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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Germany

and delivering a Council opinion on the 2017 Stability Programme of Germany

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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,[3]

Having regard to the resolutions of the European Parliament,[4]

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:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey,[5] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,[6] in which it identified Germany as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2017) 505 final.
4 P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
5 COM(2016) 725 final.
6 COM(2016) 728 final.

a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March 2017.[7]

(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 Recommendation for the euro area which is reflected in recommendations 1 and 2 below.

(3) The 2017 country report for Germany[8] was published on 22 February 2017. It assessed Germany's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the 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 22 February 2017.[9] The Commission's analysis leads it to conclude that Germany is experiencing macroeconomic imbalances. In particular, the persistently high current account surplus has cross-border relevance and reflects — besides a strong integration and performance of its highly competitive industry in the international division of labour — excess savings and subdued investment in both the private and the public sector. The current account surplus increased further in 2015, stayed largely unchanged in 2016 and is expected to remain at a high level. Addressing the surplus can have implications on the rebalancing prospects of the rest of the euro area and the EU because more dynamic domestic demand in Germany can ease deleveraging needs in highly-indebted Member States. Despite low interest rates that create favourable financing conditions, business investment as a share of GDP is still subdued. While the recovery in private consumption has continued, household savings have reached record high levels in the EU. The need for action to reduce the risk of adverse effects on the German economy and, given its size and cross-border relevance, on the economic and monetary union, is particularly important.

(4) On 13 April 2017 Germany submitted its 2017 Stability Programme and on 28 April 2017 Germany submitted its 2017 National Reform Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[10] where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review

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7 OJ C92/01, 24.3.2017, p. 1.

8 SWD(2017) 71 final.

9 COM(2017) 90 final.

10 Article 23 of 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.

and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[11]

(6) Germany is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2017 Stability Programme, the government plans a budget surplus of between ¼ and ½% of GDP over 2017-2021. The medium-term budgetary objective — a structural deficit of 0.5% of GDP — continues to be met with a margin throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline to 57% in 2021. The macroeconomic scenario underpinning these budgetary projections, which has not been endorsed by an independent body, is plausible.

(7) Based on the Commission 2017 spring forecast, the structural balance is forecast to register a surplus of 0.6% of GDP in 2017 and 0.3% of GDP in 2018, above the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path beyond the requirements of the debt rule. Overall, the Council is of the opinion that Germany is projected to comply with the provisions of the Stability and Growth Pact in 2017 and 2018. At the same time, there remains scope to support domestic demand by using fiscal policy notably to achieve a sustained upward trend in investment, and by creating conditions for higher real wage growth.

(8) Public investment as a proportion of GDP has remained largely constant and is below the euro area average. A public investment backlog persists in particular at municipal level, where net investment remained negative in 2016. This is despite the measures taken over the last few years and significant increases in public investment at general government level in 2015 and 2016. Additional measures were taken in 2016 which should increase the scope for public investment, including at federal State and municipal level. These include a reform of federal fiscal relations that, once adopted, will take effect in 2020. Moreover, extending consulting services on infrastructure investment planning to include municipalities should improve the planning and implementation of infrastructure investment at municipal level. This appears particularly relevant given that infrastructure investment projects in the federal States and municipalities are only executed to a limited extent and are influenced by capacity and planning constraints. The favourable budgetary position generally indicates available fiscal space, for example to provide additional funds to increase public investment at all levels of government.

(9) Overall public and private education and research expenditure has been rather stable relative to GDP in recent years, but it remains below the EU average. At 9.1 % in 2015 it fell short of the national target of 10 % of GDP. Additional investment in education, research and innovation is crucial for Germany's future economic success and in particular to effectively integrate recently arrived immigrants. To achieve the latter, Germany has undertaken considerable efforts, especially in the area of vocational education and training. In the coming years, comparable efforts will be necessary in other educational sectors.

(10) The German tax system remains complex, tax administration costs are high and several corporate taxation provisions may be hampering private investment. Despite significant reductions, corporate capital costs in Germany are still among the highest in the EU-28. When accounting for the local trade tax (*Gewerbesteuer*) and the solidarity surcharge, the top statutory tax rate on corporate income reached 30.2 % in

[11] COM(2014) 494 final.

2016. This was substantially above the non-weighted EU average of 22.8 %. The effective average tax rate is 28.2 % compared with a non-weighted average of 21.1 % for the EU. The bias towards debt in corporate taxation was the seventh highest in the EU in 2016. At shareholder level, the extent of the debt bias is similar. This matters in particular for SMEs, which tend to have domestic shareholders. Lowering the capital costs on equity could strengthen private investment and the underdeveloped German venture capital market. Other features of the tax system that might distort financing and investment decisions are the inclusion of non-profit elements in the tax base of the local trade tax, limitations on loss carry-forwards, and tax-induced distortions with respect to the choice of legal form. Further provisions that might reduce the investment-friendliness of the tax system include the depreciation regime, the interest rate used to calculate deductible pension provisions, the taxation of capital gains, and cash accounting for the purpose of value-added taxation. If implemented effectively, the additional general and IT-specific functional authority of the federal tax administration in relation to the States' tax administrations that was agreed as part of the reform of federal fiscal relations could help in accelerating the modernisation of the tax administration.

(11) Venture capital investment has increased in Germany, but the market still remains underdeveloped by international standards. In 2015, venture capital investment accounted for about 0.03 % of GDP, which is slightly above the EU average but still below Member States such as Finland, the United Kingdom, Sweden, Ireland or France, and far below non-EU Member States such as Israel and the United States. In particular, the venture capital market in Germany appears to be failing to provide bigger later-stage investments. The federal government has taken a number of measures to support venture capital investment. For example, it simplified the taxation of investment funds, improved loss carry-forwards under the corporate income taxation system and expanded the INVEST programme for business angels.

(12) The shift towards renewable energy necessitates significant investment in electricity distribution networks. However, planned investment in domestic electricity infrastructure has been significantly delayed. Only around 35 % of the highest voltage grid projects identified in the 2009 Energy Network Expansion Act had been implemented by mid-2016, mainly owing to public opposition. Of a current total of 6 100 km of power lines planned in the Federal Requirement Plan Act, only around 6 % have been approved and only 1 % have been constructed.

(13) There are still barriers to reaping the full benefits of digitisation. For example, Germany is not performing well in the availability of high-speed and ultra-fast broadband connections, in particular in semi-urban and rural regions. Computer usage by young Germans is comparatively low and many schools lack broadband access. Performance in digital public services is also below the EU average. In particular SMEs need to catch up in terms of digitisation. Only one fifth of SMEs have a digitisation strategy. A network of SME centres of excellence has been set up to strengthen and accelerate the digitisation of SMEs and the 'Industrie 4.0' platform brings together all relevant stakeholders. While business R&D investment is growing and Germany is close to achieving its Europe 2020 R&D intensity target, investment is increasingly concentrated in large companies, while the contribution of SMEs is declining. Moreover, an ageing population may also have an impact on entrepreneurial activity in the coming years.

(14) High regulatory barriers remain in the business services sector and regulated professions. The level of restrictions is higher than the EU average in particular for

architects, engineers, lawyers and accountants/tax advisers. In addition, the business churn rate for these professions is significantly lower than the EU average, which seems to indicate relatively low dynamism and competition in professional services in Germany. These barriers include shareholding and company form restrictions for architects and engineers, and multidisciplinary restrictions for architects, engineers and lawyers. Reducing these barriers could generate more intensive competition, resulting in more firms entering the market, and leading to benefits for consumers in terms of lower prices and broader choice. In January 2017 the Commission presented reform recommendations for regulation in professional services, as part of a package of measures to tackle barriers in services markets.[12]

(15) Employment has continued to rise and unemployment has fallen to historically low levels. However, the increase in employment has been partly due to an increase in part-time work, in particular among women, and has been only partially reflected in aggregate real wage growth, which decelerated in 2016. Disincentives to work for second earners and widespread part-time work are hampering the full use of the labour market potential. Better provision of quality and affordable full-time childcare, all-day schools and long-term care is a crucial lever for increasing female participation in the workforce. Joint taxation of income for married couples and free health care insurance coverage for non-working spouses discourage second earners, in many cases women, from taking up a job or increasing the number of hours worked. Moreover, lower labour market attachment is combined with a high gender pay gap of 22 % compared to an EU average of 16.3 % in 2015.

(16) Despite a slight reduction, mini-jobs remain widespread, with about 4.8 million people having a mini-job as their only job in September 2016. The number of temporary agency workers has quadrupled since 2005, reaching around 1 million (close to 3 % of total employment) in June 2016. Protection from potential abuses in temporary agency work and work contracts is expected to improve, yet developments deserve monitoring. In addition, fixed-term contracts appear to have a comparatively high wage gap of 27 % compared to permanent contracts.

(17) The tax wedge for low-wage earners is high in comparison with other Member States, thus reducing work incentives, take-home pay and consumption opportunities. Germany increased the minimum personal income tax allowance and child allowances and adjusted the income tax brackets. These measures tend to benefit low and middle income groups, but the overall impact on the tax wedge will be limited. In spite of recent substantial rises in real disposable income, wages and productivity evolutions have been diverging over a long period, leading to a considerable accumulated gap. Higher real wage growth would also contribute to reducing the high external imbalances.

(18) Germany has done considerable efforts in receiving asylum seekers and in integrating refugees and other immigrants. Further improvements appear possible, as in 2016 the number of job-seeking refugees increased to 10% of all unemployed. Labour market integration of people with a migrant background, in particular women, remains a major challenge which, including through the education system, also applies to children born in Germany with parents born outside the EU.

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[12] COM(2016) 820 final, COM(2016) 821 final, COM(2016) 822 final, COM(2016) 823 final, COM(2016) 824 final.

(19) Not all members of society have benefited equally from the overall positive economic and labour market developments of the last few years. After a period of increases, income inequality moderated only recently, while wealth inequality remains among the highest in the euro area. Moreover, the good labour market performance has not led to a decline in the risk of poverty. The at-risk-of-poverty rate in old age is above the EU average and the number of people at risk of old-age poverty is expected to increase in the coming years. The replacement rate of the statutory pension scheme is forecasted to further decline. At the same time, the rates of enrolment in second or third-pillar pension schemes are too low to fully compensate for the decrease in the replacement rate of the first pillar. If not offset, pension adequacy is thus expected to deteriorate. It remains to be seen how effective the recent proposals to improve incentives for later retirement (Flexi-Rente) can be in counteracting the incentives for early retirement introduced in 2014.

(20) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Germany's economic policy and published it in the 2017 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Germany in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Germany, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.

(21) In the light of this assessment, the Council has examined the Stability Programme and is of the opinion[13] that Germany is expected to comply with the Stability and Growth Pact.

(22) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 and 2 below,

HEREBY RECOMMENDS that Germany take action in 2017 and 2018 to:

1. Use fiscal policy to support domestic demand and achieve a sustained upward trend in investment. Accelerate public investment at all levels of government, especially in education, research and innovation, and address capacity and planning constraints for infrastructure investments. Further improve the efficiency and investment-friendliness of the tax system. Stimulate competition in business services and regulated professions.

2. Reduce disincentives to work for second earners and facilitate transitions to standard employment. Reduce the high tax wedge for low-wage earners. Create conditions to promote higher real wage growth, respecting the role of the social partners.

Done at Brussels,

For the Council
The President

[13] Under Article 5(2) of Council Regulation (EC) No 1466/97.