Unblocking the bottlenecks: infrastructure investment to foster the recovery in Germany

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The German economy faces a difficult winter as the second wave of the COVID-19 pandemic restricts activity. With vaccines offering a glimmer of hope on the horizon, policy decisions now will be important for the pace and sustainability of the recovery.

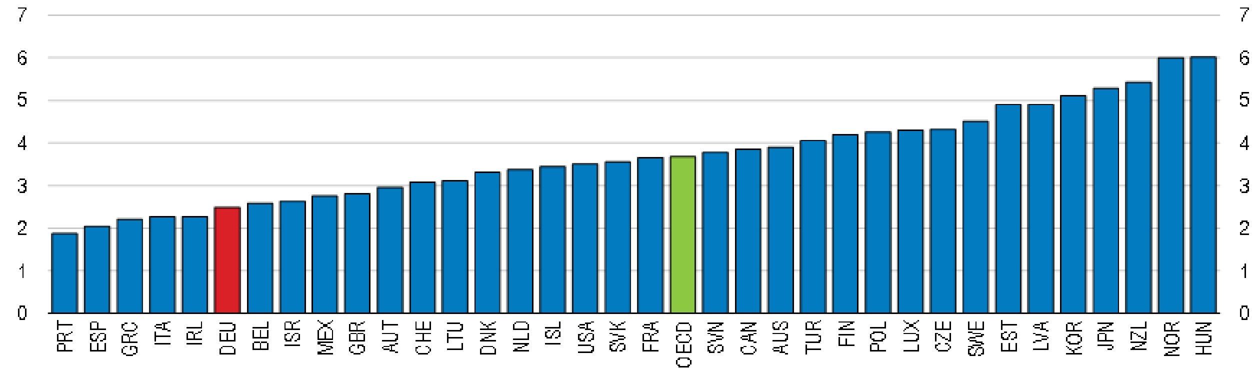
Germany managed the initial stages of the COVID-19 crisis well, as high health sector capacity and early testing, tracing and isolation of cases helped bring the initial virus outbreak under control with less stringent containment measures than in many neighbouring countries. A strong government response protected jobs and firms, using fiscal space from prudent budgeting before the crisis. Nevertheless, the German economy is experiencing a severe contraction. In 2020, GDP will decline by 5½ per cent. A rapid recovery during the summer shows the potential of the economy to rebound, but the rebound has come to a halt with the second wave of the virus.

The newly launched 2020 OECD Economic Survey of Germany argues that to aid recovery, fiscal support should be withdrawn only gradually, labour market inclusion promoted and barriers to infrastructure investment reduced while improving infrastructure governance. Greater investment would accelerate the transition to greener energy and transport, the expansion of early childhood education and all-day schooling, as well as the improvement of communication networks needed to accelerate digital transformation.

Weak public investment is not a new challenge. Public investment as a share of GDP in Germany has been among the weakest in OECD countries (Figure 1) since the mid-1990s. While public investment has picked up since 2014, municipal investment remains insufficient to cover depreciation. Net municipal capital stock has declined by some EUR 80 billion since 2003 (Figure 2), contributing to a backlog estimated at EUR 147 billion, concentrated in transport and schools.

Figure 1: Public investment is low

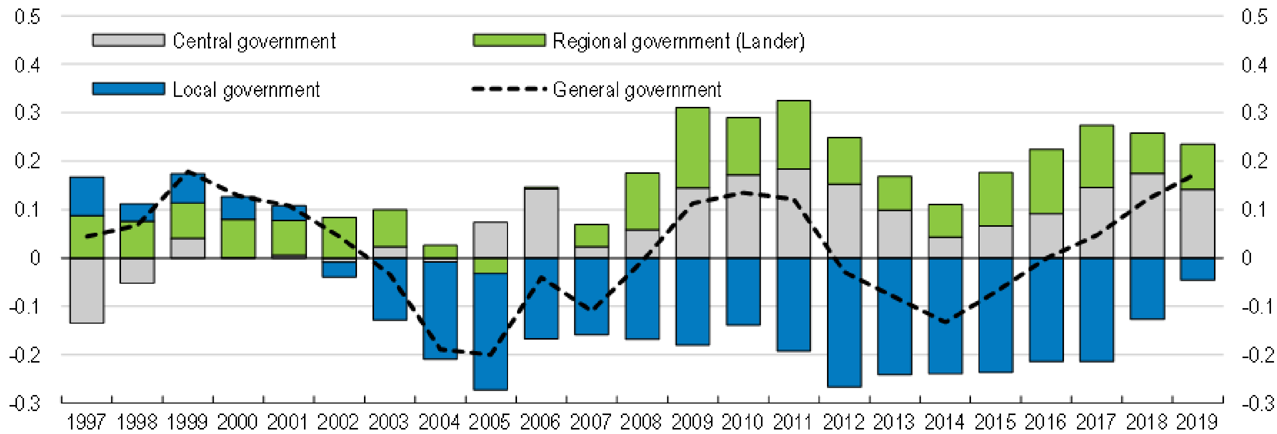
General government investment, % of GDP, 2019 or latest available year



Source: OECD Economic Outlook database.

Figure 2: Public investment has picked up, even though net municipal investment is still negative

Net public investment[1] by level of government, % of GDP



1. Public gross fixed capital formation less depreciation.

Source: OECD National Accounts database.

Nevertheless, the next couple of years may look different. The recent pickup in public investment is set to continue, owing to the recovery package and the increase in funding for public transport infrastructure. The main challenge is to make sure the new fiscal capacity is dedicated to well-directed public investment, including increased transfers to municipalities, while resolving local planning and construction industry capacity constraints. The COVID-19 crisis may create spare capacity in some parts of the economy, but a reduction in migrant flows could exacerbate shortages of construction workers. Germany should investigate opportunities to increase flexibility through reducing the stringency of occupational licensing and facilitating use of foreign labour in key construction occupations. Capacity constraints also exist in local planning agencies. Resolution requires active support from central government, clear allocation of responsibility for technical assistance and long-term commitment of all levels of government. Among EU municipalities reporting under-provision of infrastructure, Germany has the highest proportion citing technical capacity as a major obstacle. Cooperation between local governments, as is the case in New Zealand and Switzerland, would help pool capacity, develop specialisation, increase consistency and efficiency, and share learning.

Further reading:

OECD (2020), OECD Economic Surveys: Germany 2020, OECD Publishing, Paris, https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-germany-2020_91973c69-en