Tax Reform and Stock Returns

Word has gotten around that substantial reforms are needed to revitalize the Federal Republic of Germany economically. The politically popular and simplistic solution of increasing government debt and spending leads to ruin in the long run because it places an excessive burden on the younger generation, limits their options for action, and leads to dependence on creditors.

As emigration statistics reveal, it is precisely well-educated young people who are fleeing the burdens of their homeland and emigrating. Yet what the country lacks more than anything else is a healthy demographic structure, one that is consistently characterized by a strong cohort of young people. In short: the country must become more attractive. The Merz/Klingbeil administration now claims to have put forward a good proposal to that end. A tax reform, the finance minister announced, should provide financial relief to segments of the population in the coming years. But even setting aside the fact that the disclosed amount of the promised net relief is paltry and by no means substantial, what weighs much more heavily is that reviews of the figures have yielded very sobering results. Namely, when one takes into account the steady and high rate of inflation—which the European Central Bank has been failing to combat for years—it becomes clear that even those supposedly receiving relief are facing dwindling purchasing power. Technically speaking: Cold progression is not sufficiently offset, meaning that price increases more than compensate for any tax relief.

Equity fund savers, such as LOYS investors, have long been familiar with this problem. When it comes to investment income, the tax authorities take their full share and pay no heed to "cold progression." On balance, then, the government taxes paper gains that have not actually led to any increase in the investor's purchasing power. At the same time, it is well documented that Germany has a stock market that is small relative to its economic strength. If one wanted to address this shortfall, one could, for example, adjust the taxation of dividends and stocks to account for "cold progression." That would not only be fair, it would also be wise, because—especially compared to the United States—Germany suffers from insufficient private equity financing. This has often been observed in the case of start-ups. As soon as there are young companies with great potential, it is U.S. investors who step in with equity financing. Meanwhile, political circles in Berlin believe that the state-owned KfW Bank should assume this role. This shows that what Germany lacks most of all is private investment. So this is where we need to apply the lever. The investment conditions for private investors, both domestic and foreign, must be improved. To this end, the Federal Republic of Germany must be made a more attractive business location. Taxes and levies are certainly part of the business environment. To attract capital—whether for housing construction or AI investments—the framework conditions must be right. If this is not the case, the public-sector share of the economy will continue to rise, and the market-based economic framework will be increasingly eroded. Even today, the government has created far too many people dependent on the state.

In this regard, it is long overdue and desirable for the government to eliminate tax progression on corporate investments. However, to offset the loss of revenue resulting from this obvious gain in fairness, the government must finally begin to cut spending. The DOGE approach from the U.S. could serve as a model here. After all, the government there reduced its workforce by 10% in a relatively short period of time. Given the demographic labor shortage in this country, the qualified employees made redundant would immediately be employable in the labor market.

Your fund manager and co-investor

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