



Federal Ministry
of Finance

German Fiscal Policy post-Corona

9th Global Fiscal Forum

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Outline

- I. Economic and fiscal projections
2022 – 2025
- II. Achieving the digital and ecological
transformation: the role of public
investment

Disclaimer

Transition from Caretaker to new Federal Government

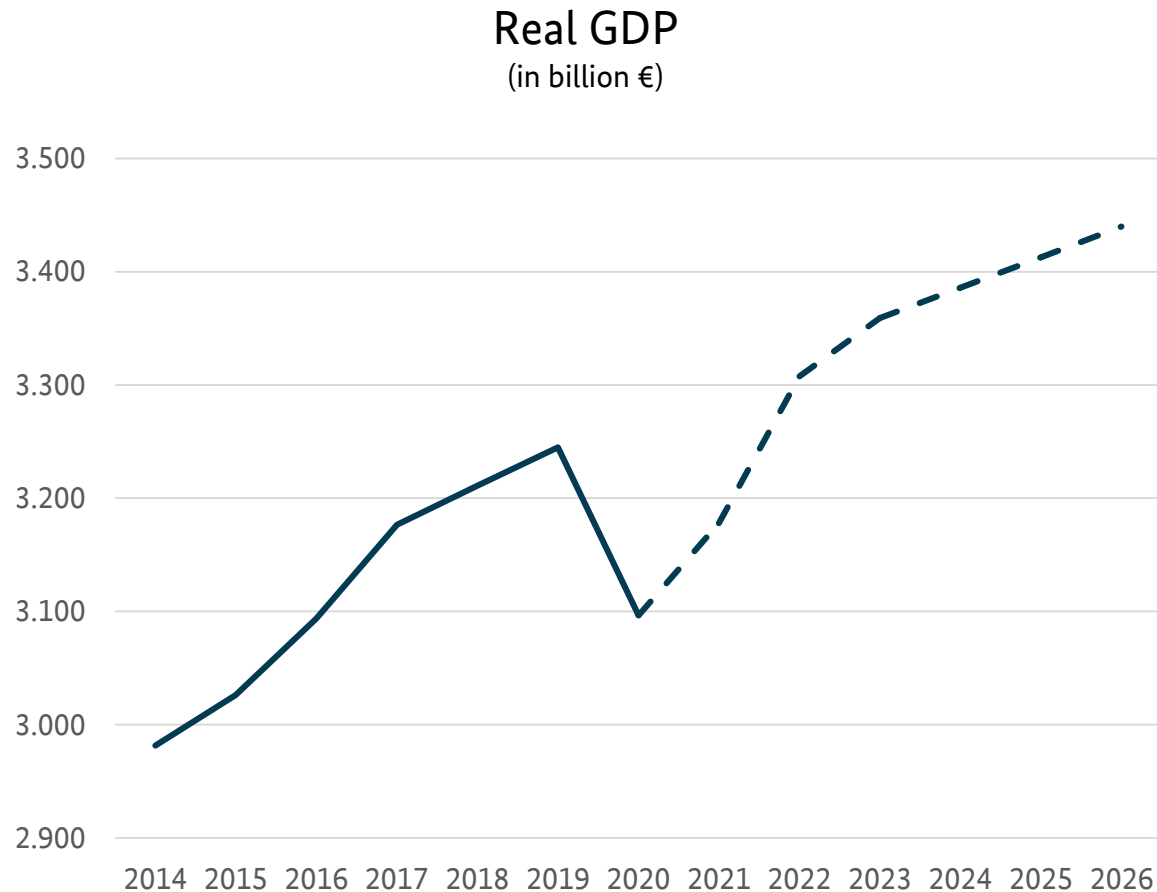
- Federal Election in Germany took place on September 26, 2021
- Negotiations over a new centre-left coalition currently underway between Social Democrats, Greens and Liberal Democrats
- New government could take office in early December

Preliminary Budget and Fiscal Policy Priorities

- Draft Federal Budget for 2022 and medium-term Financial Plan for 2023-25 were prepared by outgoing government in June
- Incoming government will present amended 2022 budget draft to Parliament, which will likely decide on it during Q1/2022
- Final budget numbers and priorities will therefore differ from outlook presented today

I. Economic and fiscal projections 2022 - 2025

Macroeconomic Outlook



- GDP growth projections

(Federal Government, as of Oct 27):

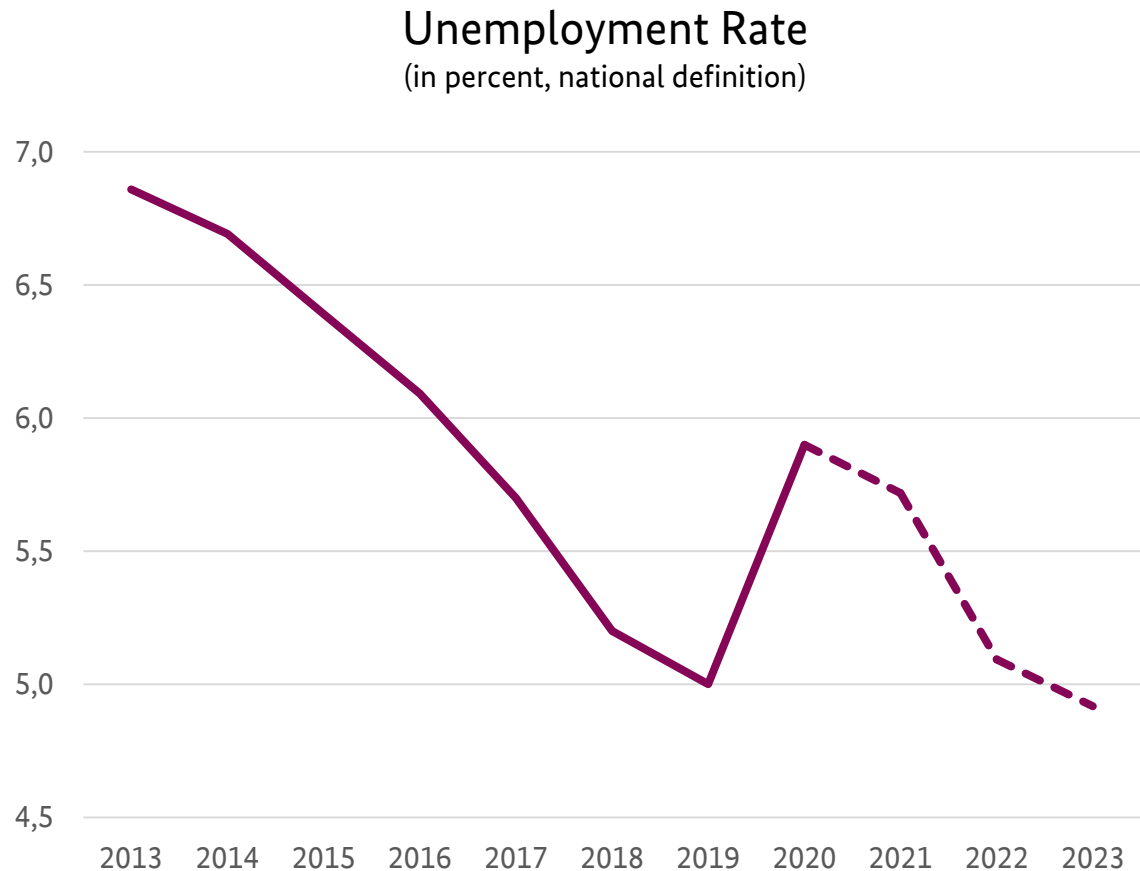
2021: +2.6%

2022: +4.1%

2023: +1.6%

- Supply side bottlenecks currently curb industry, expect catch-up effects next year (record-high order backlog)
- Strong recovery underway in service sector (also due to successful vaccination campaign)

Labor Market Recovery



- 2020: Rise in unemployment after years of continued decline, but labor market largely resilient
- Short-time work scheme (STW) has proved successful in stabilizing the labor market. Large numbers of workers returned to regular employment over the summer. Special provisions of STW expire end of 2021.
- Full recovery of unemployment rate with decrease back to pre-crisis level over the course of 2022 expected

Risks to the Macro Outlook

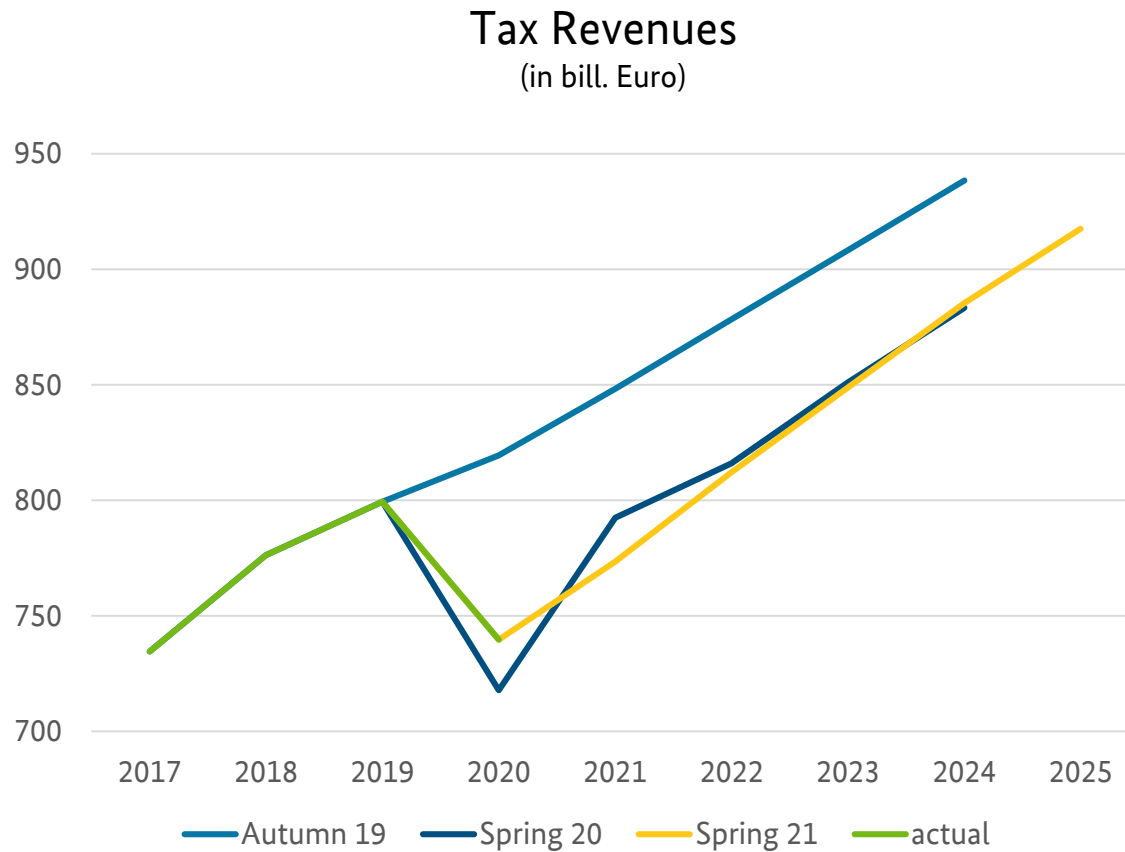
Downward risks:

- Longer than expected supply chain disruptions could delay or even prevent rebound in manufacturing sector
- (Global) pandemic developments, e.g., related to virus variants, could curb economic development, esp. private consumption

Upward risk:

- (Involuntary) savings were accumulated during the pandemic. Pent-up demand could be stronger than assumed (“undershooting” of savings rate), additionally fuelling consumption (but also currently elevated inflation)

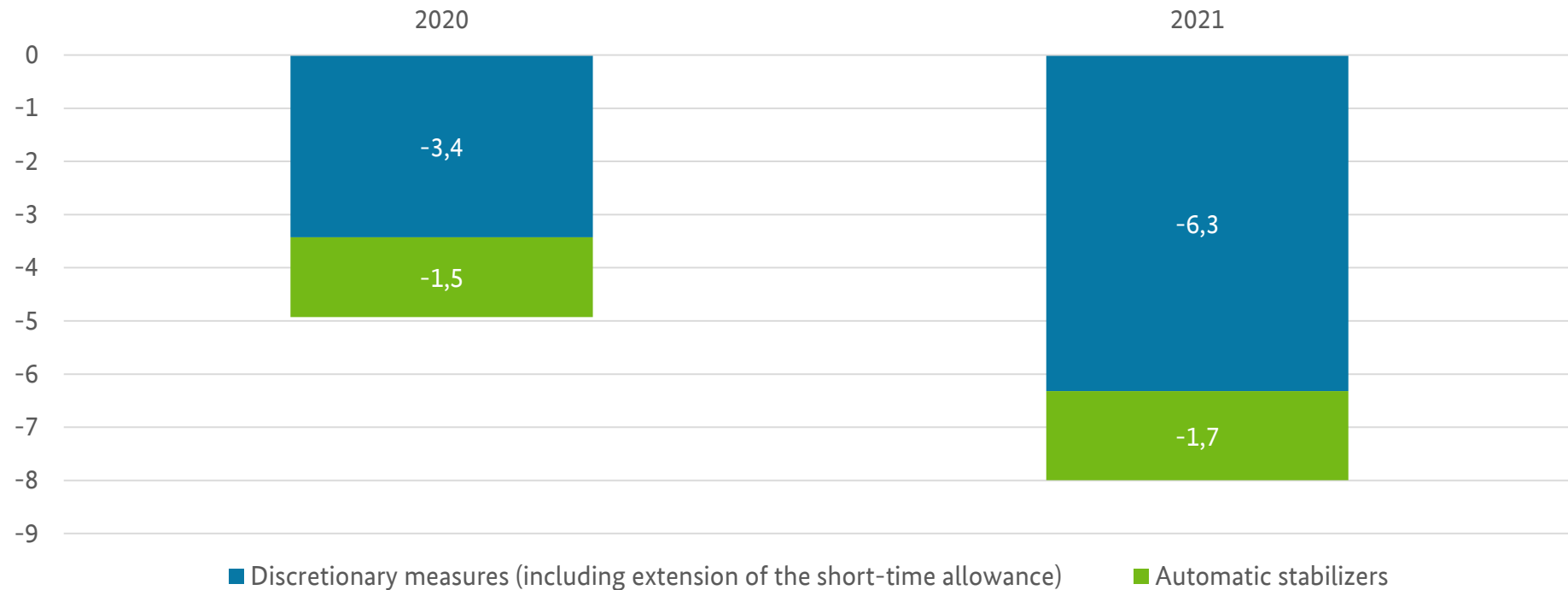
Tax Revenues Forecast



- Tax revenues decreased markedly in 2020 due to drop in economic activity and tax measures to support the economy (temporarily lower VAT rates, deferrals, lowered prepayments etc.)
- With strong recovery, also strong rebound in tax revenues expected (already visible in the monthly data)
- Independent „Working Party on Tax Revenue Estimates“ will publish its next official forecast mid-November

Fiscal Measures of General Government

Impact of automatic stabilizers and discretionary measures on fiscal balance
(in % of GDP)
as of April 2021 (German Stability Programme 2021)

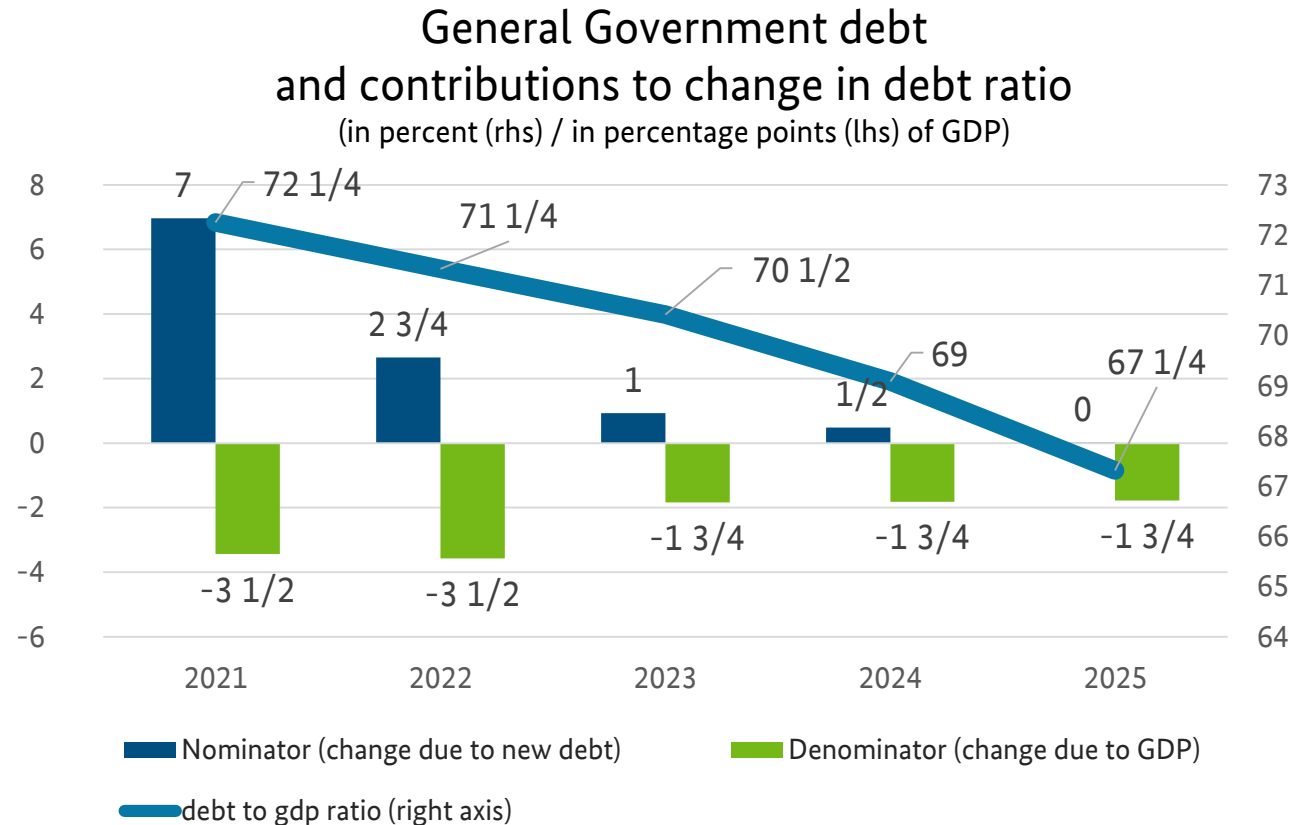


Projection of Public Finances

- **Strong fiscal stimulus in 2020 and 2021** results in large fiscal deficits in both years.
- Unusually large **deficit 2021 mainly due to planned net borrowing by the central government**. Projection assumes full outflow of provisions for additional expenditure on measures to fight the pandemic included in the budget.
- **Debt-to-GDP ratio might increase to 72 ¼ % in 2021** (much lower than after Financial Crisis in 2010 at 82.5%); declining debt ratio in the medium term due to low interest rates and recovering growth

General government budget balance and debt projections	2020	2021	2022	2023	2024	2025
	in % of GDP					
Budget balance	-4.3	-7 ¼	-3 ¼	-1 ½	- ½	0
Structural balance	-1.8	-6	-3 ¼	-1 ¼	- ¼	0
Maastricht debt-to-GDP ratio	68.7	72 ¼	71 ¼	70 ½	69	67 ¼

Development of General Government Debt



- Debt-to-GDP ratio projected to decline to 67 1/4 of GDP in 2025
- GDP effect (denominator effect) outweighs effect of public deficit (nominator effect) in 2022 and subsequent years
→ declining debt-to-GDP ratio
- Debt-to-GDP ratio expected to fall more rapidly in medium-term as fiscal deficits become smaller

II. Achieving the digital and ecological transformation: the role of public investment

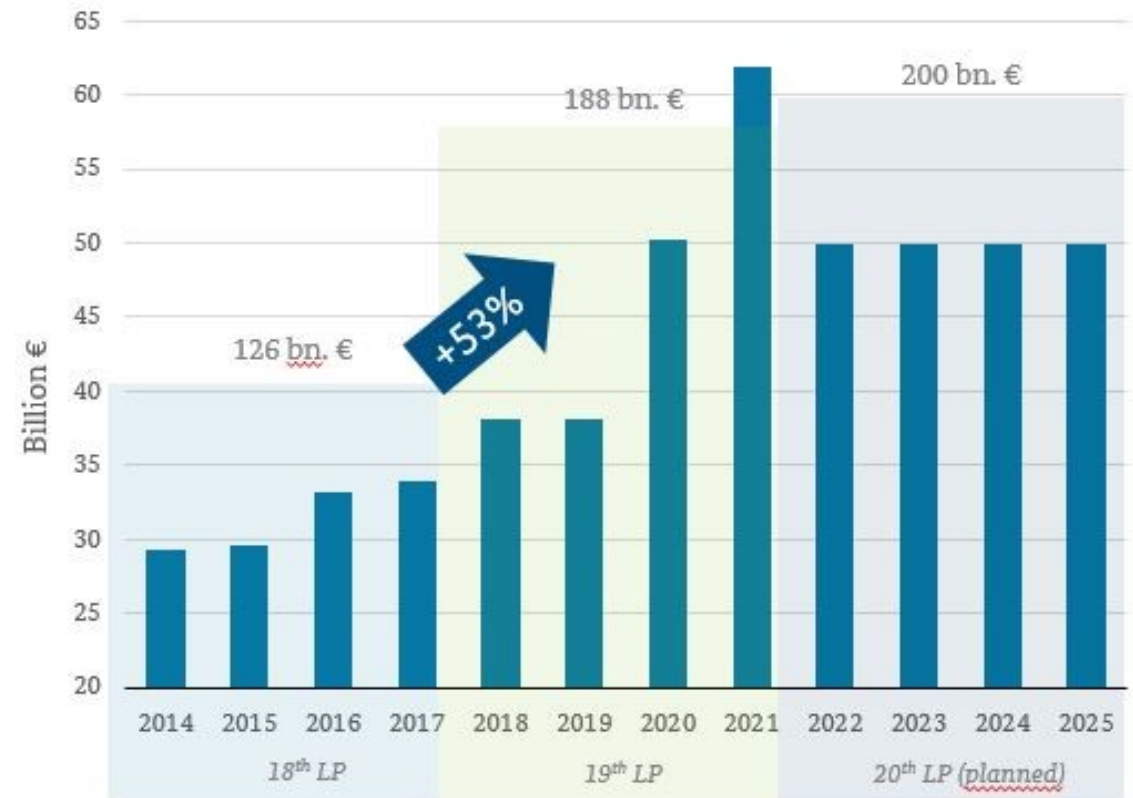
Strengthening public investment to support green and digital transformation

Throughout the crisis, Germany maintained strong focus on **transformative public investment**.

- “Future package” of stimulus package (> €50 bn.) accelerates modernisation and expands medium-term growth potential.
- Wide range of measures are taken in areas crucial for future growth and sustainability, and needed to
 - ensure energy transition and compliance with climate commitments,
 - promote sustainable mobility,
 - provide better protection against pandemics,
 - invest in hydrogen technology, and
 - foster digital innovation in private sector and public administration

Federal Government Investment

Comparison between different legislative periods



Public investment essential in speeding up necessary economic and societal transformations

- **Allocation of investment needs** to achieve carbon neutrality between public and private sector difficult to assess: most estimates assume a significant share of public investment (between 10 and 35%)
- **Dual role of public investment:** investment in public capital stock plus bridging cost gaps for green and digital investment in private sector. Needs for latter depend on a number of factors, esp. carbon prices.
- **Provide key infrastructure** needed for establishment of new markets, especially in case of natural monopolies
- **“Crowding in” of private investment:** transformative public investment can trigger substantial additional private investment, effect is even stronger during recessions and in times of high uncertainty
- **Reduce uncertainty in times of crisis and disruptions:** committing to significant amount of transformative investment is a strong signal to the private sector, providing critical infrastructure for carbon neutral activities reduces uncertainty surrounding existing technologies
- **Investment in “lighthouse”-projects** that may otherwise be too risky or massive for private firms and thereby driving technological change
- **Investing in research and development** in order to stimulate more innovation and new technologies supporting climate goals

Expanding digital infrastructure to provide further impetus to digitization in Germany

- Germany only mid-table in various digitization rankings. **Untapped potential** both in expansion of **digital infrastructure** and use of digital technologies and services, as well as in area of **digital skills**.
- Even though the expansion of digital infrastructure in Germany is currently primarily being carried out by the private sector, the public sector increasingly plays a crucial role by **providing public infrastructure as prerequisite for private investment** - such as AI, 5G or cloud infrastructure.
- The “future package” of the economic stimulus program adopted during the Corona crisis provides important stimulus in the **area of digital infrastructure**. This includes substantial investment in key **digital technologies** such as AI and quantum technology, as well as measures to **digitize public administrations**, and investment into the digital transformation of the **federal healthcare system**.
- Beyond these forms of support, federal government provides substantial financial resources for expansion in areas where no private investment is forthcoming, especially in the areas of **digitization of schools, fiber optics and mobile communications** in remoter areas of the country.
- Expenditure on digital infrastructure has always been a high priority for the federal government and **is likely to be a key focus for the next government**. In this regard, continuing to reduce obstacles such as lack of construction and planning capacity will be crucial.

Innovation policies beyond “classical” industrial policy

- In EU budget, financial resources allocated to **innovation activities** still significantly lower than for other budget components (volume of “Horizon EU” – the EU’s key funding programme for research and innovation – is about 22% of expenditure on EU’s Common Agriculture Policy)
- Nationally, predominant “classical” industrial policy **skewed towards existing technologies and leading sectors**, this might hamper progress on climate goals and digital transformation to the extent that technologies to achieve digital and carbon-neutral transformation have not been developed yet
- **Shift towards smart innovation policies required:** promote new technologies that support climate goals, secure leadership in area of climate technology, close the gap with other countries in digital technologies
- Key components of “smart” innovation policy:
 - Need focus on entirely **new technologies, processes and products** to **complement** policies aimed at transferring present technologies into the post-carbon future
 - Improve existing and develop new **efficient and effective institutional designs** (learn from international best practice)
 - **“Mission-based” approach** (formulating and pursuing overarching societal goals, e.g. as in the area of carbon neutrality) may provide additional focus for public sector both on national and European level

Thank you very much for your attention!

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