

# IfM-Background Paper

## Comments of the IfM Bonn on the economic recovery, crisis management and future package

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## **1 Preliminary remarks**

With the Economic Recovery and Crisis Management Package (June 2020), the immediate business relief measures of recent months are now being supplemented by measures to revive the economy and preserve jobs in the long term. The Future Package for the first time takes on an economic policy perspective that goes beyond the immediate need for support and is aimed at sustainable economic development based on renewal. For small and medium-sized companies (SME), these economic policy decisions are an important basis for their future strategic orientation.

In principle, the focus of the Economic Recovery and Crisis Management Package continues to be on measures with immediate effect. This is understandable insofar as, in view of the economic situation, direct economic effects are to be achieved even beyond emergency aid. However, structural approaches to stimulate entrepreneurial initiatives also play a subordinate role in the Future Package, although they would be important for the intended push towards modernisation. In our opinion, more room should be given to such long-term growth prospects in the Future Package. After all, SMEs can make a significant contribution. Accordingly, their importance for the restructuring of the economy should not be underestimated. Another important starting point would be to examine the (national) legal framework – beyond the (temporary) changes in tax and insolvency law mentioned below – in order to see how it can be simplified and reformed with regard to SMEs.

The specifics of the Corona crisis present major challenges for economic policy in the coming months – and perhaps in the coming years. The crisis affects the SME sector currently in very different ways. Crisis effects are regionally differentiated, and they are already being felt with a time lag by companies that were initially not affected. This requires continuous adjustment and, if necessary, a re-start of immediate business relief measures. In the following, we examine SME-relevant measures of the Economic Recovery and Crisis Management Package with regard to their general suitability for revitalising SMEs and point out possibilities for improvement. With regard to the Future Package, we limit ourselves to a summary assessment.

## **2 On the Economic Recovery and Crisis Management Package**

### **Value added tax**

The temporary reduction in the VAT rate is considered by some to be relatively ineffective, partly because it is not clear how much of this will be passed on to consumers. It is true that the VAT reduction will have relatively little impact on the decisions of suppliers and consumers in individual cases. However, this is advantageous because it distorts individual decisions to a much lesser extent than in the case of "targeted" measures. Instead, the overall tax burden will be reduced, giving producers and consumers greater room for manoeuvre – irrespective of whether the reduction is passed on directly to consumers or not. From the perspective of SMEs, this measure is therefore to be welcomed.

In view of the estimated financial requirement of EUR 20 billion, the VAT rate reduction is understandably limited to six months. However, such a structural measure has a medium to long-term effect. Despite the considerable financial requirements, it would therefore be worth considering whether this reduction should be maintained over a longer period and communicated as early as possible. Such a step would also have the advantage that the fundamentally positive effects of the VAT reduction would be less diluted by the additional bureaucratic efforts for SMEs.

### **Social security contributions**

The stabilization of social security contribution rates makes sense. In the face of massive recourse to short-time work benefits and increased unemployment with simultaneous increases in health care spending, a sharp rise in social security contribution rates would otherwise be likely. This would result in both an increase in non-wage labour costs and a simultaneous reduction in the disposable income of employees. At the same time, this hampers economic recovery. The measure is initially limited until 2021, but should be kept under review. If there is no sustainable economic recovery by the end of 2021, there will be a significant increase in social security contributions. This would have a correspondingly negative impact, especially on the economic recovery of SMEs.

### **Tax measures**

The temporary extension of the tax loss carry-back in combination with the introduction of a mechanism for immediate use in the 2019 tax return protects

the liquidity of companies and is therefore reasonable. However, it is unlikely to have any long-term effects on growth.

In principle, the introduction of a declining-balance depreciation method is to be welcomed as a fiscal investment incentive. However, it should be kept in mind that investment incentives are not meaningful per se. Investments should primarily serve to adjust the capital stock to the respective circumstances. In the case of generally lower investment requirements due to falling demand, any additional investment stimulation is problematic because companies may be induced to invest in unprofitable projects.

### **Improving employee participation**

From a regulatory point of view, the tax incentives for employee share ownership should be viewed critically: It gives preference to capital investment in the employer company over other forms of investment and entails the double risk of capital and job loss for employees. Why this special form of capital investment is supposed to be particularly advantageous from an economic point of view is not clear to us. In addition, empirical evidence from the past decades suggests that the vast majority of employees in SMEs have no interest in employee share ownership. Tax incentives do not cancel out the various costs – also on the part of the employers. Many of the presumed positive effects of employee share ownership cannot be proven either theoretically or empirically.

The planned incentive to attract skilled workers for start-ups competing internationally is likely to be rather low in terms of the tax incentives envisaged. It is possible that start-ups in Germany score points in the international competition for skilled workers with other advantages such as German labour law and the social security system.

### **Insolvencies**

The introduction of a pre-insolvency restructuring process in accordance with the EU Directive of 2019 (implementation by 07/2021) will improve the chances of companies being restructured, especially if they have problems with debt financing. The new procedure can be expected to be applied for by only a few hundred companies per year. It is likely to be unsuitable for the majority of micro and small enterprises threatened by insolvency.

The planned shortening of the residual debt discharge phase from 6 to 3 years improves the possibility for failed entrepreneurs to restart. This legislative pro-

cedure should be accelerated in order to enable entrepreneurs and founders who have failed through no fault of their own, but due to the pandemic, to make a quick restart.

### **Bringing forward public investment**

Early public investment is welcomed if it improves the public infrastructure in a meaningful way (e.g. digitalisation, expansion of public transport, improvement of education). Large parts of the SME sector will benefit from the additional demand generated by this.

### **Bridging aid and extension of the simplified basic income support**

Since parts of the SME sector are still struggling with significant restrictions, the bridging aid programme makes sense. However, solo entrepreneurs with little or no fixed operating costs will hardly benefit from it. To cover their living expenses they may therefore have to rely on basic income support. Extending simplified access to basic income support is therefore important. However, the crediting of possible additional household income can lead to considerable income losses for this group of persons.

The conditions for support should also be reconsidered and be graduated. The criterion of turnover decline by at least 60% compared to the previous year appears to be one-dimensional and arbitrary. For example, companies that have suffered a 50% or 55% drop in sales and therefore do not receive any bridging aid are only slightly less affected. Graduating support payments in relation to the scope of turnover declines could be a less distortive solution. With regard to the reference period, it should also be kept in mind that not all companies – but especially freelancers – have continuous and steady revenue streams. As a consequence, companies may be unduly disadvantaged (favoured) compared to companies with steady revenue streams, for example, because payments for services provided over a longer period of time are (not) received.

As the Economic Stabilization Fund provides substantial resources to support primarily larger companies, it seems also appropriate and justifiable to provide targeted support in the form of grants to SMEs that have been negatively affected but are economically viable. Nevertheless, from an economic policy perspective, it should be avoided – not least because of the heavy burden on the state budget – to support existing companies whose market and survival

prospects are doubtful. Further support for start-ups once the immediate crisis period is over may be a more reasonable policy option.

### **Programme to mitigate the effects of the pandemic in the cultural sector**

The cultural sector in particular is suffering heavily from the effects of the corona pandemic. Many solo entrepreneurs in this sector have experienced total income loss. Most likely, they cannot benefit from the bridging aid because they have no fixed operating costs. It is true that these self-employed persons can (and should) in principle make use of the basic income provision. However, many want to avoid this at all costs. Taking out loans is also not an option, because income losses can only rarely be compensated and therefore loans would be difficult to pay back. A separate programme for this sector therefore seems appropriate and justifiable.

### **Strengthening local authorities**

Local authorities are particularly hard hit by the corona pandemic due to the loss of trade tax revenues and rising expenditures for social security and basic welfare. Strengthening the municipalities financially makes sense insofar as otherwise a strong decline in municipal infrastructure measures would be expected. However, it is precisely these measures that oftentimes directly benefit local small and medium-sized enterprises.

### **Bonus for trainees**

Trainees are the urgently needed skilled workers of tomorrow. Up to now, SMEs have often trained more people than they themselves needed. The planned financial subsidies for maintaining or expanding training contracts may be nominally small, but they express the public esteem for SMEs providing vocational training. In addition, it is important to support training with a view to future training activities. Experience has shown that once SMEs discontinue providing in-house vocational training during times of crisis, they rarely resume their activities afterwards. Limiting the measures to SMEs with up to 249 employees is justified because these companies will have greater difficulties in maintaining their commitment to training due to the pandemic.

With regard to the take-over premium for trainees from insolvent companies, however, an extension to larger companies should be examined. This premium is intended to create an incentive for SMEs. However, it remains to be seen whether they can actually take them on from insolvent companies – and are

willing to do so. In the interest of those to be trained, it would therefore be helpful to expand the group of eligible companies.

From the point of view of SMEs, the expansion of digital teaching and learning offerings should also be promoted in order to be better prepared for possible future external shocks.

### 3 On the Future Package

The Future Package aims to actively support economy and society by means of a modernisation drive and the rapid elimination of existing deficits (e.g. in the digital infrastructure). The focus is on *strengthening future technologies* in the areas of *digitization, sustainability/climate and health care*.

SMEs in particular can benefit from many of the measures envisaged. But they can make a significant contribution to sustainable development in these areas, too. For this purpose, it is important not only to support SMEs in the use of future technologies. When implementing the Future Package, economic policymakers should also ensure that the measures are designed in such a way that the potential of small and medium-sized enterprises for the development and marketing of future technologies in all the areas mentioned can unfold.

The *rapid and comprehensive digitisation* mentioned throughout the Future Package is a prerequisite for fully enhancing the contribution of SMEs to an innovative and future-oriented economy. The digitisation of administrative services in particular is likely to have considerable downstream effects and will in turn push digitisation in SMEs.

*Greater consideration to regional aspects of future-oriented economic development.* The IfM Bonn assumes that not only the short-term but also the medium to long-term effects of the corona pandemic on SMEs (established companies and start-ups) will differ considerably from region to region. This will increase existing regional disparities. In our opinion, however, this aspect is still neglected in the current Future Package. The Economic and Crisis Management Package addresses regional challenges through providing municipal support, including the increase in the joint task of improving the regional economic structure (GRW). Overall a forward-looking regional policy strategy to stimulate the economic activities of SMEs in the longer run is still lacking.