<u>SPRING 2020 REFORM BAROMETER – GERMANY</u>

European Semester - Overall assessment of 2019 cycle

	To what extent do you agree with these statements:		Detailed comments
1.	The National Reform Programme submitted by your Government (April 2019) is appropriate.	To some extent	As in previous years, the German NRP acknowledges the fundamental challenges the German economy is facing due to demographic change and digitalisation. However, it contains only limited and few long-term measures to address them. The NRP lacks ambition in strengthening competitiveness and productivity growth and creating attractive conditions for business investment, innovation and long-term employment. Even though the NRP promises to restrict social labour contributions to 40 %, it again does not include any measure on how to achieve this goal. First steps into the right direction are the "digital pact", which aims to improve digitization at schools, and the law on skilled labour immigration.
2.	The Commission's country specific recommendations for your country are appropriate.	To a large extent	Overcoming investment backlogs in infrastructure and education as well as investing in research and innovation are still key priorities to strengthen growth potential. Inefficiencies in the tax system need to be addressed urgently in order to strengthen private investment, foster innovation and secure international competitiveness. Incentives for a higher labour market participation and longer working hours need to be improved and the sustainability of the pension system secured.
3.	The Commission assessment of reform implementation the year before is appropriate.	To a large extent	As stated, the year before, the Commission is right in assessing the progress of reform implementation based on the former year's CSRs as limited. There has been some progress in public investment, but disincentives especially regarding later retirement and labour market participation remain. No progress has been achieved in improving the investment friendliness of the taxation system.

	To what extent do you agree with these statements:		Detailed comments
4.	The Commission assessment of excessive imbalances (in-depth review) is appropriate.	To some extent	As in previous years, the Commission identifies the current account surplus which relates to an accumulated excess of national savings to investment but also to a highly competitive manufacturing sector. However, the strong position of German companies on the global market is not detrimental to European partners as they are participating in supply chains and highest trade surpluses are with non-European countries. At the same time strong wage growth and expansionary policies continue to strengthen private consumption. Hence, contributing to an increase in domestic absorption. It should be noted that, and this is not just due to EU rules on macroeconomic imbalances, reducing account surpluses of this magnitude would entail a significant amount of time (several years).

Assessment of Country Specific recommendations 2019 in detail

		Q1: The recommendation is:	Q2: implementation on effort is:	Detailed comments
CSR **1a**	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.	Extremely important	Mixed	The conditions for business investments, especially by SMEs, still need to be improved urgently. A reform of the corporate tax system and a complete abolition of the solidarity surcharge would be useful steps in this direction. In addition, more public investment in areas such as education, research and development and digital infrastructure is necessary and could contribute to the enhanced competitiveness of German business and to productivity growth. Public investment as share of GDP has increased slightly but remains below the euro area average. An investment backlog persists in particular at municipal level. Planning and approval procedures need to be improved and speeded up.

		Q1: The recommendation is:	Q2: implementation on effort is:	Detailed comments
CSR **1b**	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.	Extremely important	Mixed	The availability of very-high capacity broadband has to be improved. The federal government has to substantiate and implement its vague announcements in its mobile network strategy. Furthermore, the European Electronic Communication Code has to be implemented in a swift manner. A focus of investment-related economic policy on the mentioned topics and also on regional disparities is of high importance. However, as correctly described in recital (12) Council Recommendations 2019 - Germany, for electricity grids reasons for a lack of investments are manifold. Next to the financial question there are more hindering barriers such as lacking acceptance on the local level, planning delays or pending disputes. Therefore, an investment strategy must address all these different aspects.
CSR **1c**	Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth.	Important	Unsatisfactory	Labour costs in the manufacturing sector in Germany are among the highest in Europe. Thus, weighing on international competitiveness and hindering private investment. A main driver is the high tax wedge on labour (on average 49.5%, OECD Taxing Wages 2019), which is the second highest among OECD countries. In order to strengthen employment and investment a permanent restriction of social security contributions to less than 40% is needed. Tax relief is also needed, for example by raising the income threshold at the top tax rate (42%). However, taxing wealth would not be a useful measure as this would first of all negatively affect SMEs and their employees. It should also be noted that wealth tax is not a successful model in the EU and is only (partially) levied by Spain, France and Luxembourg.

		Q1: The recommendation is:	Q2: implementation on effort is:	Detailed comments
CSR **1d**	Strengthen competition in business services and regulated professions.	Important	Mixed	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.
CSR **2a**	Reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners.	Extremely important	Unsatisfactory	In light of increasing skill shortages, it is crucial to reduce disincentives to work more hours. Referring to the high tax wedge (not only for low wage earners), contributions to the unemployment insurance system were reduced by 0.1 ppt with the start of 2020. However, this reduction is only temporary until 31 December 2022. It must not be used to justify an increase of contributions to other branches of social security. All in all, there is still no long-term plan to limit social security contributions to less than 40%. Instead, the recent pension package will lead to higher contributions being paid. Contrary to the objective of eliminating false incentives against an increase in working hours, the decided increase of the Midi-Job-Transition-Zone from 850 € up to 1.300 € even provides additional false incentives against an increase in working hours. The decided contribution and pension benefits have mainly an effect on part-time work. With the restriction of fixed-term contracts and the possibility to retire at 63 without deductions labour market participation is still rather hampered than incentivized. There is also still much room for improvement when it comes to the availability of child care.

		Q1: The recommendation is:	Q2: implementation on effort is:	Detailed comments
CSR **2b**	Take measures to safeguard the long-term sustainability of the pension system, while preserving adequacy.	Extremely important	Unsatisfactory	In November 2019, the coalition partners reached an agreement on a so-called “basic pension” (Grundrente). It foresees a pension supplement for people who have worked and paid contributions for 35 years and whose income is below a certain threshold. The proposal is expensive (costs amount to billions of euros) and lacks a solid financial basis. Furthermore, it is not an appropriate means to counter poverty in old-age and it would aggravate injustices in the pension system: A pensioner who is entitled to the “basic pension” would receive the same pension as a pensioner who paid almost twice the amount of contributions but is not entitled to it. Part-time-workers are particularly likely to benefit from the scheme. Thus, it creates more disincentives to increase working hours instead of reducing them. All in all, the government’s pension policy, including the double retention line, is not sustainable in the long term, puts a disproportionate burden on the younger generation and is likely to cause further financial transfers.
CSR **2c**	Strengthen the conditions that support higher wage growth, while respecting the role of the social partners.	Irrelevant	---	Wage growth should not be decoupled from productivity and be decided upon by social partners, not governments. Furthermore, it needs to be borne in mind that excessive wage growth might harm the competitiveness of German business. Labour costs in Germany are still 30 % higher than on average in the EU. Unit labour costs continue to increase strongly, whereas productivity growth remains very low. Hence, focus should be on increasing productivity growth, especially by improving conditions for private investment.

		Q1: The recommendation is:	Q2: implementation on effort is:	Detailed comments
CSR **2d**	Improve educational outcomes and skills levels of disadvantaged groups.	Important	Mixed	German government recognized the need to improve digital skills and concluded a digital pact with the Laender, aiming at promoting digitalization in schools with 5 billion Euro. However, progress is still unclear as the Laender have to contribute financially and develop/implement the respective concepts and curricula. A recent introduction of a minimum remuneration in vocational initial training/apprenticeships is a step backwards as it does not consider regional disparities and differences between sectors. The National Further Training Strategy (Nationale Weiterbildungs-Strategie) of 2019 - a common approach of government and economy – has a strong focus on raising the competence level of low qualified target groups by strategies for alphabetisation and for acquisition of modularised qualifications.

Reform Progress in your Member State in 2019

How would you assess reform progress in 2019, for the following broad areas:

Taxation and Public Finances	Unsatisfactory
Business environment (regulation/access to markets)	Unsatisfactory
Labour market	Unsatisfactory
Innovation and skills	Mixed
Access to finance and Financial stability	Satisfactory

Reform priorities for 2020

	I. Policy Area	II. Concrete Recommendations	III. Are the proposed recommendations already in the agenda of your Government?
Priority 1	Tax reforms	Improve effectiveness and investment friendliness of tax system	No
Priority 2	Labour supply measures for specific groups (older workers, women...)	Make labour laws more flexible regarding working hours in order to adequately adapt to digitization and individual demands	No
Priority 3	Public investment	Increase investment in particular in digital, transportation and energy infrastructure.	Yes
Priority 4	Making work-pay: interplay of tax and benefit system	Reduce the high social security contributions wedge (not more than 40% of gross income)	Yes
Priority 5	---	---	---