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Investment, output gap, and public finances in the medium term: Implications of the Second Supplementary Budget 2021

With the Second Supplementary Budget 2021, the German government plans to allocate a reserve of 60 billion euros to the Energy and Climate Fund. This additional spending is also meant to reduce the macroeconomic follow-up costs of the pandemic. According to the IWH's medium-term projection, the expenditure is expected to increase output by about 0.5% at the peak of its impact in 2024. "While this macroeconomic effect is welcome, the additional investment will by no means compensate for the lack of investment activity since the beginning of the pandemic," says Oliver Holtemöller, head of the Department Macroeconomics and vice president at Halle Institute for Economic Research (IWH). Moreover, the supplementary budget is likely to reduce confidence in the reliability of the debt brake.

The supplementary budget gives fiscal policy additional leeway for the years in which the debt brake takes effect again. This is because the allocation will be booked as deficit-increasing government expenditure in 2021 when the debt brake is still suspended, but not in later years when the money will actually be spent. In order to estimate the pandemic-related macroeconomic losses to be expected in the medium term, the IWH's current medium-term projection from December 2021 can be compared with the IWH projection from the end of 2019, i. e. before the outbreak of the pandemic. The current projection includes a slightly positive output gap for the years 2023 and 2024, mainly due to catch-up effects in private consumption. However, potential output in the coming years is more than 1.5% below the value projected by the IWH at the end of 2019, mainly due to lower labour supply, partly because of significantly lower immigration. In addition, according to the current projection, fixed capital formation in the coming years is significantly lower than expected in 2019.

The extent to which the supplementary budget might help make up for these shortfalls can be estimated using the IWH's fiscal policy simulation model. According to the simulation, the additional expenditure triggered by the supplementary budget, when its effectiveness is at its peak in 2024, causes overall economic activity to be about 0.5% higher than in the baseline scenario. To roughly the same extent, the additional expenditure leads to an expansion of private investment activity. The expected effects are thus rather small, and the total economic capital stock remains permanently smaller than projected before the pandemic. This has a lasting negative impact on potential output. The impact is, however, much smaller than the negative labour market effects mentioned above.

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From a macroeconomic perspective, credit-financed measures to increase public and private investment thus seem justifiable. They could strengthen potential output to some extent, especially since the decarbonisation of the economy is likely to weaken potential output, as it is associated with write-offs of parts of the existing capital stock. It should be taken into account, however, that allocating credit authorisations into a subsidiary budget probably contradicts the intentions of the German debt brake, and its conformity with the constitution is therefore disputed. "Ultimately, policy has to weigh the positive macroeconomic effects of additional investment against the negative effects on the credibility of the debt brake," says Oliver Holtemöller.

Long version (in German)

Andrej Drygalla, Katja Heinisch, Oliver Holtemöller, Axel Lindner, Götz Zeddies: Investitionen, Auslastungsgrad und Öffentliche Finanzen in der mittleren Frist: Implikationen des Zweiten Nachtragshaushalts 2021, in: IWH, Konjunktur aktuell, Jg. 9 (4), 2021, 141–148. Halle (Saale) 2021.

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