likely to be "no". Since governments intervene where the market fails, we must fear that the reintroduction of the market on the higher level of state competition tends also to fail (selection principle). Thus we must expect, for example, that competition among social states results in competition of repulsion (United States), that competition with taxes and infrastructure leads in the end to subsidisation of capital input (east Germany) and that competition of bank regulation systems causes a dangerous increase in lemon-banking (Asian crisis).

For these reasons globalisation must go hand in hand with a change in the framework of system competition. It includes, for example, the proposals to integrate immigrants into the social system only after a certain delay, to harmonise taxes on capital earnings in Europe, to extend the EU ban of subsidies to the provision of infrastructure, and to harmonise bank regulation as planned by the Basel II agreement.

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* October 3, 2001.

27

Economies, Businesses and Economists*

Germany is competing to attract new investment. The revamping of the traditional social welfare state, the harmonisation of the tax system, the reform of the entrenched labour market are on the political agenda. The need for action is great, as is the need for qualified advice from well-trained economists. Financial market analysts are not the only source of advice.

The typical economist is not a corporate or investment consultant but a policy adviser who is able to comment on the fundamental and practical issues of economic policy. Economists have never felt at home in ivory towers. They head governments, ministries, public agencies and research institutes. They advise governments and are the dominating forces at international organisations such as the World Bank, the IMF or the OECD. Frequently they are employed as business economists when a company needs an overall perspective. But to be sure, since there are fewer economies than businesses, there is less need for economists than for business economists.

It is true that especially international organisations often search desperately for German economists with Anglo-Saxon degrees. To conclude from this, however, that German economists are not keeping pace is a sign of ignorance. The typical economist attends more international conferences than his colleagues that teach law or business administration, he publishes much more in international journals and has significantly more international contacts. Even if German economists lagged behind their counterparts in other countries after the War, this has been rectified. Young German economists make respectable showings on international podiums and successfully publish in the best journals. This applies not only to post-doctoral economists but also to young professors, who contribute added brilliance to our faculties.

The dynamism and pioneering spirit that prevails in economics in Germany may not be widely publicised, but it is nonetheless remarkable. The quality of the two-hundred plus papers presented at the annual conferences of the Verein für Socialpolitik, the association of German economists, compares well with the best international conferences. The association awards prizes for presentations at international conferences and for successful international publications, it publishes the German Economic Review, the third

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* Published in a similar version as "Unsere Universitäten bieten Qualität," *Financial Times Deutschland*, no. 187, September 26, 2001, p. 32.

largest economics journal in Europe, and discusses research problems at more than twenty annual committee meetings.

The largest research institutes, like the IfW, the DIW and the Ifo Institute, engage actively in international discussions. The Munich CESifo research network with more than 300 researchers worldwide is one of the largest networks for economists, whose working papers are among the most frequent downloads of the Social Science Research Network, the most popular Internet website of the profession.

Not only the major economics faculties, like those at the universities of Bonn, Berlin, Mannheim and Munich, have gained international respect, the smaller faculties have also succeeded in excelling in special areas. The economics faculties were among the first to adjust their curricula to international requirements. They were pioneers at their universities in introducing credit point systems, student evaluations of professors and post-degree courses of study. It is common practice in the meantime that young economists spend a year abroad during the course of their studies, and the Munich faculty requires that new professors have a year of teaching experience in America. In Munich, the number of economics students is certainly not declining. In fact, only a fixed number of students are admitted and many are turned away. The case for economics in Germany is certainly not hopeless.

26

The Japanese Disease[*]

The Japanese economic miracle has long since faded. During the past ten years, the Japanese economy – once looked to as a model in the West – fell 20 percent below the international growth trend. Whereas the Asian tiger economies have apparently recovered from the 1998 crisis, Japan is still in the doldrums. In 2000, real GDP growth amounted to a mere 1.7 percent, and from the first quarter of 2000 to the first quarter of 2001 it grew only by 0.9 percent. In 2000, prices fell for the first time, and in 2001, a deflation of 0.7 percent is expected, which – given the insufficient inclusion of quality improvements in the price statistics – may in fact amount to a 1.5 percent reduction of the price level. This makes Japan the only OECD country to register deflation..

The new government of Prime Minister Koizumi hopes that structural reforms will solve the problem. However, as important as these reforms may be, deflation is a macroeconomic problem that can only be solved with macroeconomic means. Supply policy is not needed when demand is lacking, apart from measures aimed at loans which have turned non-performing due to the crisis.

The problem is excessive savings of private households and insufficient investment by business. Paradoxically, Japanese firms have also joined the ranks of net savers. Unlike firms in other countries, they are not demanders of private households' savings to finance their investment but are themselves providers of savings to the financial markets. According to the IMF, in 2000, the private sector as a whole, i.e. firms and households together, had savings in excess of investment amounting to 9.3 percent of Japanese GDP. That is most unusual. In the EU the private sector invests even more than it saves.

While Japanese excess savings flow partially into capital exports, most – an amazing 8.2 percent of GDP – goes to financing government deficit spending.

This is precisely the problem. The Japanese economy is apparently in a state of "secular stagnation", in the words of Alvin Hansen. Large scale investment, fed by the high savings of an ageing society making provisions for retirement, have created an ample capital stock and a corresponding low marginal productivity of capital. Thus it becomes increasingly difficult to invest productively the permanent inflow of new

[*] Published as "Der japanische Patient benötigt mehr als nur Strukturreformen," *Handelsblatt*, no. 112, June 13, 2001, p. 12.

savings, with the result that the state has had to create the corresponding investment opportunities. Japanese savers are accumulating claims against the Japanese tax payers because private investors refuse to become debtors.

Hansen called the excess of planned saving over planned investment "the deflationary gap", because it implies a lack of aggregate demand. The government can close the gap by incurring more and more debt. But the ability of continuing this policy year after year diminishes, since it creates an investor confidence crisis with unforeseeable consequences for the state. In 1992, Japanese debt amounted to 60 percent of GDP. Only eight years later it was in excess of 130 percent, and the debt keeps spiralling. In the whole of Europe there is no single country with a comparable debt-GDP ratio. Even Belgium and Italy, with ratios of 104 percent and 106 percent respectively, have been superseded by Japan.

Whenever deficit financing becomes difficult, an expansionary monetary policy is the obvious choice for lowering interest rates and for giving firms incentives to make the necessary investment. Unfortunately, this road is also blocked since short-term interest rates are already close to zero. Japan finds itself, as Paul Krugman has noted, in the Keynesian liquidity trap. For decades the liquidity trap described by Keynes was purely a textbook phenomenon. Now that it has been deleted from most textbooks it has re-emerged in the real world.

An economy in the liquidity trap cannot be revived by monetary policy because monetary policy would have to cut interest rates; but it is impossible to make nominal interest rates negative. People would rather hoard their money than lend it at negative interest rates.

There is, however, a trick to lower at least real interest rates. The trick was pointed out back in 1991 by Larry Summers, later the U.S. treasury secretary. Get business accustomed to an inflation trend before the crisis strikes. If prices are constantly rising, monetary policy can lower real interest rates below zero, and perhaps low enough to get the economy in recession moving again. The Japanese would be better off today if they had inflation. But once you are in a liquidity trap, it is hardly possible to create inflation, at least not with monetary policy.

The only real option left for Japan is to devalue its currency. The Bank of Japan can produce a devaluation any time by printing additional yen and selling them for dollars in the foreign exchange markets. Devaluation strengthens foreign demand and thus directly helps the economy. Indirectly, it helps by making possible the creation of an inflationary trend and thus providing the central bank, during a temporary recession, with the instrument of a negative real interest rate in order to revive investment.

The problem remains, however, that even under the new government the Japanese savers have a structural majority in parliament. The new prime minister represents the Liberal Democrats, and the middle class backing this party benefit from deflation, as it adds to the real value of their monetary wealth. A policy of devaluation may be technically possible, but it is politically unfeasible. This is true today and will be even more so in the future, as the rapidly ageing population tends to increase the political weight of the Japanese savers. Japan is in not only in an economic, but also in a political trap, and only radical political change can free it.

25

In Defence of the Free Movement of Labour*

After EU enlargement, considerable migration can surely be expected. The sheer size of migration in itself, however, does not justify policy action. Small numbers could exceed the optimum level, and large numbers could fall below it. As long as the optimum cannot be calculated, no recommendations for migration policy can be derived from the estimated migration numbers.

In principle, the migration of a portion of the Eastern European population is a good thing for Western Europe and for the EU candidates of Eastern Europe. Insofar as migration is motivated by wage differences between the countries, free migration choices lead to welfare gains in all countries. The sending country gains because the wage increases of the immigrants surpass the migration costs, and the target country gains because the immigrants' wages are below the value added that they create. A westward migration from the transformation countries, especially one that is self-correcting in the course of subsequent economic progress, is the hallmark of a reasonable transformation strategy. It would have been good if this principle had been followed in the process of German reunification. Econometric estimates are not required to reach this conclusion.

Two problems must not be overlooked, however. It is possible, firstly, that migration will encounter an encrusted labour market with rigid wages, and that domestic workers will be forced into unemployment as a result. Secondly, it cannot be ruled out that some migration will be motivated not only by wage differences but also by differences in the social systems. Both problems jeopardize the joint migration gains and should induce policy-makers to take action.

The distortion of migration from the social system is particularly problematic. The generosity of the redistributing state induces excess migration and threatens to erode the western European welfare states, since these states could engage in competition to reduce social benefits to discourage poverty migration. Numerous experts have pointed out this danger, including the Advisory Council to the Germany Ministry of Finance.

Reacting to the insistence of the German government, the European Commission has proposed a five-year transition period during which migration quotas will be put into

* Published as “Ein Plädoyer für die Freizügigkeit,” *Handelsblatt*, no. 84, May 2, 2001, p. 10.

effect. This is a defensible but problematic solution since it lessens pressure on enacting domestic reforms. It would be better to create conditions in Western Europe that would allow Eastern Europeans to enjoy the free movement of labour immediately upon joining the EU.

In Germany this would require a reform of the labour market, including opt-out clauses for sector-wide pay agreements, a loosening of the wide-reaching job protection laws, and especially a social welfare system, based on American and French models, that rewards initiative. Only by lowering wages in this way can jobs be created for the immigrants in the primary labour market without causing social hardship.

In addition, there should be a waiting period before immigrants have access to all tax-financed social benefits of Western European countries in order to correct the imbalance between what an immigrant receives from the state and what he contributes and to eliminate artificial migration incentives. Both the Ifo Institute and the Advisory Council to the Ministry of Finance have recommended such a policy.

Selectively delayed integration into the social systems of the target countries, that would immediately grant entitlement to contribution-based benefits but would delay entitlement to certain tax-financed social benefits such as housing subsidies or supplemental social benefits, is a major condition for the creation of a single European labour market. Anchoring this in EU law would not contradict the EU Association Agreements and would pave the way to European integration without government regimentation.

24

Back to Nature*

After the first BSE cases in Germany, there were loud cries of protest over the slaughtered animal herds of the affected farmers. Yet when the EU demanded the culling of 400,000 cattle to buttress meat prices, only a few animal rights defenders dissented. Fortunately for the EU, prices are now being supported by measures to prevent the spread of foot and mouth disease. The EU is primarily concerned about producer interests; consumers have no lobbies.

The horrifying pictures in the TV news show, in heightened form, how European agricultural policy has failed. With its anti-market interventions in the price-formation process it has caused immense welfare losses for many years. The European agricultural market is characterised by numerous, massive government interventions, all of which result in an artificial increase in market prices for the benefit of the farmers and the detriment of consumers. Flexible import equalisation levies eliminate any price advantage that foreign suppliers may have, minimum prices force consumers to pay considerable mark-ups on production costs, volume quotas linked with slaughter and land-retirement premiums accompany the high-price polices. When all else fails, the EU buys up the excess supply to drive up prices, sells the products at dumping prices on the world market, downgrades them into substandard products, or ultimately destroys the whole lot. These are absurd interventions in market processes that have no place in a market economy. Huge welfare losses that far surpass the budgetary costs of agricultural policies are the result. And worst of all, the poor, who pay a high proportion of their earnings for food, have real income taken from them. High-price policies lead to a large portion of pension and income-support payments winding up in the pockets of land owners, many of whom are not even farmers.

At the same time the high-price polices lead to an undue intensification of agriculture. The higher the prices, the more profitable mechanisation is, the greater the number of cattle per hectare fed on imported feed, the more fertiliser is used, and all the greater is the environmental damage caused by agriculture. Many fields have become dumping grounds for liquid manure, dangerous nitrates filter down and concentrate in the groundwater, and a Sunday walk is not possible unless you first check the wind direction.

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* Published as “Marktpreis statt Massentötung,” *Die Zeit*, no. 18, April 26, 2001, p. 23.

All this can only be prevented by a return to prices that clear the markets. The whole intervention apparatus should be abolished, and international trade in agricultural products should be liberalised. Consumers would profit from such policies, especially low-income groups, and agriculture would again return to the less intensive and more environmentally friendly production methods of the past. Also the developing countries would finally have the chance to supply us with those goods, at fair conditions, where they have a comparative trade advantage in production costs. Back to nature is now the motto, and this is only possible with lower prices for agricultural products.

If farmers are to receive money from the state, this should not be through high-price policies but the result of targeted payments for rural and cultural conservation. The cultural assets of agriculture deserve to be protected, since they are the foundation of national culture, and they are an important bridge linking us to the values and knowledge of past generations. If this is to be preserved in an intact natural surrounding, Brussels' policies must undergo a complete turnaround.

23

Socialisation of Human Capital*

A comment on the recent decision of the German Constitutional Court

The birth rate in Germany is below the replacement level, the ratio of old to young people will more than double by 2035, and Germany will then have the oldest population in the world. No fewer than 40 million younger immigrants would be needed to keep the present ratio of young to old constant up to 2035.

The ageing population is the result of changing lifestyles. The DINK family (dual income, no kids) is becoming increasingly popular. It's easier for two family members to live on two incomes than for five on one. Many young people don't even consider having children.

Demographic developments will weaken the growth forces in Europe. The largest age cohorts in Germany are still between 35 and 40. In the coming years, these people will advance the New Economy and boost growth. But in fifteen years the oven will cool down, and in thirty years the fire will have gone out. Today's 35 year olds will be retired, and after this generation not much will follow.

Providing for the elderly will become more problematic. If pension benefits are adjusted in accordance with increases in gross wages, the pension contribution rate will have to increase from today's 20 percent to more than 40 percent. Only by cutting benefits in 1992, 1999 and 2000 and by shifting the pension costs to the general budget was the contribution rate capped at 24 percent and the illusion of a problem solved created. But who will pay the taxes, and how will society deal with increasing poverty among the elderly?

It is high time that Germany takes the problem of an ageing population seriously. The consequences and the causes of the high proportion of elderly are related. A generation that fails to build up human capital by having children, or real capital by accumulating savings, will go hungry when they are old, since you can't get out what you haven't put in. Germans now prefer to have fewer children than they once did, and they have also chosen to decrease their savings rate. This means that a crisis is looming in the provision for the elderly. Increasing savings is the least that can be done to avert the crisis. Opting for promoting savings instead of making savings obligatory was a mistake the

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* Published as "Rentenhöhe nach Kinderzahl," *Welt am Sonntag*, no. 14., April 8, 2001, p. 56.

German government made in the recent pension reform. Whoever saves money by not having children can certainly be expected to put the money away in a savings plan, especially since the suspicion arises that these people don't save because they expect to live off social welfare in old age.

It would be more important, of course, to change young people's attitudes toward children and family. This doesn't mean that the government should get involved in matters that are not its business, but it can put an end to the massive influence on family planning that it currently exerts via the pension insurance system. Pension insurance is insurance against childlessness since it gives an individual entitlements against the children of other people if that individual has no children of his own. This insurance is justified to the extent that the ability to have children is unpredictable. But the problem is that the number of children is largely planned and not accidental, and the pension insurance system has contributed to the declining number of children that people now have.

Before Bismarck introduced the statutory pension scheme, everyone knew that they would be poor in old age without children of their own and would have to rely on relatives to support them. For this reason, children were a planned part of people's lives, as is the case in most countries of the world. Pension insurance, however, has destroyed the connection between the living standard in old age and the number of own children. The example of the uncle or aunt who managed to survive in old age without having had children, has become the accepted thing. From generation to generation, life planning has gradually changed, and today the relationship between children and the standard of living of the elderly has vanished completely from the consciousness of young people. People no longer think about pensions when they think about having children. This proves how strong the fertility restraints of the statutory pension system are.

The false incentives provided by the pension system must be rescinded. Scaling the contributions to the pension and nursing-care insurance scheme according to the number of children, which the Constitutional Court has called for, is a reasonable solution. But it doesn't help relieve the pressure on future generations, who cannot be expected to bear the contribution burden in light of their few numbers. It would be much better to scale pension benefits to the number of children. All pensioners who helped create the foundation for pension benefits by having their own children should not be subject to benefit cuts. The rest must get by with less, but they already have the funds needed to offset benefit reductions with their own savings.

Such a system would impress upon young people in Germany that they are responsible for their own pensions, and it would at least restore a portion of the natural motivation for having children. Traditional family assistance attempts to offset the socialisation

of human capital in the pension system by giving transfer payments to large families. It attempts to compensate one government intervention by another. The scaling of pension benefits according to the number of children achieves a similar goal by reducing the volume of intervention. In principle it is the correct means for meeting the demands of the Constitutional Court.

22

Thank You, England![*]

Following the example of Margaret Thatcher and John Major, the wave of privatisation has swept over the entire European continent. Driven by the hope of cost savings and price reductions, it received further momentum from the prospects of higher remuneration for executives and from an easier compliance with the Maastricht debt criteria. But regardless of the true motives, consumers have certainly benefited from the privatisation of the telecommunications and electricity industries.

At the same time, the privatisation of the British railways has given us a timely example of how not to proceed. Railtrack PLC, which manages the rail network, has made its stockholders and managers rich, but it has robbed the British public of an efficient infrastructure. It has certainly not managed to keep the railway network intact much less expand it. Why waste good money on it? The consequences of this profit seeking are apparent in the growing number of disasters reported in the daily news. And it is not even the many accidents that are the main problem but the extremely long travelling times resulting from having to dramatically reduce top speeds for safety reasons. The English railways are no faster today than they were one hundred years ago.

Privatising a state-owned enterprise only makes sense if competition can be introduced. This is possible *on* the rails but not *with* the rails. Several railway companies can certainly use the same stretches at different times. If, unlike England, a co-ordination agency is set up to synchronise the schedules, this could help bring about meaningful competition. But the railway network cannot be split up into parallel stretches that compete with each other. Canada has two railway companies each of which owns a single east-west route. This is a possible but not an economical solution. For technical reasons, the network is a natural monopoly and it belongs in the hands of the state if an over-charging of customers and an under-usage of the rails is to be avoided.

A private monopoly whose prices are under state control would also not function well since no state regulator would be able to withstand the profit interests of private lobbies and to act in the interests of the consumer. Without competition privatisation makes

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[*] Published as "Die Eisenbahn-Trassen gehören in die Hand des Staates," *Handelsblatt*, no. 53, March 15, 2001, p. 12.

little sense. The inordinate price increases after the formal privatisation of Deutsche Bahn demonstrate the relevance of the problem.

The railway network is a public good for which there is only limited rivalry of usage. In agreement with the EU white paper on transport infrastructure policies and the principles of economics, only marginal costs should be charged for the use of public goods, which are comprised of the maintenance costs as well as the congestion costs in the form of mutual obstruction of travellers, but not the construction costs. These marginal cost prices help optimise the traffic flow but do not bring in sufficient revenues to completely cover the construction costs. Profitability criteria are thus not applicable. A financing deficit in the provision of a railway network is a necessary although of course not a sufficient condition for economically efficient user prices that are to be claimed from private railway companies.

It is good that the German Minister of Transport has now decided to cross the plans of Deutsche Bahn AG. It makes no sense to take the national wealth of railway routes that has been built up over one hundred and fifty years and that lead into the finest inner-city locations, whose true value is immeasurable, and peddle it away on the stock market to private owners for purposes of profit maximisation. Thanks to England, this nonsense has been prevented at the last minute.

For financing the railway routes, the Transport Minister wants to create a financing agency for the transport infrastructure which will also administer the motorways. The agency will have the power to collect tolls from private motorists and the private train operators and to cross-subsidise the different transport channels. Cross-subsidies do not fundamentally contradict the economic principles of optimal toll fees, and there can be no doubt that an effective regulation of motor traffic is only possible via tolls linked to particular roads and the time of day. Roads are also public goods, and in providing them financing deficits are to be expected if the toll rates are chosen optimally. Here, too, tolls should only cover the maintenance costs and the costs of congestion but not the construction costs. In this respect there is no avoiding an on-going co-financing of all transport channels from general tax revenues. Maintaining transport channels is the task of the state – a principle which in no way is opposed to neo-liberal thinking.

21

Social Welfare Reform[*]

The stronger German economy has led to a decline in unemployment. This however cannot disguise the uninterrupted trend towards greater unemployment in Germany since the 1970s, especially among the less qualified. This unemployment means a loss in GDP and is a major social tinderbox. Since millions of eastern Europeans will enter the German labour market after EU expansion, problems are inevitable. The labour market needs structural reforms, and social welfare reforms are certainly the most important.

German social welfare is tantamount to a minimum wage floor that prevents the creation of new jobs. No one is willing to work for wages below the level of welfare benefits. And no business will hire anyone whose wages exceed labour productivity. People whose labour productivity falls below welfare cannot find jobs for this reason. They are caught in the poverty trap.

The effect of social welfare is based on its wage substitution function, but this need not be so. Instead of providing payments for idleness, the state could insist that beneficiaries have some market income, so long as family or medical circumstances do not prevent this. This type of welfare has been practised in the United States for many years under the Earned Income Tax Credit programme. In Germany the state cuts welfare payments by seventy pfennig to one mark when the welfare recipient earns a mark on his own. In the U.S. the government provides an additional 40 cents for every dollar earned, up to a particular level.

The German social welfare system fixes a lower limit for wages. The American system makes wages flexible in the lower regions. If Germany adopted the U.S. welfare system, the conflict in Germany between the goal of a minimum standard of living and private-sector employment would be eliminated. Illicit work would lose its appeal and people would be prepared to work for lower wages since only the proof of their own earnings would entitle them to welfare benefits. In America the lowest wages are about 30 percent of the average wage; in Germany they are about 70 percent. It is no wonder that the U.S. has experienced a job miracle and that Germany has run out of jobs.

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[*] Published as "Befreiung aus der Armutsfalle," *WirtschaftsWoche*, no. 4, January 18, 2001, p. 32.

American social welfare differs from the German not only in its incentive structure but also in the level of the protection provided. Despite state support, the income of the less qualified is considerably lower than in Germany. To avoid the problem of the American working poor, the system must be much more generous than in the U.S. This has the additional advantage that the lowest collectively bargained wage rate will begin to erode more quickly, which will allow the creation of jobs for the less qualified. A general boost in growth would occur, and the distributable amount of goods and services would increase. Social policy performance would probably also improve. Those to be helped would have two incomes instead of one and with welfare and own earnings would have more income than before at the same amount of state social welfare expenditure.

Inherent in the U.S. system is the harsh treatment of those who could but refuse to work. This harshness is not contrary to the goal of helping the less qualified in a dignified way. On the contrary, this system is in a better position to reach this goal. The German welfare system makes people feel useless, encourages idleness, and creates habitual patterns for children who grow up in these circumstances. Neither a Christian- nor a social-democratic philosophy demands that assistance to the less qualified be conditional on idleness. It is hard to believe that this is the way the system still works.

A transition to an earned income tax credit may not be smooth. For this reason welfare benefits should be lowered gradually and the money saved should be used for supplemental wage payments. The needy should be gradually moved from their TV armchairs to the shop floors where their income should be bolstered.

The problem with the transition lies in increasing the acceptance for low-wage jobs in the private sector without at the same time forcing the needy who cannot find jobs into financial hardship. To solve this problem, the state must offer limited employment so that everyone is provided for and so no one can claim that jobs are not to be found. The wages for these jobs must be low enough so as not to compete with private-sector employment and high enough to ensure a suitable overall income.

Whoever doesn’t work although able to can expect only limited help from the state. Whoever takes on a state job can receive in addition a wage that would lift him to the level of current welfare benefits. Whoever finds a job in the private sector receives both a wage and a wage supplement that increases his total income to a level above that from a state job. These are the ground rules for a new, incentive-creating welfare system that lets people free themselves from the poverty trap. This is the only way to make the labour market fit for the new economy, for globalisation and for EU enlargement.