Financing Investment in Times of High Public Debt

2023 European Public Investment Outlook

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3. Germany Lacks Political Will to Finance Needed Public-Investment Boost

Katja Rietzler, Andrew Watt, and Ekaterina Juergens

After more than a decade of weak public investment, Germany has accumulated a substantial public-investment backlog. The requirements for additional public investment in the next decade are in the range of €600 to 800bn, implying a further commitment of 1.6 to 2.1% of GDP each year. The federal government had made provisions for much smaller programmes, evading the debt brake. After the federal constitutional court ruled that shifting € 60 bn to an off-budget fund is unconstitutional, even this is now under threat. The court ruling casts doubt over similar operations at the federal and state levels, and comes when fiscal policy was already tightening under the pressure of the reapplied debt brake and rising interest rates. As this publication goes to press Germany is engaged in a fierce debate how to resolve the budget crisis.

3.1 Situation and Recent Developments

After more than a decade of weak public investment, Germany has accumulated a substantial public-investment backlog, particularly at the local-government level. Investment needs, which range from roads and school buildings to the digitalisation of public administration, were already estimated in 2019 at €457bn over a ten-year horizon (Bardt et al. 2020). With the recently enhanced climate goals of the EU and the German government, additional investment needs in the health sector, as well as higher prices, the requirements for additional public investment and investment promotion in the next decade are more likely in the range of €600 to 800bn, which would imply a further annual commitment of 1.6 to 2.1% of GDP (Dullien et al. 2022; Rietzler and Watt 2022).[1] Whereas infrastructure investment should be raised substantially and smoothed—to avoid the problem of intermittency and procyclicality—over the

1 The estimate was based on 2022 GDP.

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long-term, investment to reduce greenhouse-gas emissions needs to be frontloaded, as the remaining carbon budget is shrinking rapidly. Investment to decarbonise the economy is mainly required in the private sector (in particular, production, transport, and heating), but the government plays a vital part in providing incentives for the private sector via investment grants in addition to carbon pricing and regulation. Furthermore, the government sector must decarbonise its own facilities, which amount to about 176.000 units at the local-government level alone (BMWi 2018). The current federal government is well aware of the requirements, having promised 'a decade of investment' in its coalition agreement (Rietzler and Watt 2022). Thus, one would expect a sustained and sizable increase in investment spending.

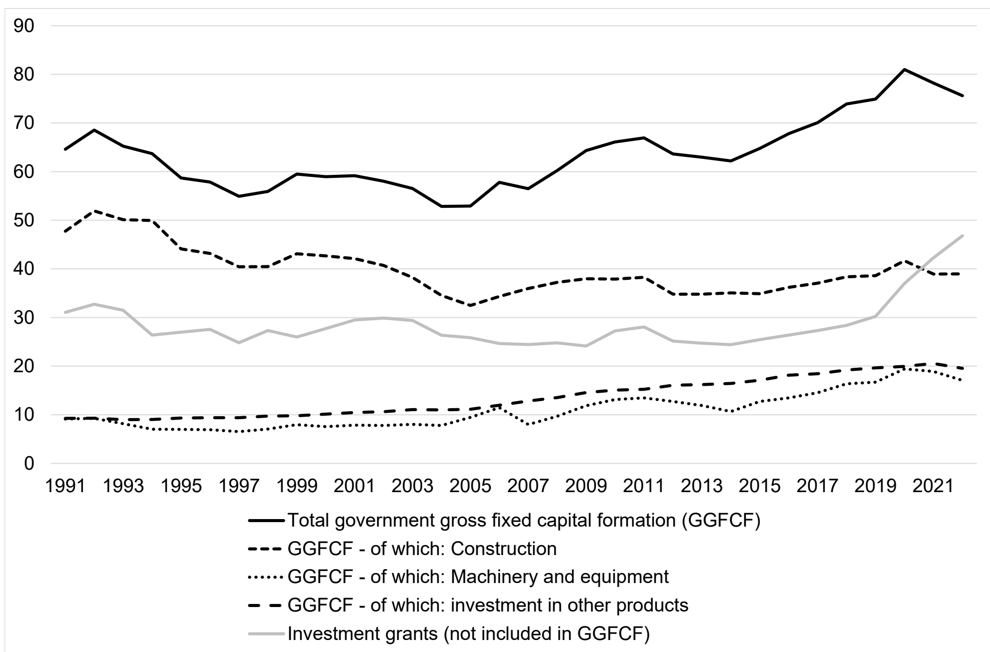

Fig. 3.1 Government Investment (GGFCF and its Components) and Investment Grants.
Note: in €bn, price adjusted, reference year 2015.
Source: Destatis, calculations of the IMK.

So far, the required massive additional public investment is nowhere to be seen in the data. Figure 3.1 shows that, after a strong increase in 2020 that was partly induced by the pandemic response, real government gross fixed-capital formation (GGFCF) declined again in the following two years. Investment in machinery and equipment, in construction, and in other products all dwindled. In early 2023, these trends showed little sign of reversing. In the first half of 2023, overall government investment declined by 2.7% compared to the second half of 2022, masking a strong decline of investment in machinery and equipment but somewhat stronger investment in construction compared to the previous half year; this was mainly at the municipal and state level,

while federal-construction investment declined strongly even in nominal terms. Thus, part of the catch-up process since 2015 has been reversed.

Particularly in construction, double-digit price increases prevented nominal growth rates of a magnitude not seen since the German-reunification boom from translating into higher investment in real terms. In 2022, both nominal government construction investment and the respective deflator increased by 16%, leading to mere stagnation in real terms. In the first half of 2023, price increases for government-construction investment slowed somewhat. Municipalities, which accounted for 59% of the overall public-construction investment (almost three times the amount spent by the federal level), still report that their actual investment spending—85% of which is construction (cf. Figure 3.2)—regularly remains below what they had planned to spend. Municipalities face staff shortages in their administration and complain about capacity constraints in the construction industry (Raffer and Scheller 2023), both of which delay the roll-out of projects.

Unlike public investment itself, government investment grants to the private sector have increased massively since 2019 both in nominal and in real terms.[2] Here too, the expansion in real terms has recently been slowed by strong price increases.

3.2 What Does the German Population Expect? Results from an IMK Survey

Against the background of the accumulated-investment gaps, the adequacy of infrastructure has become a major barrier to economic activity in Germany—and Europe more generally—as firms report in surveys (European Investment Bank 2023, p. 69). Two other main barriers to private investment being voiced by managers are high energy costs and perceived uncertainty about the future (ibid.). These latter concerns could be at least partly alleviated, however, by improving the investment activity of the state. For instance, a more extensive public-goods provision in the renewable energy sector and the greater reliability of government investment spending could reduce uncertainty for private enterprises.

2 The deflator of private gross fixed-capital formation is used for price adjustment.

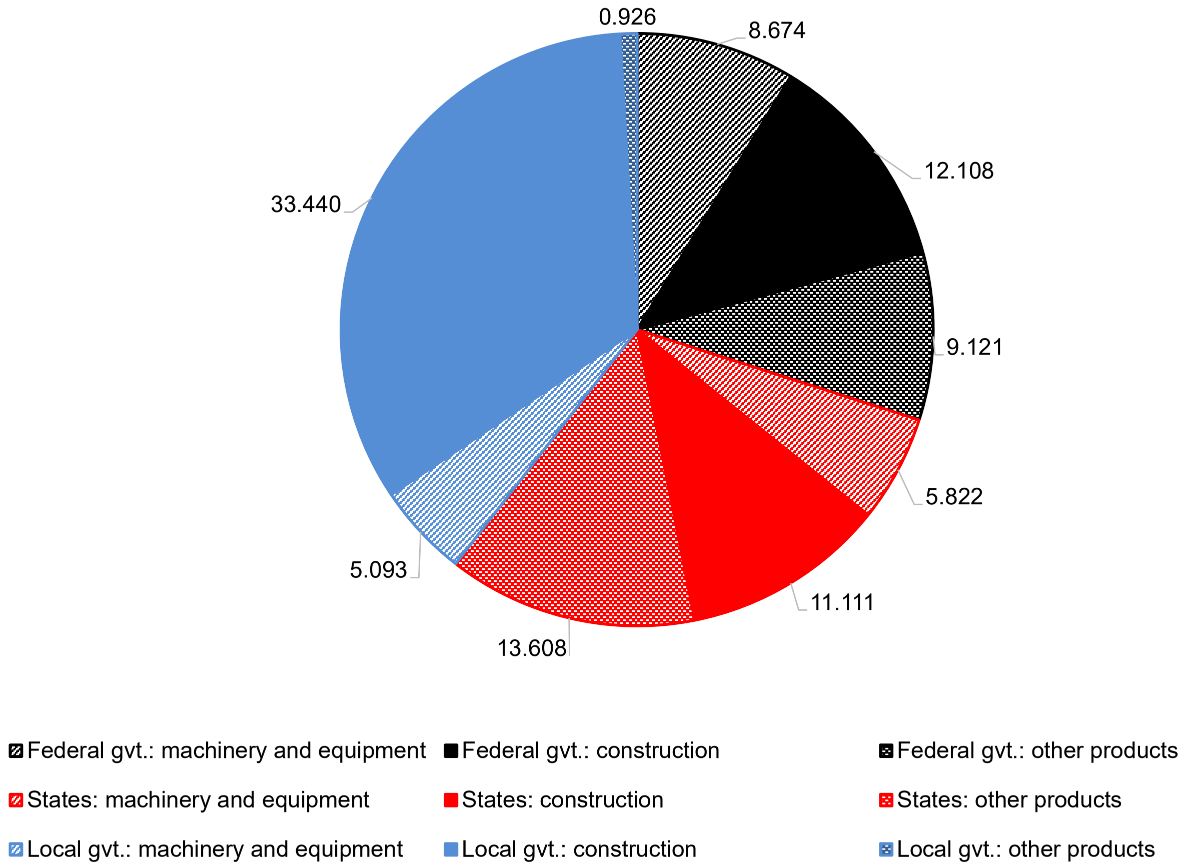

Fig. 3.2 Nominal Gross Fixed Capital Formation of Government Subsectors in 2022, on Federal, State, and Local Levels, in €bn.
Source: Destatis, excluding social security, which accounted for only €0.9bn or 0.8% of the GGFCF.

It is not only business leaders, however, who are concerned. A recent nationwide survey shows that German citizens and residents—whose votes ultimately determine the funding available for public-investment and spending priorities—are also discontented with the deterioration of public infrastructure and would prefer stronger public investment activity (Behringer et al. 2021; Henze et al. 2022). The survey examined public satisfaction with public infrastructure in various categories (see Figure 3.3) and attitudes towards government-investment activity in the run-up to the 2021 German federal election. The data was collected as a computer-assisted online survey, and the total dataset encompassed 8,483 individuals aged between 18 and 75, selected representatively according to main sociodemographic and geographic characteristics, such as gender, age, income, and federal state. The results of the survey reveal that, across all investment categories, the overall satisfaction with infrastructure is rather low and the desire for more government investment is strong in Germany.

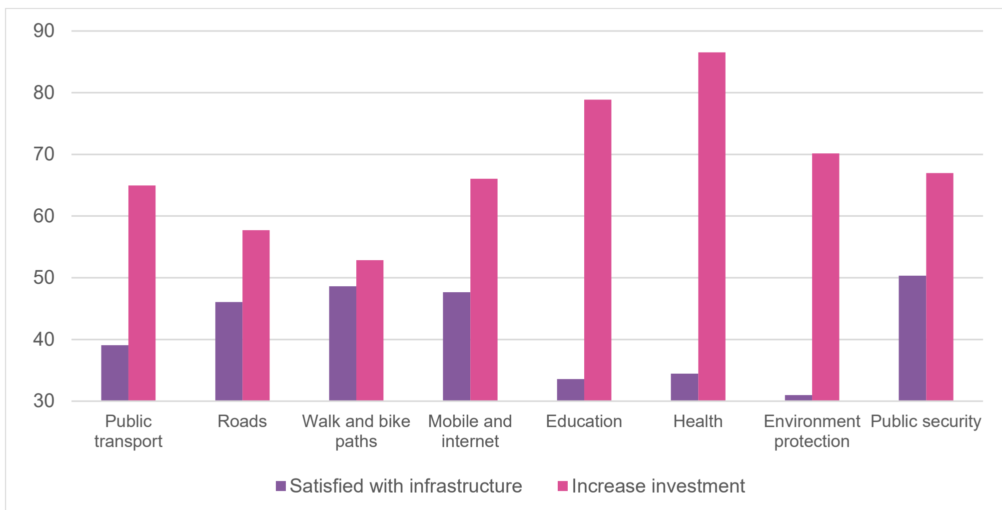

Fig. 3.3 Satisfaction with Public Infrastructure and Desire for More Investment, in % of Total Respondents.
Note: Respondents shown were 'somewhat satisfied' or 'very much satisfied' with public infrastructure, and their desire was that investment would 'increase somewhat' or 'increase substantially'.
Source: Henze et al. (2022).

As Figure 3.3 shows, satisfaction with the state of public infrastructure is low on average, being lowest for categories such as climate protection (31%) as well as education and health (34%). Accordingly, about 68% of surveyed individuals are generally in favour of an increase in government investment. The respondents see the greatest need for investment by far in the areas of health (87%) and education (79%), which is consistent with their dissatisfaction with the state of infrastructure. Since the survey was conducted during the COVID-19 crisis, these responses reflect the detrimental consequences of curbing investment in the health-care system that was

vividly exposed by the pandemic. In addition, environmental protection is seen as an important area by more than two thirds of those surveyed.

Notably, the majority of respondents prefer an increase in public investment in almost all German federal states. In some of these, more than 70% see a need for additional investment (North Rhine-Westphalia, Schleswig-Holstein, Rhineland-Palatinate, and Berlin). Some significant differences in responses from urban and rural areas as well as from East and West Germany, however, are worth mentioning.

Firstly, residents of cities report a much higher satisfaction with public transport (48%) than those of rural areas (31%). Analogously, the urban population is much more content with internet and mobile networks (52% versus 44%). The quality of infrastructure in these categories is, of course, much higher in metropolitan areas than in the countryside. It is nevertheless striking that a relatively low satisfaction in rural areas does not translate into a proportionally higher demand for investment in public transport and digital infrastructure. This stands in stark contrast to, for example, health care, which shows an expected correlation between lower satisfaction and higher-investment desire in the countryside.

This interpretation does not imply that public-transport and digital-infrastructure issues are negligible in rural areas: there, a broad majority is in favour of more investment, too. However, while rural respondents seem to be more willing to accept cutbacks in public transportation, they report a higher interest in increased infrastructure investment benefitting private vehicles, such as roads and bridges (60% in the rural areas versus 56% in the cities. The difference is statistically significant). These patterns suggest self-selection between urban and rural areas and 'lock-in effects'. Residents of smaller towns must rely largely on cars for transportation. Since they don't use public transport, they do not express such an interest in investing in a better network, perpetuating the current situation, even though they are dissatisfied with it. The same phenomenon can be noticed in the case of bicycle infrastructure. Only 53% of all respondents expressed their preference for higher investment in this category, mirroring a still very low volume of traffic by bicycle in Germany. Accordingly, the need for the state to take an active role in providing alternatives becomes even more relevant: the green transition does not emerge by itself but builds on the systems already in place, and existing infrastructure shapes not only the current behaviour but also people's expectations of possible solutions and their plans.

Secondly, the biggest difference between East and West Germany is in the desire for more investment in environmental protection. While 73% of surveyed individuals voiced their preference for more investment in climate protection in West Germany, only 60% of respondents—still a majority—shared these demands in the East. The difference in responses of residents of East and West Germany does not reflect a lower objective need for environmental protection in the East. Rather, these are differences in the perceived urgency of climate issues in comparison to other economic and social concerns between the two groups.

Importantly, the respondents were asked how the additional public investment should be financed. This is necessary in order to elicit comprehensive preferences on public finance. Upon being confronted with the question of how to pay for the increase in public investment, about 6% of all survey participants who voiced a preference for this increase withdrew their request, and a further 7% of respondents could not answer the question. On the other hand, 17% specified that they would prefer the investment to be debt-financed; 62% (the majority) indicated that they would prefer other expenditures to be reduced; last but not least, 8% of the respondents were in favour of a tax increase to finance the additional public investment.

3.3 Financing Government Investment Spending

3.3.1 General Overview

Germany faces various challenges in overcoming its huge investment backlog and implementing the necessary investments for the economic transformation. Until the surprise constitutional court ruling on 15 November 2023, funding did not seem to be the critical issue. Staff shortages, both in relevant economic sectors and in public-sector administration, play a prominent role; and spending often remains substantially below plan (Raffer and Scheller 2023; Rietzler and Watt 2022). According to extrapolated survey data from the Research Institute of the Federal Employment Agency (IAB 2023), there were almost 1.7 million vacancies in the second quarter of 2023. This is an exceptionally high number by historical standards despite a decline compared to the fourth quarter of 2022. The ratio of registered unemployed persons to the estimated total vacancies was 1:1.5. In the second quarter of 2022, vacancies in construction were estimated to be above 162,000 and in public administration (including social insurance) nearly 30,000.

Despite two major crises, massive fiscal stimulus, and high deficits in some years; German public finances are in relatively good shape. The debt-to-GDP ratio of 66.1% at the end of 2022 is substantially below the euro-area average and has risen by much less than in the financial crisis. Employment is at a record level, and most forecasters, including the IMK (Dullien et al. 2023), expect declining deficits as the energy crisis is overcome and the spending on the ‘electricity-price brake’ and the ‘gas-price brake’ remains far below plan as gas prices have returned to pre-war levels (Figure 3.4).

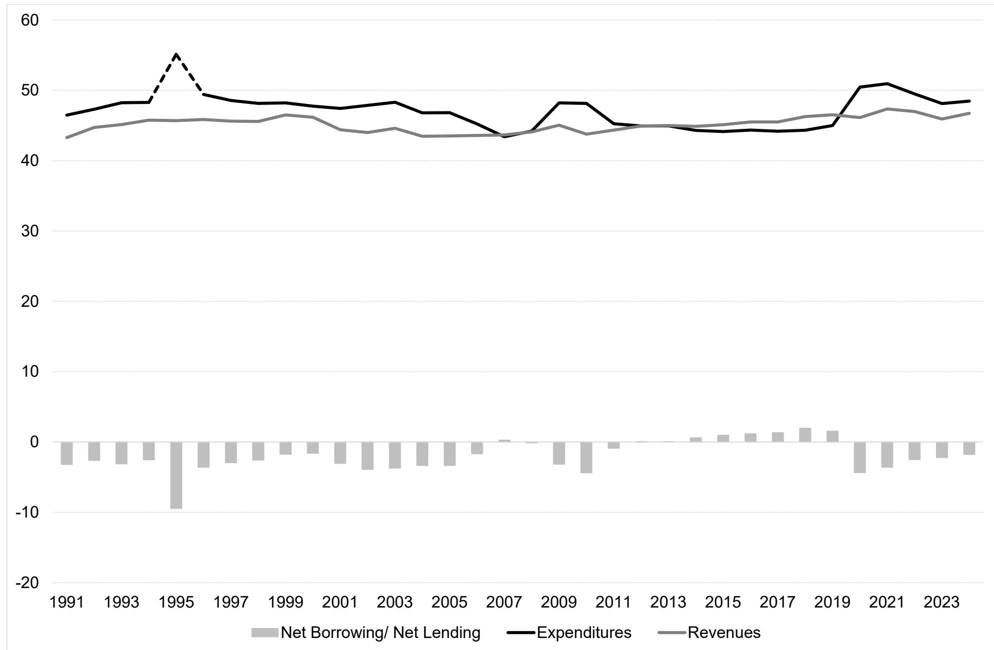

Fig. 3.4 General Government Revenues, Expenditures, and Net Borrowing/Net Lending, as % of GDP.
Source: Destatis, IMK forecast for 2023 and 2024.

Nevertheless, fiscal pressure was rising already before the court ruling. Recent income-tax cuts on top of extensive temporary measures to support household incomes in the energy crisis are causing permanent revenue losses. Unlike in the period before the pandemic, public finances no longer benefit from the tailwinds of declining interest rates that created additional fiscal space from year to year. On the contrary, interest spending has been rising since its nadir in 2021 and is now squeezing the fiscal room for manoeuvre. Its effect, in the case of the federal government, is exacerbated by booking discounts of new bond emissions immediately instead of spreading them over the term of the securities (Deutsche Bundesbank 2021). In this environment, the focus of fiscal policy is now clearly on consolidation. The German finance minister has announced his intention to restructure expenditures away from consumption and social spending towards more investment (BMF 2023a). While there is always scope for some efficiency gains, it is doubtful that double-digit billions of euros can be made available with this approach.

Against this general background, the financing options differ widely between government subsectors. These are now analysed in greater detail.

3.3.2 Fiscal Situation of the Federal Government

The debt-brake limits net new debt to 0.35% of GDP.[3] In addition, it allows for a cyclical component estimated according to the European Commission's production-function approach. Financial transactions, such as the purchase of shares in businesses or extended loans, are excluded. After a suspension for three years in the wake of the COVID-19 crisis, the debt brake was put back in force in 2023, one year earlier than the European fiscal rules. Due to a negative cyclical component of €15.3bn and financial transactions of €17.7bn, in addition to the permitted structural new debt of €12.6bn,[4] the federal government can take on new (net) debt amounting to €45.6bn in 2023, according to the budget plan. At €86.4bn, the planned deficit is almost twice as high. This is possible because €40.5bn of the €48.2bn in reserves accumulated before the pandemic are to be used (see Table 3.1).

Table 3.1 New Debt Permissions Under the Debt Brake and Planned Deficit in 2023

	Initial budget plan 2023
Permitted structural new debt	€12.61bn
Debt permitted due to negative cyclical component	€15.34bn
Balance of financial transactions	€17.67bn
Total permitted new debt	€45.62bn (1.1 % of GDP)
Planned fiscal deficit	€86.37bn
Deficit exceeding permitted new debt	€40.75bn
Use of reserves accumulated before the pandemic (Total: €48.2bn)	€40.50bn
Emission of coins	€0.25bn

Source: Haushaltsgesetz 2023, calculation in % of GDP based on IMK forecast (Dullien et al. 2023).

As a first reaction to the court ruling the federal government has decided to invoke the escape clause retroactively for 2023. An amendment to the federal budget is to be implemented mainly to legalise this year's spending out of the economic stabilisation fund, an off-budget fund to support households and businesses in the energy crisis. The amendment also affects the core budget, e.g. via an updated cyclical component.

3 GDP of the year before the draft budget is set up, that is, usually two years prior to budget execution.
4 0.35% of 2021 GDP.

The court ruling has made the draft budget for 2024 obsolete (and so it is not reported here). The strategy of the federal government had been to transfer credit permissions granted under the escape clause to off budget funds for future use. While the core budget was planned to be tightened somewhat, substantial room for manoeuvre was seemingly created in off-budget funds According to the constitution, the debt brake also applies to extra-budgetary funds as long as these are not legally independent bodies. Thus, in order to use so-called 'Sondervermögen' (special funds lacking a legal personality) to create fiscal space, the legislature also had to change the booking rules. This was done with a budget amendment for 2021 passed in early 2022, against which the conservative opposition (the Christian Democratic Union and the Christian Social Union) started legal action before the constitutional court. According to the old public-accounting rule, operations of the off-budget funds became relevant at the time of expenditure. This change of rules enabled the government to shift new debt to future periods. Table 3.2 provides an overview of credit permissions transferred to future years at the beginning of 2023.

Table 3.2 Unused Credit Permissions of Relevant Extra-Budgetary Funds ('Sondervermögen')

	Reserves (unused credit permissions) beginning of 2023	Planned withdrawals for 2023
Economic Stabilisation Fund ('WSF')	€169.8bn	€121.2bn (unrealistically high)
Climate and Transformation fund ('KTF')	€90.8bn	€14.1bn
Fund for the Army	€100bn	€8.4bn
Reconstruction Fund 2021	€14.0bn	€3.0bn
Digitisation	€6.4bn	€2.7 bn

Sources: Bundesrechnungshof (2023b), Deutscher Bundestag (2023b), estimates of the IMK.

The largest off-budget fund is the economic stabilisation fund (WSF), established during the pandemic and has been used to support gas suppliers and to implement the electricity- and gas-price brakes. Because gas prices have been much lower than forecast, actual disbursements have been substantially below plan. The emergency budget amendment 2023 seeks to bring past disbursements in line with the constitution. The fund will now expire in 2023, which means that other sources would have to be made available to fund the planned disbursements of roughly € 14 bn by April 2024.

The Climate and Transformation Fund (KTF) has so far been the government's key instrument to support climate-protection investment. Its regular revenue from carbon pricing is not nearly enough to finance the envisaged grants for climate investment

and electricity subsidies for the German industry. The additional credit permissions were already insufficient as they were expected to be used up by 2026. Now the underfunding is becoming even more serious. In addition, the coalition agreement of 2021 had envisaged a 'climate allowance' ('Klimageld') that returns revenues from Germany's carbon tax to the population on a per-capita basis. This is one option for ensuring social justice in the transformation (Gechert et al. 2019) and, thus, bolstering acceptance, So far institutional-administrative weaknesses have prevented a direct 'climate payment' to the population, but if it is these revenues would not be available for investment or for transformation-related investment grants.

In principle the constitutional court ruling of November 2023 applies to all credit permissions made available to extra-budgetary funds under the suspended debt brake. It could thus also affect the Reconstruction Fund 2021, which envisages €2bn for the repair of federal infrastructure and up to €14bn to rebuild the regional infrastructure in Rhineland Palatinate, North Rhine Westphalia, and Bavaria—areas affected by torrential rain and flooding in summer 2021. Although the investment is not additional, it will modernise the regional infrastructure and can also include climate-adaptation measures. A cancellation is hard to imagine, but funding is now in doubt.

The other funds are of minor importance. Measures put in place to address massive needs, particularly the funding of digitisation, are quite insufficient. Progress on such projects, however, has been impeded not only because of funding issues but also due to the fragmentation of responsibilities between the levels of government and the lack of a coherent strategy (Bundesrechnungshof 2023a).

Unlike the other funds, the fund for the army setting aside €100bn for a modernisation of the German armed forces in response to the Russian aggression against Ukraine has been established outside the scope of the debt brake through a change of the German constitution, supported by a large majority in both the Bundestag[5] and the Bundesrat.[6] The envisaged spending is mostly classified as investment according to the national accounts, but it does not contribute to the modernisation of infrastructure or transformation.

If the court ruling is applied to all affected operations, the underfunding of the federal budget in the coming years may exceed €110 bn. As this publication went to press it is still not clear what the 2024 budget will look like, nor when it will be passed. The court ruling has triggered a fierce debate about whether and how to finance the originally envisaged spending. Some are calling for substantial social spending cuts, others for reductions in subsidies, particularly those harmful to the climate. The finance minister remains opposed to tax increases. Many, including previous supporters, are demanding a comprehensive reform of the debt brake or even its abolition, for which, however, there is not the required two-thirds majority. One option to provide the necessary funding for state support of the ecological transformation

5 The German federal parliament.

6 The representation of the federal states in the German legislature.

within the framework of the debt brake would be to endow the KTF with the same constitutional credit financing rights as the fund for the army. The overall volume could be comparable. However, this would also require a two thirds majority both in the Bundestag and the Bundesrat.

If the envisaged spending is scrapped or is now financed by other spending cuts or – less damaging – tax hikes, rather than borrowing, it is very likely to push the German economy into a recession once more in 2024. But the issue is not merely one of cyclical demand management. The planned investment in infrastructure and the support for businesses and households in accomplishing the needed decarbonization, while insufficient, is certainly necessary for Germany to modernise and address widely recognized weaknesses in its production model. Any serious cutbacks pose a threat to that endeavour.

The difficult fiscal-policy choices need, moreover, to take into account that substantial additional demands on the spending side will arise. The thirty-year redemption of debt incurred during the pandemic years 2020 to 2022 (€358.2bn) begins in 2028, while the debt incurred via the economic stabilisation fund (WSF) and up-to-€100bn debt incurred for the armed forces will also have to be paid off, beginning no later than 2031. Unless EU own resources are expanded, Germany will also have to service its share of the common debt assumed to finance the Recovery and Resilience Facility. (If the maximum underfunding of more than € 100 bn materialises – of course the redemption will be lower.)

3.3.3 Fiscal Situation of the Federal States

In Germany, the sixteen federal states play a limited role in public investment. They are directly responsible for research and development (universities) and education as well as some infrastructure and transport investment. They also play an important indirect role by supporting local authorities via regional fiscal-equalisation systems. Fiscal surpluses of the states taken altogether disguise large regional disparities, notably in terms of outstanding debt burdens per capita but also the challenges posed by structural change. Moreover, the financial situation at this level is rather opaque: numerous off-budget funds, differing debt-brake rules, and limited data complicate the assessment of the fiscal situation.[7] A number of states have resorted to similar practices as the federal government For instance, Saarland and Bremen—both poor states, with an important role for steel production—have invoked the emergency clause of the debt brake to create transformation funds. Saarland has set up an off-budget fund for the transformation while Bremen is using a ‘crisis fund’ within the core budget. Berlin

7 The scientific advisory board to the Stability Council has recently demanded more transparency concerning off-budget funds of both the federal and the state levels of government (Unabhängiger Beirat des Stabilitätsrats 2023). Cf. also Deutsche Bundesbank (2022).

decided to establish an off-budget fund for climate protection. All these models may now be at risk in the wake of the constitutional court ruling.

The states also face substantial fiscal pressures due to revenue losses from tax cuts and the end of the housing boom, which led to a large downward revision of revenues from the real estate transfer tax, the most important state tax. In addition, the states' VAT share is gradually reduced in favour of the federal government as a temporary crises-related increase and some federal programmes are phased out. By 2028, it is scheduled to decrease by 5.3 percentage points from 52.9% in 2020.[8] In addition, some states face noticeable budget burdens due to short redemption horizons for the debt incurred in the pandemic. The states cannot expect much additional support from the federal government. On the contrary, the federal ministry of finance argues that the federal government bears the lion's share of the crises-related expenditures and that it has reached a limit, where no further support of states and municipalities is possible (BMF 2023b). While it is true that the federal government has shifted substantial funds to the other government subsectors and incurred most of the crises-related additional debt, the states and municipalities are affected by decisions of the federal level—for example, offering shelter to refugees or setting standards. In this way, their capacity to conduct public investment at the regional level is limited.

3.3.4 Fiscal Situation of Local Government

Local governments play a vital role in public investment (Figure 3.2). However, their financial capacity to exercise this role is hindered even more severely, than on the state level. There are two key problems: permanently increasing assignments and responsibilities passed on from central government—for instance in the context of refugees, most recently from Ukraine—but with only limited additional funding; and substantial and persistent regional disparities (Raffer and Scheller 2023). High investment for years in wealthy Bavaria and low investment in regions going through structural change such as Saarland or the Ruhr Area (Ruhrgebiet) in North Rhine Westphalia are continuing to widen the gap. Both problems need to be tackled to overcome the investment backlog and at the same time invest enough in climate protection and adaptation. Local communities need additional revenues to finance long-term climate-related investment and sufficient transfers from the federal and state levels to finance expenditures related to the inflow of refugees (roughly one million from Ukraine alone). The growing population requires not only current spending, but also additional infrastructure investment, for example, in school buildings as refugees attending school in Germany from Ukraine alone exceed 200,000 (KMK 2023).

To overcome the problem of self-reinforcing regional disparities, more federal finance for social spending is required beyond the steps already taken and the

8 According to the most recent official tax forecast of October 2023.

distribution mechanism for the VAT share of the local communities, which currently favours economically strong communities, should be changed. However, such improvements for the municipalities would increase the fiscal pressure for the federal level.

Helping overindebted municipalities also remains on the agenda, as SPD, Greens and Liberals promised a solution in their coalition agreement but have yet to deliver. After several states (Hesse, Saarland and Rhineland Palatinate) started their own debt-relief programmes, North Rhine Westphalia, the most populous state, has announced its own programme (Landesregierung Nordrhein-Westfalen 2023). While such state debt-relief programmes receive much praise, it must be noted that the municipalities still bear a large share of the debt service burden under these programmes. This is particularly true in the case of North Rhine Westphalia, where the state hardly injects any funds of its own.

3.4 What has Been Achieved under the German RRF Plan?

As was noted in last year's chapter on Germany (Rietzler and Watt 2022), funding from the Recovery and Resilience Facility (RRF) is currently playing and will continue to play a minor role in financing public investment, in contrast to some other Member States. Originally, the German national plan to implement the RRF (DARP: Deutsche Aufbau- und Resilienzplan) foresaw €25.6bn in grants to be made available for projects from 2021–2026. Germany did not avail itself of the option to draw on RRF loans, because the interest rate on such loans was slightly higher than that which Germany, with its safe-haven status, enjoys on international bond markets. At the start of 2023, an additional €2.4bn were made available to Germany based on a recalculation of the RRF allocations to Member States, thus adding firepower of just under 10%. In addition, the REPowerEU programme, which was designed to help Member States to wean themselves off Russian energy as quickly as possible, made available to Germany an additional €2.1 for energy-related investment, specifically.

Despite these welcome top-ups, Rietzler and Watt's 2022 finding that EU programmes are of only secondary importance in Germany continues to hold true. This is the case because the substantial redistributional element in the original RRF targeted Member States severely affected by the COVID-19 crisis and those with GDP per capita below the EU average (Watt and Watzka 2020).

The end of 2023 marks the mid-point of the RRF programme. Assessing the progress made by the roll-out of RRF projects in Germany is not easy. At the time of writing (October 2023), Germany has only received the pre-financing which was paid out, unconditionally, in 2021. None of the envisaged five tranches, each of which requires detailed national reporting and approval by the EU Commission, has been disbursed,

although a request for payment of just under €4bn was submitted in mid-September.[9] Correspondingly, the EU Commission RRF Scoreboard reports that Germany, to date, has not been officially assessed as having achieved any of the envisaged milestones and targets.

To a considerable extent, however, this situation reflects a processing delay that stems from the conceptualisation of the RRF facility. Only a 100% achievement score of milestone and targets triggers a full payment. Therefore, Member States shy away from submitting payment requests to receive their funding if all milestones and targets due for that tranche have not yet been achieved fully, so as to avoid receiving only partial payments, creating additional bureaucracy. An answer to a recent parliamentary question by the German Finance Ministry (8 June) indicated that the German government had, as of 30 April, itself designated 58 of the total 129 milestones and targets set out in the DARP as completed (Deutscher Bundestag 2023a: 36). Most milestones have been reached in the first two pillars of the DARP: decarbonisation (21) and digitalisation (11). Milestones in the other four pillars are in single figures: education (8), social inclusion (6), health (5), and public administration (7). In many cases, the inception-stage milestones achieved so far have been of a preparatory legal nature: passing/publishing legislation or administrative decisions enabling private-sector actors to claim various forms of support or bid for public contracts. In some cases, though, programmes have already been implemented with concrete and quantified outcomes; examples include support for electrical-vehicle purchases, tablets for teaching purposes, and the digitalisation and modernisation of hospitals. Changed circumstances led to the revision of 2 milestones, and the finance ministry is currently preparing to submit the first funding application, which will cover 36 milestones/targets.

Even if the RRF makes a relatively minor contribution to public investment in the German case, its expiration in 2026 will see this source of financing dry up. Unless EU resources are expanded, Member States including Germany will, moreover, be jointly responsible for servicing the loans taken out to finance the RRF. Discussions are ongoing about whether a successor facility, one likely to be differently structured and possibly permanent, will be put in place. To judge by the most recent EU Commission proposal (the Strategic Technologies for Europe Platform (STEP), June 2023), however, there does not seem to be much appetite for a centrally-funded facility of anything like the required order of magnitude.

9 Germany is not alone in this: a number of other Member States have, to date, not yet received funding by regular tranches.

3.5 Outlook

Germany's huge public-investment needs are widely recognized. Despite the pledge to initiate a decade of investment that the governing coalition made when it took office at the end of 2021, too little has been achieved. Understandably, recent focus has been on supporting households in the energy and inflationary crisis sparked by the Russian invasion of Ukraine (Watt 2022). As energy prices have declined from their peaks in 2022, the government is concentrating on its exit from the crisis mode. Already before the constitutional court ruling, the key objective was clearly the consolidation of public finances, not the raising of investment, however. The finance minister, from the liberal FDP, aimed to solve the trade-off between budget consolidation and additional investment via cuts in social and consumption spending (BMF 2023a). While this is politically popular insofar as it avoids the need for tax increases or higher borrowing, it proves difficult in practice to achieve spending cuts by orders of magnitude that would free up substantial additional resources. Most spending is on the basis of legal entitlements that are difficult to change substantially in the short run.

The government is still not prioritising public investment in the modernisation of Germany and its transformation to a low-carbon economy. It is not sufficiently understood that digital and ecological transformation are a once-in-a-generation challenge, like German reunification, which—among other instruments—was financed via a mixture of public debt and tax increases. Similarly, the modernisation and transformation of the economy should be financed using a mix of instruments. To the extent that future economic activity and, consequently, tax revenues are increased via public investment, debt finance in line with the golden rule is economically justified. Already politically difficult thanks to the debt brake, the constitutional court ruling has now seemingly ruled out deficit financing of a substantial proportion of the planned additional investment and accompanying support measures for business and households.

Given this, and the fact that climate protection and adaptation will not, in all cases, contribute to future growth and additional revenues it would make sense to finance some of the investment via additional tax revenues and also cut back ecologically damaging tax breaks. At the moment, however, there is a political majority for neither tax increases nor for a substantial reform of the German debt brake. Germany is also opposing reforms of the European fiscal rules which could increase the scope for public investment. It was already likely that public investment in Germany, even if there are increases in certain areas, would remain substantially below what is necessary. After the constitutional court ruling there is heightened uncertainty as to the path forward and a real risk of a substantial scaling back of the level of ambition.

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