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Recommendation for a

COUNCIL RECOMMENDATION

on Germany's 2014 national reform programme

and delivering a Council opinion on Germany's 2014 stability programme

{SWD(2014) 406 final}

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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 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2014) 406 final.
4 P7_TA(2014)0128 and P7_TA(2014)0129.

the ‘integrated guidelines’. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on Germany’s national reform programme for 2013 and delivered its opinion on Germany’s updated stability programme for 2012-2017. On 15 November 2013, in line with Regulation (EU) No 473/2013[5], the Commission presented its opinion on Germany's draft budgetary plan for 2014[6].

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[7], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[8], in which it identified Germany as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for Germany[9], under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Germany is experiencing macroeconomic imbalances, which require monitoring and policy action. In particular, the current account has persistently recorded a very high surplus, which reflects the positive effects of strong competitiveness, with a large amount of savings being invested abroad. It is also a sign that domestic growth has remained subdued and economic resources may not have been allocated efficiently. Although the current account surpluses do not raise risks similar to large deficits, the size and persistence of the current account surplus in Germany deserve close attention. The need for action to reduce the risk of adverse effects on the functioning of the domestic economy and the euro area is particularly important given the size of the German economy.

(8) On 14 April 2014, Germany submitted its 2014 national reform programme and on 8 April 2014 its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) The objective of the budgetary strategy outlined in the 2014 Stability Programme is to ensure the continued achievement of the medium-term objective. The Stability Programme confirms the medium-term objective of -0.5 % of GDP, which reflects

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5 OJ L 140, 27.5.2013, p.11.
6 C(2013) 8001 final
7 COM(2013) 800 final.
8 COM(2013) 790 final.
9 SWD(2014) 78 final.

the requirements of the Stability and Growth Pact. According to the Stability Programme, the (recalculated) structural balance will remain positive in 2014 and thereafter and gross debt is planned to fall to 76 % of GDP in 2014 and to remain on a sufficiently downward path thereafter. Therefore, the budgetary strategy outlined in the programme is in line with the requirements of the Stability and Growth Pact. The macroeconomic scenario underpinning the budgetary projections in the programme, which has not been formally endorsed by an independent body, is plausible, as it is broadly in line with the Commission 2014 Spring Forecast. Based on the assessment of the Stability Programme and the Commission Forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that public finances in Germany remain overall sound as the medium-term objective is forecast to continue to be maintained and the debt rule respected.

(10) Only limited progress has been made by Germany in enhancing the cost-effectiveness of public spending on healthcare and long-term care, although new initiatives have been announced. While their aim is to improve the cost-effectiveness of health care, these plans might not be sufficient to contain expected future cost increases. The recently adopted pension reform aims to improve early retirement conditions ("*Rente mit 63*") and pension levels for certain groups, the latter also including a pension supplement for those having raised children born before 1992 ("*Mütterrente*"). The reform puts an additional strain on the sustainability of the public pension system and is planned to be financed by a higher pension contribution rate, with negative implications for disposable incomes of the active labour force. The reform could also have a negative impact on take-up of complementary second and third pillar pensions. Germany has made limited progress in increasing spending on education and some progress concerning higher research spending. Further efforts appear necessary at all levels of government to meet the target for total public and private expenditure on education and research of 10 % of GDP by 2015, and even more ambitious follow-up targets should be aimed for in order to catch up with the most innovative economies. Infrastructure investment has been increased in Germany in recent years and plans exist to reinforce it further, but additional efforts appear necessary.

(11) Germany has made overall limited progress in improving the efficiency and growth-friendliness of the tax system and to reduce the high tax burden on labour. No major measures are foreseen to shift towards more growth-friendly revenue sources. The application of the reduced value-added tax (VAT) rate (currently 7 %) could be narrowed and the general VAT base broadened. Rather low revenues from recurrent property taxes suggests that there is scope for increases and the distribution of the tax burden could be fairer if the tax base for the municipal real estate tax (*Grundsteuer*) would be reassessed. Conditions for investment in Germany could be further improved by reforming the local trade tax (*Gewerbesteuer*), cutting the administrative burden linked to tax collection, and reducing the existing corporate tax bias in favour of debt-financing.

(12) The fiscal framework has been complemented by a national balanced-budget rule and the establishment of an independent advisory board. Specific rules for implementing the constitutional balanced-budget rule ('debt brake') appear still to be required in several *Länder* so as to ensure the effective application of the debt brake in the annual budgetary cycle. The planned review of fiscal relations between the federation, *Länder* and municipalities should be used to strengthen fiscal responsibility and accountability.

(13) Wages have risen in recent years after a prolonged period of wage moderation, but in 2013 real wage growth was more moderate than in 2012. Germany plans to introduce a general minimum wage of EUR 8.50/hour in 2015, which will take full effect as of 2017. The introduction of the planned general minimum wage, which is aimed at ensuring an adequate minimum income for workers, requires close monitoring of its impact, notably on employment. Limited effort has been made to reduce the high tax wedge, notably for low-wage earners. The adopted pension reform and current reform plans in the area of long-term care, which involve a rise in social insurance contribution rates, could again increase the tax wedge. Germany has made some progress in raising the educational achievement of disadvantaged people, but the link between educational achievement and socio-economic background remains strong and persists over people's working life. Despite some progress towards appropriate activation and integration measures, long-term unemployment remains a concern, signalling a need for additional measures. Only limited progress has been made in taking measures to facilitate the transition from mini-jobs into forms of employment subject to full mandatory social security contributions. No progress has been made to reduce fiscal disincentives to work for second earners. Germany has made some progress in expanding the availability of full-time early childhood education and care places, while progress in the extension of all-day schools has been limited. At the same time, childcare facilities and all-day schools are still the subject of quality concerns and regional disparities.

(14) The government proposal for a revision of the Renewable Energy Act aims to slow down overall energy cost increases, distribute the costs more evenly across consumers, control the expansion of renewables and promote market integration. The implementation of the reform needs to be carefully monitored with regard to its impact on the cost-effectiveness of the support system. Further efforts are needed as regards network expansion and coordination with neighbouring countries.

(15) Policy action to further stimulate competition in the services sectors has been limited, even though isolated reforms in specific professions and regions have been enacted, for instance as regards authorisations and commercial communication in the construction sector. While productivity growth may be structurally lower in the service sectors than in industry, it is particularly low in some service sectors, notably professional services. There are still barriers to entering the market and exercising professional services. These include restrictions on the legal form and shareholding, and professional qualifications requirements. The diversity of regulatory arrangements for professional services across *Länder* suggests that there is scope for identifying the least burdensome regulatory approaches and extending them throughout the country. The value of contracts published by the German authorities under EU procurement legislation remains one of the lowest in the EU. The comprehensive transition to a transparent e-procurement market could increase competition. In the retail sector, planning regulations in certain *Länder* continue to restrict new entries in the market. Progress in improving competition in the railway markets has been limited.

(16) Germany has made limited progress on measures taken to consolidate the banking sector, in particular by improving the governance framework. Commission state aid decisions have largely driven the restructuring of *Landesbanken* in recent years and the sector remains fragmented. Further efforts are needed to address structural and governance obstacles that hamper a market-driven consolidation, which would also increase the overall efficiency of the financial sector. Reviewing the legal framework

of the second banking pillar could further support consolidation in the public banking sector.

(17) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Germany's economic policy. It has assessed the stability programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Germany but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (4) below.

(18) In the light of this assessment, the Council has examined Germany's stability programme, and its opinion[10] is reflected in particular in recommendation (1) below.

(19) 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 under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below.

(20) In the context of the European Semester the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations for Member States whose currency is the euro. Germany should also ensure the full and timely implementation of these recommendations.

HEREBY RECOMMENDS that Germany take action within the period 2014-2015 to:

1. Pursue growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective continues to be adhered to throughout the period covered by the Stability Programme and that the general government debt ratio remains on a sustained downward path. In particular, use the available scope for increased and more efficient public investment in infrastructure, education and research. Improve the efficiency of the tax system, in particular by broadening the tax base, notably on consumption, by reassessing the municipal real estate tax base, by improving the tax administration and by reviewing the local trade tax, also with a view to foster private investment. Make additional efforts to increase the cost-effectiveness of public spending on healthcare and long-term care. Ensure the sustainability of the public pension system by (i) changing the financing of new non-insurance/extraneous benefits ("*Mütterrente*") to funding from tax revenues, also in order to avoid a further increase of social security contributions, (ii) increasing incentives for later retirement, and (iii) increasing the coverage in second and third pillar pension schemes. Complete the implementation of the debt brake consistently across all *Länder,* ensuring that monitoring procedures and correction mechanisms are timely and relevant. Improve the design of fiscal relations between the federation, *Länder* and municipalities also with a view to ensuring adequate public investment at all levels of government.

2. Improve conditions that further support domestic demand, inter alia by reducing high taxes and social security contributions, especially for low-wage earners. When implementing the general minimum wage, monitor its impact on employment. Improve the employability of workers by further raising the educational achievement of disadvantaged people and by implementing more ambitious activation and

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

integration measures in the labour market, especially for the long-term unemployed. Take measures to reduce fiscal disincentives to work, in particular for second earners, and facilitate the transition from mini-jobs to forms of employment subject to full mandatory social security contributions. Address regional shortages in the availability of fulltime childcare facilities and all-day schools while improving their overall educational quality.

3. Keep the overall costs of transforming the energy system to a minimum. In particular, monitor the impact of the Renewable Energy Act reform on the cost-effectiveness of the support system for renewable energies. Reinforce efforts to accelerate the expansion of the national and cross-border electricity and gas networks. Step up close energy policy coordination with neighbouring countries.

4. Take more ambitious measures to further stimulate competition in the services sector, including certain professional services, also by reviewing existing regulatory approaches and converging towards best practices across *Länder*. Identify the reasons behind the low value of public contracts open to procurement under EU legislation. Increase efforts to remove existing planning regulations which restrict new entries in the retail sector. Take action to remove the remaining barriers to competition in the railway markets. Pursue consolidation efforts in the *Landesbanken* sector, including by improving the governance framework.

Done at Brussels,

For the Council
The President