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From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2019 National Reform Programme of Germany and delivering a Council opinion on the 2019 Stability Programme of Germany

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2019) 505 final.

COUNCIL RECOMMENDATION

of …

on the 2019 National Reform Programme of Germany and delivering a Council opinion on the 2019 Stability Programme of Germany

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.

Whereas:

(1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Germany as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the Recommendation on the economic policy of the euro area[3] ('2019 Recommendation for the euro area'), which sets out five euro-area recommendations ('the euro-area recommendations').

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Germany should ensure the full and timely implementation of the 2019 Recommendation for the euro area, as reflected in recommendations (1) and (2) below. In particular, investment measures and supporting wage growth will help address the first euro-area recommendation as regards euro-area rebalancing, and shifting taxes away from labour will help address the third euro-area recommendation as regards the functioning of the labour market.

[3] OJ C 136, 12.4.2019, p. 1.

(3) The 2019 country report for Germany was published on 27 February 2019. It assessed Germany's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018[4], the follow-up given to the country-specific recommendations adopted in previous years and Germany's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 27 February 2019. The Commission's analysis led it to conclude that Germany is experiencing macroeconomic imbalances. In particular, the slowly declining current account surplus remains high and has cross-border relevance. The surplus slightly narrowed in 2018 in the context of a pick-up in domestic demand and is expected to continue to decline gradually in the coming years, while remaining above the threshold set in the Macroeconomic Imbalance Procedure. The surplus reflects a subdued level of domestic investment relative to savings in both the private and public sectors. Measures have been taken to boost private and public investment, which has increased substantially. This has contributed to a growth more driven by domestic demand. Nevertheless, as a share of gross domestic product (GDP), investment and consumption could have been expected to grow more given the favourable financing conditions, the public investment backlog, especially at municipal level, and the available fiscal space. Wage growth increased somewhat with the tightening labour market, yet real wage growth remains modest.

(4) Germany submitted its 2019 National Reform Programme on 16 April 2019 and its 2019 Stability Programme on 17 April 2019. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

[4] OJ C 320, 10.9.2018, p. 19.

(5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[5], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

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[5] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(6) Germany is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans a budget surplus of between ½ and ¾ % of GDP over 2019-2023. Based on the recalculated structural balance[6], the medium-term budgetary objective — a structural deficit of 0,5 % of GDP — continues to be overachieved throughout the programme period. According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to fall below the 60 %-of-GDP Treaty reference value in 2019 and to gradually decline to 51¼ % in 2023. The macroeconomic scenario underpinning those budgetary projections is favourable. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 1,1 % of GDP in 2019 and 0,8 % of GDP in 2020, above the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path. Overall, the Council is of the opinion that Germany is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. At the same time, while respecting the medium-term budgetary objective, it would be important to use fiscal and structural policies to achieve a sustained upward trend in private and public investment, notably at regional and municipal levels.

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[6] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

(7) Public and private investment increased robustly in 2018, but the investment ratio remains below the euro-area average. Public investment in 2018 grew by 7,7 % nominally and 3,8 % in real terms, but more efforts are still needed to clear the large investment backlog, particularly for investment in infrastructure and education. Real public investment growth has been positive for the last three years, after a period of negative growth rates. Nominal investment at municipal level has grown by almost one fifth in 2018 alone. This reflects government efforts to boost investment. However, investment at municipal level remained lower than depreciation. Referring to KfW Municipal Panel 2019, the perceived investment backlog accumulated by 2018 was at 4 % of GDP. Together with the favourable budgetary position, this indicates that there is scope to increase investment at all levels of government, in particular at regional and municipal levels. Investment in public infrastructure is still held back by capacity and planning constraints at municipal level. Measures to overcome these constraints have been introduced, but have yet to show sustained tangible results. Moreover, there is scope to improve digital public services and public procurement. Private investment has increased noticeably, but not across all asset types. Equipment investment has grown robustly in response to record-high capacity utilisation. Housing investment continues to boom. However, the construction sector now reports capacity constraints and price increases. Non-residential construction has been increasing sluggishly in real terms, suggesting that essential infrastructure may not have kept up with the economy's needs.

(8) Public expenditure on education, at 4,1 % of GDP in 2017, remained below the Union average of 4,6 %. Out of overall government expenditure, 9,3 % was spent on education, which is also below the Union average of 10,2 %. Spending on education and research remained at 9 % of GDP in 2017, falling short of the national target of 10 %. Even if education expenditure increased in real terms, the large investment backlog grew further due to demographic developments. Legislative changes allowing direct investment by the federal government in digital education in addition to the resources allocated by the Länder (*Digitalpakt*) are promising, but have yet to show results. Challenges such as growing student numbers, teacher shortages, digitalisation and further expansion of early childhood education and care will require appropriate public financing. Additional spending on education and on research and innovation is crucial for increasing Germany's potential growth and adapting to technological change.

(9) Germany has made progress in recent years in increasing its research and development (R&D) intensity, mainly as a result of an increase in R&D spending by large companies, especially in medium/high-tech manufacturing sectors and in particular the automotive sector. The R&D intensity of small and medium-sized enterprises ('SMEs') is significantly below the Union average and continues to fall behind. SMEs tend to benefit less from cooperation with public research institutes than large companies. These two factors harm business innovation, which are on a long-term downward trend. Additional investment in R&D is essential not only to increase innovation capacity across the economy and boost productivity, but also to facilitate the transition to a low-carbon and circular economy, notably in relation to sustainable transport, green energy technologies, eco-innovation and recycling, and to further increase the performance of the public research sector and its contribution to these goals.

(10) Digitalisation of the German economy is progressing slowly and SMEs remain slow adopters of digital technologies. Germany is lagging behind in deploying very high-capacity broadband (gigabit speeds) at national level, and particularly in rural areas, where stronger investment could improve productivity growth. Only 9 % of German households (in mid-2018) is covered by high-performance fibre-based access networks, compared with the Union average of 30 %. Instead, upgrading existing copper cable networks (vectoring) continued to be the incumbent's preferred technological solution. While many services rely on very high speed connectivity, 23 700 business parks were not connected to a fibre network in 2017 and 28 % of all companies lacked access to networks of at least 50 megabits. A lack of such connectivity holds back investment, especially by SMEs, many of which are located in rural and semi-rural areas. Public intervention in the deployment of ultrafast (≥100 Mbps) broadband infrastructure in rural areas remains crucial, and different options going beyond subsidies could be explored. Performance in digital public services and in e-health is far below the Union average. Only 43 % of German internet users used e-government services in 2018 (compared to a Union average of 64 %). Regarding e-health, 7 % of Germans have used health and care services provided online (compared to a Union average of 18 %). E-prescription is used by 19 % of general practitioners (compared to a Union average of 50 %).

(11) More investment in transport infrastructure and clean mobility solutions is needed in Germany to tackle mobility and air quality challenges, as well as to support climate change mitigation and adaptation. Greenhouse gas emissions from road transport have increased over the last five years. Air quality in Germany gives serious cause for concern, especially in urban areas where traffic accounts for about 60 % of harmful NOx emissions. Freight transport could benefit from more developed inter-modality solutions. Cars remain by far the most commonly used means of transport for daily commuting and the average time spent in traffic jams is about 30 hours per year. Congestion and looking for parking spaces has been estimated to cost EUR 110 billion per year, or about 4 % of Germany's GDP. Although vehicles running on alternative fuels have seen the steepest increase in new registrations, the numbers remain low. Car sharing and ridesharing are still heavily underexploited. Considerable public and private investment will also be needed in view of new supply chains for batteries and critical raw materials.

(12) Germany's electricity networks are slowly adapting to renewable production and significant investment in transmission and distribution grids remains necessary. Substantial delays in carrying out many projects have entailed considerable costs to German and European electricity networks and electricity markets. Of the 1 800 km of the grid projects identified in the 2009 Energy Network Expansion Act, only around 800 km had been implemented by the second quarter of 2018, in part because of public opposition. Delays in extending the grid will lead to higher congestion costs and result in more distortions in market functioning, both inside Germany and across borders. Investments in energy networks that promote sector coupling, diversification and an appropriate grid infrastructure are crucial for the flexibility of the energy system and for better integration across different sectors of the economy in view of the achievement of energy and climate targets.

(13) Housing in Germany has become less affordable. Since 2015, both rents and house prices have grown faster than their long-term averages, in particular in large cities. In 2017, 20 % of the people aged 65 and over in Germany faced an excessive housing cost burden (i.e., the total housing cost represented more than 40 % of their disposable income), compared to 10 % of Europeans aged 65 and over. For the population with the lowest income, the housing cost overburden rate was 10 percentage points above the Union average of 35,3 %. The government reacted with certain measures, including a 'price brake' restricting rent increases (*Mietpreisbremse*), a support scheme to buy new property (*Baukindergeld*), as well as a change of basic law to enable the federal level to financially support the construction of social housing. Nevertheless, the completion of new dwellings remains considerably below demand and well below the government target of 375 000 per year. Further measures may be necessary, such as accelerating the construction of social housing, improving transport options, as well as reforming land-use and building regulation.

(14) Germany has particularly benefited from integration in the internal market and plays an important role in its further development. However, barriers to competition in the business services sector in Germany remain high in comparison to other Member States. This concerns various areas, including regulated professions such as architecture, engineering, and legal services, where regulatory restrictions, such as reserve of activities and regulation on prices and fees, stifle competition. However, also unregulated business services face more restrictions to the general business environment compared to other Member States. Changes in the regulation of business services to increase competition would boost the efficiency and effectiveness of investment and economic activity.

(15) After some improvements in previous years, there has been little progress over the past year to reform Germany's tax system to foster domestic private investment and growth. The tax system remains complex, distorts decision-making, e.g. on labour market participation, investment and financing, and could provide more effective incentives for investment and consumption. Most progress was recorded with labour taxation, but this is not yet visible in the data. There is still potential to reduce distortive taxation on labour through a tax shift away from labour to sources of revenue more supportive to inclusive and sustainable growth. The taxation of earnings from labour in 2018 (the tax wedge) remained among the highest in the Union, both for average and low-wage earners. Social security contributions of employees are particularly high compared to other countries, and social security contributions overall account for about two thirds of the tax wedge, while income tax accounts for one third. In turn, revenues from environmental taxes as a share of GDP are among the lowest in the Union. The cost of capital and the effective average corporate tax rate, which differ across regions, are among the highest in the Union. The effective average tax rate amounted to 28,8 % (national aggregate) as compared with a Union average of 20 %. Due to the interplay of the corporate income tax, the local trade tax and the solidarity surcharge, the corporate tax system is complex, involves high tax administration costs and distorts the level and location of investments. In addition, the corporate income tax distorts financing decisions, with a bias towards debt financing, estimated to be the third highest in the Union, according to 2017 data. Lowering the capital costs on equity could increase private investment and strengthen the relatively under-developed venture capital market.

(16) The labour market remains strong, while the labour market potential of certain groups is underused. The employment rate for ages 20-64 reached 79,9 % in the fourth quarter in 2018, one of the highest in the Union. Unemployment sank to a record low of 3,2 % by the beginning of 2019. High job vacancy rate and labour shortages are becoming increasingly apparent and are restraining production significantly in some regions and sectors. Still, the labour market potential of certain groups, like women and people with a migrant background, is underused. At 46,7 %, Germany's percentage of female part-time work is very high. Taxes on labour in Germany remain relatively high, including for lower wage earners. The particular rules governing joint income taxation for married couples (*Ehegattensplitting*) mute the incentives for second earners to work, notably longer hours. People with a migrant background have a considerably lower employment rate than people with a native background, with a particularly high gap for women. Measures have been taken to support the integration of refugees in the labour market, but challenges remain, including their lack of proficiency in the German language, missing or non-transferable qualifications, caring responsibilities towards children and relatives, and lack of experience with informal rules on the German labour market.

(17) The retirement of the baby boomer generation is affecting Germany more than other Member States. In the long-run, this demographic change will strain German public finances, could challenge the adequacy of pensions, and could degrade the currently limited share of the older population (aged 65 and above) at risk poverty or social inclusion. By 2040, the country is expected to be facing one of the largest increases in spending in relation to GDP on public pensions in the Union (up by 1,9 percentage points of GDP), while the public pension benefit ratio is expected to fall by 4,4 percentage points, to 37,6 %, according to the 2018 Ageing Report (European Commission, 2018d). Recent pension reforms increased benefit levels for certain groups, yet it is not clear that the achieved social benefits are commensurate to their considerable fiscal cost. The government also set two 'stop lines' (*doppelte Haltelinie*): a maximum pension contribution rate of 20 % and minimum income replacement rates of 48 % up to 2025. Retaining these limits is expected to require significant fiscal transfers, increasing further the burden on younger generations. In addition, the adequacy of the retirement income of low-income workers remains an issue.

(18) Despite increasing labour shortages, real wage growth remains modest, while nominal earnings rose by 3,1 % in 2018. In addition, a concentration of employment growth in better paid full-time jobs and a reduction of the share of marginal part-time work in total employment contributed to overall wage growth in 2018, also slightly ahead of productivity growth. Collective bargaining coverage continued to decline (by 2 percentage points from 2016 to 2017), to 49 % in the west and 34 % in the east. There are significant differences in terms of coverage across sectors, with better coverage in the public sector and industry, while services have a much lower coverage. Low-paid workers have generally benefited from the minimum wage that has been introduced since 2015. Hourly wages at the very bottom of the wage distribution, notably the two lowest wage deciles, increased substantially. However, the share of low-paid workers, at 22,5 % in 2017, remains considerably above the Union average. The number of people employed only in mini-jobs fell by 6,8 % over 2010-2018 and employment subject to social insurance rose by around 18,1 % in the same period. Strengthening the conditions to promote wage growth would support domestic demand and contribute to euro-area rebalancing.

(19) Upward social mobility in education is low in Germany. National sources confirm little progress in reducing the influence of socio-economic background on educational outcomes. Germany has a good track record of integrating recently arrived migrants and refugees into education and training. However, people with a migrant background typically face bigger challenges than students with a native background (e.g., early school leaving rates and difficulty in finding apprenticeship places). Increasingly heterogeneous classrooms calls for strong efforts to reinforce the teaching profession, at a time of already considerable teacher shortage. The participation of employees in adult learning is a concern for future labour market performance of workers, in particular for the 6,2 million people who lack basic reading and writing skills.

(20) Though the number of people at risk of poverty or social exclusion has fallen since its peak in 2014, challenges in equality of opportunities remain. In particular, the risk of poverty or social exclusion was, in 2017, 67 percentage points greater for the children of low-skilled parents than for the children of highly skilled parents. This gap is substantially higher than the average gap (53,9 percentage points) in the Union.

(21) The programming of Union funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the 2019 country report. This would allow Germany to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

(22) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Germany's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme, the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Germany in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Germany, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(23) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion[7] that Germany is expected to comply with the Stability and Growth Pact.

(24) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (2) below. Those recommendations also contribute to the implementation of the 2019 Recommendation for the euro area, in particular the first euro-area recommendation. The fiscal policies referred to in recommendation (1) below contribute, inter alia, to addressing imbalances linked to the current account surplus,

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7 Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Germany take action in 2019 and 2020 to:

1. While respecting the medium-term budgetary objective, use fiscal and structural policies to achieve a sustained upward trend in private and public investment, in particular at regional and municipal level. Focus investment-related economic policy on education; research and innovation; digitalisation and very-high capacity broadband; sustainable transport as well as energy networks and affordable housing, taking into account regional disparities. Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth. Strengthen competition in business services and regulated professions.

2. Reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners. Take measures to safeguard the long-term sustainability of the pension system, while preserving adequacy. Strengthen the conditions that support higher wage growth, while respecting the role of the social partners. Improve educational outcomes and skills levels of disadvantaged groups.

Done at Brussels,

For the Council

The President