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Halle Institute for Economic Research
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The medium-term economic development in Germany from 2017 to 2022 and opportunities for fiscal policies of a new federal government

Due to the cyclical upswing in Germany, in case of unaltered legislation, the general government would achieve considerable budget surpluses in the years ahead. As a consequence, there is large fiscal scope for a new federal government. With the fiscal policy simulation model of the Halle Institute for Economic Research (IWH) – Member of the Leibniz Association, the macroeconomic effects of various fiscal policy measures are analysed. The results show that additional government expenditures, like the expansion of social benefits, do have a stronger effect on GDP than revenue cuts, like for instance tax reliefs. „Due to the already high capacity utilisation, revenue cuts seem to be advantageous from a business cycle perspective. Moreover, a reduction of the high taxes and charges on labour would, in contrast to an expansion of social benefits, have a positive effect on potential output“, says Oliver Holtemöller, head of the Department of Macroeconomics and IWH vice president.

Table 1:
Government net lending/borrowing and output gap, 2017 to 2022

	2017	2018	2019	2020	2021	2022
general government overall balance (Bln. Euro)	44,4	43,5	46,9	48,7	46,4	44,2
general government overall balance, in % of nominal GDP	1,4	1,3	1,3	1,3	1,2	1,1
output gap in % of potential output	0,2	0,7	0,7	0,6	0,2	0,0
structural budget balance, in % of nominal GDP	1,5	0,9	0,9	1,0	1,1	1,1

Sources: Federal Statistical Office; calculations and forecasts of IWH.

The German economy is in a strong cyclical upswing.* The cyclical position contributes to a surplus in the balance of the general government that is likely to rise to almost 45 billion euros in 2017. If laws stayed as they are and the fiscal stance were, from 2019 onward, neutral, this surplus would as well be more or less constant in the coming years (see Table 1). The structural balance, i.e. the balance that is cyclically and for one-off effects adjusted, would, starting from about 30 billion euros in 2018, increase even further.

This gives a future government considerable scope for lowering revenues or expanding spending. Using the IWH model for simulating effects of fiscal policy, we simulate three scenarios: one with a programme that lowers revenues, one with a

* See IWH Press Release39/2017 „Cyclical upswing in Germany and in the world“ of December 14, 2017.

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spending programme, and a third that is a combination of the former two programmes (see Table 2).

Since coming to a political decision about such a bunch of policy measures and thereafter implementing them will take some time, the fiscal stimuli are assumed to be quite limited in 2019. In 2022, however, they are as high as 33 or 34 billion euros. The simulations show that additional GDP is higher if caused by the spending programme than in the case of lower revenues (see Table 3).

Thus in the present cyclical situation a revenue programme is more appealing since its pro-cyclical effects are smaller than those of a spending programme. A further aspect in favour of a revenue programme is that the share of general government revenues in GDP has increased in recent time. Reversing this trend makes sense. Lowering the tax- and social security-burden on labour could raise potential output and contribute to stabilising the financial position of the state in the long run, preserving its fiscal scope for future times.

Table 2:
Fiscal measures
Revenue shortfalls/additional expenditures vis-à-vis 2018, Bln. Euro

	2019	2020	2021	2022
			scenario 1	
revenue-related measures:				
abolition of the solidarity surcharge (‚Solidaritätszuschlag')		10,2	15,9	22,1
reduction of contribution rate to unemployment insurance	3,3	3,4	3,5	3,6
increase of child and basic tax-free allowance in personal income tax	1,9	3,9	6	8,1
sum	5,2	17,5	25,4	33,8
sum (accumulated)	5,2	22,7	48,1	81,9
			scenario 2	
expenditure-related measures:				
increase of child and basic tax-free allowance in personal income tax	1,9	3,9	6	8,1
additional investment measures	2	8	9	12
extension of monetary social benefits	5	8	12	13
sum	8,9	19,9	27,0	33,1
sum (accumulated)	8,9	28,8	55,8	88,9
			scenario 3	
mixture of revenue- and expenditure-related measures:				
additional investment measures	2	8	9	12
increase of child and basic tax-free allowance in personal income tax	1,9	3,9	6	8,1
reduction of contribution rate to unemployment insurance	3,3	3,4	3,5	3,6
extension of monetary social benefits	1,7	4,6	8,5	9,4
sum	8,9	19,9	27,0	33,1
sum (accumulated)	8,9	28,8	55,8	88,9

Source: calculations and forecasts of IWH.

Table 3:
Effects of fiscal measures according to the IWH model for fiscal policy simulations

	2019	2020	2021	2022
			scenario 1	
revenue-related scenario (scenario 1):				
Gross Domestic Product[a]	4,2	13,4	17,0	19,7
Gross Domestic Product (accumulated)[a]	4,2	17,6	34,7	54,3
total hours worked[b]	0,1	0,3	0,3	0,3
output gap[c]	0,1	0,4	0,5	0,6
GDP deflator[b]	0,1	0,2	0,3	0,4
general government overall balance[d]	44,1	40,2	34,8	27,7
general government overall balance, in % of GDP[e]	1,5	1,3	1,1	0,9
structural budget balance, in % of GDP[e]	0,9	0,6	0,6	0,5
			scenario 2	
expenditure-related scenario (scenario 2):				
Gross Domestic Product[a]	6,4	17,0	23,4	31,2
Gross Domestic Product (accumulated)[a]	6,4	23,4	46,9	78,0
total hours worked[b]	0,2	0,3	0,3	0,3
output gap[c]	0,2	0,6	0,8	1,1
GDP deflator[b]	0,1	0,1	0,1	0,1
general government overall balance[d]	42,4	40,9	36,5	32,9
general government overall balance, in % of GDP[e]	1,4	1,3	1,2	1,0
structural budget balance, in % of GDP[e]	0,8	0,5	0,5	0,3
			scenario 3	
mix scenario (scenario 3):				
Gross Domestic Product[a]	7,0	16,9	22,6	29,9
Gross Domestic Product (accumulated)[a]	7,0	23,9	46,5	76,4
total hours worked[b]	0,2	0,3	0,3	0,3
output gap[c]	0,3	0,6	0,8	1,1
GDP deflator[b]	0,1	0,1	0,1	0,2
general government overall balance[d]	42,5	40,9	36,1	32,2
general government overall balance, in % of GDP[e]	1,4	1,3	1,1	1,0
structural budget balance, in % of GDP[e]	0,8	0,5	0,5	0,3

[a] Deviation form baseline-scenario, bln. Euro, price-adjusted. – [b] Deviation form baseline-scenario in %. – [c] In % of potential output. – [d] Bln. Euro. – [e] in %.
Source: calculations and forecasts of IWH.

Long Version:

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The Halle Institute for Economic Research (IWH) – Member of the Leibniz Association was founded in 1992. With its three research departments – Macroeconomics. Financial Markets. and Structural Change –,IWH conducts economic research and provides economic policy recommendations. which are founded on evidence-based research. With the IWH's guiding theme "From Transition to European Integration". the institute's research concentrates on the determinants of economic growth processes with a focus on efficient capital allocation in a national and European context. Particular areas of interest for the institute are macroeconomic dynamics and stability. microeconomic innovation processes. productivity and labour markets. the dynamics of structural adjustment processes. financial stability and growth and the role of financial markets for the real economy.

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