Council of the European Union

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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. prev. doc.:	9816/25
Subject:	COUNCIL RECOMMENDATION on the economic, social, employment, structural and budgetary policies of Germany

Delegations will find attached the above-mentioned draft Council Recommendation, as revised and agreed by the Employment Committee and the Social Protection Committee, based on the Commission Proposal COM(2025) 205 final.

ANNEX

Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Germany

THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) 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,

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1 OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.
2 OJ L 306, 23.11.2011, p. 25, ELI: http://data.europa.eu/eli/reg/2011/1176/oj.

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, Whereas:

General considerations

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular, the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on

the length of the national legislative term. The net expenditure[3] path in these plans has to comply with the Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years. Member States were required to submit their national medium-term fiscal-structural plans by 20 September 2024, unless they agreed with the Commission to extend the deadline by a reasonable period of time. The Commission granted Germany the possibility to present a plan based on a solid political commitment, agreed to a delay in the submission of the plan, and expects Germany to present a medium-term plan by the end of July 2025.

[3] Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[4], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[5] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Germany added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

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[4] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

[5] Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1, ELI: http://data.europa. eu/eli/reg/2023/435/oj).

(4) On 28 April 2021, Germany submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of that Regulation, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V. On 13 July 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Germany[6], which was amended under Article 18(2) on 8 December 2023 to update the maximum financial contribution for non-repayable financial support, and on 9 July 2024 to include the REPowerEU chapter[7]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Germany has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the achievement of preceding milestones and targets for the same reform or investment has not been reversed.

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6 Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Germany (10158/2021).

7 Council Implementing Decision of 9 July 2024 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Germany (11674/2024).

(5) On 26 November 2024, the Commission adopted an opinion on the 2025 draft budgetary plan of Germany. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it identified Germany as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[8] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

[8] Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 22.5.2025, ELI: http://data.europa.eu/eli/C/2025/2782/oj).

(6) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(7) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. These country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(8) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(9) On 4 June 2025, the Commission published the 2025 country report for Germany. It assessed Germany's progress in addressing the relevant country-specific recommendations and took stock of Germany's implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Germany is facing. It also assessed Germany's progress in implementing the European Pillar of Social Rights and in achieving the Union's 2030 headline targets on employment, skills and poverty and social exclusion reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(10) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Germany. The main findings of the Commission's assessment of macroeconomic vulnerabilities for Germany for the purposes of that Regulation were published on 13 May 2025[9]. On 4 June 2025, the Commission concluded that Germany is no longer experiencing macroeconomic imbalances. In particular, vulnerabilities related to the large current account surplus, which had cross-border relevance, have declined over the years, while significant policy progress has very recently been announced. The current account surplus came below 6% of GDP in recent years, after having reached a trough in 2022 on account of exceptionally high energy prices. The reduction of the current account is largely reflecting an adverse external backdrop, whereas the overall underlying vulnerabilities in terms of a significant savings-investment gap have not changed fundamentally. Investment needs have been increasing over the years, mainly linked to public investment at regional level and corporate investment, whereas actual investment has receded in real terms in recent years. Combined with other structural challenges, low public and private investment provided amongst the lowest contributions to potential GDP growth in the EU. Real wages have reached their pre-pandemic level during 2024 following moderate increases in nominal wages. However, considerable policy announcements were made in early March 2025, following the parliamentary elections, including the revision of the Constitutional budgetary framework. This policy package marks a major step and a clear acceleration from recent patterns, which, if implemented, will lead to significantly higher defence spending and infrastructure investment.

[9] SWD(2025) 69 final.

Assessment of the Annual Progress Report

(11) On 25 April 2025 Germany submitted its Annual Progress Report[10] on relevant fiscal outturn data and projections and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Germany's biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(12) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025. Following the request of Germany on 24 April 2025, the Council, upon a recommendation of the Commission, could adopt a recommendation allowing Germany to deviate from, and exceed, the recommended maximum growth rates of net expenditure, once they have been set by the Council following a recommendation from the Commission.

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[10] The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en.

(13) Based on data validated by Eurostat[11], Germany's general government deficit increased from 2.5% of GDP in 2023 to 2.8% in 2024, while the general government debt fell from 62.9% of GDP at the end of 2023 to 62.5% at the end of 2024. According to the Commission's calculations, these developments correspond to a net expenditure growth rate of 4.0% in 2024. In the 2025 Annual Progress Report, Germany estimates the net expenditure growth in 2024 at 3.8%. Based on the Commission's estimates, the fiscal stance[12], which includes both nationally and EU financed expenditure, was neutral in 2024.

(14) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Germany expects real GDP growth at 0.3% in 2025, while inflation measured by the GDP deflator[13] is projected at 2.1% in 2025. The Commission Spring 2025 Forecast projects real GDP to stay neutral at 0% in 2025 and grow by 1.1% in 2026, and HICP inflation to stand at 2.4% in 2025 and 1.9% in 2026.

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[11] Eurostat-Euro Indicators, 22.4.2025.

[12] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

[13] Inflation measured by the Harmonised Index of Consumer Prices (HICP) is not reported in the Annual Progress Report.

(15) In the Annual Progress Report, the general government deficit is expected to decrease to 2½% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 62¾% by the end of 2025. These developments correspond to net expenditure growth of 2½% in 2025. The Commission Spring 2025 Forecast projects a general government deficit of 2.7% of GDP in 2025. According to the Commission's calculations, these developments correspond to net expenditure growth of 2.1% in 2025. The difference between the general government balance projected by Commission and Germany is due to slightly more pessimistic fiscal revenue numbers in the Commission forecast. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be contractionary, by 0.4% of GDP, in 2025. The general government debt-to-GDP ratio is set to increase to 63.8% by the end of 2025. The increase of the debt-to-GDP ratio in 2025 mainly reflects low nominal GDP growth.

(16) General government expenditure amounting to 0.1% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.1% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Germany.

(17) General government defence expenditure in Germany amounted to 1.0% of GDP in 2021, 1.0% of GDP in 2022 and 1.1% of GDP in 2023[6]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected at 1.3% of GDP in both 2024 and in 2025. This corresponds to an increase of 0.3 percentage points of GDP compared to 2021. The period when the national escape clause will be activated (2025-2028) would allow Germany to reprioritise government expenditure or increase government revenue so that lastingly higher defence expenditure would not endanger fiscal sustainability in the medium term.

(18) The 2025 Annual Progress Report does not include budgetary projections beyond 2025. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects a government deficit of 2.9% of GDP in 2026. The increase of the deficit in 2026 reflects declining revenue growth on the back of lower wage growth and elevated expenditure growth. These developments correspond to net expenditure growth of 3.2% in 2026. For Germany, a full assessment of compliance cannot yet be undertaken in the absence of a medium-term plan. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be slightly expansionary, by 0.2% of GDP, in 2026. The general government debt-to-GDP ratio is projected by the Commission to increase to 64.7% by the end of 2026. The increase of the debt-to-GDP ratio in 2026 mainly reflects declining revenue growth.

Key policy challenges

(19) Despite a slight increase in public investment as a share of GDP in recent years, it continues to fall short of actual investment needs. Germany has streamlined its planning and approval procedures for renewable energy, grid expansion and transport infrastructure but further bottlenecks persist and require additional measures. Two decades of low public investment have significantly reduced planning capacities in crucial sectors such as construction. The complexity of federal structures and fragmented responsibilities may hinder the timely and efficient implementation of projects. A lack of clear planning, strategic direction, and defined goals has previously curbed the flow of investment in infrastructure. Public-private partnerships can help mobilise private-sector expertise and finance while also enhancing public service delivery. The new infrastructure fund could help alleviate the shortfall in public investment.

(20) Demographic ageing and labour shortages are putting pressure on the old-age dependency ratio, the sustainability of the pension system and the adequacy of pensions. As a result, overall pension expenditure is expected to increase. In recent years, transfers from the federal budget to the pension system have consistently been over EUR 100 billion (around 25% of federal government expenditure), leaving less scope for more productive spending. Furthermore, attempts to further develop a private-sector pension pillar are behind schedule and limit the scope to channel savings into possible long-term financing solutions for the economy.

(21) Other measures that could improve the sustainability of the pension system include reducing the incentives for early retirement, adjusting pension indexation and revising contribution ceilings. Such measures could also help contain the need for budget transfers and increases in social security contributions. The overall efficiency of public spending can also be improved, for instance by conducting further spending reviews and phasing out or replacing non-essential subsidies.

(22) An optimal tax mix is a key lever for more inclusive and sustainable growth as well as stronger competitiveness. Workers in Germany face the second highest tax wedge (the taxation of earnings from labour) in the EU. High taxes in conjunction with strict benefit rules (such as reduced benefits as income increases) reduce the incentives to increase the number of hours worked, especially for low-wage and second earners. These are often women, as indicated by the very high share of working women who work part-time. Germany also has one of the highest corporate income tax rates in the EU, including the local trade tax (*Gewerbesteuer*). The corporate taxation system provides few incentives for investment and innovation. Temporarily increasing depreciation options and offering R&D tax credits – as planned in the coalition agreement – can be cost-effective ways of stimulating investment. At the same time, there is scope to make greater use of environmental taxes and other less distorting taxes.

(23) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan including the REPowerEU chapter, is essential to boost Germany's long-term competitiveness through the green and digital transitions, while ensuring social fairness. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(24) The implementation of cohesion policy programmes, which encompass support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), and the European Social Fund Plus (ESF+) has accelerated in Germany. It is important to continue efforts to ensure the swift implementation of these programmes, while maximising their impact on the ground. Germany is already taking action under its cohesion policy programmes to boost competitiveness and growth while enhancing social cohesion. At the same time, Germany continues to face challenges, including those relating to enhancing competitiveness in the context of industrial transition, affordable housing, skills, active inclusion as well as increasing water resilience. In accordance with Article 18 of Regulation (EU) 2021/1060, Germany is required – as part of the mid-term review of the cohesion policy funds – to review each programme taking into account, among other things, the challenges identified in the 2024 country-specific recommendations. The Commission proposals adopted on 1 April 2025[14] extend the deadline for submitting an assessment – for each programme – of the outcome of the mid-term review beyond 31 March 2025. They also provide flexibilities to help speed up programme implementation and incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition, and to investments in skills in priority sectors while maintaining the focus on persons in most vulnerable situations in ESF+ programmes.

[14] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review - COM(2025) 123 final.

(25) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU programme supporting investments in priority areas. Germany could use these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(26) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Germany faces several additional challenges related to the need to tackle the bottlenecks for investment and innovation as well as the acute shortage of skilled workers, digitalisation and the green transition. Additional investment would help narrow the investment-savings gap.

(27) Private-sector innovation is highly concentrated in large companies and specific regions. R&D expenditure by small and medium-sized enterprises (SMEs) remains low (0.20% in 2021 against the EU average of 0.42%). The declining share of SMEs engaged in innovation activities risks slowing productivity growth and the broader adoption of new technologies. Public R&D spending has also stagnated over the last years (0.92% of GDP in 2023, 0.90% in 2015). The innovation environment could benefit from more public funding for deep tech and transformative innovation. R&D output has fallen when measured as a share of the most cited publications and patent applications. The country struggles to turn excellent research into successful products, partly because knowledge transfer is not viewed as a holistic, continuous process.

(28) Business dynamism in Germany is weak, posing challenges to its economic transformation, as shown by the declining rate of business creation and weak business expansion in almost all sectors of the economy. To foster innovation, it is crucial to create a more supportive environment for business creation, innovation and expansion. Financing remains a key challenge for young entrepreneurs, in particular for start-ups and scale-ups. Strengthening the role of institutional investors as capital providers could help deepen capital markets and improve efficiency and investment growth.

(29) As set in the Competitiveness Compass, all the EU, national, and local institutions must make a major effort to produce simpler rules and to accelerate the speed of administrative procedures. The Commission has set ambitious goals for reducing administrative burden: by at least 25% and by at least 35% for SMEs; and has created new tools to achieve these goals, including systematic stress test of the stock of EU legislation and enhanced stakeholders' dialogue. To match this ambition, Germany also needs to take action. 64% of businesses consider the complexity of administrative procedures to be a problem for their company when doing business in Germany[15]. Bureaucracy and tight regulations are critical barriers to investment, with 90% of firms reporting this as an obstacle. The bureaucratic burden is considered to be high and increasing, and concerns include lengthy administrative procedures, multiple data entry requirements and the lack of communication between authorities.

[15] 'Businesses' attitudes towards corruption in the EU' Flash Report, Eurobarometer Report (April 2024).

(30) Germany has made further efforts to improve the digitalisation of its public services, but implementation progresses slowly. Germany lags behind the EU average on key Digital Decade targets regarding the provision of digital public services for citizens. The use of electronic identification and connected data registers for public services is underdeveloped. The nationwide roll-out of digital services faces particular difficulties given the lack of funding at municipal level. The distribution of legal and financial responsibilities between different government levels has led to inconsistent implementation of services between federal, state and municipal levels, with insufficient coordination and cooperation across administrative levels. Increasing the degree of standardisation of digital services to facilitate re-use and further guidance by the federal government will be key to speeding up the roll-out of services and to enabling citizens to take up these services nationwide.

(31) Germany continues to make good progress in deploying fibre broadband (FTTP) connections, but the country's overall level of coverage (29.8%) remained the second lowest in the EU in 2023. The low level of fibre coverage (25.6% of households) and level of connections to the very high-capacity network (37.6%) remained pronounced in rural areas. The trend for 2024 appears positive but is not yet confirmed in EU-level data. These gaps in coverage undermine competitiveness and productivity growth, especially for small and medium-sized enterprises (SMEs). Improving framework conditions for network deployment, for example by increasing planning and implementation capacity in the public sector, is crucial to accelerate fibre coverage. To meet the network targets, Germany could work on the administrative procedures involved in applying for and granting permits and on standardising alternative, less time-consuming installation methods.

(32) Housing investment in Germany fell in 2024 for the fourth year in a row, resulting in a shortage estimated at up to 600 000 homes. Housing scarcity exacerbates the affordability challenges and has macroeconomic implications as it hinders labour mobility. Addressing this challenge requires innovation in construction, streamlined regulations, better land-use planning and better transport links. Overly strict rent controls risk deterring much-needed private investment.

(33) Germany has continued to make progress on the energy transition, notably by increasing renewable electricity production and diversifying its gas supply. However, fossil fuels still account for a substantial share of the energy mix. To meet its climate goals, Germany should further accelerate the phase-out of fossil fuels across all sectors, in particular in housing and transport, while supporting the cost-effective roll-out of renewable energy.

(34) Despite the progress made, structural challenges remain in integrating new volumes of renewable energy generation efficiently into the electricity system. Grid congestion due to the geographical mismatch between renewable generation and demand centres limits the full use of renewable energy and raises system costs. Germany continues work to expand the transmission grid but progress should accelerate to ensure a minimum of 70% of technical cross-border capacity available for trading. Despite recent efforts to this end, higher grid fees in renewable-rich regions are a disincentive to locate industry near generation sites. Germany has taken steps under the RRP and national measures to accelerate permitting and support flexibility solutions. It would nevertheless be beneficial to increase the scope, ambition and pace of action to expand and digitalise the electricity grid.

(35) Emissions from the housing and transport sectors, which fall under the EU's Effort Sharing Regulation, remain significant. Germany should accelerate action to decarbonise these sectors to meet its climate targets and improve energy efficiency. In the buildings sector, Germany has expanded its regulatory and financial measures, but further cross-cutting efforts on energy efficiency, including reductions in primary energy consumption, are needed to achieve its 2030 targets. In the transport sector, battery electric vehicle adoption is increasing, supported by subsidies and fiscal incentives. However, progress remains insufficient, particularly in terms of expanding the charging infrastructure as needed. Investment in upgrading and expanding the rail network is also needed to support a modal shift from road to rail, particularly freight transport, where road haulage remains predominant. Despite ongoing measures funded under the RRF and other national initiatives, major railway projects continue to face significant delays.

(36) Shortages of skilled labour are a significant bottleneck to growth, productivity and the digital and green transitions. In early 2025, around one third of companies reported being affected by labour shortages and the vacancy rate remains above the EU average. Although the employment rate is high, average hours worked are among the lowest in the EU and continue to decline. The labour shortage is aggravated by a lack of skills. For example, only slightly over half of all adults have at least basic digital skills, far below the national Digital Decade target of 80% by 2030. Consequently, labour shortages are particularly acute in the care and IT sectors, the construction sector, and scientific and technical professions. Labour shortages also affect sectors that are key for the green transition, such as water supply, sewerage, waste management and energy. Lastly, there is untapped potential for attracting and retaining talent, for example by speeding up administrative procedures for labour migration.

(37) Low and worsening education outcomes, especially for disadvantaged groups, and significant numbers of early school leavers further aggravate the shortage of skilled labour. According to the OECD Programme for International Student Assessment (PISA), the share of high-performing pupils has fallen, while the share of underachievers almost doubled over the last decade. Around 3 in 10 young students in Germany lack a minimum level of proficiency in mathematics, and 1 in 4 lack a minimum level in reading and science. The influence of socioeconomic and migrant backgrounds on education outcomes has increased since the 2018 PISA results.

(38) Strengthening quality early childhood education and care (ECEC) and whole-day schools could further enable full-time employment of carers, often women, as well as promote equal opportunities for all children. Half of all female employees work part-time, one of the highest levels in the EU. Caring for children and elderly relatives is a frequent reason for working part-time, partly driven by a gap in the provision of quality, flexible early childhood education and care and whole-day schools. Access to quality ECEC and whole-day schools can also help mitigate disadvantages due to socioeconomic background and language deficiencies. Currently, children from wealthier households are enrolled in ECEC at nearly twice the rate of their less affluent peers.

(39) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, in 2025, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the 2025 Recommendation on the economic policy of the euro area. For Germany, recommendations (1), (2), (3), (4) and (5) help implement the first euro-area recommendation on competitiveness, while recommendations (1), (3), (4) and (5) help address the second euro-area recommendation on resilience, and recommendation (1) helps address the third recommendation on macro-economic and financial stability set out in the 2025 Recommendation.

HEREBY RECOMMENDS that Germany take action in 2025 and 2026 to:

1. Reinforce overall defence spending and readiness in line with the European Council conclusions of 6 March 2025. Submit the medium-term fiscal-structural plan by end-July 2025, as planned. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure in 2025 and 2026 to a rate consistent with putting the general government debt on a plausibly downward trajectory over the medium term and maintaining the general government deficit below the 3% of GDP Treaty reference value, while making use of the allowance under the national escape clause for higher defence expenditure. Strengthen public investment by tackling the bottlenecks in planning and execution at all levels of government. Improve the quality of public finances by containing transfers from the federal budget to the pension system and reviewing the efficiency of public spending. Safeguard the long-term sustainability of the pension system, while maintaining pension adequacy, including by promoting longer working lives and reducing the incentives for early retirement. Improve the tax mix to support inclusive growth and sustainable competitiveness, in particular for second earners.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, ensure the effective implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of cohesion policy programmes (ERDF, JTF and ESF+), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the scope provided by the InvestEU and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Boost innovation by facilitating research commercialisation and by increasing public funding for transformative innovation. Facilitate the diversification of the economy, business dynamism and boost private investment by supporting entrepreneurship, improving access to finance for start-ups and scale-ups, simplifying regulation, and reducing administrative burden. Speed up the digitalisation of the public administration, including by improving the geographic coverage of digital public services and facilitating cooperation between governmental levels. Accelerate the roll-out of very high-capacity digital communication networks, also involving the private sector. Improve the conditions for housing investments by simplifying regulation and procedures, reviewing rental law and mobilising additional building land, with the concurrent aim of tackling the housing affordability challenges.

4. Further reduce the overall degree of dependency on fossil fuels and facilitate the expansion of renewable energy. Focus investment on efficient and integrated energy systems, including by upgrading the electricity network, ensuring cost-efficient expansion and flexibility to support the integration of renewable energy and to adapt to fluctuating demand and supply to meet increased balancing needs. Accelerate the process of decarbonising the buildings and transport sectors, including by renovating the rail network.

5. Increase labour supply and tackle the shortage of skilled workers, notably by increasing hours worked, strengthening basic, green and digital skills and better attracting and retaining talent from non-EU countries. Improve education outcomes, including by promoting excellence and providing targeted support to disadvantaged groups. Improve the availability and quality of early childhood education and care and whole-day schools to encourage carers, often women, to work and to promote equal opportunities for all children.

Done at Brussels,

For the Council
The President