Germany Must Invest More in Its Future

by Stefan Bach, Guido Baldi, Kerstin Bernoth, Jürgen Blazejczak, Björn Bremer, Jochen Diekmann, Dietmar Edler, Beatrice Farkas, Ferdinand Fichtner, Marcel Fratzscher, Martin Gornig, Claudia Kemfert, Uwe Kunert, Heike Link, Karsten Neuhoff, Wolf-Peter-Schill, and C. Katharina Spieß

Shortly before the parliamentary election in 2013, Germany is riding on a wave of euphoria: hardly any other euro country has weathered the financial and debt crisis so well. Since 2009, GDP has grown by over eight percent and 1.2 million new jobs have been created. Public finances were consolidated and, in 2012, there was a fiscal surplus of 0.2 percent of GDP. An impressive financial position indeed for a country that, only ten years ago, was considered the "sick man of Europe." But it is also a deceptive one. If one substitutes these for other comparative figures, then this image is seriously tarnished. Since 1999, Germany has achieved lower economic growth than the rest of the euro area. Real wages have barely increased since 1999 and real consumer spending has grown much more in the euro area on average than in Germany. In addition, German net public assets have contracted significantly. In 1999, net state assets were about 20 percent of GDP and, by 2011, they had declined to 0.5 percent of GDP and are, therefore, no longer available for future generations. In many areas, Germany has not really progressed at all and in some areas it has fallen significantly behind other countries. These arrears have not been balanced out by recent positive developments.

Overall, Germany has missed significant opportunities for growth. Not only is the Federal Republic of Germany one of the world's biggest exporters, but it is also one of the best savers in the world. Hardly any developed country has such a high savings rate as Germany. A considerable part of these savings were not invested in Germany, but abroad. However, these foreign investments did not bring the returns investors had hoped for. Since 1999, German investors have lost about 400 billion euros through bad investments abroad, about 15 percent of GDP. From 2006 to 2012, this figure was as high as 600 billion euros—or 22 percent of gross domestic product.

The money lost abroad was not, therefore, available for domestic investment. The German rate of investment is low by international standards, and it continues to drop. In 1999, it represented about 20 percent of GDP and it is currently at just over 17 percent. Even countries with difficult economic environments at present, such as France and Italy, invest more in their own countries. Since Germany places due to its specialization in research-intensive industries and knowledge-intensive services comparatively high demands on its production environment in terms of human capital, resource conservation, and mobility, it should, therefore, invest significantly more than other countries so as to be able to ensure healthy growth and increase income in the long term.

Since 1999, Germany has had an investment gap of three percent of GDP compared with the average in the euro area (not including Germany). Cumulatively, this corresponds to roughly one trillion euros since 1999—over 40 percent of current GDP. Had the rate of investment corresponded approximately to the euro area average, GDP per capita would have grown by almost one percent more each year.

A large portion of total investment is financed by firms and private households. If they were to divert only a portion of their investment and invest it profitably in Germany, instead of losing it abroad as in the past, much would be gained—also for the investors. Investment in Germany in the first decade of this century proved extremely profitable. The government must provide another portion of total investment and it has scope to do so, despite the debt brake. Last year—with weak economic growth—only a small surplus was achieved initially. By 2017, the annual surplus will rise to around 28 billion euros. At the same time, financing costs for the German government are currently lower than ever. This provides flexibility without necessarily the need to discuss the revenue or expenditure side.

The main question is how private investment activity in Germany can be increased and the investment gap bridged in the medium term. The response to the significant losses recorded in foreign investment in recent years will play a role here. Private investors will adjust their investment strategies and investing in Germany should become more appealing. Furthermore, increased public investment in areas such as education and transport infrastructure will improve domestic production conditions. The increased attractiveness of Germany as an investment location will then act as a driver for private investment. In addition, the implementation of the energy policy will also provide significant impetus to private investment activities.

Both the government and employees stand to benefit from the "returns" on these additional investments. According to our estimates, bridging the investment gap could lead to significantly higher economic growth in the medium term. In 2017, potential growth would be 0.6 percentage points higher than it would be in a scenario of persistently low investment activity. Instead of potential growth of about one percent, it would be 1.6 percent. This would not only help to reduce the national debt but also allow greater labor productivity and stronger wage growth.

Researchers at DIW Berlin are interested in highlighting the urgency of the issue and the investment opportunities in Germany, and, for instance, to name three investment areas where additional investment would be particularly fruitful: energy, transport infrastructure, and education. The present study does not claim to outline a detailed investment plan to comprehensively analyze all areas with investment opportunities or to take away investment decisions from individual stakeholders.

The implementation of the energy transition will require significant investment in facilities for the use of renewable energies in the power and heat sectors and in infrastructure, particularly in power grids. In addition, substantial investments are needed to improve energy efficiency, for example, by insulating buildings. Without this form of investment, the objectives of the energy policy are not achievable. We take the implementation of the energy policy in accordance with the German government's plans as given and simply intend to show what opportunities it offers. Our model estimations show that reorganizing energy supply could have a permanently positive effect on added value in Germany. However, the basis for these types of investment, which must be predominantly privately financed, are stable framework conditions in all these areas.

Maintaining a quantitatively and qualitatively efficient transport infrastructure is a fundamental prerequisite for economic success and prosperity in Germany. However, in recent years, substantial investment in the maintenance and quality of transport infrastructure has been neglected. In road maintenance alone, calculations in our brief expert report show that an annual investment gap of almost four billion euros has opened up in the past few years. Assuming that at least this investment gap is required for maintaining the transport infrastructure in coming years, and if the cumulative result of years of neglect is also taken into account, the additional annual investment required will be at least 6.5 billion euros, money which will have to come mainly from public finances. In addition, there is also investment need in vehicles and selective network and capacity expansion that is difficult to estimate.

According to national accounting spending on education does not fall in the category of investment, but in the category of government consumption expenditure. Nevertheless, from an economical perspective the education sector can be seen as one of the most important areas of investment. It is a key factor for the future of modern economies. Investment in this area pays dividends, particularly to the overall economy. With education spending at around 5.3 percent of GDP, Germany is below the EU-21 average and also below the OECD-33 average of 6.2 percent. Germany has a particularly large investment gap in early childhood education where prospective returns on education are especially high.

It is a matter of urgency that Germany deals with this lack of investment and closes the investment gap. It is essential for Germany to pave the way for this now since it takes time for investments to bear fruit. In addition, Germany and especially Europe are still in crisis, and in a very weak position economically. Increased public and private investment today would not only fuel Germany's economic growth but also provide a significant impetus for growth in Europe as a whole. At present, this would be the most effective way for Germany to help its neighbors. Moreover, the investment gap should be tackled now since the German government, and also businesses and private households, have never been so economical to finance as they are today. In the long term, such a strategy is, therefore, not only fiscally possible but also beneficial to a sustained course of fiscal consolidation.

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DIW Berlin—Deutsches Institut
für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
T +49 30 897 89 -0
F +49 30 897 89 -200

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