Germany

Infrastructure under threat

- **The quality of Germany's infrastructure is deteriorating because of lack of spending.**
- **In particular, the municipalities have reduced their investments, because of increased social spending and financial problems.**
- **The *Länder* are also cutting back on capital spending in preparation of tighter budget rules that will come into force in 2020.**

Germany's infrastructure is one of the best in the world. In the WEF Global Competitiveness Report 2016-2017, its infrastructure ranked eighth just behind France, but before the UK (9th) and the US (11th). However, the country is falling behind in this area. In the 2009-2010 Competiveness Report, its infrastructure came in first. The decline is in particular noticeable in the quality of road infrastructure. It tumbled from the fifth position in the 2009-2010 report to the 16th place in the latest.

The reason for Germany's relative decline is the lack of investment spending on infrastructure. Following the reunification-related investment boom in the early 1990s, public capital spending has settled at around 2.2% of GDP (chart 1). This is one of the lowest in the EU. For example, in France, public investment amounted to 3.5% in 2015. The gap can be partly attributed to differences in definitions. Moreover, the increase in the public investment rate elsewhere in Europe in the run-up to the financial crisis was related to the boom in real estate prices. The differences have clearly narrowed in the aftermath of the crisis.

Germany's modest capital spending is hardly enough to compensate for the depreciation of the capital stock. Since 2013, net investment, i.e. gross investment minus depreciation, has been even negative (chart 2). This situation is not unique for Germany. Also in Spain and Italy, net investment is currently in negative territory.

In Germany, investment spending by municipalities, which carry out more than 60% of all public investment, has particularly come under pressure (chart 3). It dropped from 17% of their total expenditure in 1995 to only 9.7% in 2015. This is largely a result of the expansion of municipalities' responsibilities in the area of social security. Between 2002 and 2010, municipal social spending doubled. The Federal government has taken measures to reduce the financial pressure on the local authorities, such as taking on the costs of the old-age basic pension. Also outsourcing, for example, in the field of waste management, has played a crucial role. Net capital spending has been in negative territory (chart 4).

The KfW Municipal Survey reports that in particular financially-weak municipalities have been cutting back on capital spending. On average, municipalities with a budget deficit invest one third less than those with a balanced budget or a surplus. This is also confirmed by the statistics. Local authorities in the wealthier *Länder* such as

Gross public investment (as % of GDP)

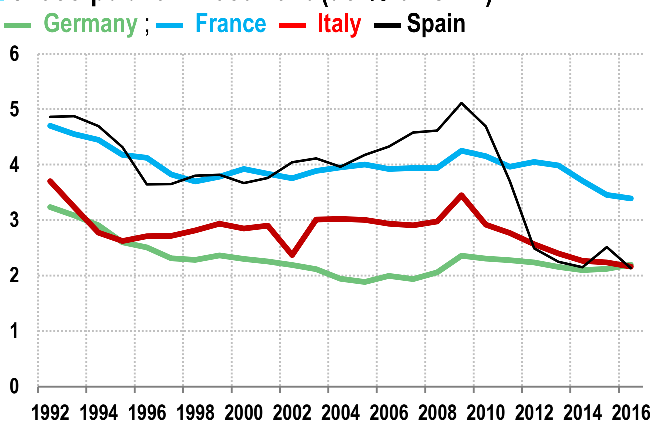

Chart 1 Sources: Eurostat and BNP Paribas

Net public investment (as % of GDP)

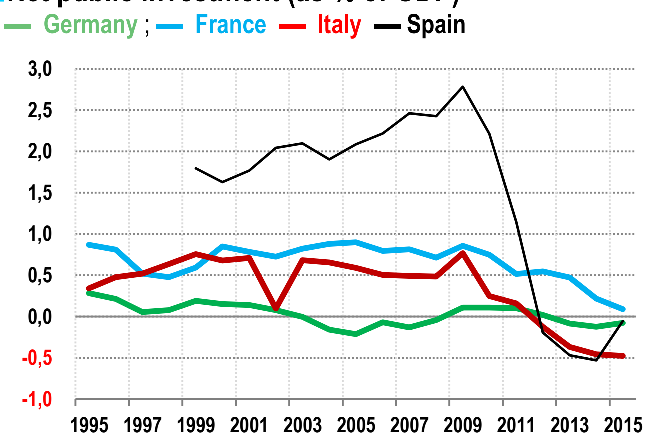

Chart 2 Sources: Eurostat and BNP Paribas

Gross capital formation (as % of total spending)

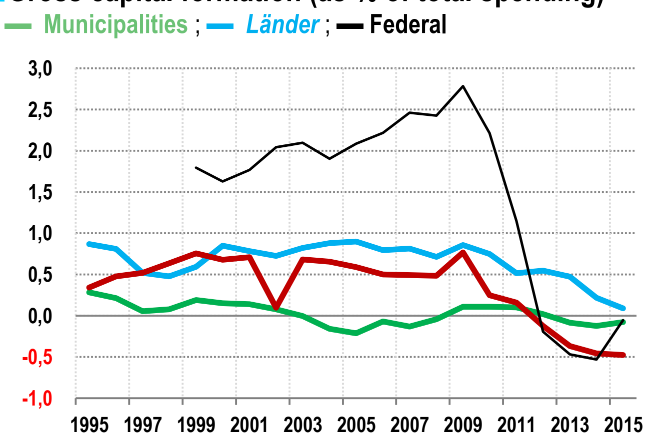

Chart 3 Sources: Eurostat and BNP Paribas

Bavaria and Baden-Württemberg invest considerably more than in the poorer ones (chart 5). In addition, the KfW Survey notes that municipal projects are often not undertaken or with a certain delay because of uncertainty concerning the division of costs between the state and the municipality, and lack of administrative capacity for the planning and implementation.

As a result of weak investment, the local authorities' fixed assets decreased by EUR 60 billion between 2003 and 2015. According to the KfW Survey, the total observed backlog amounted to EUR 136 billion in 2015, EUR 4 billion more than in preceding year. Maintaining the capital stock at the same level requires a permanent increase in spending by at least EUR 4 billion. In order to reduce the backlog, the additional investment would need to rise to close to EUR 8 billion.

Public investment is likely to come under increased pressure in the coming years because of the application of the so-called debt brake (Schuldenbremse). This policy instrument requires structural balanced budgets at federal and *Länder* level, in accordance with the European Stability and Growth Pact. The debt brake came into force at the federal level in 2016 and from 2020, structural deficits will be forbidden for the *Länder*. As the *Länder* may not borrow anymore for structural purposes, they may have to reduce their investment spending by about EUR 20 billion. This is already affecting their investment spending. Certain *Länder* have even renounced tapping federal or European investment funds because they are unable to contribute their share in the co-financing arrangements.

The policy goes against the recommendations of the international organisations, such as the IMF and the OECD. They have called on Germany to step up public investment, as this would not only stimulate demand in the near term, but would also improve the growth potential of the economy. Moreover, a temporary fiscal stimulus in Germany can support growth in the rest of the eurozone and reduce Germany's current account surplus.

The German government is extremely reluctant to heed this advice, preferring to stick to the tight budget policy. A possible solution for improving the country's infrastructure would be the setting up of public-private partnerships. However, in the case of motorways, such financial construction has been met with great resistance, as the population is fiercely opposed to the introduction of tolls for passenger cars. Moreover, many fear that the involvement of private capital in the provision of public goods will result in these goods being subject to profit considerations.

Net investment (as % of GDP)

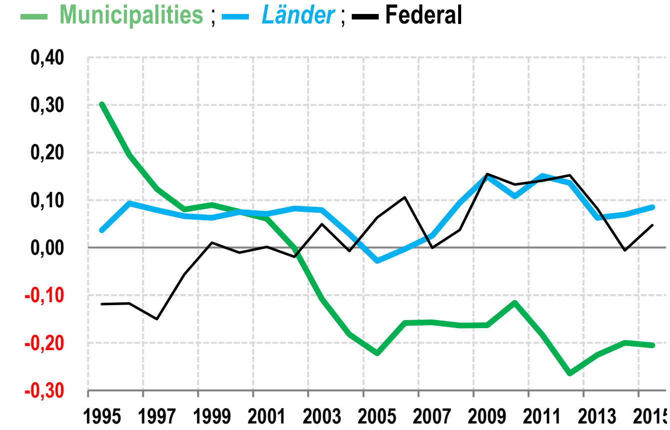

Chart 4 Sources: Eurostat and BNP Paribas

Municipal investment by *Länder*

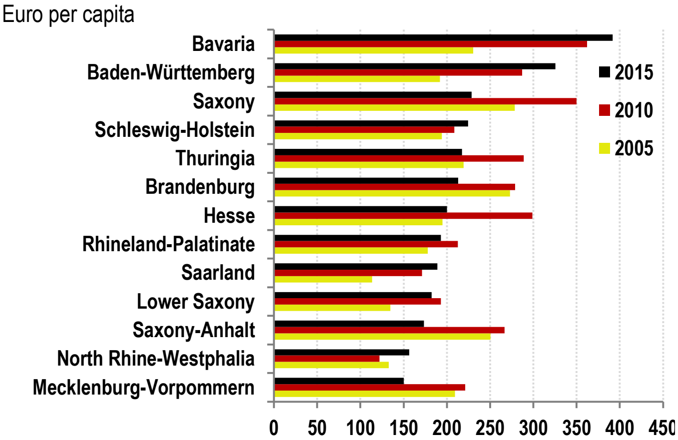

Chart 5 Sources: Destatis and BNP Paribas