Federal Ministry
for Economic Affairs
and Energy

SOZIALE MARKT WIRT SCHAFT

2019 Annual Economic Report

Strengthening the social market economy – leveraging potential for growth, boosting competitiveness

Imprint

Publisher
Federal Ministry for Economic Affairs
and Energy
Public Relations Division
11019 Berlin
www.bmwi.de

Text and editing
Federal Ministry for Economic Affairs
and Energy
Editing team JWB 2019
JWB2019@bmwi.bund.de

Current as at
January 2019

Printed by
Druck- und Verlagshaus Zarbock GmbH & Co. KG
60386 Frankfurt am Main

Design
PRpetuum GmbH, 80801 München

Image credits
Kugler / Bundesregierung / S. 6

You can obtain this and other brochures from:
Federal Ministry for Economic Affairs and Energy,
Public Relations Division
Email: publikationen@bundesregierung.de
www.bmwi.de

Central ordering service:
Tel.: +49 30 182 722 72
Fax: +49 30 181 027 227 21

Federal Ministry
for Economic Affairs
and Energy

SOZIALE
MARKT
WIRT
SCHAFT

2019 Annual Economic Report

Strengthening the social market economy – leveraging potential for growth, boosting competitiveness

Contents

List of diagrams

List of overviews

List of boxes

Preface

The German economy is continuing to grow this year for the tenth successive year. The economic successes of recent years form part of the continuity of seventy years of success of Germany's economic model – the Social Market Economy. The Social Market Economy has proven to be an efficient economic system because it combines individual freedom, social participation and responsibility for society.

"Prosperity for all" has long since ceased to be a distant utopia: the economic successes of recent years are reaching Germany's citizens. The rise in employment is continuing, the unemployment rate will probably fall further in 2019, and there will be a further increase in employees' net wages and salaries.

However, past successes cannot hide the fact that the headwinds, mainly from outside Germany, are getting stronger. Overall, the underlying cyclical dynamism is likely to slow to some extent. On top of this, there are the overarching challenges facing our economy, primarily digitisation, which is revolutionising the corporate landscape and placing question marks over traditional forms of work and economic models. The same goes for demographic change, globalisation and Europe's future – economic policy must respond to these developments in order to continue the successes of the Social Market Economy.

This makes it all the more important to set the course for future growth. The engine of the Social Market Economy only keeps running due to the hard work and productivity of the companies and their employees. We need to create greater room for enterprise, and in particular, to utilise the financial scope available. I find it especially important to keep the level of social security contributions below 40% of wages and salaries. The aim must be to make the German economy more competitive and more attractive to investors. One element of this is the introduction of tax incentives for research and development. But that is not enough on its own: we need to become so competitive on taxes that German firms, and SMEs in particular, remain competitive in a changing global tax environment.

Digitalisation is revolutionising our economy and the world of work. In order to utilise the opportunities, we need to stimulate and maintain entrepreneurial creativity, entrepreneurial spirit and the pleasure of innovation. My economic policy is focused on boosting the level of start-up activity and self-employment. If the market-based dynamism is to be maintained, new companies must keep bringing innovative products and business models to the market. I have therefore launched a start-up campaign which is providing additional funding for innovative start-ups in 2019. Further to this, the new KfW venture capital company KfW Capital is to foster the market for venture capital. In order to safeguard the long-term success of the Social Market Economy in the digital era, the Federal Government has adopted the "Shaping the course of digitisation" strategy, formulated the goals of digital policy and pooled the priority digitisation projects. These include a modern "ordoliberal" digital policy which gives companies security whilst facilitating start-ups and innovation by allowing businesses to access and use data. I am particularly excited by the use of living labs as regulatory test beds for new business models. These will help us in the Federal Government to understand how best to develop the regulatory framework.

In the Social Market Economy, the state delivers a reliable policy environment which safeguards the competitiveness of the economy. This policy environment includes fair international competition and highly innovative basic research. Against this backdrop, I am pursuing a modern industrial policy. Targeted backing is to be given to key enabling technologies, and technological sovereignty is to be maintained in key areas of technology. Particularly, great potential can be found in the establishment of battery cell manufacturing in Europe, AI and the bio-economy.

A stability-oriented economic and fiscal policy is based on two pillars: sound public-sector finances, and investments in the fundamentals of our prosperity. With its balanced budget and no new borrowing, the Federal Government is delivering solid public-sector finances. At the same time, the federal budget provides for much higher spending on investment in future years than was the case in the last legislative term. At €154.5 billion in 2018-2021, a record level of expenditure is allocated for investment in this legislative term.

One consequence of demographic change is a lack of skilled workers. This can slow down macroeconomic growth. We need to resolutely tackle the impending skills shortage. In the shape of the Skilled Immigration Act, we have put in place a modern framework to steer and regulate the influx of qualified workers to Germany.

In the field of energy policy, we are continuing to strike a balance between security of supply, environmental compatibility and affordability. At the same time, the expansion of the power grid is becoming more and more urgent, because not enough new powerlines are being built to keep pace with the expansion of renewables. It is therefore important to speed up the expansion of the grid and to make better use of the existing grid. This is where the Grid Expansion Acceleration Act 2.0 comes into play: it is to simplify and speed up approval procedures whilst ensuring that the public is involved in the process. I have also taken a step towards a more appropriate distribution of the grid expansion costs by enacting the Ordinance on the Gradual Introduction of Uniform Nationwide Transmission Grid Fees.

Germany remains very closely integrated with the rest of Europe. Our economy will only flourish when Europe does well. Even after the economic and financial crisis, structural challenges still exist, e.g. in the Economic and Monetary Union. It is therefore necessary to bring about a lasting improvement in the growth potential of Europe's Member States. The triad of ambitious structural reforms, pro-growth fiscal consolidation, and accelerated investments is a good way to make Europe fit for the future.

It is clear that we will only continue to enjoy further growth and a high level of competitiveness if our economic policies offer scope for individuals to realise their ideas. It is necessary to ensure that companies both small and large, as well as individuals, remain able to participate in economic and social life.

Peter Altmaier
Federal Minister for Economic Affairs and Energy

The 2019 Annual Economic Report of the German Federal Government

In accordance with Section 2 of the Act to Promote Economic Stability and Growth, the Federal Government hereby submits its 2019 Annual Economic Report to the German Bundestag and the Bundesrat. It also provides benchmark data for the overall orientation of the economy in 2019, in accordance with Section 3 of the Act.

In Part I of the Report, the Federal Government presents central priority fields of economic and fiscal policy. The German version of this Annual Economic Report also contains an Annex which provides a detailed inventory of the measures that the Federal Government has taken since the submission of the 2018 Annual Economic Report as well as the measures planned for 2019. As stipulated by the Act to Promote Economic Stability and Growth, Part II of the Report discusses the Government's projection of overall economic trends in the current year.

The Federal Government would like to thank the German Council of Economic Experts (GCEE) for its detailed and comprehensive analysis of economic developments in 2018 and the outlook for 2019, as well as for its discussion in its 2018/19 Annual Report of the guiding principles of economic policy. In the Annual Economic Report, the Federal Government comments on the Council of Economic Experts' 2018/19 Annual Report.

In preparing the Annual Economic Report, the Federal Government discussed its economic and fiscal strategy with the *Länder* and municipalities within the framework of the Konjunkturrat für die öffentliche Hand (a government economic advisory council). This strategy was also discussed with union representatives as well as with the Gemeinschaftsausschuss der Deutschen Gewerblichen Wirtschaft (a joint committee that serves as a co-ordinating body for German business associations).

I. The Federal Government's economic and fiscal policy

A. Building on success, strengthening the Social Market Economy for the future

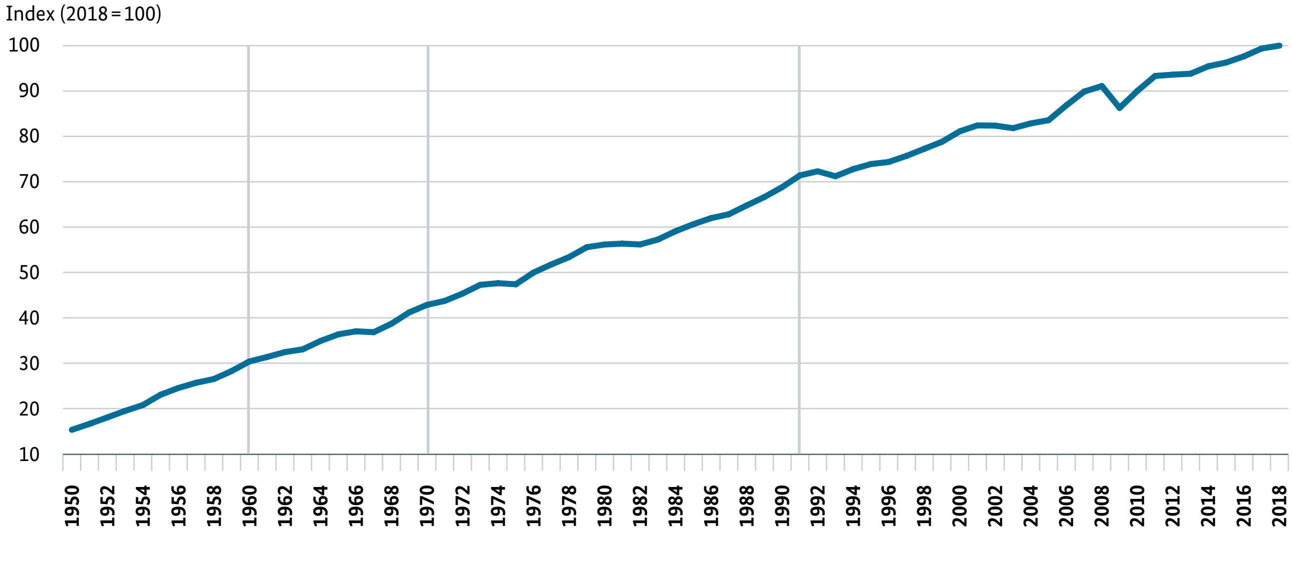
1. The German economy is continuing to grow, making this year the tenth successive year of expansion. The Federal Government expects a 1.0% increase in price-adjusted gross domestic product in 2019. The labour market is continuing to develop positively. The unemployment rate is expected to drop to 4.9% in 2019, whilst the number of people working rises further to 45.2 million. As a consequence, personal incomes will again see a substantial increase: the net wages and salaries of employees will grow by 4.8% in 2019, with a role being played by the cuts in taxes and charges. In view of rising wages, employment and corporate investment, the domestic economy will remain an important pillar of economic activity. At the same time, the low interest rates are providing a clear stimulus, particularly for the construction sector. The expansionary fiscal policy is giving the economy a further boost. Overall, Germany's economic development remains positive, but it has entered more troubled waters. The risks, primarily from the external economic environment, have increased. This is a reason why the pace of growth is slower than it was last year.

2. The economic successes of recent years fit into the impressive success story of the Social Market Economy, which has now served as Germany's economic model for seventy years: economic output – measured as per-capita GDP – has more than sextupled since 1950 (cf. Diagram 1). Whilst GDP – measured in 2018 prices – amounted to approximately €6,300 per inhabitant in 1950, it rose to roughly €40,900 per inhabitant in 2018.

3. Despite all the past successes, it must be noted that the economic opportunities and risks have changed over time. At present, the digitisation of commerce and society is of outstanding importance. It is not only revolutionising the corporate landscape and its business models: it will also transform all areas of work, learning and communication. Globalisation offers major opportunities, but has also brought challenges and risks in recent times. In particular, protectionist tendencies pose a risk to an open economy reliant on free world trade. Furthermore, climate change is creating major challenges for Germany and the international community. Demographic development is resulting in a decline in the total labour force and a growing need for old-age pensions, health and long-term care. The Federal Government thus agrees with the German Council of Economic Experts about the major challenges facing the German economy (cf. GCEE Annual Report, Items 2 and 24 ff.).

4. In view of these challenges, the principles of the Social Market Economy continue to guide the Federal Government's economic and fiscal policy: the Social Market Econ-

Diagram 1: Development of the price-adjusted gross domestic product per capita since 1950



Source of underlying figures: Federal Statistical Office. The figures in the chained-back series are not fully comparable due to changes in the definition of the National Accounts. Until 1990: former federal territory (West Germany).

omy combines an efficient economic system characterised by individual freedom, responsibility for one's actions, free collective bargaining and competition with a welfare system, social participation and responsibility for society. In the light of digitisation, economic policy needs to respond to the digital transformation in all areas with a view to maintaining macroeconomic prosperity: it needs to focus on structural change, corporate processes and the world of work, and on education from schools through to vocational training and life-long learning. A Social Market Economy in the age of globalisation means that welfare gains resulting from cross-border trade in goods and services should benefit the totality of economic actors. At the same time, it is necessary to counter protectionist tendencies, to defend global free trade and multilateralism, and to modernise the rules governing trade and investment via cooperation at European and international levels. Finally, the ongoing process of demographic change requires answers regarding the maintenance of the growth potential, the labour market and the social security systems. In the light of these and other long-term trends, there is a need for structural decisions to maintain and strengthen the viability of the Social Market Economy.

Creating scope for action, enabling participation, promoting investment

5. The Social Market Economy thrives on the commitment and productivity of its protagonists. For this reason, economic policy must set incentives which ensure that achievers – entrepreneurs and employees – can harvest the fruits of their hard work. For example, use is being made of fiscal scope – not least in the form of cuts in taxes and welfare charges – to safeguard sustainable growth and further strengthen social cohesion. In order to ensure that scope remains in place in future for employees and companies, and that Germany remains competitive – whilst maintaining appropriate welfare benefits in the interest of a sustainable economic development – the Federal Government intends to keep social security spending below the 40% level. In this context, it has reduced the contribution to unemployment insurance. Furthermore, the Act to reduce the burden on families is increasing the disposable income of private individuals: the basic personal allowance is being aligned with the increased subsistence level and fiscal drag is being offset; also, child benefits and the child allowance are being increased. The Act to reduce the burden on families alone results in relief totalling €9.8 billion in 2019 and 2020 (annualised figure).

6. The Federal Government will provide companies with pro-growth, fair tax conditions on a lasting basis. To this end, the Coalition Agreement contains a first key measure to boost competitiveness in the form of tax breaks for research funding (cf. Item 93). The Federal Government will present draft legislation for this in the first half of 2019. Further to this, the Federal Government is constantly reviewing corporate tax legislation in terms of the need to adjust it to a changing situation, particularly with regard to small and medium-sized enterprises. An important element is the abolition of the solidarity surcharge, starting with a clear first step for 90% of those paying the surcharge in order to reduce the overall tax burden on individuals.

7. "Prosperity for all" also means that all of Germany's regions must participate in the economic expansion. Here, again, there are both familiar and fresh challenges: for example, the eastern German *Länder* have yet to fully catch up, despite impressive progress (cf. Annual Report on the Status of German Unity in 2018, pp. 16 ff.). Further to this, structural change, e.g. in the course of advancing digitisation, globalisation and policies on energy and climate change, is a development of national significance. In order to provide a fresh regional stimulus against this background, the Federal Government set up the Commission for Growth, Structural Change and Employment and the Commission on Equal Standards of Living. In particular, the latter is to draw up a national funding system for structurally weak areas for the time after the Solidarity Pact II expires at the end of 2019. The overarching goal of the Federal Government's efforts is to make it possible for the regions to participate in social and economic progress and to permit the economic potential to be tapped all around Germany.

8. The public-sector budget has been in surplus since 2014. The overall public-sector debt ratio has been falling steadily since 2013 and, according to the current projection by the Federal Government, will be below the Maastricht threshold of 60% of GDP this year. This development has been fostered not only by a good cyclical situation but also by the very favourable interest rates. With its balanced budget and no new borrowing, the Federal Government is contributing to solid public-sector finances. At the same time, the federal budget provides for much higher spending on investment in future years than was the case in the last legislative term. The Federation's spending on investment is to rise by €32.8 billion in 2018 – 2021 compared with the 2014 – 2017 period (€121.7 billion) (cf. Diagram 2). At €154.5 billion in 2018-2021, a record level of expenditure

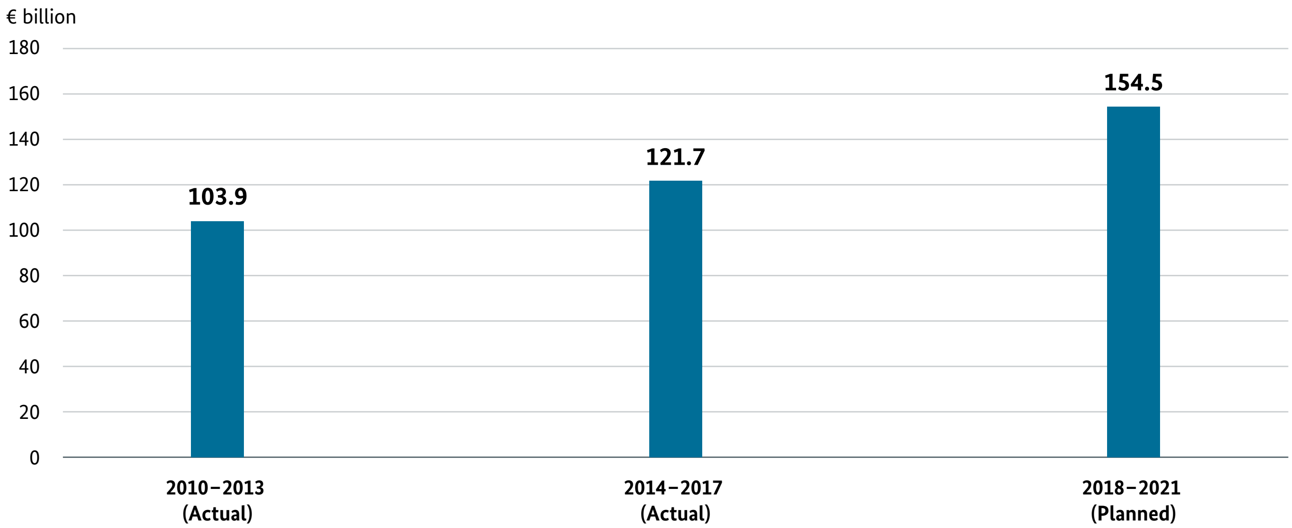
is allocated for investment in this legislative term even though the €10 billion Investing-in-the-Future Programme from 2015 is expiring. Also, the unbundling resources amounting to approximately €3 billion are being transferred to regular VAT shares of the *Länder* from 2020. This means that they will no longer be recorded as investment by the Federation, but will still be available to the *Länder* for investment. The Federal Government is combining sound budgets with higher investment and will continue to improve the foundations for future growth in the coming years.

9. Not least, the Federal Government is relieving the burden on the *Länder* and municipalities in the field of welfare spending and municipal investment activity. The measures adopted in 2018 mean that the Federation will relieve the burden on the *Länder* and municipalities by an additional €29 billion up to 2022. The areas affected are the costs of migration (€6.3 billion), municipal transport (€1.7 billion), child day-care centres (€5.5 billion), all-day schools/care for children of primary school age (€2 billion from 2020) and social housing including compensatory funding (an additional €2.5 billion for 2019 – 2021). Also, the Federal Government has put the sub-constitutional preconditions in place so that it can continue to give the *Länder* and municipalities targeted assistance with the expansion of digital infrastructure. The revenues of the "Digital Infrastructure" special fund include the revenues from the auctioning by the Federal Network Agency of 5G frequencies for mobile communications. In 2018, the special fund was launched with €2.4 billion from the federal budget. Furthermore, from 2019, the *Länder* contribution to the "German Unity Fund" will end. This will increase the *Länder*'s share of VAT by over €2.2 billion from 2019, to the detriment of the Federation. Beyond this expenditure, some of which is designated a priority by the Coalition Agreement, the fiscal relations between the Federation and the *Länder* were radically restructured in mid-August 2017. From 2020, the *Länder* will enjoy financial relief of rather more than €9.7 billion a year.

Shaping digitisation, improving the environment for innovation, SMEs and industry

10. In the course of digitisation, structural change in the economy will be even faster than it has been in the past. Key factors for the success of the Social Market Economy are therefore entrepreneurial creativity, entrepreneurial spirit and the joy of innovation. The Federal Government is banking on the dynamism of companies whose ideas and products are a major engine of innovation and progress. It is improving the policy environment in numerous areas, particularly for small and medium-sized enterprises (SMEs). If the market-based dynamism is to be maintained, it is

Diagram 2: Federal spending on investment (2010 – 2021)



Source: Federal Ministry of Finance. Excludes payments to the ESM (2012-2014); in 2018 including allocation of €2.4 billion to Digital Infrastructure special fund), from 2020 excluding unbundling funds (*Länder* then receive these in their share of VAT).

important that new companies keep bringing innovative products and business models to the market. For this reason, a key priority of economic policy is to boost the level of start-up activity and self-employment. The Federal Government has launched a start-up campaign and is providing additional funding for innovative start-ups in 2019. It is working to encourage a new culture of entrepreneurship and structures that foster spin-offs from science and research. Further to this, the new KfW venture capital company KfW Capital is to foster the market for venture capital. The third Cutting Bureaucracy Act is to significantly reduce the compliance costs for businesses. The Federal Government is supporting private-sector initiatives by providing enhanced and reformed funding for research and development and by setting up an Agency for Breakthrough Innovations. The plans also include an initiative to improve technology transfer and tax breaks for research and development, particularly for SMEs (cf. Item 6).

11. In order to safeguard the long-term success of the Social Market Economy in the digital era, the Federal Government has adopted the "Shaping the course of digitisation" strategy, formulated the goals of digital policy and pooled the priority digitisation projects. If Germany is to remain competitive in future, it needs nation-wide, high-capacity digital infrastructure. In order to support the broadband rollout, particularly in rural areas, and to improve the digital infrastructure for schools, a Digital Infrastructure special fund has been set up. Another key milestone is the adoption of the European Electronic Communications Code, which sets important regulatory incentives for comprehensive private-sector investment in high-performance digital infrastructure. The ongoing development of the Digital Single Market strategy is of high overall priority at the European level. A further key aim of the Federal Government is to support SMEs as they undergo the digital transformation and address IT security, e.g. via the expansion of the Mittelstand 4.0 centres of excellence, the establishment of a programme for grants towards investments in digital technologies and expertise, and the strengthening of the IT Security in Business initiative. Another priority is to promote the development of cutting-edge digital technology. This includes the funding for artificial intelligence (AI) on the basis of the Federal Government's AI Strategy and the drafting of a Blockchain Strategy. Finally, the issue of data protection is of great importance. The Federal Government has set up a Data Ethics Commission to draw up responses to ethical and legal issues relating to the use of algorithms, AI and digital innovations. The state will increasingly digitalise its activities. The aim is that all administrative services provided by the state to its citizens and companies are provided digitally.

12. Further to this, the Federal Government is continuing to adapt the regulatory framework to the needs of digitisation. Market-based competition must continue to serve as an engine of economic progress in future and in the digital economy. For this reason, the 10th amendment to the Act against Restraints of Competition is to modernise national competition law and accelerate procedures. Further to this, the Federal Government has set up a commission on "Competition Law 4.0", which is to draft recommendations for action for a revision of EU competition law, in particular, by the autumn of 2019. The Federal Government shares the overarching view of the Council of Economic Experts that regulation should not result in distortions of competition for new competitors and companies already on the same market (cf. GCEE Report Item 160).

13. In the Social Market Economy, the state supports the decisions made by private actors and market processes by putting a reliable framework in place which safeguards competition. Further commitment by the state to individual sectors can, in particular, be justified when it comes to ensuring a level international playing field or funding basic research. This is the case, for example, with regard to the establishment of battery cell manufacturing in Europe, AI and the bio-economy. These key enabling technologies can make a major contribution towards safeguarding the long-term competitiveness of German industry. Against this background, the Federal Government will present an industrial policy strategy to boost targeted key enabling technologies and to maintain technological sovereignty in key areas of technology.

Meeting the demand for skilled workers, setting up social security for the future

14. The robust development on the labour market is continuing, so that a new record level of employment can be expected in 2019 (cf. Diagram 3). At the same time, the companies are finding it increasingly difficult to recruit suitable staff in certain sectors and regions. Skills shortages can prevent companies from making full use of the opportunities open to them. This can slow down macroeconomic growth. In view of demographic change, the skills shortages may become even more obvious in future. Even if there is a considerable amount of immigration, the number of people of working age (15–64 years) in Germany is likely to fall by

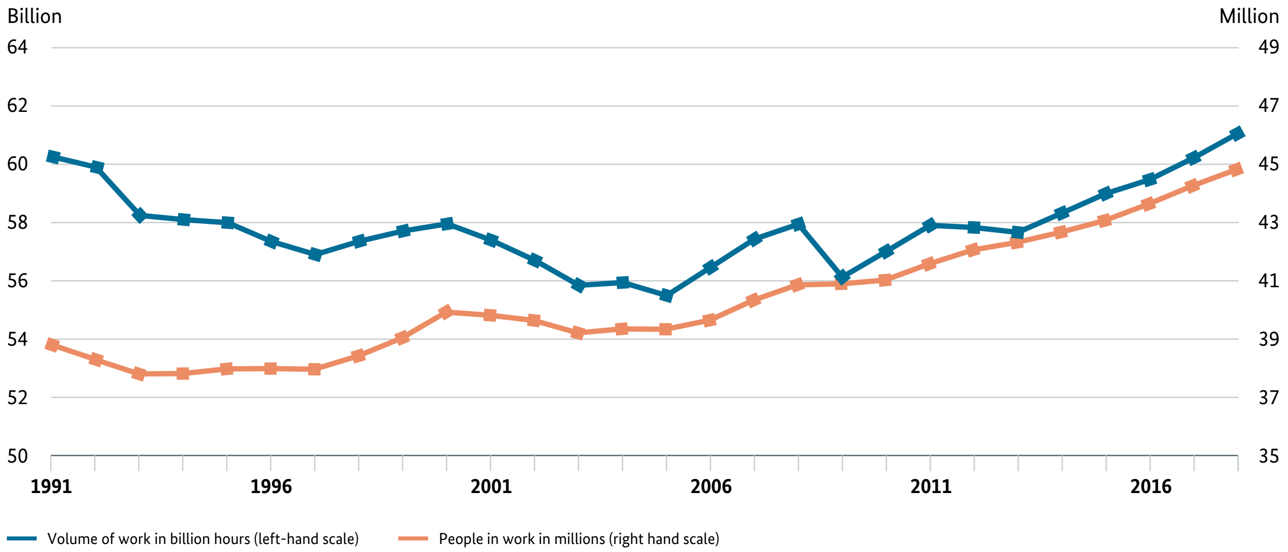
more than eight million by 2050. This equates to roughly one-sixth of the total labour force in 2017. The mobilisation of skilled workers will therefore develop more and more into a challenge for the Social Market Economy. More than six out of every ten companies say that the skills shortage poses the greatest risk to their business.

15. To address skills shortages in Germany, the Federal Government is pursuing a three-pillar Skilled Labour Strategy: firstly, the aim is to attract people in Germany to join the labour market and to improve their skills; secondly, the aim is to utilise the possibilities offered by the free movement of skilled workers from EU Member States; and thirdly, the aim is to attract qualified professionals from outside the EU. If even greater use is to be made of the domestic labour potential, attention must be paid to the changing skills requirements in the course of digitisation. For this reason, the Bundestag has adopted legislation like the Act on Opportunities to Gain Qualifications, on the basis of which the promotion of further training opportunities for employees and the unemployed will be expanded so that they can develop their skills in the face of technological change. Here, it is also important for companies to identify future requirements and provide for further training and recruitment programmes.

16. In addition to tapping the skills available on the domestic and European markets, Germany also needs to become even more attractive for qualified professionals from outside the EU. This is to be addressed by a Skilled Immigration Act and accompanying measures. The aim is to put in place a modern framework to steer and regulate the influx of qualified workers to Germany. The Skilled Immigration Act improves the legal framework for the recruitment of skilled workers from outside the EU. Further measures are to include improvements on the recognition of foreign qualifications and the promotion of German language skills in Germany and abroad, a strategy to attract skilled workers here and abroad, developed together with the business community, and more efficient and transparent administrative procedures.

17. The demographic development also creates a major challenge for the social security system. The Federal Government has adopted a pensions package with specific measures, which include improved entitlements in the case of reduced earnings capacity and for child-raising periods, and a reduction in the burden of charges borne by low-earners. Further to this, the contribution rate to pension insurance is not to rise above 20% up to 2025, and the level of pensions is not to drop below 48%. The handling of long-term challenges in the context of pension provision is being worked on by the Reliable Intergenerational Contract commission. The Federal Government has also taken measures to reduce the burden on people paying in contributions in the form of the return to parity-based financing

Diagram 3: Development of volume of work and number of employees



Source: Federal Statistical Office.

and the reduction in the minimum contributions for self-employed persons voluntarily insured in statutory health insurance schemes, and the reduction in the contribution to unemployment insurance. At the same time, the Federal Government has decided to increase the contribution rate to long-term care insurance by 0.5 percentage points. This will make it possible to fund important measures to improve the situation of people in need of care and to make the working conditions more attractive for carers in order to reduce the burden on them and to attract more people to work as carers.

18. Adequate housing is an indispensable precondition for quality of life in general, and is also a basis for employment and the retention of workers at a specific location. Supply and demand on the housing market vary extremely widely around Germany. Whilst the housing market is tense in many conurbations and regions with brisk economic activity, and has experienced sharp price rises in recent years, properties lie vacant elsewhere. In September 2018 the Federal Government adopted key principles for a housing campaign. In order to expand the housing supply and thus to help relieve the tensions on the housing market, the Federal Government aims to boost the construction of social housing, to give tax breaks to the construction of new rented accommodation via a special depreciation allowance, and to introduce a building-related child benefit. A reform of the housing benefit in 2020 is to improve housing benefit. Further to this, the Federal Government is aiming at a rapid reform of real property tax. The Federal Government also aims to strengthen municipalities affected by an exodus of inhabitants as places to live and work, thereby relieving the burden on the tense housing markets in the conurbations.

Pressing ahead with the energy transition on a market basis

19. The energy transition is a central, long-term policy to make Germany attractive for business and to safeguard the Social Market Economy. In this way, the Federal Government aims to attain its energy and climate targets at national and European level and to meet the commitments deriving from the Paris agreement on climate change. In particular, the Federal Government adopted the Climate Action Plan 2050 to this end in 2016, and it will underpin this with a programme of measures. The triad of energy policy goals – security of supply, environmental compatibility and affordability – remains the key principle for Germany's energy policy. In order to ensure that the energy transition stays affordable for commerce and individuals, it is important to implement it as efficiently as possible in macroeconomic terms, e.g. by making more use of competitive procedures. The structural change entailed by the energy transition needs to be supported in a way that offers the affected sectors and regions opportunities for sustainable economic dynamism and high-quality employment.

20. A major determinant of the success of the energy transition is the expansion of the grid, which has not so far been able to keep pace with the expansion of renewable energy. As a consequence, it is not always possible to transport electricity generated from renewable energy from the main centres of generation to the main centres of consumption. It is therefore necessary to optimise, upgrade and expand the electricity grid. Furthermore, the expansion of renewables must be more synchronised with the expansion of the grid. A crucial role here is played by the capacity of the electricity grids to take up renewable electricity. In order to speed up the expansion of the grid and to make better use of the existing grid, the Federal Government has launched measures to flesh out the Electricity Grid Action Plan, including a draft for a revised Grid Expansion Acceleration Act (NABEG 2.0). The Federal Government has already taken a step towards a more appropriate distribution of the grid expansion costs by enacting the Ordinance on the Gradual Introduction of Uniform Nationwide Transmission Grid Fees.

21. Over the last few years, the Federal Government has placed the expansion of renewable energy on a more market-oriented basis. In particular, most of the funding rates to support the generation of electricity from renewable energy have been set by competitive auctions since 2017. This has resulted in a more cost-efficient expansion. Overall, it has proved possible to stabilise the price of electricity for private residential customers (cf. Diagram 4).

22. In addition to the market-based expansion of renewable energy and the expansion of the grid, higher energy efficiency has a particularly great contribution to make towards a more cost-efficient energy transition. The Federal Government will therefore adopt a horizontal energy efficiency strategy. It is to contain specific measures to attain the German contribution to the EU's energy efficiency target for 2030, as well as a long-term roadmap to halve energy consumption by 2050. The Federal Government plans to revise the legislation on energy conservation in buildings in the form of a Buildings Energy Act. Furthermore, the Federal Government is examining various ways to design the tax-based support for improving the energy

performance of buildings, as agreed in the Coalition Agreement as a priority measure, also taking account of the budgetary requirements of the Coalition Agreement, in order to attain the energy and climate targets in the buildings sector.

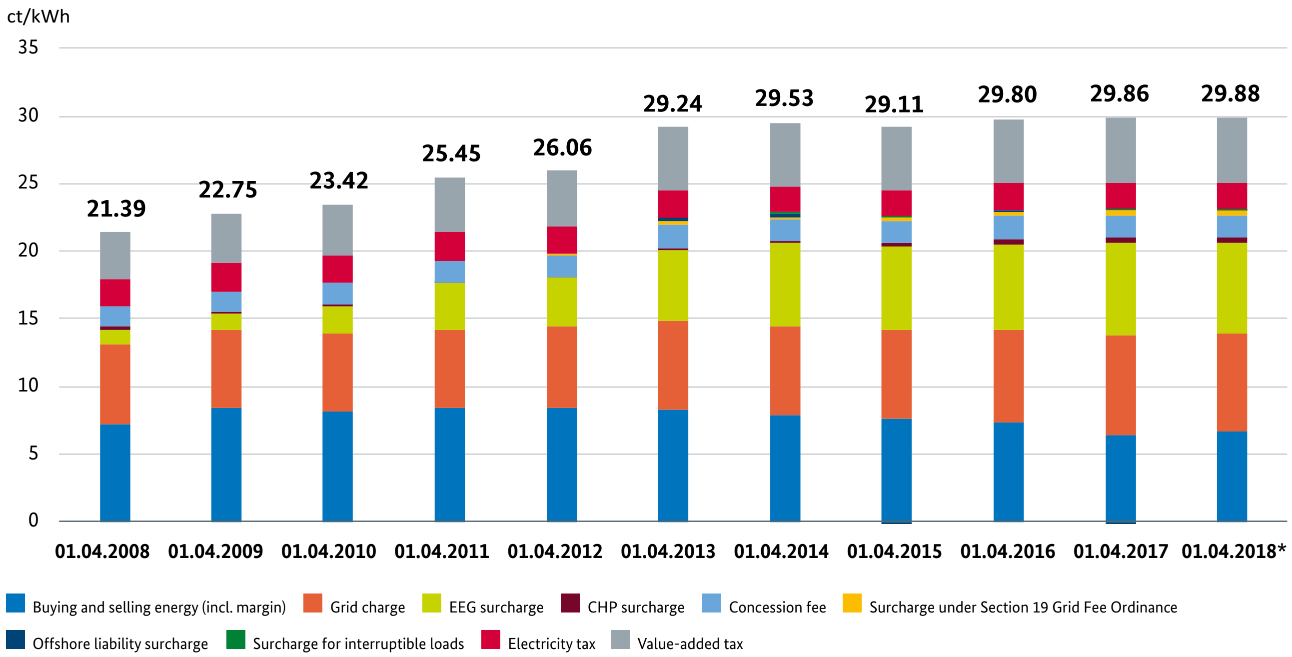
23. "Prosperity for all" can only exist in the long term if economic actors and economic policy orient themselves to a sustainable development. The Federal Government is therefore committed to the basic principle of sustainability. It is advocating observance of this principle at all levels and by all actors, national and global. The implementation of the Agenda 2030 and the fostering of sustainable development set the benchmark for the government's policies. As the Agenda 2030 continues to be rolled out, the Federal Government has updated the German Sustainability Strategy and will continue to revise it until 2020.

Consolidating Europe, continuing the development of the Economic and Monetary Union

24. Germany's Social Market Economy is deeply embedded in Europe. The project of European unification is a fundamental precondition not only for peace and social cohesion, but also for economic success and the high and rising level of affluence in Germany. Whilst the economic crisis has been overcome, and all the EU Member States are recording positive growth rates, structural challenges remain in many parts of the EU, e.g. in the financial market sector, and in terms of public debt, unemployment and competitiveness. It is therefore necessary to bring about a lasting improvement in the growth potential of Europe's Member States. To this end, the Federal Government is continuing to rely on a triad of ambitious structural reforms, pro-growth fiscal consolidation, and accelerated investments.

25. In this context, the Federal Government welcomes the focus on innovation and investment in the European Commission's proposal for the EU's Multiannual Financial Framework for 2021–2027. One element, in addition to the future Research Framework Programme, is the high proportion of cohesion policy funding – and of other budget lines – going into innovation and research. These include the continuation of the European Fund for Strategic Investment (EFSI), which will in future be merged with other financial instruments in the new InvestEU programme. Here, it is important to ensure that the funding goes to additional investment, and also, in general, to create an environment which fosters

Diagram 4: Development of electricity prices for residential customers



* 2018 figure is provisional.

Source: Federal Network Agency. Figures for 1 April of each year.

investment. Further to this, the European Commission has made proposals to support the implementation of structural reforms in the Member States. The Federal Government supports this intention, although questions remain to be clarified about individual proposals.

26. The Federal Government remains intensively involved in the debate about the future development of the Economic and Monetary Union. To this end, it has launched joint proposals with the French Government, and these fed into the results of the Eurogroup and Euro summit in December 2018. Elements of the reform refer to the future development of the European Stability Mechanism (ESM), a budget for the euro currency area and the completion of the Banking Union. This year, the focus will particularly be on implementing the decisions of the Euro summit of December 2018 (cf. Item 159). The Federal Government regrets the decision by the United Kingdom to withdraw from the European Union. It welcomes the agreement of a Withdrawal Agreement and a Political Declaration in the framework of a future relationship, is continuing to work towards an orderly departure of the United Kingdom, and aims at a continuing close future relationship between the EU and the United Kingdom on the basis of the guidelines from the European Council.

Utilising globalisation, shaping fair international competition

27. Global trade makes a major contribution to prosperity, growth and employment, particularly in the developing and emerging economies, but also in Germany. Open markets are of especial importance for an exporting country like Germany. Almost one in four jobs depends on exports; in industry, it is as many as one in two. In future, global economic integration looks set to increase. If globalisation is to boost the level of prosperity, there is a need not only for open markets but also for rules and a level playing field for trade and investment. National policies foster the adaptation of the economic structure in the course of globalisation. Against this background, the Federal Government is working to counter protectionist tendencies, most recently at the level of the G20, and is advocating a strengthening and modernisation of the multilateral trading system of the World Trade Organization (WTO) as a regulatory framework for rules-based world trade. The WTO offers a common set of rules and guarantees their enforcement via binding dispute settlements. At the same time, the multilateral trading system improves market access for small and medium-sized enterprises, and effectively counters trade and subsidies practices which distort competition. On top of this, the Federal Government is advocating bilateral EU free trade agreements which remove impediments to trade and investment whilst setting binding high standards. Such forward-looking free trade agreements have been successfully concluded with Canada and Japan. There are also negotiations and the conclusion of further major bilateral agreements by the EU, e.g. with Mexico, Mercosur, Singapore and Viet Nam, as well as talks about a deepening of transatlantic trade relations.

28. Open markets are important not only for trade, but also for investment and capital movements. Here, it is important to take account of European and national security interests in foreign direct investment and to ensure that a level playing field exists. The Federal Government is working to make sure that the EU Member States can protect themselves more effectively against state-directed direct investment from outside the EU in companies of relevance to security. At the same time, it is developing the set of national screening instruments so that it can devote greater appropriate consideration to security interests relating to foreign direct investment.

B. Continuing a sound fiscal policy, strengthening the foundations for growth, addressing structural change

29. The Federal Government continues to pursue a consistently sound, pro-growth fiscal policy. Germany has not taken on any new federal debt since 2014, and investment spending has increased considerably since 2013. According to initial calculations by the Federal Statistical Office, last year's total public-sector balance of finance (national accounts definition) amounted to a surplus of €59.2 billion. The Federation also contributed to this result: due, in particular, to the dynamic growth of the economy overall and financing conditions that have remained very favourable. Last year the Federation achieved a surplus of €20.3 billion according to the national accounts definition. In the forecast period, surpluses will be reported primarily by the *Länder* and municipalities, due in part to allocations by the Federation to the Länder and municipalities. The favourable fiscal situation is also reflected in the development of the total public debt-to-GDP ratio, which dropped further last year to an anticipated 60 ¾%. According to the Federal Government's current projection, the debt-to-GDP ratio is expected to fall below the Maastricht threshold of 60% of GDP in 2019 (cf. Diagram 5).

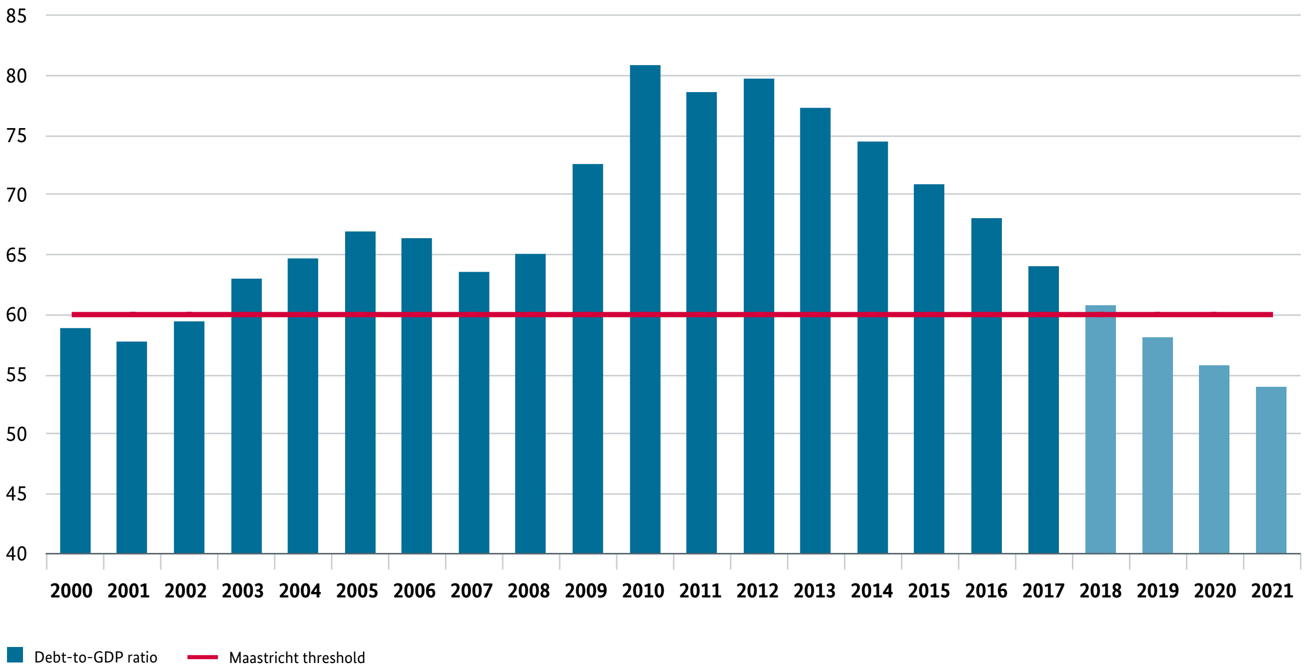
Viable public budgets are a basic condition for the government to be able to continue to perform its functions in the Social Market Economy in the future. This is all the more true in light of the challenges posed by a rapidly aging society. In addition to measures that directly redress social imbalances, one of the central roles of government is public-sector investment activity: if the German economy is to remain competitive in the future, it requires a strong public infrastructure and investment in education. For this reason, the Federal Government is placing a priority on areas such as the upgrading and improvement of the transport system (cf. Item 98), the development and expansion of a modern digital infrastructure (cf. Item 51), and is also focussing on social housing (cf. Item 122) and relief for families (cf. Item 40). The total financial volume of the measures planned by the Federal Government that are designated priority expenditures in the Coalition Agreement, as well as other quantifiable measures, will amount to around 4% of the GDP through to 2022 (see the "German Draft Budgetary Plan 2019"). Broken down, around two-thirds of this financial volume is derived from additional spending and around one-third from lower revenue receipts.

30. Since 2013, the Federation has increased its investment spending by around 54% to €38.1 billion in 2018 (including investment allocation of €2.4 billion to the Special Fund for Digital Infrastructure), (cf. Diagram 6). For the period 2018 through to 2021, the financial plan makes provisions for record investment spending of €154.5 billion in total, despite the expiry of the Investing-in-the-Future Programme, which was launched in 2015 with a budget of €10 billion. The measures envisaged in the financial plan support economic activity and secure the basis for future growth. In addition, unbundling funds totalling roughly €3 billion will be incorporated into regular *Länder* shares in VAT tax revenue from 2020 onwards. While statistically this means that the funds are no longer reported as a federal investment, they are still available to the *Länder* for investment.

Scope for investment in the *Länder* and municipalities

31. Public-sector investment is primarily the responsibility of the *Länder* and municipalities. The excellent revenue performance of recent years – with annual average growth rates of over 5% since 2010 – has also given the *Länder* and municipalities additional scope for investment, which is increasingly being exploited. The *Länder* and municipalities will also continue to see dynamic revenue growth in the coming years. In particular, according to the current tax

Diagram 5: Development of the Maastricht debt-to-GDP ratio



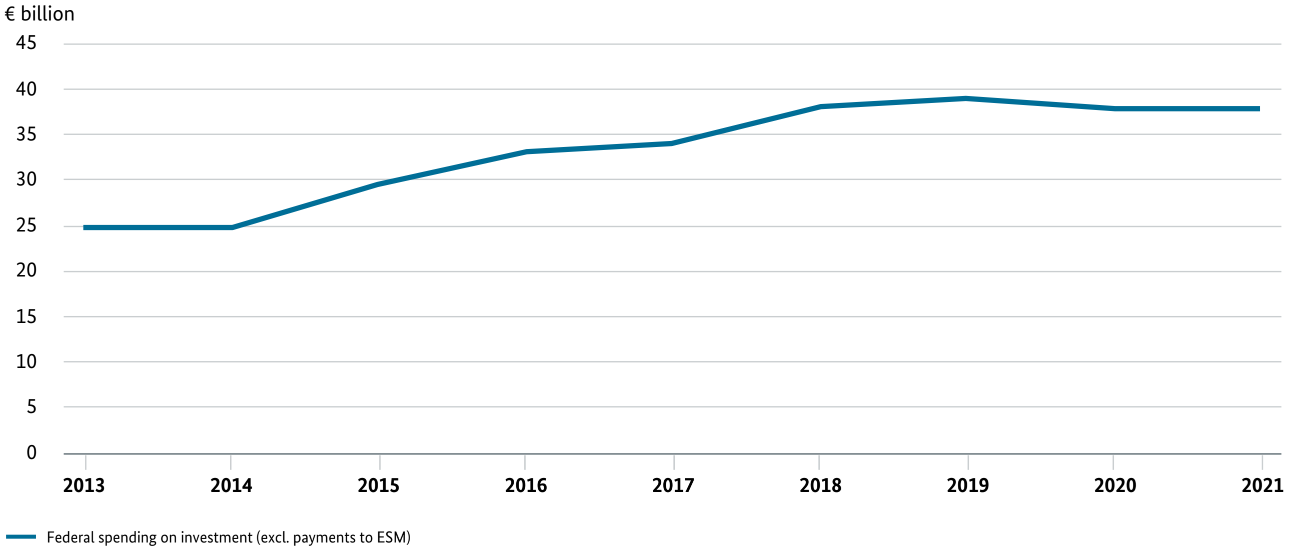
Source: Figures for 2000-2017 Deutsche Bundesbank/Federal Statistical Office; 2018-2022 projection by Finance Ministry, as of November 2018; projection figures rounded to quarter percentage points.

revenue estimation, the tax ratios will continue to shift in favour of the *Länder* through to 2023. The Federal Government's *Länder*- and municipality-friendly policy is also a key contributor to the improved financial situation. The Federation provides relief to the municipalities, particularly with regard to welfare spending. For example, the Federation fully reimburses the municipalities for expenditure on basic security benefits in old age and in the event of reduced earning capacity (amounting to €5.9 billion in 2018) and makes a greater financial contribution towards the cost of accommodation and heating under Book II of the Social Code, including coverage of the costs of refugee-related accommodation and heating expenses (roughly €7.0 billion in 2018).

32. In addition to the extensive relief provided with regard to spending on social benefits, the Federation also makes continued contributions to strengthen municipal investment activity. Through two programmes, the Federation is providing total financial aid of €7 billion to the *Länder* for investment in financially weak municipalities. Within the framework of an Infrastructure Programme (Act to Promote Municipal Investment, Chapter I), which has a budget of €3.5 billion and runs from 2015 to 2020, funds are provided for investment in various areas of municipal infrastructure, such as urban development, noise mitigation and broadband expansion. A School Modernisation Programme (Act to Promote Municipal Investment, Chapter II) – also with a financial volume of €3.5 billion and running from 2017 to 2022 – makes funding available for the modernisation, upgrading and expansion of general education and vocational schools.

33. The Federation will also continue to provide relief to the *Länder* and municipalities in the future. Measures adopted in 2018 make particular provisions for continued relief for refugee-related expenses (€6.3 billion), increased funding for the Municipal Transport Financing Act (€1.7 billion through to 2022 inclusive), spending on childcare services (€5.5 billion) and on all-day schools/all-day care for children of primary school age (€2 billion from 2020) and in the area of social housing, including compensation funds (an additional €2.5 billion for the 2019 – 2021 period). In addition, funding for the Digital Pact for Schools and for the expansion of gigabit networks is provided through the Special Fund for Digital Infrastructure. The Special Fund was allocated €2.4 billion from the federal budget in 2018. In addition, the *Länder* are no longer required to contribute to the "German Unity Fund" from 2019 onwards. This will increase the *Länder* share in VAT by roughly €2.2 billion annually at the Federation's expense from 2019 onwards. The *Länder* and municipalities will benefit from these expenditures already agreed by the Federal Government to the sum of around €29 billion through to 2022. Furthermore, the fiscal relations between the Federation and the *Länder* were completely restructured in mid-August 2017

Diagram 6: Federal spending on investment (2013–2021)



Source: Federal Ministry of Finance; planned figures for 2019 – 2021.

(cf. 2018 Annual Economic Report, Item 19), providing the *Länder* with additional financial relief of just over €9.7 billion per year from 2020 onwards. Overview 1 provides a list of selected federal measures which have been adopted since 2014 to relieve the burden on the *Länder* and municipalities.

34. To establish the legal basis to implement some of the priority spending measures designed to support the *Länder* and municipalities, the Federal Government introduced a draft bill to amend the Basic Law as early as May 2018. For example, the power of the Federation to grant assistance for investments by the *Länder* and municipalities in the municipal education infrastructure, which are important for the nation as a whole, is to be increased under Article 104c of the Basic Law. This is the basis for the implementation of the Investment Campaign for Schools. Alongside the current School Modernisation Programme, this Investment Campaign assists the *Länder* in their investment efforts in the digitisation of schools and the expansion of all-day schools and childcare services. Further to this, there are also plans to include a new Article 104d in the Basic Law to give the Federation the power to grant financial assistance specifically for investments in social housing by the *Länder* and municipalities which are important for the nation as a whole. No stipulations regarding a time limit or a degressive form of support are to be made in this context. In addition, an amendment to Article 125c of the Basic Law makes it possible to increase funding for federal programmes under the Municipal Transport Financing Act prior to 2025. Urgently needed investment in the rail infrastructure for local public transport services can move forward as a result. Furthermore, the insertion of Article 143e into the Basic Law provides the guarantee, under constitutional law, that the Federation will have sole responsibility – with effect from 1 January 2021 at the latest – for planning, building, operating, maintaining, financially managing, and funding the federal autobahns and the federal trunk roads if responsibility for this area is assigned to the federal administration at the request of a *Land*.

Joint development of regional structural policy for eastern and western Germany

35. The positive economic development in the country overall has also helped less successful regions to catch up economically. A general trend towards convergence can be seen with regard to income per capita. This is a slow process, however, and does not take place at a uniform pace across all regions. Despite the positive developments, there are still significant regional differences in Germany on the whole in terms of economic strength, gainful activity and the level of unemployment. The *Länder* in eastern Germany, in particular, are still clearly lagging behind their counterparts in western Germany: in 2017, the gap between the *Länder* was roughly 27% in terms of GDP per capita. A further complication is that – with the exception of a few urban regions - most regions in the new *Länder* are structurally weak. This is primarily due to small-scale business structures, which frequently limit the possibilities for development in the regions. Furthermore, in most peripheral rural regions, the population and the number of potentially employable people are also declining (cf. Annual Report on the Status of German Unity 2018, P. 56 ff.).

36. With its regional policy, the Federal Government seeks to improve the economic prospects of people in structurally weak regions – in eastern and western Germany alike and in both urban and rural areas – and help establish equal living conditions. Aside from well-established and new programmes, such as the joint programme for the "Improvement of Regional Economic Structures" or the "Mining Regions Venture", the Federal Government has also set up a "Commission for Equal Living Conditions". The Commission is tasked, inter alia, with examining the financial situation of the municipalities with regard to parity of living conditions, and with putting forward possible solutions to address the problem of existing debts and short-term liquidity loans in the municipalities, with due regard for responsibilities under constitutional rules governing public finance. Given that the Solidarity Pact II is due to expire at the end of 2019, the Commission is also to develop a pan-Germany federal funding system for economically underdeveloped regions, building on the principles set out in the last legislative term. The funding system will be geared towards supporting all structurally weak regions in Germany and encompass important programmes for the economic development of the regions. The Commission will submit a report containing concrete proposals by July 2019. On the basis of these proposals, effective and visible steps towards parity of living conditions are to be taken by the end of the 19th legislative term and beyond.

37. Further to this, the Federal Government set up the "Growth, Structural Change and Employment" Commission on 6 June 2018. Consisting of stakeholders from a variety of economic and social groups, the Commission's responsibilities include the development of proposals that ensure the 2030 target for the energy sector – as agreed under the 2050 Climate Action Plan. Furthermore, it is also to issue recommendations for the gradual reduction and

Overview 1: Selected federal measures adopted since 2014 to relieve the burden on the *Länder* and municipalities

Year of entry into force	Measures	Explanation
2014	Full reimbursement by the Federation for the costs of basic security benefits in old age and in the event of reduced earning capacity	• Approx. €23 billion in the period 2014 – 2017, €5.9 billion for 2018, and €7.1 billion for 2019
2014 ff.	Amendment to the Unbundling Act	• €2.6 billion p.a. from 2014 to 2019; compensation benefits under Article 143c of the Basic Law continued at same level • 2015/2016: Increased "housing promotion" compensation payments (€500 million in 2016; €1 billion p.a. in 2017 and 2018, €500 million in 2019) • 2018: Increased "housing promotion" compensation payments (€500 million in 2019)
2014 ff.	Expansion of childcare services for children under three; from 2017 (4th Investment Programme) for children under six	• Investment costs: €580.5 million in total for 2013 to 2014 (2nd Investment Programme), €550 million in total for 2015 to 2018 (3rd Investment Programme) and €1.126 billion for 2017 to 2020 (4th Investment Programme) • Assistance towards operating costs: €845 million p.a. since 2015 and an additional €100 million p.a. in both 2017 and 2018 through an increase in the *Länder* share in VAT
2015	Full financial responsibility for benefits under the Federal Training Assistance Act	• €1.2 billion p.a. for an unlimited period
	Act for Further Relief for *Länder* and Municipalities as of 2015	• €1 billion p.a. from 2015 to 2017, 50% via accommodation expenses and 50% via the municipal share in VAT
	Act to Promote Investment in Financially Weak Municipalities and to Relieve the *Länder* and Municipalities in Receiving and Accommodating Asylum Seekers	• Financial assistance through the Municipal Investment Promotion Fund, Chapter I: €3.5 billion in total in 2015 to 2020 • €1 billion via higher municipal share in VAT revenue and €500 million via higher federal quota for accommodation expenses in 2017
2015 ff.	Relief for the *Länder* and municipalities with regard to refugee-related expenses	• €2 billion in 2015 via higher Länder share in VAT revenue • Since 2016, contribution by the Federation towards the costs incurred by the Länder and municipalities for asylum-seekers and persons whose asylum application has been rejected: the Länder receive a total of approx. €8.8 billion via VAT in the form of advance payments and ex post reconciliations up until 2019. • €2 billion p.a. in 2016 to 2018 as a lump sum for integration, €2.435 billion in 2019 • €0.35 billion p.a. from 2016 for refugees who are unaccompanied minors • Approx. €2 billion in total from 2016 to 2018 to improve childcare services • Relief for municipalities with regard to housing and heating costs for persons with a recognised right to asylum and protection, anticipated at roughly €3.1 billion for 2016 to 2018 and around €1.8 billion for 2019
	Increased state funding for local and regional passenger rail services	• Increased to €8.2 billion in 2016 • Annual increase of 1.8% from 2017 through to 2031
2017	School Modernisation Programme	• Financial assistance through the Municipal Investment Promotion Fund, Chapter II: €3.5 billion in total in 2017 to 2022
	Immediate Action Programme for Clean Air and additional measures for the near-term reduction of NO_2 emissions in particularly affected municipalities	• Funding of approximately €2 billion
2018	Relief for the municipalities in connection with the Federal Participation Act	• €5 billion annually from 2018 onwards (*Länder* and municipal share in VAT, costs of accommodation and heating)
	Special Fund for Digital Infrastructure	• Allocation of €2.4 billion for the expansion of gigabit networks and the Digital Pact for Schools
2019	Child day-care facilities (fees and quality)	• €5.5 billion in total in 2019 to 2022
	Financial closure of the "German Unity Fund"	• The *Länder* are released from their compensation payments of €2.224 billion p.a. to the Federation as a result of a change in the distribution of VAT revenue in connection with the financial closure of the "German Unity Fund"
2020	All-day schools/all-day care	• €2 billion in total through to 2021
	Promotion of social housing	• €2 billion in 2020/2021
	Increased funding under the Municipal Transport Financing Act federal programme	• Increased to approx. €665 million in 2020, and to €1 billion in 2021, continuation with dynamic increases from 2022 (€333 million p.a. to date)
	Restructuring of fiscal relations between the Federation and the *Länder*	• Initial relief for the Länder of approx. €10 billion p.a.

phase-out of coal-based electricity generation and develop suggestions for forward-looking sustainable structural development in the regions concerned. The Commission is expected to submit its recommendations at the start of 2019.

38. Tourism can play a key role in the economic development of structurally weak regions. The Federal Government is developing a national tourism strategy. Building on the programmatic corner stones of this strategic framework, the Federal Government, the *Länder* and other stakeholders in the tourism sector will develop and implement action plans with tangible goals and measures. The action plans are to reflect the entire spectrum of tourism, which cuts across multiple areas, addressing topics such as digitisation, the supply of skilled labour, internationalisation and liveable regions for and via tourism. Working together with the *Länder*, the Federal Government will develop an overall concept for tourism policy and engage in intensive dialog with all the relevant stakeholders to this end.

A fair and efficient taxation system

39. Overall, Germany has a fair and effective system of taxes, contributions and transfers. This system is an expression of the Social Market Economy, strengthens social cohesion, but also guarantees performance incentives. The taxes and contributions are set against a level of public services that is appropriate for a highly developed industrialised country and a well developed social security system. At the same time, in order to strengthen the Social Market Economy further, the Federal Government is putting its energies into achieving targeted and fair improvements in the transfer systems that boost incentives, and into reducing the tax wedge in a manner that favours growth and will benefit large swathes of the population.

40. The Act to Relieve the Taxation Burden on Families and to Amend Additional Tax Rules entered into force at the start of 2019. As tax-related benefits that take the role of families into account, the tax allowance for children and the child benefit ensure fair levels of taxation for families. To strengthen and relieve families, the monthly child benefit will be increased by €10 per child to €204 (1st/2nd child) with effect from 1 July 2019. In addition, in 2019 and 2020, the tax allowance for children will increase in line with the annual effect of the higher child benefit. To ensure the minimum subsistence level is not subject to income tax and to offset the effects of fiscal drag, the basic personal allowance will be raised to €9,168 in 2019 and to €9,408 in 2020, and the other tax rate thresholds will be raised for the 2019 and 2020 assessment periods. These income tax measures for 2019 and 2020 alone will reduce the burden of taxes on tax payers by €9.8 billion per year in total.

41. The Federal Government is also providing tax stimulus in the area of housing policy. With the law passed by the German Bundestag on 29 November 2018, the tax stimuli for the construction of new rental housing in the affordable rent segment, as set out under the Housing Campaign (cf. Item (122)), are to be implemented. As an indispensable source of revenue for the municipalities, the land tax is also to be restructured; in this context due consideration will be given to the requirements set by the Federal Constitutional Court, the current revenue volume will be safeguarded, and the right of municipalities to set the tax rate will be retained. The aim of the reform of the law governing property valuation is to establish an administrative assessment basis for land tax that is legally reliable. The Federal Government is working hard on a reform and seeks to reach a joint solution with the *Länder*. The Federal Government is examining a tax allowance for a real estate transfer tax for families for the first-time purchase of residential property without an effect on the fiscal equalisation between the *Länder*. The Council of Economic Experts (GCEE) is fundamentally in favour of a general allowance for a real estate transfer tax (cf. GCEE Annual Report, Item 753).

42. The Federal Government will secure a fair, growth-friendly tax framework for businesses on a lasting basis. In the recent past, the United States has considerably reduced the corporate tax burden. Tax reforms are also planned in neighbouring European countries, such as the United Kingdom, Belgium and France. It is necessary to continue to safeguard Germany's tax competitiveness so that German companies, particularly SMEs, remain competitive on a global scale. To this end, the Coalition Agreement contains a key first measure with the introduction of tax incentives to support research (cf. Item 93). The Federal Government will present draft legislation to this end in the first half of 2019. Another important element is the phase-out of the solidarity surcharge, starting with a significant first step that will apply to 90% of all payers of the solidarity surcharge. This will relieve the overall tax burden on private citizens.

43. Furthermore, a constitutional regulation has been established for loss deduction when transferring shares in corporate entities. This relieves the burden on businesses as it repeals the partial loss forfeiture rule when up to 50% of shares are transferred. Together with Section 8d of the

German Corporate Income Tax Act, which was introduced in the last legislative term and permits the use of loss if the business operations of the corporation continue, and the restructuring clause which applies again following the ruling of the European Court of Justice, this regulation ensures that the use of loss in the event of the transfer of shares is now possible again to a much greater extent. This strengthens equity financing for companies, which is a specific objective of the Federal Government.

44. In addition to relieving the tax burden on citizens and businesses, action against tax fraud and tax evasion is a central concern of the Federal Government's tax policy. Therefore the Act for the Prevention of VAT Revenue Losses from Trading with Goods over the Internet and Amendment of Further Tax Provisions of 11 December 2018 established liability for operators of e-commerce platforms with regard to the payment of value added tax.

45. The Federal Government is also committed to achieving a fair and effective tax system beyond national borders. A comprehensive, internationally agreed approach is needed to address current challenges, also with regard to the taxation of the digital economy. In this context, action to tackle the causes of base erosion and profit shifting (BEPS), as a continuation of the successful G20/OECD BEPS Project, remains an issue of central importance. The existing BEPS problems are further exacerbated by the digital economy, in particular. To address the challenges of taxing digital economy businesses, and BEPS issues that go beyond this, the reallocation of taxing rights from the country in which multinational enterprises are domiciled to the market country is being discussed at the OECD level. Further to this, in a joint initiative Germany and France have proposed to also drive forward measures for an effective international minimum level of taxation. The details are currently being discussed in the OECD. This initiative is seen as a long-term solution and encompasses all sectors of the economy; it would, however, also address the problems of taxing the digital economy. Alongside this, the EU is also working on a solution. On 21 March 2018, the European Commission presented a legislative package for the taxation of digital business models. For one, a digital services tax (DST) is to be introduced as an interim solution. Under the European Commission's proposal, a tax of 3% is to be levied on revenues generated by large companies (with a turnover of €750 million or more) from digital business activities (advertising services, intermediation services on digital platforms and the sale of user data). Furthermore, a second draft directive is designed to extend the definition of permanent establishment - which serves as the basis for the taxation of revenues and profits - to the existence of a "significant digital presence". The Federal Government is calling for a long-term solution at the international level that respects international taxation principles and develops them further. The Council of Economic Experts does not consider a separate tax on digital revenues to be an appropriate approach. Furthermore, the GCEE has serious misgivings regarding concepts of a digital permanent establishment that are based on the collection and use of data (cf. GCEE Annual Report, Item 624). While the Federal Government does, in principle, share some of the concerns raised with regard to the proposed digital tax and digital permanent establishment, it does, however, also see the need to have an interim solution in place in case a long-term solution cannot be reached at the international level. For this reason, Germany and France have issued a joint declaration that the Digital Tax Directive is to enter into force on 1 January 2021 if no solution is reached at the OECD level by 2020. Under the terms of the declaration, the digital tax is to expire at the end of 2025 and focus on advertising services. With regard to the extension of the definition of a permanent establishment, Germany is actively assisting the work at the OECD level and following developments closely. An internationally agreed approach is only possible in this way. Furthermore, in terms of taxation the Federal Government is also prepared for Brexit. The Act on Taxation-Related Provisions concerning the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union (Tax Act relating to Brexit) creates legal certainty for the period following the withdrawal of the United Kingdom.

46. Due to the need to implement measures resulting from the Anti-Tax Avoidance Directive ((ATAD), 2016/1164/EU), the Federal Government is taking this opportunity to examine a number of these regulatory areas to determine whether there is a need for fundamental reform. Work is currently underway on a bill for the comprehensive reform of the controlled foreign corporations (CFC) tax rules under the Foreign Tax Act. Furthermore, the Federal Government will transpose into law, by 31 December 2019, the amendment to Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border tax arrangements. The Directive is designed to increase transparency in the field of taxation. It dovetails with the international G20/OECD BEPS actions to combat tax avoidance and evasion.

47. The Franco-German cooperation on establishing a Common Consolidated Corporate Tax Base aims to expedite the process of harmonising direct taxes and inject new impetus into the stalled negotiations in the Council of the

European Union. A draft directive of the European Commission forms the basis of the cooperation. Germany and France agreed upon a common position at the meeting of German and French government ministers in Meseberg in June 2018. Talks are also underway on the possible format a European financial transaction tax may take.

C. Shaping the course of digitisation, improving the policy environment for innovation, SMEs and industry

48. The strength of the German economy is the foundation for Germany's current and future prosperity. An economic policy that is based on the Social Market Economy is centred on the freedoms and strength of business enterprises – self-employed persons, SMEs and large corporations alike. For entrepreneurial creativity and innovation to reach their full potential, businesses need a good governmental framework that is as unbureaucratic as possible. Globalisation, digitisation and demographic change present significant challenges for businesses, however. Against this backdrop, the Federal Government is modernising and enhancing the framework conditions for German business.

Moving forward with the digital transformation, shaping digital regulatory policy

49. The digital transformation offers enormous opportunities to boost prosperity and quality of life, and to safeguard the competitiveness of German business. The Council of Economic Experts also underlines the importance of the right economic policy framework to take advantage of the opportunities presented by digitisation and to leverage potential for increased productivity (cf. GCEE Annual Report, Item 136). The resolute implementation of digital policy priorities is therefore of central importance for action to strengthen the Social Market Economy that is fully focussed on the potential for innovation that digitisation offers. For this reason, in November 2018 the Federal Government adopted the "Shaping the Course of Digitisation" implementation strategy, which serves as a strategic framework and brings together the most important digitisation agendas in five action areas (cf. Diagram 3). The implementation strategy integrates the key digital priorities of all the government ministries, and also contains measurable targets. The strategy is being developed and refined on an ongoing basis; information on progress in the implementation of measures is provided under www.digital-made-in.de.

The Digital Summit and the accompanying process throughout the year serve as the central platform for collaboration on digital policy between the Federal Government and all the relevant stakeholders from the business sector, the scientific community, trade unions and society. Throughout the year, ten thematic platforms were developed and recommendations, projects and initiatives were designed to drive the process of digitisation forward in Germany and were presented at the annual summit. With "Artificial Intelligence – A Key to Growth and Prosperity" as its theme, the 2018 Digital Summit placed a particular focus on the opportunities and challenges artificial intelligence (AI) presents for Germany and Europe (cf. Item 53).

50. The Federal Government has set up a Digital Council which advises the Federal Government on approaches to shaping the course of the digital transformation – particularly with regard to changes to business and the world of work, digital skills, education and continuing training, business start-ups and digital administration, including participation via digital channels (e-participation). The Council is also to provide impetus to the continued development and implementation of the digital strategy.

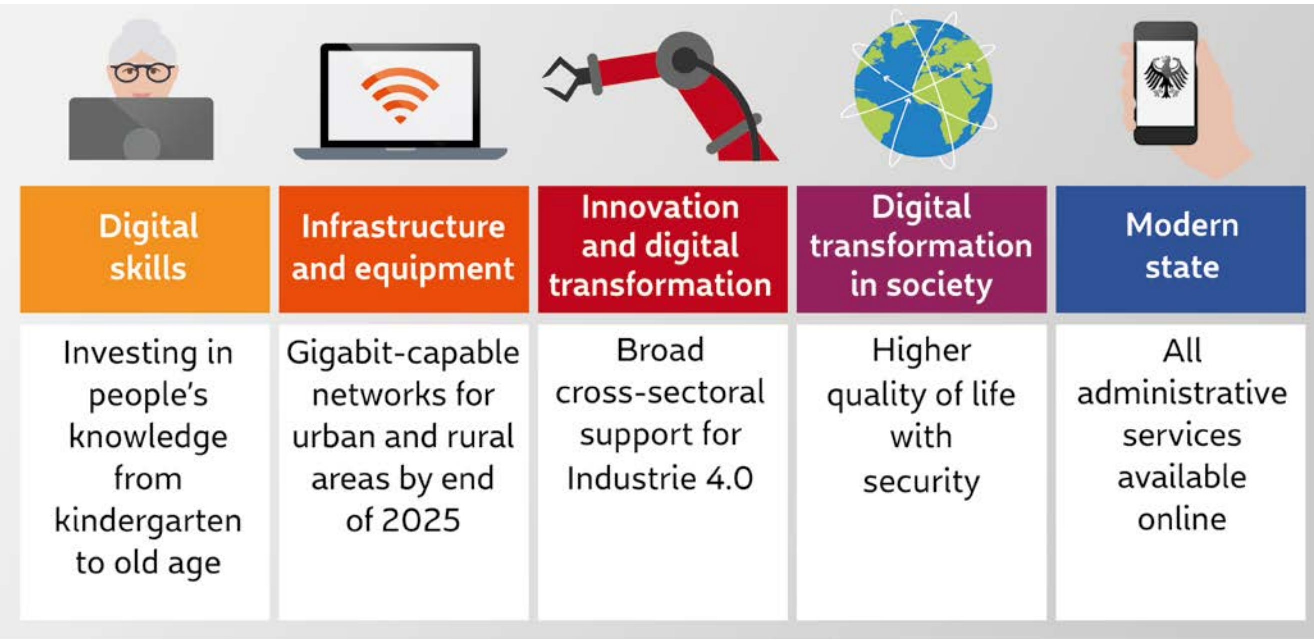
51. High-speed digital infrastructures are a key prerequisite if people and businesses – in both urban and rural areas – are to be able to act on the opportunities of the digital transformation. If Germany is to have a virtually nationwide infrastructure of gigabit networks by 2025, this will require considerable investment from the private sector, above all. Under the amendment to the Telecommunications Act, regulatory conditions are to be introduced that create a more favourable environment for innovation and investment, whilst also safeguarding competition. In the previous legislative term, the Federal Government already provided funding of €4.4 billion primarily for rural areas in which networks were not developed by the private sector in a period of three years. Funding for the expansion of gigabit networks in areas that are not economically viable is provided through the Special Fund for Digital Infrastructure. In future, gigabit networks are to be available in every region and in every municipality - directly to the home wherever possible. Priority is given to the connection of schools, business parks, public social facilities and hospitals. In this context, only development phases that use fibre optic technology are eligible for funding. In the opinion of the Federal Government, a higher share of fibre optics in all existing network infrastructures is vital to deliver reliable gigabit connectivity. Therefore, the expansion and further development of networks should be based on fibre optic

technology as much as possible, as this is the only technology that provides sufficient network capacities and guarantees the long-term viability of network investments.

52. In order to ensure good quality mobile coverage throughout Germany, the Federal Government intends to take swift action to close gaps in cell phone and mobile Internet coverage and eliminate dead spots. Together with the *Länder*, municipal central associations and mobile network operators, the Federal Government adopted a programme of measures at the Mobile Communications Summit in July 2018 that is designed to provide coverage to 99% of households by the end of 2020. The frequency auction planned for 2019 will be tied to a number of mandatory development requirements that place a particular focus on coverage along transport routes and are geared to dynamically accelerate the expansion of 5G networks. The aim is to make Germany a leading market for 5G applications. Planned for 2019, the Federal Government's 5x5G Strategy aims to equip selected urban centres and regions – chosen in a competitive process – with 5G technology, in order to step up research and make application scenarios visible.

53. The Federal Government adopted the Artificial Intelligence Strategy (AI) in November 2018. With this Strategy, the Federal Government is pursuing three primary objectives: (i) to make Germany and Europe leaders in the development and use of AI technologies and to safeguard Germany's competitiveness; (ii) to ensure the responsible development and use of AI which serves the good of society; (iii) to integrate AI into society in ethical, cultural, legal and institutional terms in the context of a broad societal dialogue and active political measures. To achieve these goals, the Strategy defines twelve action areas backed by specific measures. From the standpoint of economic policy, the promotion of research and development in this area in Germany and Europe, as well as the increased transfer of AI to practical applications, are particularly relevant. Better framework conditions are also to improve data availability and usability. Workers are to be better prepared for a changing working environment and the availability of skilled AI professionals is to be significantly increased. In the 2019 federal budget, the Federation is making a total of €500 million available for 2019 and subsequent years in a first step towards strengthening the AI Strategy. On this basis – and also using funds for research and development to reach the 3.5% target – the Federation will allocate a financial volume of roughly €3 billion towards the implementation of the AI Strategy in the period 2018 to 2025. Measures directed at the business sector focus on support for small and medium-sized enterprises in the transfer of research findings to practical applications, support for AI start-ups, the development of an AI data infrastructure, the creation of a European AI innovation cluster, and the promotion of

Diagram 7: Shaping the Course of Digitisation implementation strategy: fields of action



Source: Federal Government.

AI research and technology. Initial steps include the "Smart Data Economy" technology programme and the mission to "translate artificial intelligence into applications" as set down in the Federal Government's High-tech Strategy.

54. The Federal Government's Committee for Data Ethics addresses ethical issues associated with AI, algorithms and data, and develops guidelines and recommendations for action in this regard. Consisting of 16 members from a variety of disciplines in business, academia and civil society, the Committee commenced work in September 2018. The final report is to be presented in autumn 2019. The digital transformation can be exploited, for example, to facilitate access to employment for people with family commitments and help families achieve economic stability as a result of additional gainful activity. The "Innovation Office for Digital Living" compiles, processes and disseminates innovative solutions for the digitisation of civil society, so that society can benefit from advances in technology.

55. Apart from AI, blockchain technology is another technology trend associated with digitisation and enables a broad range of applications across multiple sectors. The Federal Government is currently developing a National Blockchain Strategy that aims to consolidate findings from pilot projects, explore possible administrative uses of the technology, strengthen skills and expertise, and identify necessary changes to the regulatory framework. The Strategy is to be adopted in the summer of 2019.

56. Secure information technology is a necessary precondition for Germany's competitiveness as a business location, and is the basis for self-determination in an interconnected world. This also involves safeguarding citizens' privacy and informational autonomy. For this reason, the Federal Government is strengthening IT security research in Germany. In recent years, research has been concentrated at three centres of excellence for IT security research in Saarbrücken, Darmstadt and Karlsruhe. Now internationally renowned research and advisory centres, these centres will be incorporated into a permanent funding framework in 2019.

57. An effective digital regulatory policy is needed in order to support the digital transformation, while also ensuring it is socially sustainable and complies with competition law. To make German and European competition law fit for the challenges of digitisation, the Federal Government has begun preparing the 10th amendment to the Act against Restraints of Competition and has also set up the "Commission for Competition Law 4.0".

One focus of the 10th amendment to the Act will be the modernisation of the control of abusive practices, so that the abuse of market power, particularly in rapidly changing markets, can be addressed swiftly and effectively. This modernisation effort is based, in particular, on the findings from a study on the modernisation of the control of abusive practices for companies with superior market power, which was presented in September 2018. Another priority area will be the implementation of the EU Directive to empower the competition authorities of the Member States (ECN+). The ministry draft for the 10th amendment to the Act against Restraints of Competition will be drawn up in the course of the year.

The "Commission for Competition Law 4.0" acts as a legal policy platform for debate on the further refinement and development of European competition law, in particular. It examines issues of competition policy resulting from the ongoing development of the data economy and the growth of platform markets. The Commission is due to develop specific recommendations for action by autumn 2019.

58. Launched by the European Commission in May 2015, the Digital Single Market Strategy seeks to improve online access to goods and services for businesses and consumers throughout Europe, establish adequate conditions for digital networks and innovative services, and maximise the growth potential of the digital economy. The Federal Government supports swift progress in the negotiations and in the implementation of measures. Last year, key milestones were reached: the adoption of the European Electronic Communications Code provides important regulatory incentives for extensive private investment in an efficient digital infrastructure. Thanks to the Portability Regulation, EU citizens are entitled to use their online subscriptions for films, series, sport or music during temporary stays in another Member State. The Geoblocking Regulation addresses unjustified discrimination of customers based on their origin, particularly with regard to online trade. Under this Regulation, businesses may no longer block access to a website for customers from other Member States on account of their geographical location, or re-route them to another website with less favourable conditions.

The data economy can help enable innovative business models for European businesses, modernise public services and strengthen citizens' rights. For this, data must be accessible - with due compliance with data privacy law – and must be able to flow freely within the Single Market. Against this backdrop, in November 2018, the European Parliament and the Council of the European Union eliminated obstacles to the free flow of non-personal data within the EU. To remove barriers to the re-use of public administration data, the European Commission presented a draft amendment to the Directive on the Re-use of Public Sector Information (PSI) in April 2018. In addition, the Regulation Setting up a Single Digital Gateway (SDG) entered into force on 11 December 2018. The aim of the EU is to establish a single digital European gateway to the administrative portals of the Member States.

Supporting SMEs and industry on their path to digitisation

59. The digital transformation offers vast opportunities in the form of new lines of business and increased productivity. At the same time, digitisation creates enormous challenges particularly for small and medium-sized enterprises (SMEs), for example in the skilled crafts and trades sector: production and work processes must be digitised and linked to data-based services, while workers will require training, and jobs need to be adapted to the digital age. The SME Digital priority funding initiative supports the digital transformation of the value chains of SMEs and businesses in the skilled crafts and trades sector. SME Digital offers opportunities to demonstrate and test practical digital applications hands-on, pools the latest knowledge on digitisation issues, and shares this information with disseminators. SME 4.0 Centres of Excellence are a central part of the funding priority and provide a free, scientifically based range of services that are specifically tailored to SMEs and the skilled crafts and trades sector. Further to this, SMEs are supported on their path to digitisation with advisory and implementation services provided through the "go digital" support programme. With information specifically geared to SMEs, the "IT Security in Business" initiative raises awareness among SMEs for the importance of IT security.

60. The introduction of a new funding programme entitled "Investment grants towards digitisation in SMEs" is designed to provide targeted incentives for SMEs to improve their digital business processes and generate new business models. The aim here is to support SMEs in making investments in necessary digital technologies and in IT security.

61. The Federal Government will continue to take appropriate action to support the digital transformation of manufacturing – known as *"Industrie 4.0"*. Businesses have recognised the need to digitise their production and organisations, and the added value this generates. This positive development is in thanks in part to the effective work of the *"Plattform Industrie 4.0"*, the scope and content of which is being specifically expanded further. Focal topics include the fields of standardisation, IT security, legal frameworks, work/initial and continuing training, and digital business models. The findings and recommendations for action in this context always have a practical relevance and are geared towards direct implementation in business processes. The now well-established *"Transfer Network Industrie 4.0"* develops and implements measures to provide targeted support to businesses making the digital transformation. The focus here is also on small and medium-sized enterprises.

Working with industry to advance key enabling technologies

62. Structural change in industry is largely characterised by the advancement of key enabling technologies which cut across disciplines and which are very costly to develop. Here, the Social Market Economy relies first and foremost on the adaptability of market participants. State involvement in individual sectors may be justified, particularly if the priority is to ensure fair conditions of competition by international standards, or to promote basic research.

The Federal Government supports the actions taken by economic operators in the private sector: the aim is to help safeguard the international competitiveness of German industry and to strengthen it on a long-term basis. In light of the current economic structural change and the external policy environment, the priority is to specifically strengthen key enabling technologies on the one hand, while also upholding technological autonomy in central areas of technology on the other. The Council of Economic Experts is opposed to a "steering" function of industrial policy, where it is seen as the role of the state to identify future markets and technologies as strategically important – (cf. GCEE Annual Report, Item 158). The Federal Government does not pursue any such policy. It is, however, of the opinion that exclusive action on the part of business enterprises alone is often not enough in the face of fundamental structural changes, and that in isolated cases, temporary government support or the establishment of other suitable framework conditions can be required to strengthen key enabling technologies. The identification of strategically important technologies is the responsibility of industry. The Federal Government regularly engages in dialogue with representatives from academia and industry on topics that are of major significance for industrial policy in order to safeguard the long-term competitiveness of German industry overall. Here, discussions focus particularly on artificial intelligence (cf. Item 53), the development of European battery cell manufacturing, aerospace, the bio-economy, investment in quantum technologies, IT security, materials sciences and microelectronics.

63. In the future, vast quantities of battery cells will be needed as energy storage units for a host of different applications, particularly for electric vehicles, for the storage of renewable electricity and for battery-powered instruments. Therefore, with the High-tech Strategy 2025, inter alia, the Federal Government has made it its goal to support the expansion of battery cell production capacity in Germany, which is a central component of value creation. Research into new battery technologies is to be promoted under the "Battery Research Lab" umbrella strategy. The aim is to develop an innovation pipeline covering the entire battery chain - from the material and battery cell through to production.

64. The German aerospace industry is highly competitive by international standards. With the German Aerospace Centre (DLR), the industry has access to an effective research infrastructure to further expand its competitive position. German technology can be found in every new commercial aircraft built around the world. The Federal Government is providing additional stimulus for investment in future-oriented technologies, such as AI, big data or hybrid electric flight, especially through the Aerospace Research Programme, which was scaled up in 2018. This will also play a key role in making flying increasingly safe, efficient and environmentally friendly. Upcoming projects associated with the "Deep Space Gateway" – the further exploration of the Moon and Mars – can lead to new technical feats in the fields of robotics, AI and space transport. On Earth, the scientific knowledge and insights gained in this project can also be applied to areas other than the aerospace sector, such as AI-based services or products. All these projects also provide the opportunity to continue successful international collaboration on the peaceful use of space, as demonstrated by the ISS. To increase the participation of innovative small and medium-sized enterprises in aerospace projects, the Federal Government supports these SMEs, for example by facilitating market development business trips.

65. Bio-economy describes the transition from petroleum-based processes and products to biologically-based sustainable economic activity. Fossil fuels are replaced by alternative fuels, such as biological raw materials, residual materials and waste materials, as well as CO_2. To unlock the substantial innovative potential of the bio-economy in Germany, the Federal Government is combining its Bio-economy Policy Strategy with its Research Strategy and is working on a bio-economy monitoring system. The new "Industrial Bio-economy" platform for dialogue supports, inter alia, the development of new structures for the supply of raw materials.

66. Quantum technologies have already made their way into many disciplines: components such as transistors, diodes and lasers in computers or medical imaging are all based on principles of quantum physics. Germany is highly successful with these "first generation quantum technologies", both in scientific and commercial terms. The priority in the next step is to specifically control quantum effects. Such "second generation quantum technologies" enable more precise measuring instruments, greater data communication security, or far more powerful satellites and computers, for instance. The aim of the Federal Government is for German research institutes and businesses to shape this development and be pioneers in its implementation. For this reason, it adopted the Quantum Technologies government programme in September 2018 to advance work on research, development and the application of quantum technologies in the coming years.

67. Large segments of energy-intensive industry are facing particular challenges with regard to Germany's goal of being effectively greenhouse gas (GHG) neutral by 2050. To secure Germany's position as an industry hub over the long term and to strengthen the competitiveness of German businesses, a funding programme is to be set up to support the decarbonisation of industry.

68. The tripartite Alliance for the Future of Industry – comprising associations, trade unions and the Federal Government – was established in 2015. The focus of the Alliance is on dialogue regarding industrial policy and on increasing public acceptance of industry. Overcoming barriers and building networks between employer and employee representatives are major achievements of the Alliance. The partners to the Alliance will continue the Alliance for the Future of Industry in the 19th legislative term.

Securing the supply of raw materials

69. The extraction and supply of raw materials is of central importance to German industry, as raw materials are the basis for industrial value creation. It is primarily industry's responsibility to secure the supply of raw materials. With

its extractive resources policy, the Federal Government supports industry in this matter by creating a framework for a sustainable and internationally competitive supply of raw materials.

70. The Federal Government is also actively involved in guaranteeing the sustainability of raw materials extraction in countries which export raw materials. With the implementation of the international Extractive Industries Transparency Initiative (EITI) in Germany, the Federal Government is sending a strong signal to support developing countries and emerging economies in their common fight against corruption in the commodity sector. Further to this, the Federal Government is pushing for better compliance with environmental and social standards in the extraction of raw materials and along the supply chain. It does this, inter alia, as part of its extractive resources diplomacy, through capacity-building in the commodity-exporting countries, and by raising awareness in industry and among consumers in Germany (cf. Item 200).

71. The current extractive resources monitoring system at the German Mineral Resources Agency is being expanded, with a particular focus on the raw materials needed for electric mobility and the intermediate products required for forward-looking technologies. The German Mineral Resources Agency informs German businesses about new developments in the global commodity markets, trends with regard to supply, demand and pricing, and also potential price and supply risks.

Towards better legislation and less bureaucracy

72. The Federal Government pursues an evidence-based economic policy founded on scientific facts and findings that provide the information basis for the assessment of alternative solutions. In this context, it focuses increasingly on "reality labs" in the sense of test benches for regulation and innovation. Innovative technologies and business models are tested in these reality labs for a limited time in a particular geographical area and, where applicable, under modified legal conditions (e.g. experimentation clauses, special permits etc.). No fixed expectations apply with regard to the test outcome. In a time of digital transformation, evidence-based, experimental approaches therefore allow us to test innovations and develop the regulatory framework further. In the field of energy research, "energy transition reality labs" offer a new approach to accelerating the transfer of technology and innovation (cf. Item 150). If Germany is to remain a strong contender in the international battle for ideas and innovation it must succeed in developing a flexible and adaptable regulatory framework that keeps up with the fast pace of new technological trends.

73. The quality of law and administration is an important factor in Germany's appeal as a business location (cf. also Box 1). Over the past legislative terms, therefore, the Federal Government has steadily developed its set of tools to improve legislation and administrative procedures. In the future, too, the legal framework will need to be continuously adapted to an increasingly complex and interconnected world. Furthermore, the Federal Government intends to make communication with public administration easier for citizens and businesses. Therefore, all administrative services will also be available online by the end of 2022 – an important location factor for German businesses and particularly for start-up entrepreneurs (cf. Item 82). In connection with this, existing administrative processes are to be examined and made less bureaucratic where possible. The main objective here is to make it possible to process applications seamlessly online without changing the medium format by dispensing with obligations to provide documentary evidence and format requirements that are not absolutely essential. The goal is to achieve efficiency gains for businesses and citizens, but also for public administration itself.

74. The "bureaucracy brake" on administrative burdens for business is having the desired effect: compliance costs for business dropped by around €1.9 billion in the 2015–2017 period in connection with the brake. The Federal Government is therefore calling for the establishment of the principle of "one in, one out" at the EU level also. In 2017, one-off changeover costs for business were at their lowest since statistics collection began. An effective process for the systematic evaluation of legislation has been in place since 2013. Around 200 planned regulations are due to be submitted to the various ministries for evaluation over the next few years.

75. To further refine the legislative process on a targeted basis, the Federal Government adopted a Working Programme for Better Legislation in 2018. Among other things, this Working Programme has introduced simplifications in social security law, in business statistics, in planning and licensing law in the transport sector, and for import turnover tax.

76. The Federal Government will concentrate measures to relieve the bureaucratic burden on business in a Third Act to Reduce Bureaucracy. In particular, statistical obligations

will be scaled down and the legislation will seek to standardise limit and threshold values in various areas of law, inter alia, by reviewing thresholds particularly in tax and social law, and thresholds for reporting obligations. Furthermore, requirements under commercial law and tax law will be harmonised and double reporting to the employers' liability insurance association avoided. A further aim is to exempt new businesses from the requirement to submit monthly preliminary turnover tax returns in the first two years of operation.

77. To reduce statistical obligations, the Federal Government has set up an interministerial Federal/*Länder* working group. Its job is to push ahead with the reduction of unnecessary statistics and agree on the steps to be taken to modernise business statistics through digitisation. A particular aim is to ensure that the same data are not collected multiple times by different bodies.

78. The regulatory framework for public procurement is being continuously modernised. The reform of procurement law, which entered into force in April 2016, created a comprehensive, modern and flexible framework for public procurement above the EU thresholds. The Federal Government also overhauled public procurement below the EU thresholds with the Ordinance for Public-sector Purchasing below the Relevant Thresholds. The Ordinance entered into force for federal authorities in September 2017 (cf. 2018 Annual Report, Item 65). Since the business community has a justified interest in encountering public procurement rules which are as similar as possible across Germany, the Federal Government will continue to work intensively towards the rapid roll-out of the Ordinance in all of Germany's *Länder*. Seven *Länder* have already introduced the Ordinance, while two more *Länder* are about to do so.

79. The Federal Government will also adapt the public procurement framework with regard to public procurement in the area of security and defence. More precise legal formulations are to help simplify and expedite the procurement process in this sector. Without prejudging the outcome, the Federal Government is also examining whether procurement law can be harmonised further by merging rules for the award of contracts for public supplies and services with those for the award of contracts for public works. A joint working group, consisting of representatives from the business community, public contracting authorities, the German Bundestag and experts, will be set up for this purpose. At the same time, the procedures for the award of contracts for public works will undergo continuous development geared towards the user, and all three sections of the revised "Procedures for the Award of Contracts for Public Works, Part A" will enter into force.

80. Public-sector planning and procurement activities must be rooted in a solid basis of data. To align procurement sta-

Box 1: Life events survey

To systematically examine the quality of laws and regulations, the Federal Statistical Office has been regularly conducting surveys on businesses and citizens on behalf of the Federal Government since 2015 to gauge their experience with public administration at various events in life, ranging from the foundation of a company through to the cessation of business activities.

Key takeaways: Businesses in Germany are largely satisfied with public administration. On a scale from "very satisfied" (+2) to "very dissatisfied" (-2), the average level of satisfaction in 2017 was +0.93. For additional findings, visit: www.amtlich-einfach.de.

In the ten life events examined, businesses state that they are most satisfied with their interaction with public authorities and offices and the services they provide, in relation to training, occupational safety and health protection. As was also the case in 2015, according to the current survey, they are less satisfied with their experience "building business premises" and "participating in a competitive bidding procedure".

Following the evaluation of the results and in-depth reviews with experts and practitioners, the Federal Government has introduced targeted measures with the "Better Legislation and Bureaucracy Reduction" working group to address the shortcomings identified and implement the suggestions for improvement developed with the parties concerned. The next survey will be conducted this year.

tistics even more with the information needs of the Federation, *Länder* and municipalities, the Procurement Statistics Ordinance will be revised, also with regard to the range of data to be captured. The economic importance of public procurement and the potential for efficiency gains are the focus of a comprehensive OECD report. On completion of the report, the Federal Government will examine the recommended actions for the continued development of the public procurement system.

81. Companies committing serious white-collar crime should be excluded from public contracts or concessions. In future, public-sector contracting authorities should be able to consult a competition register to determine quickly and easily whether there are any grounds to exclude a company from the bidding process. The legal basis for this was established in the summer of 2017 in the Competition Register Act, (cf. 2018 Annual Economic Report, Item 66). The rapid development of the nationwide electronic competition register at the Federal Cartel Office is a matter of great importance for the Federal Government. A statutory instrument governing the details of the reporting obligations of law enforcement authorities is currently being prepared in close collaboration with the Federal Cartel Office, the authorities concerned and other stakeholders.

Encouraging a spirit of entrepreneurship and promoting business start-ups

82. Self-employed persons and business owners make an important contribution to our general welfare. Their strong performance is the precondition for a prospering Social Market Economy. Germany needs a stronger entrepreneurial spirit so that new businesses will continue to maintain the momentum of the market economy in the future and strengthen small and medium-sized enterprises. This requires a willingness, particularly among young people, to start a business, and a positive image of entrepreneurs in society. The Campaign to Promote Business Start-ups aims to strengthen the culture of entrepreneurship in Germany, and encourage people to identify opportunities to start a business and put their own ideas into practice. Business creation and business succession are to be made easier, and the conditions for start-up financing improved. The digital Business Start-up Platform and better web-based information and advisory services are to make the process of setting up a business easier, better and faster.

83. The 2019 Act to Define the Economic Plan of the ERP Special Fund plays a central role in improving the financing conditions for start-up entrepreneurs, SMEs and independent professionals. It forms the basis for reliable support for Germany's SMEs.

84. The EXIST programme continues to provide support to university and research start-ups in putting into practice research-based, innovative products. In addition, the structures to support start-ups at third level institutes are being developed and expanded further. The internationalisation of start-ups is promoted through start-up exchange programmes with Israel (GISEP) and India (GINSEP), as well as by the German Accelerator programme, which specifically supports the internationalisation strategy of start-ups and advises them in their efforts to enter the various start-up regions of the world.

85. The Federal Government encourages and promotes the establishment of businesses in key enabling technologies. To this end, a tailored range of support programmes has been established for people setting up new business in the fields of IT security, microelectronics, logistics, materials research and quantum technologies.

86. The "Young Entrepreneurs in Science" initiative aims to raise awareness among researchers and students early on of the possibility of starting a business, so that greater consideration is given to this option as a way to exploit scientific findings. Further to this, new methods are being developed to teach the skills needed for people to run their own business.

87. The Federal Government wishes to step up collaboration between young enterprises and established businesses in order to exploit additional potential for growth resulting from stronger co-operation. The nationwide Digital Hub Initiative plays a key role in this respect. In the twelve hubs, it brings together established companies, new business founders, research centres and investors to work together on topics of great relevance for the future, such as the Internet of Things, FinTech applications or artificial intelligence. To further attract young start-up entrepreneurs, investors and skilled professionals from abroad, a team has been set up at Germany Trade & Invest (GTAI), whose job is to actively reach out to these target groups in foreign countries. At the national level, the Hub Agency is responsible for communication and advisory services for the German hubs.

88. An attractive financing environment and, in particular, good access to venture capital are key to the success of start-up businesses. In recent years, the German venture

capital (VC) market has evolved considerably, thanks in part to the support instruments of the Federal Government. However, by international standards, the German venture capital market – measured as a percentage of GDP – still has potential for improvement, according to the Council of Economic Experts (cf. GCEE Annual Report, Item 139). The gap in venture capital offerings particularly affects start-ups that need to scale up a digital business model quickly in order to succeed in an international, platform-based competitive environment. For this reason, the Federal Government seeks to mobilise more private capital and institutional investors for investment in start-ups, for example through the creation of a large national digital fund together with industry.

89. The KfW equity capital framework has made significant advances with the establishment of the "KfW Capital" company in 2018. The aim of the new company is to provide a close-to-market structure for improving the quality and quantity of KfW's activities in venture capital and equity financing. The independent organisation allows the investment subsidiary to also tie in additional private funds. KfW Capital commenced operational activities on 15 October 2018.

90. Compared with other countries, the venture debt financing format is still underdeveloped in the German venture capital market. Venture debt is a type of debt financing chosen by commercial banks and funds to complement the equity financing of high-growth start-ups. With the Tech Growth Fund Initiative, the Federal Government intends to broaden this important market segment so that sufficient financial resources are available in all the stages of development of innovative businesses.

91. In addition, the Federal Government is also stepping up its efforts to boost the national and international competitiveness of various branches of the cultural and creative industries, including through the Federal Centre of Excellence for the Cultural and Creative Industries and the "Cultural and Creative Pilots" business start-up competition.

Strengthening research and development as a driver of innovation

92. Long-term prosperity, jobs with a secure future, and a sustainable economy in Germany are largely based on the ability of German businesses to innovate. This is why the promotion of research and development is a priority goal of the Federal Government and is underpinned by numerous measures.

93. For example, complementing existing project support, the Federal Government is working on a framework for the promotion of R&D activities through tax incentives – particularly for small and medium-sized businesses – which is based on personnel and project costs. The Federal Government will present draft legislation to this end in the first half of 2019. The Council for Economic Experts, however, prefers output-based incentives over the lower taxation of patent and licensing revenues (patent boxes, cf. GCEE Annual Report, Item 605). In the Federal Government's opinion, the fact that this model only provides relief for businesses once they are generating profits is an argument against it; it would not benefit young businesses in the growth phase. In addition, it could result in undesired profit shifting in the context of international tax competition.

94. Since 2006, the Federal Government has defined the strategic framework of its funding of research and innovation at the start of each legislative term with the High-tech Strategy. The High-tech Strategy 2025 (HTS 2025), adopted in September 2018, is designed to strategically underpin the policy goal of increasing public and private-sector spending on research and development to 3.5% of GDP by 2025 (cf. Diagram 8). The HTS contains goals, priorities and milestones of research and innovation policy in the years ahead, with a focus on programmes and support measures in the fields of "health and care", "sustainability, climate action and energy", "mobility", "urban areas and the countryside", "security" and "business and work 4.0". Under the "Research for Civil Security 2018 – 2023" framework programme enshrined in the strategy, innovative solutions that enhance people's security, safety and quality of life and protect vital infrastructures are being developed and put into practice. A central action area of the HTS 2025 is the creation of an open culture of innovation and risk-taking. The country's entrepreneurial spirit and the transfer of ideas to practical applications is to be strengthened significantly.

95. With the establishment of an agency to promote springboard innovations, the Federal Government is taking a person-centric approach to innovation promotion which is unique in Germany: focussing on outstanding, creative persons from the scientific community and the business sector with a proven track record in innovation – known as innovation managers – the agency gives them the scope to pursue highly innovative ideas from research and development from a specific application perspective and develop them

into application-ready products, processes or services. The work of the agency is open to all topics, disciplines and technologies.

96. Further to this, the Federal Government is launching a Transfer Initiative to help businesses translate the results of their research into products and processes more quickly. Working together with players particularly from the business sector, the Initiative explores how existing instruments of technology transfer can be improved and new instruments developed where needed. Technology-neutral support schemes for SMEs, such as the Central Innovation Programme for SMEs (ZIM), Cooperative Industrial Research (IGF) and the "go-cluster" excellence programme, already support networking among businesses and collaboration with the scientific community, also increasingly beyond national borders. The INNO-KOM innovation competence programme puts structurally weak regions at the forefront of funding: it supports projects of external non-profit industrial research facilities which, as R&D service providers and transformers of market-oriented knowledge, are very important for small and medium-sized enterprises. A pilot funding scheme for non-technical innovations extends the focus to new digital business models and pioneer solutions.

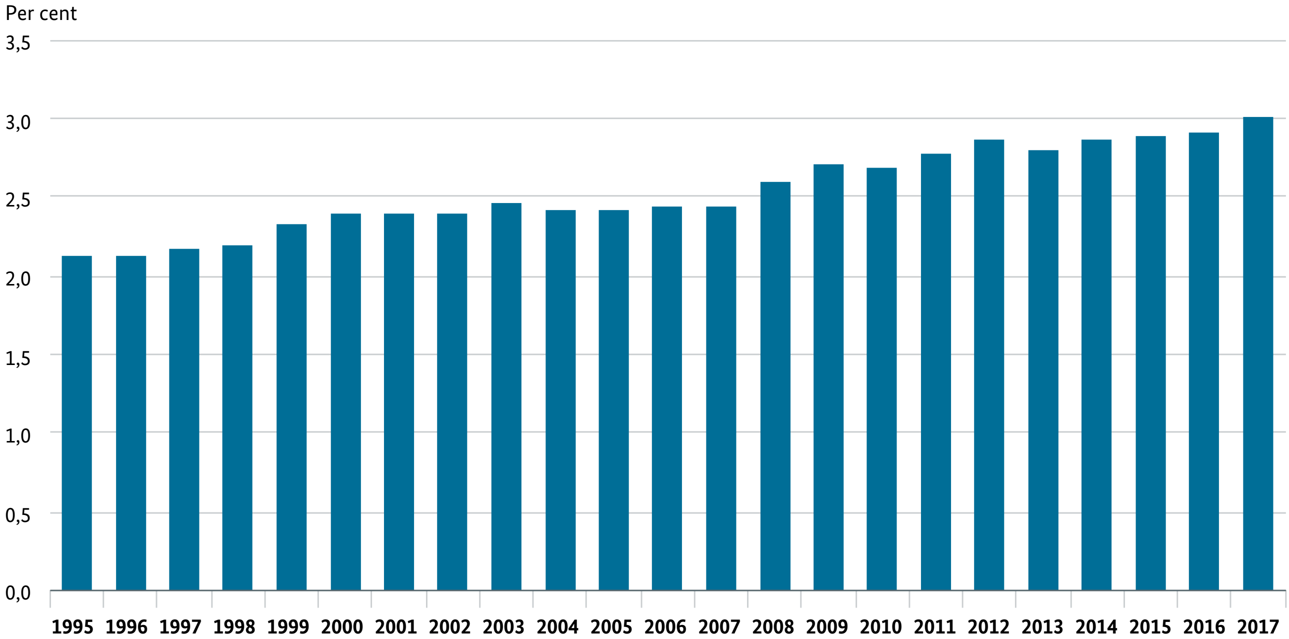
Shaping mobility for the future

97. A strong, efficient infrastructure is the bedrock of a successful economy, which is why investment in roads, rail and waterways is of tremendous importance.

98. The Federal Government will safeguard the high quality of the federal transport infrastructure and address bottlenecks with new infrastructure construction and expansion measures where necessary. Investment in federal transport infrastructures increased to approximately €14.1 billion in 2018 and is set to rise further to roughly €14.6 billion in 2019. Investment in the transport infrastructure will continue at this high level in the years after 2019.

99. In 2017, the truck toll generated revenues of roughly €4.7 billion. Since 1 July 2018, the truck toll has been levied on trucks with a permitted total weight of at least 7.5 tonnes on all the roughly 52,000 kilometres of federal roads in Germany. In addition, with effect from 1 January 2019, the toll rates have been adjusted on the basis of a new road costs calculation, which takes noise-related costs into account. As a result, annual revenue amounting to €7.2 billion on average is expected in the 2018-2022 period. This revenue is ring-fenced and will be invested in the financing of federal trunk roads.

Diagram 8: Share of GDP spent on research and development



Source: Eurostat (provisional data for 2017).

100. In Germany, planning and approval procedures for transport infrastructure projects take a lot of time and need to be expedited further. For this reason, the Act to Accelerate Planning and Approval Procedures in the Transport Sector entered into force at the start of December 2018. This Act contains regulations that make the planning and approval procedures more efficient, promote procedure transparency and digitisation, and reduce the number of interfaces.

101. The reform of the administration of federal trunk roads will also help make planning procedures for the realisation of infrastructure investments faster and more efficient in the future. IGA – the infrastructure company for autobahns and other federal trunk roads – was established with the legal structure of a GmbH (limited company) on 13 September 2018. In addition, the Federal Trunk Road Office (FBA) was also set up on 1 October 2018 as a neutral and independent supervisory and approval authority. The IGA and FBA are to be expanded continuously through to the start of 2021 in order to guarantee the planning, building, operation, maintenance, financial management, and funding of the federal autobahns by the Federation from this point onwards.

102. Under the provisions of the Directive to Promote Rail Freight Transport via the Partial Funding of Approved Track Access Charges, additional federal budget funds are to provide incentive for price reductions in the area of rail freight transport and a modal shift of freight transport from road to rail, which is more environmentally friendly. The Directive entered into force in December 2018 and implements the "Rail Freight Masterplan". It is designed to improve the competitiveness of rail freight transport.

103. Sustainable, affordable and climate-friendly mobility will become increasingly important in the coming years. The Federal Government launched the "Future of Mobility" national platform in September 2018. Six working groups are to address issues surrounding the future of mobility and put forward recommendations for action in the areas of climate protection in the transport sector, alternative drive systems and fuels, digitisation, safeguarding Germany's position as a mobility and production centre, infrastructure and networks, and standardisation.

104. The incentive to purchase electric vehicles (environmental bonus) is to be strengthened by the ability to combine it with different support instruments. To this end, the non-combination rule was lifted in March 2018 in the Directive to Promote the Sale of Electric Vehicles. In addition, under the system of business car taxation in the Income Tax Act, electric mobility is promoted by halving the assessment basis for the private use of electric vehicles and externally chargeable hybrid electric vehicles. With the "Electric Mobility" funding initiative, the charging infrastructure is to be expanded significantly and its integration into existing distribution grids is to be trialled. A legal opinion provided by the Federal Government has established clarity with regard to pricing at charging stations and the admissibility of different tariff models for charging power found on the market. The technology programme "ICT for Electric Mobility: Smart Applications for Mobility, Logistics and Energy" promotes emission-free, automated and AI-based logistics, fleet and transport applications in the commercial sector, and economical operating concepts that improve the overall costs of electric mobility.

105. The Federal Government supports the competent *Länder* and municipalities in their efforts to reduce nitrogen dioxide emissions (NO_2). Through the "Immediate Action Programme for Clean Air 2017 – 2020" and other measures, it is making close to €2 billion available to the urban centres and municipalities that are affected by NO_2 emissions above the annual mean threshold. Blanket driving bans are to be avoided where possible and disadvantages for citizens prevented.

Support is granted to measures focussing on the electrification of transport, the digitisation of municipal transport systems, the retrofitting of diesel buses used in local public transport, and the retrofitting of heavy municipal vehicles as well as light and heavy delivery vans and vehicles used by tradespeople.

The proposed amendment to the Federal Immission Control Act clarifies that traffic bans will generally not be considered in areas where the NO2 level does not exceed the threshold of 50 microgrammes per cubic meter of air. In addition, the planned amendment to the Road Transport Act will give municipalities an effective tool for the monitoring of traffic restrictions and traffic bans that are imposed under the Immission Control Act.

The Council of Economic Experts recommends the introduction of a city centre congestion charge as an alternative to a ban on driving (cf. GCEE Annual Report, Item 30). The incentive effects with regard to traffic reduction, environmental pollution and change in user behaviour would vary depending on the system. The Federal Government does not plan to introduce a city centre congestion charge. The *Länder* and municipalities are at liberty to introduce a charge for the roads under their jurisdiction.

D. Shaping a modern working environment and social security systems; developing attractive living conditions

106. Demographic developments, digitisation and structural change call for a modern organisation of the labour market. The social security systems also need to be brought into line with these developments. The Federal Government is actively addressing this central policy challenge. It is also redoubling its efforts to create attractive housing conditions and living environments, a key prerequisite for people to be able to properly participate in social life.

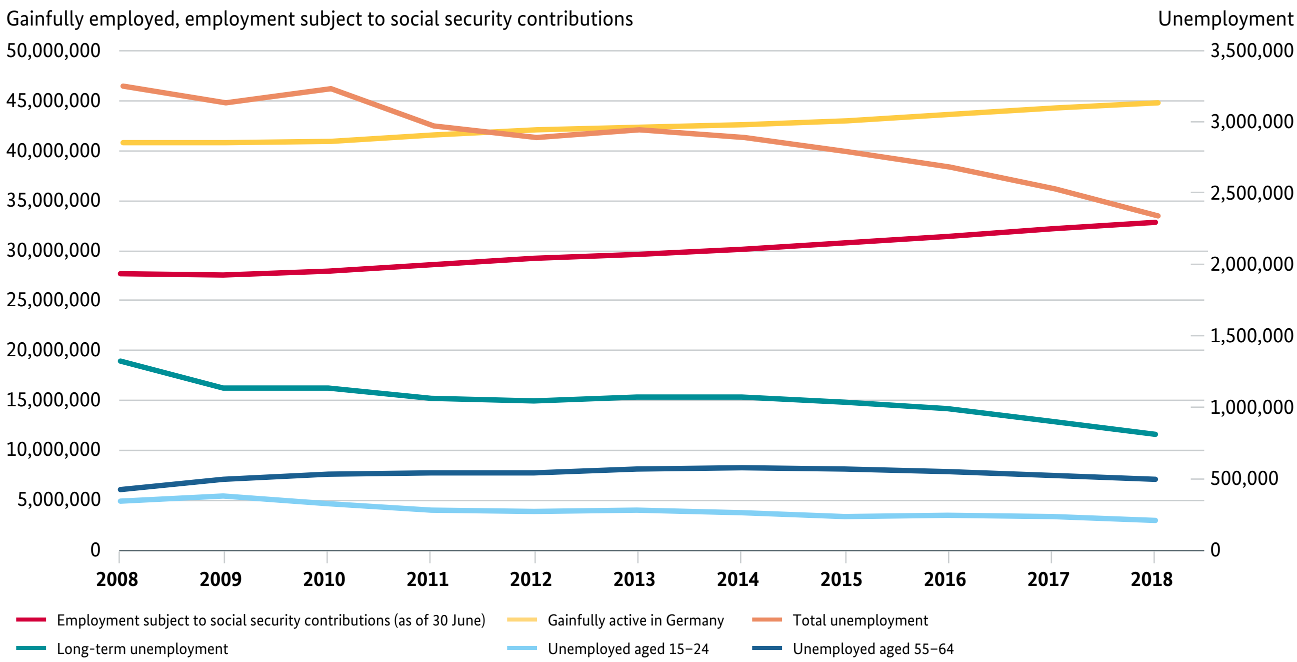
Creating the framework for the positive development of the labour market

107. The labour market is in the best shape it has ever been since reunification (cf. Diagram 9). Gainful activity in Germany rose again significantly in 2018. According to provisional annual figures from the Federal Statistical Office, around 44.8 million people were engaged in gainful activity on average last year – an increase of roughly 562,000 people over 2017. This rise in gainful activity is primarily driven by an increase in the number of people in employment requiring compulsory social insurance payments, which amounted to 32.9 million (as at 30 June 2018). Unemployment dropped to 2.3 million, down by around 193,000 persons in the previous year. The unemployment rate averaged 5.2% in 2018, compared with 5.7% in 2017. Developments in long-term unemployment and youth unemployment are also positive. Compared with the previous year, the number of long-term unemployed in 2018 fell by 9.7% on an annual average to 813,000. The number of unemployed young people was down by 8.8%, or 210,000, on average in 2018.

Securing the skills base: skilling of workers, labour market integration of unemployed persons and refugees

108. In light of the ongoing positive economic climate in Germany, and the greater willingness of enterprises to hire as a result, as well as digitisation and demographic developments, an increased focus is being placed on the situation of skilled labour in Germany. This is because labour bottlenecks are becoming apparent in certain regions and industries, and with regard to certain skills and qualifications. This is particularly true for professions in the health care and nursing sector, as well as for individual technical professions and the skilled crafts and trades sector.

Diagram 9: Development in the labour market



Source: Statistics of Federal Employment Agency; annualised figures; 2018 figures: provisional figures from Federal Statistical Office; status: January 2019.

109. Global competition, increasingly noticeable demographic change, and the rapid advance of digitisation are driving far-reaching changes in the labour market. There is a heightened risk that the labour shortages we are already witnessing will intensify and that the mismatch between the skills job-seekers possess and those required by companies will increase. To address skills shortages in Germany, the Federal Government is pursuing a three-pillar Skilled Labour Strategy, which focuses (i) on tapping domestic potential and getting people in Germany better qualified for the labour market; (ii) on exploiting the opportunities of the free movement of skilled workers from Member States of the European Union; and (iii) on recruiting skilled professionals from countries outside the European Union.

In Germany, the Alliance for Initial and Further Training plays a key role as the central policy platform for the dual system of training and education. The principle aim of the Alliance is to further improve the quality of the dual system of training and education and make it more appealing, and it is committed to ensuring that as many young people as possible get a qualification. As part of the restructuring of the Alliance for Initial and Further Training starting in 2019, the partners to the Alliance seek, in particular, to bring together more businesses and young people, to support the career orientation and mobility of young people, and to strengthen vocational training.

In addition, vocational training is being modernised with the Vocational Training Pact. The permeability of the vocational initial and further training system is to be improved and vocational training is to be made more attractive.

The reskilling and upskilling of existing workers is becoming an increasingly important area. For this reason, the Federal Government has introduced the Upgrading Opportunities Act as an initial step, the key elements of which entered into force in 2019. In future, workers whose jobs are affected by structural change, or who wish to pursue continuing vocational training in a profession affected by skilled labour shortages, will receive support in the form of full or partial coverage of the costs of the continuing training programme. Employers can receive a wage subsidy for the time their workers spend in skills development programmes. The Federal Government is continuing this approach by developing a National Strategy for Continuing Training in tandem with the social partners and the *Länder*. With this Strategy, access to continuing training is to be made easier for everyone by making further training opportunities more transparent and by providing incentives for people to avail themselves of these opportunities. Workers' opportunities for professional development and promotion are also to be systematically supported throughout their working lives. In addition, the continuing training programmes of the Federation and the *Länder* are to be better aligned with one another.

Further to this, the Inclusion Act gives the long-term unemployed new prospects for participation in the labour market. The introduction into Book II of the Social Code of one new and one redesigned support instrument – "Inclusion in the labour market" and "Integrating the long-term unemployed" – gives the long-term unemployed new employment options on the general and social labour markets with the help of subsidies for wage costs. The sponsored employment scheme is backed by intensive mentoring and skills development measures.

110. In addition to tapping domestic potential for more home-grown skilled workers, more skilled professionals are also to be recruited from other EU Member States and from countries outside the EU. Due to the freedom of movement for workers, immigration from EU countries is already significantly higher than immigration from countries outside the EU. To attract even more skilled professionals from European Member States, additional improvements are to be made with regard to language learning – both in Germany and abroad – as well as with regard to the procedures for recognising educational and professional qualifications, and the opening up of conditions for training support.

111. While the number of residence permits granted to well-qualified professionals from non-EU countries for the purpose of labour-related migration has increased in recent years, relatively few qualified professionals from non-EU countries have availed themselves of the existing possibilities for labour-related migration thus far. If the German economy is to remain competitive, it must specifically attract more skilled workers, including workers from outside the EU. To this end, on 19 December 2018, the Federal Government adopted the Government draft of a Skilled Labour Immigration Act in the Federal Cabinet which includes provisions, inter alia, for easier labour market access for skilled professionals. Accompanying measures include provisions to improve recognition and visa procedures (cf. also Item 16). The Council of Economic Experts welcomes efforts to support the immigration of skilled professionals, particularly from non-EU countries, in the form of a Skilled Labour Immigration Act (cf. GCEE Annual Report, Item 96 ff.).

The Federal Government has already implemented an important accompanying measure for the recruitment of skilled labour: in November 2018, the "Make-it-in-Germany" information portal became the Federal Government portal for international qualified professionals. With information presented in a uniform, consistent manner on a single site, the portal allows interested skilled professionals to obtain all the information they need from a central official source and receive advice that is tailored to their situation.

While the level of unemployment among refugees remains high, it is on a downward trend, however. Considerable progress has already been made with regard to the labour market integration of persons with a recognised right to protection. Significant increases in labour market participation can be reported for this demographic group, with the rate of employment among citizens from the eight main countries of origin of asylum seekers reaching 32.3% in October 2018. However, the further integration of refugees into the labour market will take time. Many refugees have taken part in language learning or labour market measures. To support the positive employment trend, measures that focus on the acquisition of general and job-specific German language skills and the placement of people with a recognised right to protection in training and employment continue to be necessary. There is also a need for appropriate support services and assistance with regard to the recognition of foreign professional qualifications or the documentation of professional skills and expertise. This is because the speed at which refugees are integrated into the labour market, and the success of such efforts, also depend on the availability of tailored support services with regard to training and skills development in businesses and institutions.

Improving conditions to balance family life and work commitments, reducing the burden on low-income families

112. The expansion of childcare services makes it easier for parents to participate in the labour force and therefore also helps ensure the supply of skilled workers. Furthermore, it improves opportunities for learning and participation for children. With federal support, over 400,000 childcare places for children under three have been created in the last ten years. Funding of around €1.1 billion in total will be provided for an additional 100,000 places in the period from 2017 to 2020. The Federation also contributes €845 million annually towards the regular operating costs of childcare facilities, with an additional €100 million provided in both 2017 and 2018.

To improve the quality of childcare services, the Federal Government has introduced the "Quality Childcare Act". The aim of the Act is to help create a level playing field in the area of early childhood education and greater equality of opportunity for children, and to further strengthen the framework for reconciling work and family commitments. The *Länder* receive additional tax revenue through the system of VAT revenue distribution for defined action areas which are relevant for quality. These funds can also be used for measures to relieve the fee burden on parents. The Federation will conclude individual contracts with the *Länder* for continued quality development and better participation in childcare facilities. Overall, the Federation will make total funding of around €5.5 billion available to the *Länder* through to 2022.

Investments in childcare services and the family policy benefits that have been introduced – such as parental allowance, for example – have contributed to increasing the labour force participation rate of mothers. For example, the percentage of working mothers with children under the age of eight increased by seven percentage points in total from 2007 to 2017 from 49% to 56% (special analysis of the micro-census (2007 – 2017), concept of performed gainful activity, calculation by Prognos AG).

113. Apart from the expansion of childcare services, flexible work time models that can be adapted to individual situations also help improve the conditions for balancing family life and work commitments. The Act on the Further Development of the Right to Part-time Work – Introduction of Bridging Part-time Employment" entered into force in 2019. In particular, the Act ensures that workers who have opted for part-time employment for a limited period – for reasons of child-rearing, for instance – can return to their previous working time arrangements.

114. In a Social Market Economy, incentives to work must be preserved. Therefore, under the Strong Families Act, the child supplement is to be increased regularly for low-income families such that the child supplement and the child benefit together cover the average needs of a child – at the amount of the material subsistence level which is to be tax-free – excluding the amount for education and participation. This new regulation will apply with effect from 1 January 2021. To this end, the first step will be to raise the maximum child supplement to a standard amount of €185 for an interim period from 1 July 2019 to 31 December 2020. Furthermore, the child supplement is to be designed in such a way that the benefit will be phased out gradually if the family's income increases. At present a "cut-off point" applies to the current maximum supplement of €170 per child, with the result that a family whose income exceeds a certain level

abruptly loses its entitlement to the child benefit supplement. Additional expenditure of up to approximately €1 billion is earmarked in the years 2019 to 2021 for the expansion and restructuring of the child supplement. Benefits for education and participation are also to be improved under the Strong Families Act. The aim is for children to be given a fair chance to participate in society, receive an education and develop their skills and abilities irrespective of their parents' financial means. In addition, the system of benefits for education and participation is to be simplified, including the application process and billing system, particularly in the case of school excursions. Furthermore, with effect from 1 July 2019, the monthly child benefit will be increased by €10 to €204 per child for the first and second child, to €210 for the third child and €235 from the fourth child onwards; the tax allowance for children will be raised accordingly (cf. Item 40).

Gearing social security systems to the future

115. Gearing social security systems to the future is high on the Federal Government's agenda in order to continue to safeguard social cohesion. In this context, positive employment growth makes a significant contribution to stabilising the social protection systems. Social contributions are to be kept stable at under 40%.

116. With regard to unemployment insurance, the burden on contributors is reduced. The contribution rate to unemployment insurance has been reduced by law by 0.4 percentage points and by decree by an additional 0.1 percentage points for a limited period up until the end of 2022. This ensures that the Federal Employment Agency retains the ability to act in the event of risks and crises and – if the economy continues to perform well – has reserves of around 0.65% of the GDP, but also guarantees that contribution revenue that is not needed is returned to the contributors. The contribution to unemployment insurance therefore stands at 2.5% with effect from 1 January 2019. In addition to relieving the burden on contributors, the Federal Government is also simultaneously taking measures to support long-term unemployed persons who are not benefiting from the strong performance of the labour market. For example, individualised support and mentoring services are provided under the Inclusion Act (cf. Item 109).

117. In the statutory pension insurance system, the Act to Improve Benefits in and Stabilise the Statutory Pension Insurance Scheme makes provisions for the introduction of dual safety parameters to maintain pensions at a minimum level of 48% and the contribution rate at a maximum level of 20% through to 2025. The lower limit for the contribution rate is 18.6% through to 2025. The Act contains provisions for additional benefit improvements with regard to pensions for persons with reduced earning capacity and the recognition of time spent raising children. Furthermore, by raising the upper limit for "midi-jobs", the Federal Government is relieving the burden on lower wage earners via lower employee contributions to the social security system without this later resulting in lower pension entitlements.

To craft a long-term strategy designed to safeguard and refine statutory pension insurance and the two other pillars of the pension system in the period after 2025, the Federal Government set up the independent "Reliable Intergenerational Contract" Commission in May 2018. The Commission is tasked with adjusting the pension insurance system so that it is balanced in the long term, and to put forward a proposal outlining the minimum reserves that are needed to guarantee the year-round liquidity of the statutory pension insurance system. It is to present its report by March 2020.

118. The planned pension information system spanning all three pillars of the pension system (statutory, in-company and private pension provision) is designed to provide citizens with transparent information on their individual old-age provision and help them identify potential need for action.

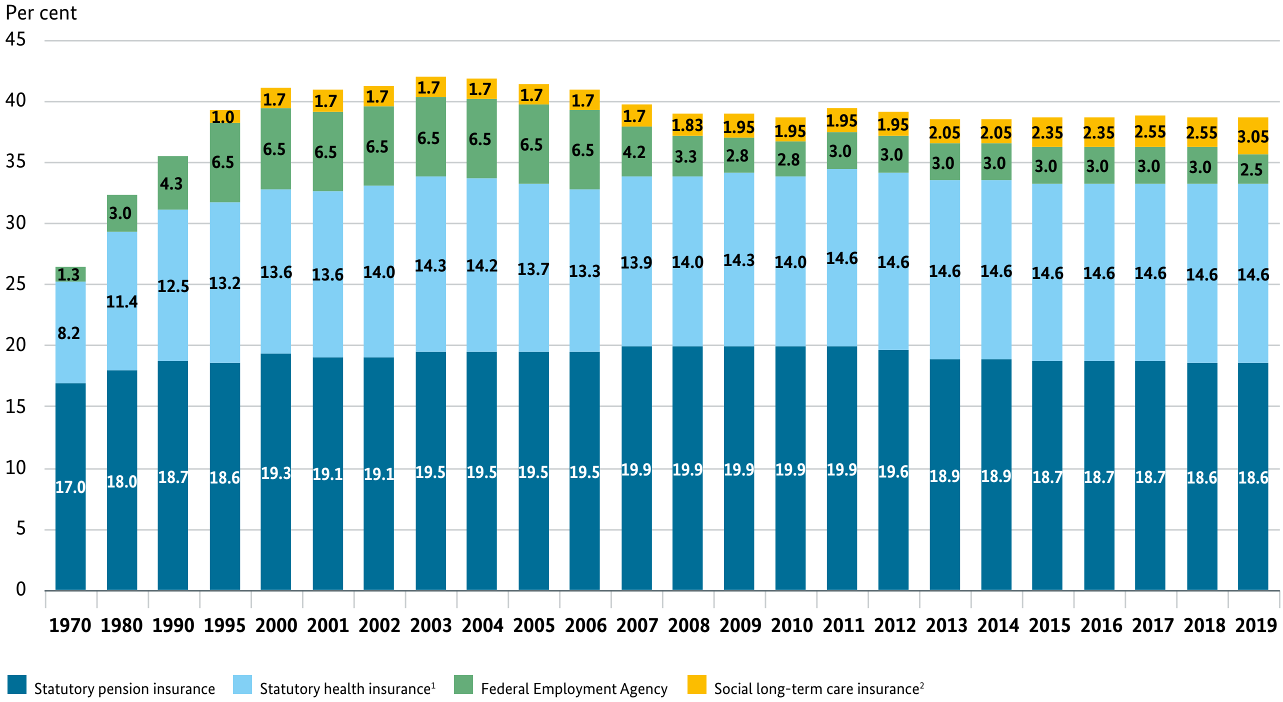
119. In the statutory health insurance system, the Federal Government has provided annual relief of roughly €8 billion to contributors. In future, the contributions to statutory health insurance will be financed again in equal part by employers and members; this results in an average reduction of 0.5 percentage points in the additional contribution rate for members. Further to this, several structural measures will be introduced to develop the statutory health insurance system further and make it viable for the future in order to accommodate changing health care needs in light of an aging population and technical advances in medicine, and to safeguard the long-term financing of the statutory health insurance infrastructure. To restructure the system of financing statutory health insurance, the Council of Economic Experts proposes a flat-rate per capita health insurance premium with a non-income-related contribution assessment (cf. GCEE Annual Report, Item 824). However, the Federal Government is of the opinion that this financing model, which the GCEE has been discussing for over a decade, ignores the vast implementation difficulties, distribution policy issues and constitutional barriers.

Additional targeted measures to improve the provision of heath care, particularly in rural areas, will be rolled out with the Appointment Service and Care Act. One of the objectives of this Act is to ensure that people insured under the statutory health care system can get a doctor's appointment more quickly.

To further develop the provision of health care under the statutory health insurance system, an innovation fund was already set up in the last legislative term. An Innovation Committee, consisting of representatives of the self-governing bodies within the health care system and representatives of the Federal Government, decides on the level of support for new forms of health care that go beyond current standard care, and support for health care research projects that are geared towards gaining insights and knowledge to improve the current care system. A total amount of €1.2 billion from statutory health insurance funds is provided for the fund in the period 2016 to 2019. Beyond 2019, the innovation fund will be continued and developed further with annual funding of €200 million.

The Council of Economic Experts criticises the fact that the German health care system has excess capacities in the hospital sector and believes that it needs to become more competitive (GCEE Annual Report 2018/19, P. 60, Items 122–128). With the creation of a hospital structure fund, the Federal Government already took an important step in the last legislative term towards adapting capacities in the inpatient sector to actual demand. Funding to reduce hospital capacities – through the closure or conversion of hospitals, for example – is available through the fund. The fund will be continued for a period of four years from 2019 onwards. According to the Council of Economic Experts, competition in the health care sector should be increased further with the option of selective contracting between health insurance funds and hospitals. In addition, the GCEE calls for a reform of the morbidity-based risk adjustment scheme. The Federal Government will develop the risk adjustment scheme further with the goal of establishing fair competition.

Diagram 10: Annual average contribution rates to social insurance as percentage of gross wages liable to contributions



[1] General contribution rate (parity-based funding, excluding member-based special contribution)
[2] Excluding the contribution surcharge for those without children of 0.25% levied since 1 January 2005.

Source: Federal Ministry for Labour and Social Affairs; status: January 2018.

Furthermore, the Federal Government has set up a federal/*Länder* working group that is to develop proposals for the continued development of cross-sectoral care by improving the linkages between the outpatient and inpatient system. In addition to placing more emphasis on patients' health care needs, this is also to tap potential for efficiency gains. The Council of Economic Experts strongly advocates the better dovetailing of the inpatient and outpatient sector (cf. GCEE Annual Report, Item 128).

120. Digitisation also offers enormous potential for the improvement of processes in the health care system. One example in this context is the electronic patient record, which can enable access to medical data with the permission of the insured party. In digitising the health care system, the priority is to also reduce misdiagnoses, unnecessary examinations and long waiting times.

121. Another central goal of the Federal Government is to secure and increase the supply of skilled staff to address the increasing numbers of people in need of care owing to demographic change.

In July 2018, the Federal Government launched the "Concerted Action for Nursing" (KAP) campaign, involving all stakeholders in the nursing sector. The Federation and the *Länder* will work together to develop concrete measures within one year to improve the situation of nursing professionals.

In addition, as a result of the Act to Strengthen Nursing Staff, 13,000 additional nursing positions in inpatient nursing facilities can be filled as of January 2019; these positions will be financed by the health insurance system. Appropriate hospital staffing levels will be guaranteed as a result of the new nursing budget which is to be introduced with effect from 2020 under the provisions of the Act to Strengthen Nursing Staff, and with the Ordinance on Minimum Nurse Staffing Requirements for care-intensive hospital areas.

To cover the additional expenditure in the care sector for the current legislative term and to therefore ensure contribution stability through to 2022, the contribution rate to social long-term care insurance is increased by 0.5 percentage points with effect from 1 January 2019.

Liveable cities and towns, attractive regions and affordable housing

122. Liveable cities and towns, attractive regions and affordable housing are fundamental to our life and work, and for social cohesion. They are also important locations both for businesses and for public administration: vacancies in urban centres should not go unfilled because high accommodation costs deter interested applicants from moving to take up a post. The aim of the Federal Government is for 1.5 million new residential units to be built in Germany in this legislative term.

At the Housing Summit on 21 September 2018, a package of measures was agreed on with the *Länder* and municipalities (cf. Diagram 11). The broad package of measures goes far beyond the arrangements in the Coalition Agreement and takes the interests of tenants, owner-occupiers and investors into account. With this package, the Federal Government is seeking a combination of support for individuals and the promotion of the supply of property, i.e. a smart mix of measures that make an acceptable housing cost burden possible.

123. Social housing is a key component of the package of measures. The Federation is providing a total of €5 billion towards social housing in the period from 2018 through to 2021 (inclusive). For this purpose, compensation funds are increased once again by €500 million to around €1.5 billion for 2019; in 2020 and 2021, the Federation will provide a total of €2 billion in financial assistance to the *Länder* that is specifically ring-fenced for the construction of social housing. Together with funds from the *Länder* and municipalities, this means that over 100,000 additional social housing units can be created. On 29 November 2018, the German Bundestag adopted an Act to Amend the Basic Law that is designed, inter alia, to enable the Federation to provide financial support for social housing even after the expiry of the compensation funds for the promotion of social housing in 2019 (cf. also Item (34)). Furthermore, since 2015 the Federation has provided the Länder and municipalities with plots of land at a reduced price for the purpose of social housing, inter alia. The ability to provide properties of the Institute for Federal Real Estate at a reduced price was extended to all federal properties with the 2018 Budget Act. The legislation also introduced the possibility of the resale of reduced-price properties to third parties in the private sector without a repayment obligation if the price reduction is transferred to the purchaser on condition that the municipality or public authority use the third party to

fulfil the public service duty or to meet the objective of the price reduction, e.g. the construction of social housing units. Families with children and single parents are specifically assisted in purchasing their first owner-occupied home with the introduction of a home buyers' child benefit. The financial support is provided over a maximum period of ten years through a grant of €1200 per year for each child under 18. In addition, the "Age-appropriate Conversions" funding programme was put on a permanent footing at an annual level of €75 million in the financial plan through to 2021, and €65 million were made available in 2018 for the burglar-proofing of homes.

124. Furthermore, the Federal Government will increase the amount of the housing allowance and strengthen its reach with effect from 2020. The Council of Economic Experts is also in favour of strengthening the housing allowance as a constructive instrument of support for individuals (cf. GCEE Annual Report, Item 112). In addition, the Federal Government has introduced tax-based measures to support affordable housing (cf. Item 41). With the planned introduction of a time-limited special depreciation allowance, the Federal Government will provide tax incentives - through to the end of 2026 - to support the construction of new rental properties for which an application for planning permission or notification of construction has been submitted between 31 August 2018 and the end of 2021. Complementing the support schemes launched by the Länder, this measure is intended to specifically encourage private investors to build affordable rental apartments. Furthermore, the Act to amend the Regulations on the Permitted Rental Price at the Start of a Rental Agreement and to Modify the Regulations Surrounding the Modernisation of the Rental Object (Tenancy Law Amendment Act) increases transparency and relieves the burden on tenants if extensive modernisation measures are carried out. As a result, the percentage of the costs of modernisation which may be passed on to tenants is reduced from 11% to 8% in areas with a tight housing market. Other measures include the introduction of a cap on the rent increase following modernisation, an obligation on the part of the landlord to provide information regarding exceptions from the rent control mechanism, particularly a higher previous rent; and the penalisation of the abuse of modernisation measures as a way to terminate existing rental agreements.

125. In the area of urban development, the Federation is supporting the Länder and municipalities with federal financial assistance for urban development under the "National Urban Development Policy" initiative. Programme funds amounting to €790 million were available in 2018. Provisions for continued financial assistance at this level are made for 2019. On top of this, a further €200 million in programme funding is provided for the "Social Integration in the Neighbourhood" investment pact and up to roughly €146 million in 2018/2019 for the "National Urban Development Projects" programme. This means that, in total, more than €1 billion in federal funds are available for the promotion of urban development in 2019.

Diagram 11: Decisions of the 2018 Housing Summit

Stimulus for investment in house-building	Making sure that housing is affordable	Cutting costs of building and tackling skills shortage
– Boost to building of social housing – Building-related child benefit – Special depreciation for building of new rented accommodation – Building of housing for staff in public and private sector – House-building premium – Energy efficiency and climate action in buildings sector – Age-appropriate reconstruction, security against break-ins, community living – Revision of home ownership legislation – Promotion of urban development	– Further development of rental legislation – Housing benefit reform – Commission of experts on mobilising sustainable land for building and land policy – Building Code – Cheaper sale of public real estate – Further measures (e.g. reducing possibilities to converted rented into owner-occupied housing, land tax reform)	– Developing and harmonising building regulations – Pressing ahead with serial and modular building – Simplifying procedures, utilising opportunities of digitisation – Restricting follow-up costs of regulation and standardisation – Establishing low-cost systems for technical fittings in buildings – Tackling skills shortage and expanding construction capacities

Source: Federal Ministry for Economic Affairs and Energy.

E. Continuing energy and climate policy on a market-led basis

126. Energy and climate policy are of central importance for the Federal Government. The goal of the energy transition is to restructure the energy supply away from predominantly fossil and nuclear energy sources to predominantly renewable energy sources. In this way, it helps Germany to meet its national and international climate targets and also ensures energy security and affordability. It thus takes account of the basic concept of the Social Market Economy: to combine economic progress and competitiveness with the concept of sustainability and the needs of future generations.

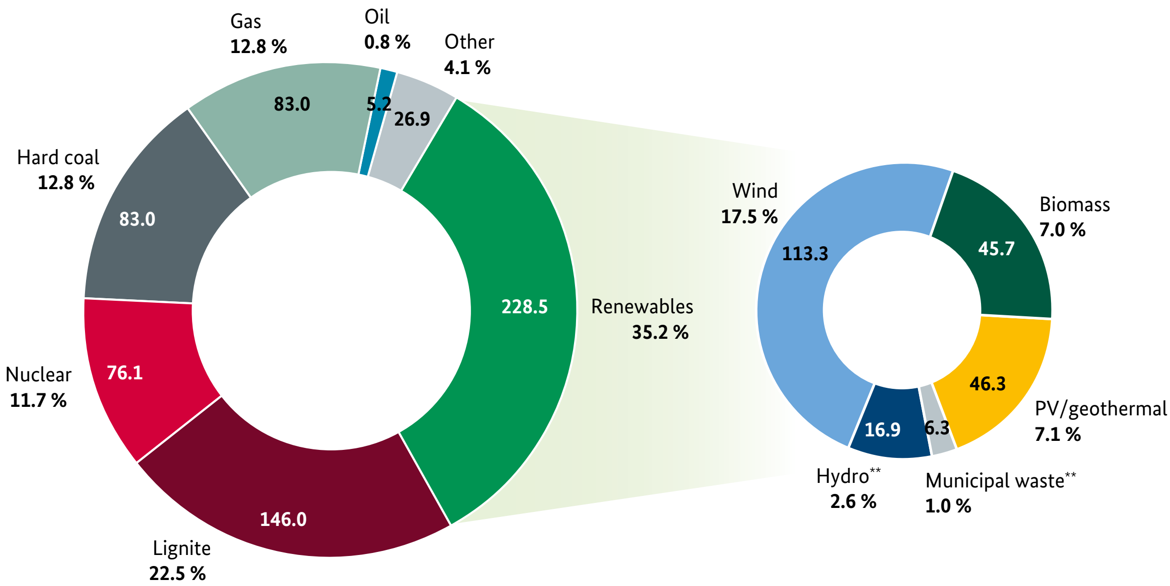
127. As a modernisation project, the energy transition creates economic opportunities for forward-looking technologies and thus for exports and jobs. At the same time, the process of transformation in the affected regions which is related to the energy transition is being supported constructively in the form of structural policies.

128. With a view to achieving macroeconomic efficiency and an increasing shift away from the combustion of fossil fuels, the Federal Government's energy policy is pursuing a strategy which starts by utilising potential for efficiency and reducing energy demand on a cross-sectoral basis (electricity, buildings/heat, industry and transport) (the "efficiency first" principle). Renewables are to cover the remaining demand for energy. This should take place directly wherever this makes sense; in all other cases, it will take place indirectly via the efficient use of renewable electricity for heat, industry and transport (sector coupling).

129. The Federal Government regularly reviews the progress made on implementing the energy transition as part of the "Energy of the Future" monitoring process so that it can fine-tune it where necessary. The expansion of renewable energy is proving particularly successful. Renewable energy has become a key pillar of the electricity supply. Its share of gross electricity generation keeps growing. It stood at 35.2% in 2018 (cf. Diagram 12).

130. It is just as important to limit the costs of the energy transition for those consuming energy. High spending by final consumers on energy, e.g. by private households or energy-intensive industry, should be avoided. The development of energy prices is primarily driven by the global

Diagram 12: Gross electricity generation in Germany in 2018 in terawatt-hours (TWh)*



Total gross electricity generation: 649 TWh
* Provisional figures, some estimated
** Regenerative share
Geothermal included in photovoltaics due to small quantity

Source: AG Energiebilanzen, status: December 2018.

market situation. The Federal Government will review the impact of the components of the energy price currently imposed by the state in the form of charges and taxes. With regard to the pricing of CO_2, the Federal Government shares the view of the Council of Economic Experts (cf. GCEE Annual Report Item 25) that this should take place as globally as possible in order, not least, to ensure the global competitiveness of our energy-intensive industry. It points out that the EU emissions trading system already delivers a European carbon pricing and reduction instrument, which recently underwent an effective revision. Also, starting from the ecological tax reform, the energy and electricity taxes are increasingly viewed in terms of climate change mitigation.

131. Despite the progress already achieved on the energy transition, much remains to be done: the reduction of greenhouse gas emissions is lagging behind Germany's own targets. Between 1990 and 2017, greenhouse gas emissions fell by 27.5%. In order to attain the national climate target for 2020 (a drop of 40% from the 1990 level) as quickly as possible, the Federal Government is examining what supplementary measures need to be taken. The Commission for Growth, Structural Change and Employment set up by the Federal Government is tasked not only with drafting proposals for a gradual phase-out of coal-fired power generation and sustainable and forward-looking structural development but also with drafting proposals for a contribution by the energy industry to help Germany come as close as possible to meeting its 2020 climate target.

The goal for 2030 is a reduction of at least 55% from the 1990 figure. If the energy transition is to succeed, it is also necessary to have better synchronisation of renewable energies and power grid capacities, to accelerate the grid expansion, and to modernise and optimise the existing grids. Primary energy consumption rose in 2017 compared with the preceding year. Initial estimates for 2018 show a fall in primary energy consumption. However, much remains to be done in order to attain the goal of cutting it by 20% between 2008 and 2020. This is particularly true of the heating and transport sectors.

132. The Coalition Agreement states that a targeted and efficient expansion of renewable energy, which is synchronised with grid capacity and increasingly market-oriented, is a prerequisite for a successful energy transition and climate policy. The Federal Government is aiming – particularly in the context of the challenges of improving the synchronisation of renewable energy and grid capacity – to increase the proportion of renewable energy in the electricity sector in order to attain the target anchored in the Coalition Agreement of roughly 65% by 2030. A crucial role here is played by the capacity of the electricity grids to take up renewable electricity. It is necessary to step up the expansion of renewables not least to cover the additional demand for electricity so that the climate targets can be met in the transport, building and industrial sectors.

Using competition to make renewable energy more cost-efficient

133. The paradigm shift brought about by the 2017 Renewable Energy Sources Act, away from fixed tariffs administered by the state to funding rates determined by competition, marks an important step towards transforming the energy transition into a market-based concept. It has resulted in a more cost-effective expansion of renewables. This is reflected in the outcomes of the auctions for ground-mounted photovoltaic installations. For example, the average funding rates for ground-mounted PV installations have dropped by more than 45% since April 2015 (cf. Diagram 13).

In the auctions for onshore wind energy installations, the average funding rates dropped in the first three auction rounds from May 2017 on, initially by roughly a third, from 5.71 ct/kWh to 3.82 ct/kWh. All of these auctions were characterised by a high intensity of competition and were significantly oversubscribed.

In the latest auctions since the beginning of 2018, the volumes of the bids have fallen sharply. In one auction round, they were less than the volume up for auction. The consequence has been rising funding rates (1 February 2018: 4.73 ct/kWh, 1 May 2018: 5.73 ct/kWh, 1 August 2018: 6.16 ct/kWh, 1 October 2018: 6.26 ct/kWh). This shows how important it is for there to be effective competition between bidders and for there to be a secure basis on which to plan with sufficient sites authorised and available for wind and PV, if the expansion targets for renewables are to be attained whilst the costs of expansion are limited.

In the first three auction rounds, the overwhelming majority of funding awards for onshore wind energy went to citizens' energy companies, i.e. to projects which did not yet have the necessary authorisation under the Federal Immission Control Act. Also, the citizens' energy companies were granted a longer implementation period than other bidders. In order to tackle this distortion of competition and other undesirable developments, the legislature adapted the special rules applying to the citizens' energy companies. For example, in future, the projects for which citizens' energy companies bid will have to already have been authorised under the Federal Immission Control Act. Also, the implementation period was harmonised.

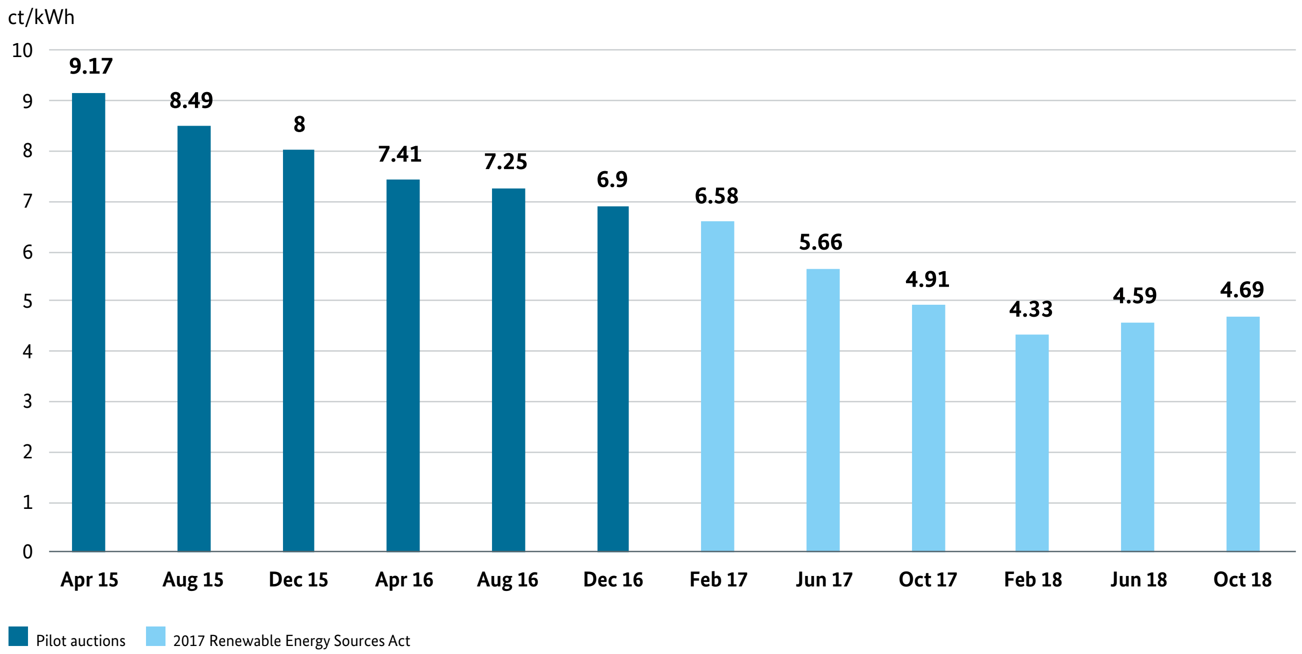
In principle, the Federal Government aims to safeguard stakeholder diversity and thus improve the possibilities for citizens to participate in auctions without this increasing the costs of the expansion of renewable energy. In order to boost the public acceptance of the expansion of renewables, consideration is also being given to how a nationwide arrangement can ensure that municipalities hosting renewable energy installations can benefit more from the value added by such installations.

The Federal Government is maintaining its policy of a resolute expansion of renewable energy. It has decided to hold special auctions of an additional 4 gigawatts each for both onshore wind and PV by 2021. Also, it is introducing needs-based night-lighting for onshore wind turbines as a first measure to increase public acceptance. In future, wind turbines will only blink red lights at night when an aircraft in the vicinity actually needs to be warned by the lights. Regarding other public acceptance issues, the members of the coalition have set up a working group which is to deliver its findings by 31 March 2019. On the basis of this, as well as the findings of the Commission for Growth, Structural Change and Employment and the future grid expansion measures, decisions will be taken by autumn 2019 about specific measures to enhance public acceptance and the further expansion curves up to 2030 in order to attain the envisaged target of 65% of gross electricity consumption covered by renewable energy. Also, in a three-year pilot phase (2019 – 2021), the Federal Government is gathering experience with cross-technology auctions.

Accelerating the expansion of the grid

134. Important aims of the Federal Government include cost-efficient optimisation, strengthening and an accelerated expansion of the power grids. This is because the energy transition and its anchoring in the single European market are increasing the need to transport large amounts of electricity. This is all the more true against the background of the intended accelerated expansion of renewable energy up to 2030 and the expansion of cross-border trade in electricity envisaged by the EU Electricity Market Regulation via compulsory opening up of the interconnectors. Otherwise, there will be rising costs for redispatch or the curtailing of renewable energy installations. Also, a question mark might be placed over the ability to attain the climate targets in the electricity sector.

Diagram 13: Average rates of funding awarded in auctions for ground-mounted photovoltaic installations



Source: Federal Ministry for Economic Affairs and Energy.

Measures for optimised operational management and a higher level of capacity utilisation of the grids are intended to boost their capacity in the short and medium term. In this way, any need for expansion beyond the projects of the Power Grid Expansion Act and the Federal Requirements Plan Act is to be minimised. The Network Development Plan for 2019 – 2030 will take account of the higher expansion target of 65% for renewable energy.

135. At the end of the third quarter of 2018, 800 kilometres of the 1,800 kilometres of grid needed according to the Power Grid Expansion Act had been realised, or approximately 45% of what is required. 150 kilometres of the 5,900 kilometres of measures to strengthen existing and build new grid according to the Federal Requirements Plan Act had been realised, or roughly 3%.

136. In order to accelerate the expansion of the power grid, the Federal Government adopted the draft Grid Expansion Acceleration Act in the cabinet on 12 December 2018. The Act aims to simplify and speed up authorisation procedures. There will be no overall reduction in material environmental standards as a result. The public will continue to be closely involved. The Act has, for example, made it possible to dispense with planning stages or to conduct notification procedures in the case of certain recabling and additional cabling. At the same time, the rules on environmental compatibility checks, nature and species conservation, and protection against electrical and magnetic fields must be complied with. It is also permitted to start building new routes or sections of routes under certain circumstances before the last kilometre of the route has been authorised. Further to this, forward-looking planning is made possible, with, for example, it being possible to lay empty conduits for future lines. The environmental impact is also fully considered from the outset.

137. The Federal Government aims to minimise the costs of the grid expansion. Also, it wants to distribute the costs in a way that reflects more fairly who is causing the costs, and to initiate a reform of the grid charge system to this end. An expert report on this is currently being compiled. The Federal Government has already taken a first step towards a more appropriate distribution of the grid expansion costs by enacting the ordinance on the gradual introduction of uniform nation-wide transmission grid fees. Accordingly, the grid charges for the use of the transmission system will be harmonised across the country in five equal steps from 2019 to 2023. At present, they vary from region to region: they are higher in those regions in which a lot of grid has been added for the national project of the energy transition than in regions where this is not the case. The refinancing of the costs of connecting offshore wind energy installations has been undertaken since 1 January 2019 via a newly designed offshore grid levy rather than via the grid charges.

Energy efficiency: core element of the energy transition

138. Making more efficient use of and saving energy is a core element of the energy transition. Energy efficiency measures help us to attain climate targets. Also, they contribute to economic success either because consumers and industrial companies save on energy costs or because industry develops particularly energy-efficient products and processes for the world market. Finally, reduced consumption can avoid the need to import energy from other countries. The Federal Government will present an Energy Efficiency Strategy in 2019. The Federal Government intends to launch both a package of specific measures for the decade from 2021 – 2030 (National Action Plan on Energy Efficiency 2.0), in order to deliver Germany's contribution to the EU's energy efficiency target for 2030, and also to present a long-term roadmap to halve energy consumption by 2050.

139. The heating sector uses double the amount of energy consumed in the electricity sector. This means that the overall energy transition can only succeed if the heating transition succeeds. The Federal Government is committed to the necessary transformation of the heating sector. This includes plans to develop cost-efficient sector coupling in heating, mobility and electricity, as well as to modernise and flexibilise combined heat and power generation. Also, the planning and financing of the energy infrastructure (gas, electricity, heat) will in future be considered in an integrated manner and will be developed in a cost-effective manner.

Roughly two-thirds of the energy demand in the heating sector is accounted for by buildings, and around one-third by the generation of process heat in industry. There is considerable potential for more energy efficiency and the increased use of renewable energy here. District heating networks fuelled by renewable energy will play an increasingly important role in the supply of heat in future. This is because they deliver renewable heat to densely populated cities into buildings where renewable heat cannot be produced locally. This applies to both the buildings and to some extent to the industrial sector.

The heating transition will also have a positive impact on the modernisation of the German economy. The carbon-free supply of heating and cooling opens up the possibility to advance technologically sophisticated and systematically optimised solutions, particularly in those areas in which German companies are traditionally strong and which offer great opportunities for value creation in Germany and for exports. On top of this, there are substantial cost savings due to more efficiently designed heating processes in industrial companies and SMEs.

140. For the buildings sector, the Energy Efficiency Strategy for Buildings, which was adopted in 2015, continues to provide the framework for a sensible combination of more energy efficiency and an increased use of renewable energy in order to attain a virtually climate-neutral building stock by 2050. Furthermore, the tax-based support for improving the energy performance of buildings is a priority measure in the Coalition Agreement, in order to attain the energy and climate targets in the buildings sector. In the context of the implementation, the Federal Government is examining various design options, also giving consideration to the budgetary requirements of the Coalition Agreement. If the tax breaks are to have a proper impact, there is a need for substantial incentives for further modernisation of the building stock. Also, the measures need to be anchored sensibly amongst the existing funding measures. Here, use is to be made of the effect of multipliers, e.g. tax advisors, in order to make the support available for energy-related modernisation better known.

141. The Federal Government will prune red tape from and simplify the legislation on energy conservation in buildings, and will merge the Energy Conservation Act, the Energy Conservation Ordinance and the Renewable Energies Heat Act in a modern Buildings Energy Act. According to the Coalition Agreement, this will implement the requirements of EU law and maintain the current energy-related requirements for existing and new buildings. Furthermore, the Coalition Agreement states that the "neighbourhood approach" will be introduced. The intention is to strengthen and permit solutions for the joint supply of heat in a neighbourhood, as well as neighbourhood-wide modernisation of existing buildings.

142. The Federal Government has set up a number of programmes in recent years to make it easier for private individuals, companies and municipalities to invest in more energy-efficient buildings and processes. The funding for the investments is backed up by the funding of energy advice services for specific target groups. The implementation of the Energy Efficiency and Heat from Renewable Energy funding strategy is intended to make the various funding schemes more targeted and easy to understand by 2020 and to make it much easier to access the funding. Wherever funding instruments are used, the Federal Government attaches importance to an effective use of funding with a high basic level of efficiency.

In a first step, for example, the funding services for trade and industry have been significantly improved. The Federal Government has pooled tried-and-trusted elements from six previous programmes in one new, largely technology-neutral funding package entitled Energy Efficiency and Renewable Process Heat for Industry. The funding package will help Germany to meet its national and European climate targets. The funding package incentivises investments in energy-efficient technology and the expansion of renewable energy, thus fostering the energy transition in industry, trade, commerce and services.

Ensuring security of supply, developing combined heat and power

143. A high level of security in the electricity supply is a top priority for the Federal Government. Germany has a very reliable power supply, particularly in the international comparison. Here, the Federal Government is relying on three instruments: Firstly, the electricity market itself delivers security of supply in a competitive and efficient manner. Its rules deliver great incentives to maintain adequate power generation capacities for the long term, e.g. via stiff penalties if agreed deliveries of power are not made. Secondly, emergency capacities of around 10 gigawatts safeguard the electricity market; these include the capacity reserve. These emergency capacities have never been fully used. Thirdly, continuous monitoring of a ten-year period always ensures that potential bottlenecks are identified and can be removed at an early stage.

144. The Council of Economic Experts criticises the point that a certain binding phase-out curve for lignite-fired power generation proposed by the Commission for Growth, Structural Change and Employment would merely result in a relocation of carbon emissions to other countries as a result of European emissions trading (cf. GCEE Annual Report Item 27). This line of argument ignores the point that the market stability reserve means that pan-EU surpluses of emissions rights are being successively reduced, and the latest decisions on the ETS reform mean that this is taking place more quickly than previously planned. Also, where

electricity generation capacities are decommissioned, the Member States are now permitted as an additional national measure to cancel a corresponding amount of allowances from the national quantity up for auction in line with the Emissions Trading Directive. There is at present no decision by the Federal Government as to whether it will make use of the possibility to cancel emission allowances.

145. Combined heat and power plants (CHP plants) produce not just electricity, but also heat and are therefore more efficient than non-combined fossil electricity generation. For this reason, combined heat and power generation is to be expanded and made more efficient. The funding rate for electricity from CHP installations of between 1 and 50 MW and for innovative CHP systems has been determined via auction since the end of 2017. The Federal Network Agency held further rounds of auctions in June and December 2018 for CHP installations and, for the first time, also for innovative CHP systems. The Federal Government hopes that this will provide valuable insights into the future role of CHP installations in the public heat supply. In order to equip CHP for the demands of the future, it needs to be comprehensively developed and modernised. In particular, it needs to be made more flexible and the emissions need to be reduced.

146. The Federal Government has agreed with the European Commission on a state aids solution to reduce the EEG surcharge for the self-supply of electricity from new CHP installations (i.e. installations commissioned from August 2014). This provides the affected companies with legal certainty. In the discussions, one of the goals pursued by the Federal Government was to maintain industrial competitiveness. Amongst other things, the agreement provides that the bulk of new CHP installations (particularly those of less than 1 MW and more than 10 MW) will continue to pay an EEG surcharge reduced to 40% for self-supplied electricity.

Attaining climate targets for 2030 and 2050

147. The Climate Action Programme 2020 adopted by the Federal Government in 2014 aims to close the gap from attaining the 40% target by 2020 as estimated at the time. It is expected that the Action Programme will cut greenhouse gas emissions by between 41 and 53 million tonnes of CO_2 equivalents. Despite this contribution by the more than 100 individual measures contained in the Climate Action Programme 2020, it is estimated that greenhouse gas emissions will only be cut by roughly 32% from the 1990 level by 2020.

The reasons for the failure to attain the climate target for 2020 on the basis of the existing measures are primarily to be found in the rise in emissions from the transport sector compared with 1990 and in excessive expectations of the impact of certain measures contained in the Action Programme. Also, the growth of the economy and of the population was greater than anticipated in the estimates of the reductions. There are plans to supplement the Climate Action Programme in order to close the gap from the attainment of the climate target for 2020 as quickly as possible (cf. Item 37).

In 2019, the programme of measures for 2030, as announced in the Climate Action Plan 2050, is to be adopted by the cabinet. The aim is to attain the overall target of cutting greenhouse gas emissions by at least 55% from 1990 across all sectors by 2030.

148. European emissions trading is a market-based instrument of EU climate policy which aims to cut greenhouse gas emissions at the lowest cost to the economy. The two central concerns of the Federal Government were implemented in the reform of the EU emissions trading system for the 2021 – 2030 period: Firstly, EU emissions trading and its price signals are strengthened. Secondly, the situation facing energy-intensive industries which are exposed to international competition is addressed by freely allocating allowances to companies in the sectors at risk of carbon leakage (relocation of carbon-intensive manufacturing facilities due to climate-related costs). The Federal Government continues to favour a link-up between the European emissions trading system and other such systems around the world, and it feeds this in in various initiatives and in various forums, e.g. in the G20 context.

Further rules on greenhouse gas reduction also entered into force in 2018 for those sectors not covered by EU emissions trading.

The European Commission has presented a draft for a long-term EU climate strategy in line with the provisions of the Paris climate agreement. In the Paris climate agreement, all the parties have committed to presenting long-term climate strategies by 2020. On the basis of the draft, an EU climate strategy is to be developed by 2020, which is oriented to the targets of the Paris climate agreement and flags various ways for the EU to attain global climate targets in the long term. Germany adopted its long-term strategy in 2016 in the Climate Action Plan 2050.

Overall, the current contributions towards climate change mitigation by the parties to the agreement fall well below what would be needed to keep the global rise in temperatures within the limits stipulated in the Paris agreement. The EU will continue to advocate more ambitious climate targets worldwide.

Developing tomorrow's energy technologies

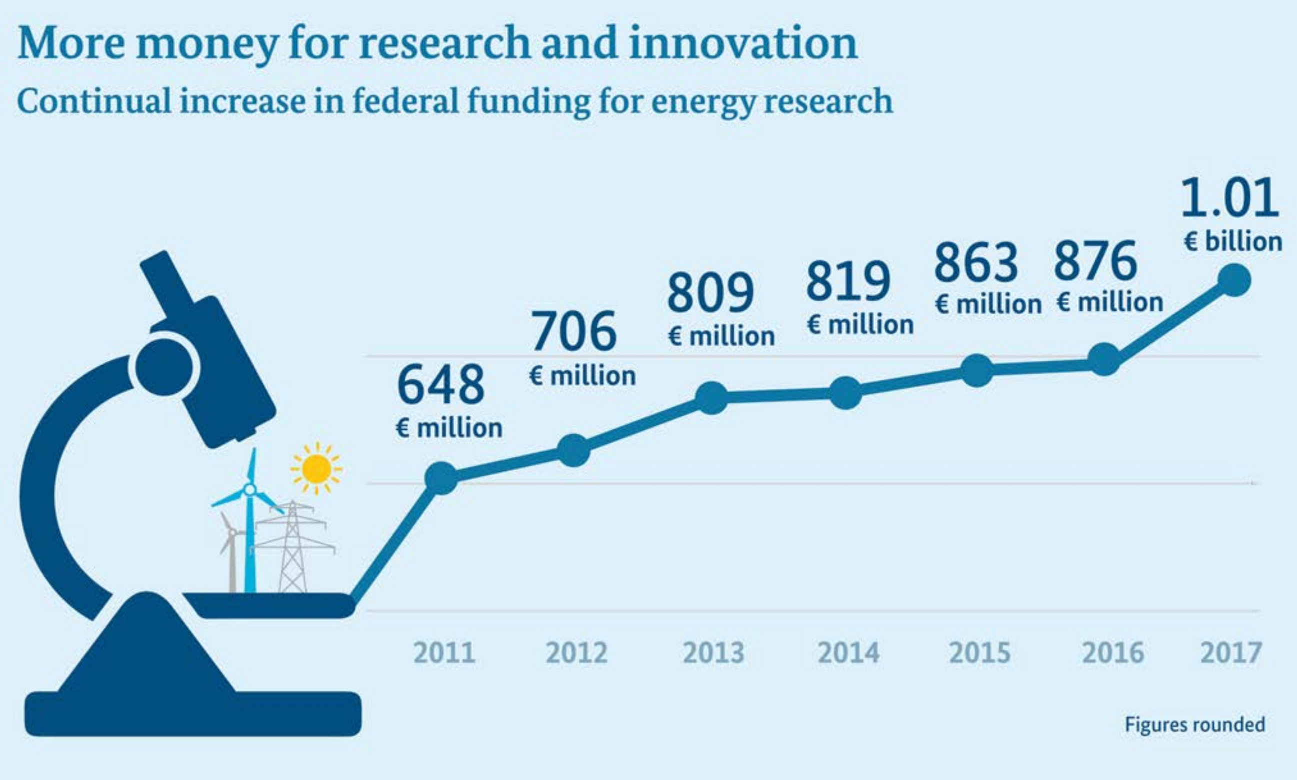
149. In a market economy, advances in technology form a crucial basis for innovation and growth. The energy transition is one of the greatest modernisation projects for Germany. Here, a central role is played by energy research with a view to developing innovative, environmentally acceptable and reliable technologies. In 2017 alone, the Federal Government invested around one billion euros in energy research; the figure for 2016 was approximately €880 million. The spending on energy research has been rising for years (cf. Diagram 14). The largest proportion of the current funding (around 80%) goes into research on renewable energy and energy efficiency.

150. In September 2018, the Federal Cabinet adopted the 7th Energy Research Programme entitled "Innovations for the Energy Transition", and again increased the funding for energy research. In the 2018 – 2022 period, 45% more funding, totalling €6.4 billion is being provided, and the range of the programme extended: living labs for the energy transition are being introduced as a new funding pillar. These represent a new approach to accelerating the transfer of technology and innovation via large-scale demonstrations combined with forward-looking business models, and to opening up paths to new regulatory approaches. €100 million is being provided each year from 2019 – 2022 for the living labs for the energy transition. The new Energy Research Programme places new thematic focuses on overarching issues, particularly on sector coupling and digitisation.

Continuing a European and international approach to energy and climate policy

151. Energy and climate policy can only succeed in the European and international context. The European legal

Diagram 14: Federal research funding



Source: Federal Ministry for Economic Affairs and Energy.

framework for the energy sector up to 2030 is being redesigned in the Clean Energy for All Europeans legislative package. The Federal Government played a key role in achieving agreement on this last year. It favours an ambitious EU energy and climate policy.

152. Up to 2030, the share of renewable energy in final energy consumption within the EU is to increase to at least 32%; at the same time the European electricity markets are to grow closer together and become more flexible, not least in order to absorb the rising share of renewable energy. Cross-border trade in electricity is to be strengthened. EU-wide energy consumption is to be cut by 32.5% compared with a reference development by 2030. At the end of 2014, the EU committed to cutting greenhouse gas emissions within the EU by at least 40% between 1990 and 2030.

153. In future, the EU Member States will improve their coordination of energy and climate policy. Here, a key role is played by the integrated National Energy and Climate Plans (NECPs) of the Member States. They must present goals and measures for energy and climate policy up to 2030. The plans should be mutually comparable and, in particular, contain the national contributions by the Member States to the EU's 2030 targets for renewable energy and energy efficiency and for the reduction of greenhouse gas emissions. This is to enable a reliable governance system to identify at an early stage failures to meet these EU 2030 targets in particular and to undertake necessary corrective measures. The Federal Government transmitted a first draft of its NECP to the European Commission on time at the end of 2018 and published it. It will consult with the public and its EU neighbours on the draft in 2019. Also, the Member States must develop long-term strategies by 1 January 2020 for cutting greenhouse gases up to 2050.

154. Since 1 October 2018, congestion management of electricity flows has been in place at the German-Austrian border. This means that the previous joint bidding zone has been divided into an Austrian and a German/Luxembourg bidding zone. Electricity trading between Germany and Austria now takes account of actual grid capacity. This has a positive impact on the electricity grid in Germany, since the demand for transport is falling, with a concomitant drop in costs of congestion management. The arrangement also strengthens the European internal market for electricity. Ring flows resulting from the common German-Austrian bidding zone had created expensive problems with the grid not only in Germany, but also in several neighbouring countries: electricity that was traded but could not be transported directly to Austria caused congestion in the grids of neighbouring countries.

155. Germany is an important partner for many countries in the context of the international energy transition. There is a lot of interest in German experience, expertise and technology. The sharing of experience, e.g. at the annual international energy transition conference, the Berlin Energy Transition Dialogue, with more than 2,000 participants, is paying off: the restructuring of the energy systems has picked up speed in many regions of the world. International energy cooperation is to be expanded further. To this end, increased use is to be made of formats like the G20 or G7 and international energy institutions (IEA, IRENA), and further bilateral energy partnerships and dialogues are to be developed. The intention is also to network the German economy worldwide, to develop potential markets, and to advance the global energy transition.

F. Shaping Europe and making the financial markets fit for the future

157. The single market is a core achievement of the European Union. Current challenges lie primarily in the disruption caused by digitisation and in the foreseeable structural change caused by policies to attain the climate targets, and in efforts to strengthen the global competitiveness, adaptability and innovative capacity of the EU. For this reason, the policy environment needs to be shaped in a manner that offers European companies a good ecosystem in which to be set up and grow. Also, state aid rules should be reviewed as to whether there is potential for improvement in terms of the central aspects of the innovative capacity and future viability of European companies.

158. A competitive and resilient eurozone is a core precondition for a viable European Union. The Member States therefore agreed at the Euro summit in December 2018 on a comprehensive package of reforms to strengthen the Economic and Monetary Union. The Federal Government played an active role in this process of reform together with France.

The Federal Government was particularly interested in developing the European Stability Mechanism (ESM), which can offer Member States of the Monetary Union stability aid under strict conditions. In future, the ESM is – in close coordination with the European Commission – to help prevent crises and to be given a stronger role in its capacity as a creditor institution in ESM programmes. Also, the "precautionary" instruments are to be made more efficient so that euro member states with healthy economies can receive effective aid if, despite demonstrably good policies, they find themselves at risk, through no fault of their own, of losing access to the government bond markets. Compared with the current ESM guideline for precautionary instruments, the access criteria are to be made more strict and precise. The granting of a precautionary credit line is a sort of "quality mark" signalling to the markets that the relevant Member State is creditworthy and capable of coping with the consequences of an asymmetric shock which lies beyond its control. ESM stability assistance can only be granted to euro member states covered by the precautionary instruments after the plenary sitting of the Bundestag approves this. On top of this, there are measures designed to improve the framework for boosting the debt sustainability of Member States. Inter alia, "single limb collective action clauses" are to be introduced, which facilitate the orderly restructuring of government bonds (cf. Box 2). The ESM should be able to provide support in negotiations between Member States and creditors where restructuring is required. Furthermore, the ESM will serve as a common backstop for the Single Resolution Fund (SRF) for banks. To this end, the common backstop is to be designed as a credit line from the ESM to the SRF, the size of which is based on the volume of the SRF. In return, the ESM is in future not to be able to recapitalise banks directly. With regard to the specific details of the common backstop, the Federal Government will again continue to ensure that the constitutional requirements, and particularly the rights of participation for national parliaments, are upheld.

159. The Euro summit of December 2018 commissioned the finance ministers to draw up principles for an instrument to strengthen competitiveness and convergence for the eurozone which is to form part of the EU budget. The Federal Government shares the view of the Council of Economic Experts (cf. GCEE Annual Report Item 55) that such a budget should deliver genuine added value for the eurozone and, with regard to the details of such a budgetary instrument, advocates measures which contribute to greater convergence and enhanced competitiveness.

160. The Federal Government calls for the EU Member States to take advantage of the current positive economic situation to reduce public-sector debt and thus to gain fiscal scope for responses to a potential downturn. Here, the implementation of the rules of the Stability and Growth Pact is a central element.

Box 2: Debt restructuring and single-limb collective action clauses

Involving private creditors in the risks taken on by them when financing states is important in order to ensure that liability and action go hand in hand and that there is a fair sharing of burdens.

"Hold-outs" are a major problem when it comes to debt restructuring: some creditors of bonds resist a restructuring and generally try to enforce their claims in court. Hold-outs make orderly restructuring more expensive or even impossible. For this reason, collective action clauses were introduced in the eurozone in 2013 for all new government bonds with a term of more than one year. As soon as enough creditors are on board (in the case of a creditors' meeting about this, at least two-thirds of the nominal value of the outstanding bonds must be represented), if at least three-quarters of the value of the represented bonds out of all of the bonds affected by the intended restructuring and at least two-thirds of the individual bonds give their approval, then an agreed restructuring will apply to all. A sensible further development of this is single limb collective action clauses in which just one majority (usually three-quarters) of the bonds affected by a restructuring need to give their approval in a meeting of creditors. This makes it much more difficult to achieve a blocking majority and thereby to impede an orderly restructuring of bonds, as a quorum of individual bonds will no longer be required.

In view of the maturity structure of the bonds of the euro countries currently in circulation, it will be a few years before all bonds are subject to the new collective action clause. However, the planned introduction represents an important step towards alleviating the hold-out problem and thus towards a more stable Economic and Monetary Union.

Making the Multiannual Financial Framework fit for the future

161. The Multiannual Financial Framework (MFF) sets the upper limits for EU spending for a period which currently stands at seven years. It thus puts the foundations in place for the EU to be able to act in financial terms. The measures financed within the MFF make contributions not least to economic and social convergence, employment and competitiveness. The current MFF (2014 – 2020) has a volume of approximately €1,087 billion (in current prices). This corresponds to roughly 1% of the EU's gross national income.

162. Since mid-June 2018, the complete proposal from the European Commission for the next MFF (2021 – 2027) has been available, envisaging a higher overall volume of nearly €1,279 billion (in current prices). This corresponds to roughly 1.11% of the EU's gross national income. The European Commission proposes a greater focus on European added value and forward-looking topics for the next MFF. The Commission's proposal envisages new or enhanced priorities in the following areas: research, innovation, digital, youth, climate/environment, migration and border security, security and defence, external action. At the same time, according to the European Commission's proposal, the shares of total EU expenditure accounted for by the Common Agricultural Policy and cohesion policy will drop in future to around 60% (rather than 73% as in the past). Further elements of the proposal include a reduction in the number of programmes, the pruning of bureaucracy, the increasing of flexibility and an improved measurement of results.

In the negotiations on the MFF, the Federal Government calls for the future MFF to be oriented even more to current priorities, challenges and forward-looking topics, without fundamentally questioning the reliability of tried-and-trusted EU policies. The Federal Government shares the view of the Council of Economic Experts that European added value should be a central criterion for the justification of EU spending (cf. GCEE Annual Report Item 50). The foreseeable changes caused by the departure of the United Kingdom should be regarded as an opportunity to review all fields of expenditure in terms of their efficiency and their success. Here, a role is played by more effective incentives for economic reforms in the Member States. The EU's budget should make an effective contribution to making the EU as a whole more competitive. In the view of the Federal Government, this should take the form of a closer linkage of relevant country-specific recommendations from the European Semester to EU funding, particularly from the structural funds. In view of the great challenges to Europe's future, Germany will continue to make an appropriate contribution to the EU budget so that the EU can assume its responsibilities. However, even a continuation of the current MFF volume of 1% of the gross national income of the EU 27 would result in a greater financial burden on the Member States. It will therefore not be possible to meet all the expressed wishes. At the same time, Germany is calling for the future financing system to ensure fair burden-sharing and to avoid excessive burdens on the budgets in a relative comparison between the Member States. The Federal Government also welcomes the draft regulation presented by the European Commission along with the MFF proposal on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States, which is intended to couple the financing from the EU budget more to the upholding of the rule of law in future. The upholding of the rule of law, and particularly the functioning administrative structures and justice systems, is a fundamental precondition for economic budget management and the protection of the financial interests of the EU.

Continuing the European Fund for Strategic Investment, strengthening cohesion policy

163. The European Fund for Strategic Investment (EFSI) finances projects with an enhanced risk (e.g. first loss tranches in the case of finance provided by several creditors). These financial arrangements, which are mostly long-term in nature, are insured by a guarantee fund fed from the EU's budget. In February 2018, the investment period for the EFSI was extended until the end of 2020, the EU guarantee was raised to €26 billion and the contribution from the EIB increased to €7.5 billion. This is intended to increase the total leveraged volume of investment to €500 billion. Funding goes to small and medium-sized enterprises (including in the form of venture capital), infrastructure and innovation.

164. In the shape of InvestEU, the European Commission has made a proposal for the MFF 2021-2017 containing a successor programme to the EFSI; this is currently being discussed in the relevant bodies in Brussels. The 14 existing internal EU financing instruments are to be merged under the umbrella of InvestEU. InvestEU is to be even more clearly oriented to the political priorities of the Union, and to be focused on the four investment windows of infrastructure, research, innovation and digitisation, SMEs and social investments and skills. The Federal Government wel-

comes the proposals and calls for the establishment of effective decision-making and steering structures.

165. European cohesion and structural policy plays a fundamental role for the strengthening of economic, social and territorial cohesion in the EU. Accounting for around a third of the EU budget (€354.7 billion for the 2014 – 2020 programming period), it is the central instrument of European economic and employment policy. Cohesion policy is also of great importance for Germany in the field of economic policy. Germany is receiving a total of nearly €29 billion from the European structural and investment funds in the current programming period (2014 – 2020). More than 60% of this funding is going directly into investment into growth and jobs, primarily via the European Regional Development Fund (ERDF) and the European Social Fund (ESF). With its particular focus on research and innovation, the competitiveness of SMEs and the low-carbon economy, the ERDF aims to encourage investment which makes a key contribution to the competitiveness of the regions in the face of globalisation. In the context of the ESF, in view of economic and demographic change, a focus of the funding is placed on measures to strengthen the adaptability and innovative capacity of companies, and SMEs in particular, the needs-oriented further training of employees, and support for sustainable start-ups.

In order to flesh out its proposal for the Multiannual Financial Framework (MFF), the European Commission has also proposed a legislative package for the EU structural funds for the 2021–2027 programming period. The Federal Government particularly welcomes the fact that all regions are to continue to receive funding from the EU structural funds. The EU's cohesion policy will again focus on key policy goals like innovative and intelligent economic change, mitigating climate change, and environmental protection. In the Member States with stronger economies, like Germany, 85% of the ERDF funding is to be spent on these areas. The legal framework will be substantially simplified and there will be fresh positive approaches to flexibilisation, differentiation and the reduction of bureaucracy. In the ongoing talks at the EU-level, the Federal Government continues to advocate a strong cohesion policy to take due account of all regions while giving better support to necessary structural reforms in the Member States. It will continue to call for a closer linkage of relevant country-specific recommendations from the European Semester to the EU's structural funds and for consideration to be given to migration in the distribution of funding.

Shaping Brexit responsibly

166. Pursuant to Article 50 TEU, the withdrawal of the United Kingdom from the European Union will take place two years after the notification of withdrawal, i.e. on 30 March 2019. This deadline can only be extended by a unanimous decision by the European Council (Article 50) in consensus with the United Kingdom. The Federal Government regrets the decision by the United Kingdom to withdraw from the European Union. Following intensive negotiations, the European Council endorsed the Withdrawal Agreement and the joint Political Declaration setting out the framework for the future relationship on 25 November 2018.

167. The political endorsement of the Withdrawal Agreement and the Political Declaration has concluded the process of negotiation on the withdrawal of the United Kingdom from the European Union. The Federal Government explicitly welcomes this result. It is continuing to work towards an orderly departure of the United Kingdom from the European Union, and aims at a continuing close future relationship between the EU and the United Kingdom on the basis of the guidelines from the European Council.

The Withdrawal Agreement fully respects the conditions imposed by the European Council in the guidelines, and upholds core European and German interests. In particular, the rights of the citizens and the financial interests of the EU are protected. Following entry into force of the agreement, there is to be a transitional period up to the end of 2020, extendable once by up to two years, to give businesses time for necessary adjustments. Peace in Northern Ireland is safeguarded by a reliable backstop arrangement which – whilst maintaining the integrity of the internal market, and irrespective of the outcome of the negotiations on the future relationship – guarantees that there will be no hard border between Ireland and Northern Ireland. The central role of the ECJ in the interpretation of Union law is also ensured.

The Political Declaration setting out the framework for the future relationship will form the basis for a future partnership of unprecedented intensity with a third country. The central element is intended to be the establishment of a free trade area combined with regulatory and customs cooperation, underpinned by rules which ensure a level playing field. The European Council guidelines remain valid as they stand.

In a further procedure, the Withdrawal Agreement and the Political Declaration must be ratified by the UK and European parliaments. On the European side, the Withdrawal

Agreement has been transmitted to the European Parliament in order to commence an approval procedure. The European Council (Article 50) stressed on 13 December 2018 that there cannot be any renegotiations of the Withdrawal Agreement. However, in the Council conclusions, the EU 27 have given a political assurance that they wish to avoid the deployment of the backstop if at all possible.

168. This is also a call for all sides to take responsibility for preparing as well as possible for all scenarios. This also applies to a disorderly departure. The Federal Government has identified the necessary national need for legislative and administrative action and launched the corresponding implementation. The detailed implementation timetable envisages that all the measures will be in force at the time of withdrawal (both for an orderly and a disorderly departure). Since the Brexit referendum, the Federal Government has maintained a close dialogue with the business community to inform it about the progress made in the talks and the consequences which might derive from the departure of the United Kingdom from the EU. It meets regularly with business associations and companies for individual and joint discussions. The Federal Government also coordinates closely with the European partners of the EU 27, the Council of the European Union and the European Commission in order to prepare for the departure, to ensure that the necessary measures at the EU and national level will fit together. It is also very important for the Federal Government that the EU 27 stand together on this. However, the specific effects of Brexit on the economy will depend very much on the nature of the departure.

Continuing positive developments in the former programme countries

169. In August 2018, Greece was the last country to complete its adjustment programme. In addition to Greece, Portugal, Ireland, Cyprus and Spain also received financial assistance from the European Stability Mechanism and its predecessors in the wake of the economic and financial crisis. Some Member States also received loans from the International Monetary Fund (IMF) and bilateral loans. The financial aid was tied to reforms, the implementation of which was regularly reviewed during the programmes. All five countries successfully completed the programmes and attained substantial improvements in their fiscal and economic situations.

Following the end of the programme, post-programme monitoring takes place until 75% of the aid has been repaid. The Federal Government is involved in this in the context of the European processes and calls in the European bodies for further necessary reforms to be undertaken. This is important in order to strengthen the growth potential and competitiveness and to maintain sound public finances.

Further improving financial market regulation

170. A resilient financial system is a precondition for sustainable financing of the economy and thus for future growth and jobs. The experience from the last financial crisis has also shown that disruption in the financial system can have considerable negative repercussions on the economy as a whole, and therefore justify regulatory oversight. Against this background, consideration should also be given to the effects of climate change on financial stability. At the same time, financial market regulation should be appropriately targeted and proportionate, so that small and medium-sized enterprises in particular are not excessively burdened by the regulatory requirements.

171. The EU's Prospectus Regulation serves to make the essential information available to investors in the form of a prospectus when securities are offered and also to make it easier for companies to produce prospectuses. The Act to Exercise Options under the EU Prospectus Directive and to adapt further financial market acts is primarily intended to relieve the burden on small and medium-sized enterprises with regard to prospectus requirements. The amendments to the Banking Act, which are also contained in this Act, serve to implement the European Directive amending the BRRD (Directive as regards the ranking of unsecured debt instruments in insolvency hierarchy). In the case of insolvency of CRR banks (banks which take deposits or other repayable moneys from the public and issue loans on their own account), this has established a new class of subordinate bank liabilities. For example, it is to be ensured that in the case of a bail-in, the banks have sufficient subordinate capacities to bear losses and recapitalise so that critical functions of these banks can be maintained where the future viability of the bank is at risk.

172. Further to this, the EU Regulation creating a specific framework for simple, transparent and standardised securitisation, and the amendment of the EU Regulation on prudential requirements for credit institutions and investment firms ("securitisation package") were adopted. As an important project for the Capital Markets Union, the securitisation package is to strengthen the prudential framework for

securitisations and contribute to an improved financing of the real economy. The national amendment act puts the necessary legal basis in place for oversight in Germany.

173. The Act implementing the Directive on the activities and supervision of institutions for occupational retirement provision (IORPs) imposes higher requirements on the organisation of the business of pension funds and radically extends their risk management. It also provides for improved obligations to provide information to insured parties.

Coping with challenges in the environment of low interest rates

174. In the course of the financial and sovereign debt crisis, the independent European Central Bank took extraordinary monetary policy action. As a consequence, the financing conditions have developed very favourably for companies and private households in Germany. The enduring environment of low interest rates does, however, also entail dangers and challenges for the financial sector. For example, the revenue outlook suffers particularly where companies have made long-term promises to pay or where banks are strongly dependent on interest rate margins for their profits. The Federal Government is keeping a close eye on the low-interest environment and the potential impact on financial market stakeholders. In the insurance sector, the Life Insurance Reform Act adapted the rules to the needs of the low-interest environment specifically for life insurance back in August 2014 in order to place the system of life insurance on a stable, long-term basis. Most of the measures have proved their worth; however, there is a need for some specific changes to the rules in the low-interest environment. The safeguarding of the interest rate guarantees made to the insured parties has since been made more sustainable. Also, consumer protection is to be improved, and oversight strengthened. The Federal Government has presented measures for this which should be implemented. These include a statutory ceiling on commission payments.

Banking union: Prioritising the reduction of risks over the sharing of risks

175. The European Banking Union is helping to safeguard the stability of the financial sector. In addition to the Single Supervisory Mechanism (SSM), the second element of the Banking Union is the Single Resolution Mechanism (SRM). This means that the Member States have common instruments for the resolution of banks whose difficulties might pose a danger to the stability of the entire Monetary Union. In order to finance these resolutions, the Member States have set up a Single Resolution Fund (SRF) which is to be gradually filled up to an amount expected to be approximately €60 – 70 billion by the end of 2023. The Federal Government believes that negotiations on a European deposit insurance scheme (EDIS) cannot commence until there has been a substantial, further reduction in banking risks. This sequence was explicitly agreed upon by the EU finance ministers in June 2016, and confirmed not least in the conclusions of the enlarged Euro summit of June 2018. In December 2018, the Eurogroup decided to set up a high-level working group on EDIS to discuss possible next steps and to report in June 2019. The conclusions of the summit include an explicit reference to all elements of the 2016 roadmap in the correct sequence, and in the Federal Government's view this includes measures to regulate government bonds as a precondition for the commencement of political negotiations on EDIS.

176. In the field of the European Banking Union, the Federal Government advocates the maintenance of an appropriate balance and sequence in the necessary further reduction of risks and a distribution of risks at the European level; this approach is supported by the Council of Economic Experts (cf. GCEE Annual Report Item 78). In particular, in order to reduce the risks, it is first necessary to reduce the regulatory privilege given to claims against states. It continues to be necessary to reduce the amount of non-performing loans (NPLs) to an appropriate degree. In this context, the ECOFIN Council presented an Action Plan in July 2017 which envisages various measures with a view to an accelerated and sustainable consolidation of balance sheets, including the fostering of secondary markets for NPLs and rules on the timely correction of the value of future NPLs in balance sheet statements of banks. These measures must be implemented rigorously and on time. Further to this, the national insolvency regimes and risk provisions by banks should be improved, and sufficient buffers for losses in the case of resolution should be established. Another measure is the introduction of a leverage ratio in the context of the revision of the CRR/CRD rules and in line with international agreements. The leverage ratio provides information about the extent to which the banks must possess core capital in relation to their balance sheet total plus the off-balance-sheet activity. It is mainly calculated without reference to the risk of the transactions and it helps to identify the risk of excessive borrowing by banks.

177. In order to reduce the risks, it is also necessary to further restrict the interdependent risks resulting from the link between banks and the public sector. In the past, risks from the banking sector have repeatedly impacted the overall economy. In the other direction, sovereign debt crises impact the banking sector, e.g. when banks hold a large volume of government securities. The Federal Government will continue to work at international and European level to reduce regulatory exceptions for claims against states on banks' balance sheets. The reduction of the privilege for sovereign debt would make it possible to have a more risk-appropriate assessment, to reduce the risk of contagion in the banking sector, to facilitate the restructuring of sovereign debt and to strengthen market-based incentives for a sound budgetary policy. Furthermore, the Federal Government believes it is necessary to put reliable rules in place for potentially necessary restructuring of public-sector debt. Progress in this area remains important for the eurozone in particular (cf. Items 157 ff).

Developing the Capital Markets Union

178. The Capital Markets Union is to establish a single EU capital market by 2019 which provides companies across Europe with a broad range of financing possibilities on the capital market in addition to bank financing. The funding of diversified forms of finance in order to meet the need of the European economy for capital is more important than ever in times of Brexit.

A large number of the measures proposed by the European Commission since 2015 have already been rolled out. A series of further projects are being negotiated in Brussels, such as changes to European financial market oversight, the introduction of a Pan-European Personal Pension Product (PEPP), and a proposal to improve the oversight of central clearing offices.

179. Further to this, the European Commission made additional proposals in the spring of 2018. These include a regulation on European crowdfunding service providers, an EU framework on covered bonds, and the cross-border distribution of collective investment funds, action plans for sustainable financing and competitive FinTechs, and not least, a legislative proposal for better access for SMEs to the capital market.

It will be necessary to prioritise the ongoing measures up to the end of the legislative term in 2019 in order to accelerate adoption. In the view of the Federal Government, special attention should be devoted to issues relating directly to Brexit. These include the supervision of central clearing offices from third countries and the supervision of major securities firms, the FinTech Action Plan and the Commission's proposals on sustainable finance.

180. The Capital Markets Union is a long-term project. After the 2019 European elections, further efforts will be needed to continue the work that has begun and to strengthen the international competitiveness of Europe's financial markets. The Federal Government will continue to work constructively on this process.

Implementing the European Pillar of Social Rights

181. Sustainable development in Europe based on a highly competitive Social Market Economy and aiming at full employment and social progress is a core element of the Treaty on European Union. In order to strengthen the social dimension of the European Union, the European Commission, the European Parliament and the Council of the European Union proclaimed the European Pillar of Social Rights (EPSR) in November 2017. The EPSR is to serve as a compass in the field of the labour market and social policy as responses are formulated to current and future challenges, and its 20 principles are to help ensure that social rights are implemented in specific legal instruments and applied, taking account of the division of competence in the European Union. There are three dimensions to the Pillar: 1. equal opportunities and labour market access, 2. fair working conditions and 3. social protection and social inclusion.

The European Commission has presented several initiatives referring to the EPSR. The proposals to implement the EPSR currently being negotiated include the draft directive on work-life balance for parents and carers, the draft directive on transparent and predictable working conditions, the proposal for a Council recommendation on access to social protection for workers and the self-employed and – in broader terms – the proposal to establish a European Labour Authority. Also, July 2018 saw the entry into force of the Posting of Workers Directive, at the heart of which is the introduction of the principle of the same pay for the same work at the same place. The Member States have two years in which to implement the Directive.

182. The European Commission has proposed that the European Semester be used for the monitoring of the implementation of the EPSR, and expanded it for this purpose. The ESPR has already played a prominent role in the Commis-

sion's country reports. The Commission assesses the level attained in social and employment policy in Germany as being above-average.

The Federal Government supports the desire to further develop the social dimension of the European Union by implementing the ESPR. At the same time, national standards and existing welfare structures in the Member States must not be endangered, the existing division of competence must not be questioned, and there must always be European added value.

G. Utilising globalisation, shaping fair international competition

183. Cross-border trade in goods and services contributes to growth and jobs around the world. If globalisation is to boost the level of prosperity, there is a need for open markets and a level playing field. At the same time, it is important to shape globalisation in a sustainable and responsible manner. On the other hand, protectionist measures are threatening to reduce global prosperity, as is also highlighted by the Council of Economic Experts (cf. GCEE Annual Report Items 8 f.). For this reason, the Federal Government vigorously rejects protectionist tendencies and advocates open markets and free, rules-based trade to the benefit of all parties. To this end, the Federal Government supports the European Commission's efforts to strengthen the multilateral trading system, not least via a modernisation of the rules. At the same time, the Federal Government supports the Commission's ambitious bilateral free trade agenda.

184. In 2018, Germany had a current account surplus of an estimated 7.5% of GDP (cf. Item 210). There are economic reasons for the size of the current account surplus, these particularly being the high level of industrial efficiency, the demographic structure and the high level of foreign assets. The Federal Government does not regard the current account balance as a metric for economic policy. However, the Federal Government is pursuing a policy of strengthening investment and domestic demand, and this is tending to reduce the current account surplus. For the next few years, the current account surplus is therefore expected to fall both due to a less dynamic increase in exports in view of a weaker external economic environment and to a continuing rise in imports in view of the good domestic economic situation.

185. In the G20 group, the Federal Government continued in 2018 to advocate under the Argentinian Presidency that the existing work of the G20 and the results of the G20 summit in Hamburg on 7–8 July 2017 be upheld and comprehensively implemented. The G20 achieved a consensus in Buenos Aires on central global challenges in difficult times for multilateral cooperation. Ten years after the first meeting at the level of heads of state and government, the desire to work together on an international rules-based system and to improve it further was underscored. Many of the outcomes build on decisions taken by the 2017 G20 in Hamburg. At their summit in Charlevoix on 8–9 June 2018, the G7 heads of state and government adopted a joint declaration containing agreements on central global challenges (cf. Box 3).

Pursuing a modern trade and investment policy

186. Core elements of the Federal Government's trade and investment policy include better market access for German firms abroad, the reduction of barriers to trade and investment, and thoroughly modernised investment protection. At the same time, it advocates high consumer protection, labour and environmental standards, and a level playing field for domestic and foreign suppliers. Germany's export-oriented SMEs benefit particularly from this. National policies foster the adaptation of the economic structure in the course of globalisation.

187. The multilateral trading system of the World Trade Organization is in a difficult situation. Due to divergent interests, it was not possible to attain any substantive results at the 11th WTO Ministerial Conference in Buenos Aires in December 2017. Furthermore, the functioning of the dispute settlement system is at risk due to the blocking of the appointment of new members to the appellate body. On top of this, there are increasing protectionist movements and market-distorting conduct, e.g. via subsidies, which cannot be tackled adequately under the WTO rules. Against this background, the Federal Government is continuing to call for a strengthening of the WTO as a regulatory framework for open and rules-based world trade, and thus shares the view of the Council of Economic Experts (cf. GCEE Annual Report Item 15). The Federal Government supports the proposals made by the European Commission for modernising the WTO. These include fresh initiatives for rule-making, particularly with a view to closing gaps in the rules and creating a level playing field. In addition, it proposes measures to safeguard and improve the functioning of dispute settlement. Finally, the monitoring and surveillance function of the WTO should be strengthened. At the talks which commenced in November 2017 in the context of the

United Nations Commission on International Trade Law (UNCITRAL) to reform investor-state dispute settlement, the Federal Government showed its favour of the establishment of a Multilateral Investment Court.

188. In addition to multilateral processes, the Federal Government supports ambitious and comprehensive bilateral free trade agreements on the part of the EU. The agreement with Canada sets new benchmarks in the reduction of trade barriers whilst simultaneously safeguarding high standards and serving as a model for future agreements. The free trade agreement with Japan was signed in July 2018. It is the largest free trade agreement concluded by the EU so far, and covers more than 600 million people, more than a quarter of global GDP, and almost 40% of global trade. A free trade agreement and an investment protection agreement were

Box 3: Main results of the G7 and G20 summits in 2018

G20 summit in Buenos Aires from 30 November to 1 December 2018

- G20 commits for first time to reform of World Trade Organization – important signal of support for the multilateral trading system, which stands for open markets and against protectionism.
- Strong signal for UN COP 24 climate conference:
  - With the exception of the United States, the G20 members renew their commitment to the irreversible nature of the Paris Agreement and its unrestricted implementation;
  - For the first time, the G20 cites the goal of restricting global warming to 1.5°C;
  - G20 supports successful outcome of COP 24;
  - Germany announces it will double its contribution to the Green Climate Fund to up to €1.5 billion.
- G20 supports the continuation of the Compact with Africa Initiative launched under the German G20 Presidency.
- Healthcare, which was a major focus of the German G20 Presidency, is finally anchored on the G20 agenda.
- G20 continues to stand up resolutely for women's rights; it confirms the goal of cutting the disparity in the labour force participation rate between men and women by 25% by 2025, and aims to reduce the gender pay gap.
- G20 remains committed to working together in the fight against international terrorism.
- G20 will continue to combat unfair tax competition and aggressive tax arrangements of international companies – G20 calls for coordinated solution for the taxing of the digital economy by 2020.

G7 summit in Charlevoix, Canada, from 8-9 June 2018

- G7 is committed to rules-based global order based on the shared values of the G7 of freedom, democracy, the rule of law and respect for human rights.
- G7 confirms the outcome of the Hamburg G20 summit of 2017 regarding trade, and particularly the commitment to a rules-based international trading system and against protectionism, and calls for a modernisation of the World Trade Organization.
- G7 adopts a vision on the future of artificial intelligence with a view to utilising its benefits.
- G7 advocates gender equality and adopts measures to promote the education of women in developing countries and against online violence.
- G7 calls for a fight against plastic waste in the oceans and a responsible use of plastics so that plastics are used in a more resource-friendly and sustainable way.

signed with Singapore in October 2018. Negotiations on agreements with Viet Nam have been completed. Political agreement was reached in April 2018 on modernising the Global Agreement with Mexico. Negotiations with Mercosur, the South American league of nations, are ongoing. In addition to this, the Federal Government supports the negotiations on the modernisation of the Association Agreement with Chile (since November 2017) and on free trade agreements with Indonesia (since 2016), Australia and New Zealand (since July 2018). The Federal Government continues to support negotiations with China on an investment agreement, and in future the resumption of talks on an ambitious free trade agreement with India. Also, the Federal Government supports ambitious free trade agreements which improve global market access for European companies in the field of public procurement. Further to this, the Federal Government is continuing to scrutinise the European Commission's proposal for an instrument on international procurement with a view to permitting non-discriminatory market access.

189. The Federal Government is working towards a further deepening of transatlantic economic relations. The United States is Germany's largest export market. The Federal Government supports the ongoing talks between the European Commission and the United States on trade facilitation in key areas and calls for rapid results.

Supporting German companies on foreign markets

190. The Federal Government supports German companies as they develop foreign markets via a broad range of instruments to promote foreign trade and investment, using the global network of embassies and consulates-general, bilateral chambers of commerce and Germany Trade & Invest.

191. Guarantees for export credits, investment abroad and untied financial loans are tried-and-trusted instruments of the Federal Republic of Germany to promote foreign trade and investment. In 2018, the Federal Government provided export credit guarantees worth roughly €19.8 billion for goods and services. This represents a year-on-year rise of 17.4%. The increase in political and economic uncertainty on key export markets has boosted the level of interest taken in the Federation's guarantees. By issuing untied loan guarantees, Federal Government provides assistance for raw materials projects abroad which serve to safeguard the supply of raw materials to German industry or which are of special interest to the Federal Republic of Germany. In 2018, the Federal Government issued untied loan guarantees worth €400 million (plus interest coverage).

Investment guarantees insure direct investments by German companies against political risks in developing, emerging and former transition countries. In 2018, the Federation provided investment guarantees worth a total of €1.2 billion. As in the preceding year, the main target regions were Asia and (eastern) Europe.

192. These instruments mean that German firms are generally well equipped for global competition. However, they are facing increasing competition from Asian rivals which are given comprehensive backing by their governments. In order to prevent German firms from suffering disadvantages on the international markets as a result of this, the Federal Government will provide greater backing for German companies pursuing projects abroad. Furthermore, strategic projects abroad are to benefit from additional financial instruments.

193. The Federal Government intends to give German firms better backing as they make use of the economic potential in Africa (cf. Item (203) regarding development cooperation with Africa). It is therefore continuing its business-oriented and practical approach to fostering German investment to build up economic structures in Africa, and against this background will expand its instruments to promote foreign trade and investment. In order to promote trade and investment, the Federal Government will provide a total of €1 billion for a new Development Investment Fund in 2019 – 2021 in compliance with state aid rules, with €200 million of this going to a Business Network for Africa which gives advice and financial support to companies trading and investing in Africa. The conditions for export and investment guarantees for exports to and investments in Africa have been incrementally improved: for example, the excess charged on export credit guarantees for business with public contractors in some highly promising markets (including Côte d'Ivoire and Senegal) has been cut from 10% to 5%. This is to be extended to further African countries if they make sufficient progress on reform. In the case of suitable projects in countries covered by the Compact with Africa, the excess for investment guarantees can be cut from 5% to 2.5%. Also, the application fee charged for export and investment guarantees will be dropped for certain transactions with Compact with Africa countries.

Improving investment screening of corporate acquisitions

194. Germany, France and Italy jointly approached the European Commission in February 2017 asking it to promptly address the issue of state-led, strategic direct investment by non-EU investors in key European technology companies. On 14 September 2017, the European Commission presented a corresponding draft Regulation, on the basis of which a compromise text acceptable to all sides was negotiated with the European Parliament. The procedure is to be concluded in the spring of 2019 via the formal adoption of the text.

195. The range of screening instruments available under foreign trade and payments legislation must keep pace with the development of holdings in German companies which are of relevance to security. Recent years have seen a substantial rise in the number and complexity of takeovers of German companies by parties from outside the EU which need to be screened. Against this background, the Federal Government adopted the 9th Ordinance amending the Foreign Trade and Payments Ordinance of 14 July 2017 to ensure that an appropriate amount of time is available for the screening. Takeovers of critical infrastructure and of companies in certain critical high technology fields must be reported to the Economic Affairs Ministry. Also, the screening procedure cannot be evaded via abusive corporate structures. The more detailed definition of the terms has created more legal certainty, particularly with regard to security policy interests.

In addition to this, the Federal Government decided on 19 December 2018 to lower the threshold for screening to 10% of voting rights in certain cases. This applies in particular to the field of critical infrastructure and defence-related companies. Apart from this, the general threshold for screening of 25% remains in place. Contrary to what the Council of Economic Experts implies (cf. GCEE Annual Report, Item 18), the change does not result in a general requirement to license foreign investment.

196. Germany is open to investment. At the same time, the Federal Government calls for a level playing field: direct investment should be possible abroad at similarly good conditions to those in Germany, and take place in line with market-based criteria. Problems are created in particular by direct investment into the European Union which is subsidised by third countries which, were a Member State to act in a similar way, would trigger an intervention by the European Commission under state aid rules. If corresponding rules cannot be achieved on an international basis, consideration should be given to whether further-reaching measures might be useful.

Ensuring a high level of transparency and effective controls on exports of military equipment

197. Restricting and controlling the international arms trade makes an important contribution towards a preventive and cooperative security policy. The Federal Government is boosting transparency in the sensitive area of military equipment exports by providing rapid and comprehensive information about licensed exports. The Federal Government published the Report on Military Equipment Exports for 2017 in June 2018. It presented the interim report on the export licences issued in the first half of 2018 in October 2018.

198. The Federal Government is sticking to its strict rules governing the export of military equipment (cf. 2018 Annual Economic Report, Item 140). This is particularly true of small arms exports, which are measured against the benchmark of the tighter rules contained in the Small Arms Principles, and which can be subject to post-shipment controls. The controls are intended – initially in the form of pilot controls – to verify whether the weapons supplied are still in the country of destination and in the possession of the end-user cited in the end-use statement.

Shaping globalisation sustainably and responsibly

199. The 2030 Agenda for Sustainable Development of the United Nations is the world's central point of reference for sustainable development. It has anchored sustainability as a universal principle and covers developing, emerging and industrialised countries alike, as well as all policy fields. The Federal Government has committed to an ambitious implementation of the Agenda 2030. The main framework for this is the German Sustainability Strategy. Since being recast in 2017, this Strategy presents for the first time the national and international measures of the Federal Government to achieve all 17 Sustainable Development Goals (SDGs) (cf. Diagram 15). The German Sustainability Strategy will be comprehensively revised in the period up to 2020 in order to permit better responses to the challenges of implementing Agenda 2030.

200. The Federal Government promotes corporate social responsibility (CSR). The focus here is on sustainable global

supply chains. As an important advisory body for the Federal Government on CSR issues, the National CSR Forum consists of representatives of companies, social partners, civil society and academia. In June 2018, the CSR Forum adopted the Berlin CSR Consensus on Corporate Responsibility in Supply and Value Chains. This was the first time that employers' associations, trade unions, chambers, civil society and member companies of the CSR Forum have agreed on the requirements to be met by responsible management of supply and value chains in a globalised economy, and how this should be implemented by companies. It was also possible to reach agreement in the G20 on the promotion of sustainable global supply chains.

201. The Federal Government is implementing the National Action Plan for Business and Human Rights 2016 – 2020 adopted in December 2016 on an ongoing basis. At present, it is monitoring the extent to which companies based in Germany with more than 500 employees are implementing the core elements of human rights due diligence by 2020 in line with the provisions of the National Action Plan. At the same time, the Federal Government is offering targeted services to help the companies to live up to their responsibilities in supply and value chains. For example, sectoral dialogues are to draw up practical guidelines and best practices for human rights due diligence.

202. The National Contact Point for the OECD Guidelines for Multinational Enterprises (NCP) was evaluated by the OECD in the context of a voluntary review. The final report and the OECD's recommendations for action were published in 2018. The OECD's overall findings were encouraging. The NCP will use the implementation of the recommendations to enhance its contribution to sustainable development. The NCP will report to the OECD about this this year.

203. Sustainable and inclusive economic growth is a fundamental prerequisite for sustainable development and the reduction of poverty around the world. The Federal Government is promoting the establishment of a socially- and environmentally-oriented market economy in the countries with which it engages in development cooperation, and provides humanitarian assistance to countries in crisis. In future, external economic promotion, and securing peace and development cooperation are to be better dovetailed. Sustainable economic development which creates jobs can help to alleviate the structural causes of irregular migration and to offer prospects to the people living there and to returning refugees and migrants.

The Federal Government has substantially increased its activities on the African continent, not least in the field of

Diagram 15: Agenda 2030 – 17 global targets for sustainable development

Source: Federal Government, United Nations.

development cooperation. The strategic framework for Germany's Africa policy is provided by the Federal Government's Africa policy guidelines, which are currently being revised. The Federal Government's key elements paper entitled Economic Development in Africa – Challenges and Options, and the Marshall Plan with Africa fit into this framework. In this context, key aspects of development cooperation are based on the Agenda 2030 and the "challenge and support" principle to increase the degree of responsibility taken by the countries of Africa for themselves. One key field of the Federal Government's Africa policy work is specific measures for more investment and jobs in Africa (cf. Item 193). In order to improve the environment for private-sector investment and investment in infrastructure, the Federal Government has concluded partnerships for reform with Côte d'Ivoire, Ghana and Tunisia as part of the G20's Compact with Africa initiative, and is currently engaged in negotiations with Ethiopia, Morocco and Senegal on further such partnerships. The Special Training and Employment Initiative also supports countries in the reform partnerships as they try to attract inward investment and build up an African SME sector. Against this background, and in the context of the new Development Investment Fund of up to €1 billion, cooperation will particularly be intensified with the private sector, primarily in the Compact countries, in order to facilitate more job-creating investment by German and European companies (AfricaConnect) and to strengthen African SMEs (AfricaGrow).

II. The Federal Government's 2019 annual projection

Overview: upswing enters tenth year

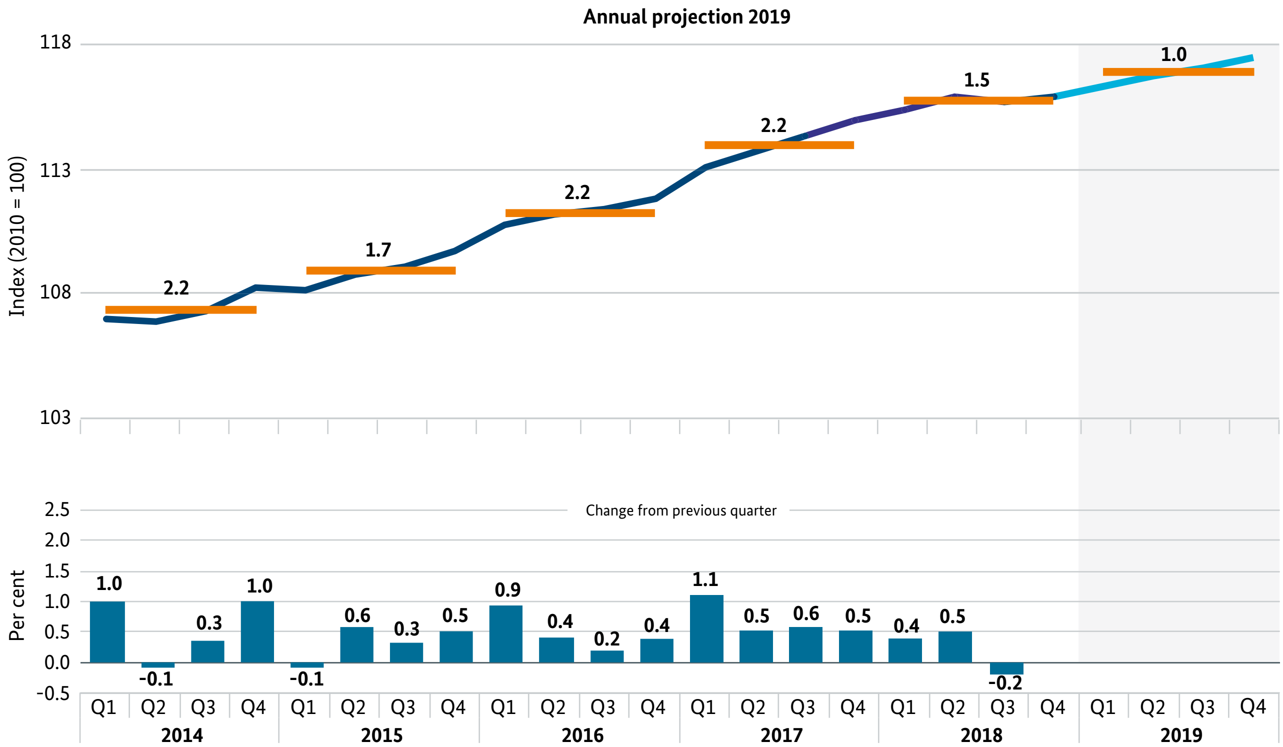
204. The German economy is continuing to grow. The expansion of macroeconomic output this year will mark the tenth successive year of GDP expansion. The solid development in the domestic economy will provide an important basis for this. Employment, incomes, and thus people's potential to consume, are continuing to grow tangibly, as is corporate investment. However, the headwinds are getting stronger, mainly from outside Germany. Also, it is becoming more difficult to keep expanding the production potential. Overall, the underlying cyclical dynamism is likely to slow considerably compared to last year.

At a rate of 1.5%, the German economy roughly matched the average level of growth seen since 2012, but was much slower than the 2.2% rate seen in the high-growth years of 2016 and 2017. In the second half of 2018, the economy was seriously affected by temporary national special factors, and particularly by the backlog in the type-approval of passenger cars (cf. Box 4). In addition, it was hit by the deteriorating global economic environment. On the other hand, positive stimuli derived from the continuing high demand for labour, and also from the low interest rates.

In the current year, the upward domestic forces will continue to prevail. At the beginning of the year in particular, they will be boosted by the cyclical impact on measures contained in the Coalition Agreement. Disposable incomes are expanding sharply because wages and pensions are rising significantly and the state is reducing the burden of taxes and charges on individuals. The domestic economic conditions for 2019 therefore remain good. However, the outlook for the world economy has deteriorated compared with last year; global economic dynamism will be lower.

For 2019, the Federal Government expects, against this background, an annual average increase in gross domestic product of 1.0% in price-adjusted terms (cf. Diagram 16 and Overview 2). Economic growth will thus be weaker

Diagram 16: Gross domestic product (price-adjusted)



Blue line: quarterly curve, in pre-year prices, adjusted for season and calendar variations
Orange lines: annual averages, in pre-year prices, year-on-year change in %
Blue columns: change in %, adjusted for season and calendar variations

Sources: Federal Statistical Office; Federal Government's annual projection.

than it was last year. Nevertheless, demand for labour will remain high. The rise in employment is likely to continue, but to be slower due to the increasing scarcity of labour. It will become increasingly difficult for employers in certain sectors and regions to fill the vacancies in their companies. This will make it more difficult for companies in the construction and skilled craft sectors in particular to expand their businesses.

There is no calendar-day effect to be noted in 2018 and 2019, so that the calendar-adjusted calculation also results in growth of 1.0% (cf. Overview 3). This means that the overall economic development will continue to point upwards. The German economy is experiencing only a slight over-utilisation of its production capacity, so that there is no cause to fear an abrupt end to the economic upswing due to the domestic economy. However, growth in the world economy and the eurozone are likely to slow somewhat in 2019. In particular, the risks from the external economic environment have increased substantially.

The Federal Government's annual projection for 2019 is well below the November 2018 forecast by the Council of Economic Experts. The Council had predicted growth of 1.5% for 2019 (cf. GCEE Annual Report, Item 276). The manufacturing sector experienced a clear drop in output at the end of the year. For this reason, the level of GDP from 2018 was less favourable, and this is also impacting the annualised rate of change for 2019. Furthermore, the cyclical outlook of the global economy has worsened further. This information was not available to the Council when it made its forecast. In contrast, the assessment of the driving forces for growth is relatively similar. Both the annual projection and the Council's forecast expect domestic expenditure, and consumer spending and investment in particular, to generate a lot of growth. The Council's view that the cyclical development in Germany is exposed to much greater risks from the global economy is definitely shared by the Federal Government.

The labour market continues to be an important pillar of the economy. The rise in employment which has been taking place since 2005 will continue this year, although it will not be as strong as in previous years. More jobs will be created in almost all parts of the economy, but primarily in the services sectors. The forecast rise in employment is being made possible not least by immigration from other EU and third countries. The labour participation rate of the domestic population is already very high in Germany compared with other countries, so that the ongoing activation of the hidden reserve is likely to slow in future. The robust state of the labour market is also facilitating the integration of the refugees, which picked up speed in 2018.

Overview 2: Selected key figures for macroeconomic trends in the Federal Republic of Germany[1]

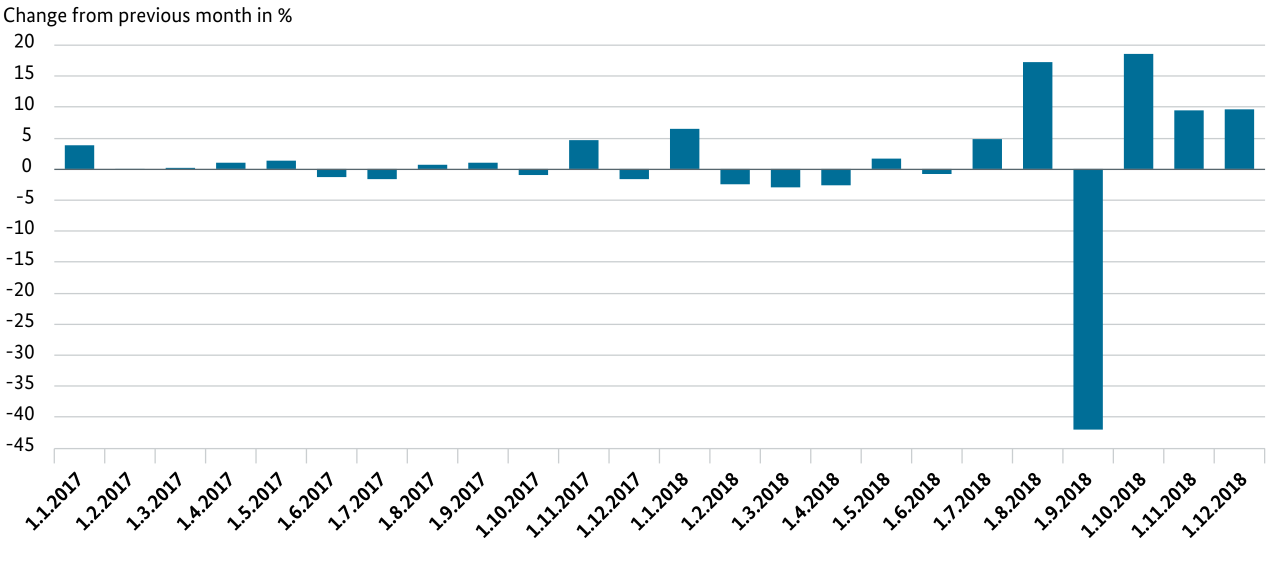
	2017	2018	Annual projection 2019
	Percentage change on preceding year		
Gross domestic product (GDP), output approach			
GDP (real)	**2.2**	**1.5**	**1.0**
Total employment	1.4	1.3	0.9
Unemployment rate in % (Federal Employment Agency definition)[2]	*5.7*	*5.2*	*4.9*
GDP by expenditure (real)			
Private consumption expenditure	1.8	1.0	1.3
Machinery and equipment	3.7	4.5	2.3
Construction	2.9	3.0	2.9
Domestic demand	2.0	1.8	1.4
Exports	4.6	2.4	2.7
Imports	4.8	3.4	4.0
External balance of goods and services (contribution to GDP growth)[3]	*0.3*	*-0.2*	*-0.3*
Total gross wages and salaries per employee	2.5	3.2	3.1

1 Up to 2018 results of the Federal Statistical Office; National Accounts Status: January 2019.
2 In relation to the total labour force.
3 Absolute change (stocks/external balance) in per cent of pre-year GDP (= contribution to change in GDP).

Box 4: WLTP

The road vehicles and vehicle parts sector of the economy (economic sector 29) is the largest sector of the manufacturing industry in terms of value creation. Also, this sector is a major purchaser of numerous upstream goods and services produced in the other branches of industry and services sectors. This means that developments in the automotive industry are of macroeconomic relevance. Since 1 September 2018, the new WLTP ("Worldwide harmonized Light Vehicles Test Procedure") has been binding in the EU for the first registration of cars with petrol and diesel engines. The new procedure is intended to deliver more realistic metrics for exhaust emissions and fuel consumption. Unlike the previous test procedures, it is based on data collected empirically in road traffic. As a result, the results are much more representative, but the procedure is much more cumbersome (cf. Jansen und Kalweit, Wirtschaftsdienst 11, 2018). Last summer, it became clear that the limited capacities on the test rigs would mean that not all models of German car manufacturers would be type-approved under the new procedure in time for 1 September 2018. Some manufacturers responded to this by cutting back their production. This meant that output in the road vehicles and vehicle parts sector dropped by 8.0% between the second and third quarters. On the other hand, prior to the switch to WLTP, the number of first registrations of cars rose sharply until August 2018 (cf. Diagram 17). This was followed by a collapse of more than 40% in first registrations in September 2018 (against August). The events in the automotive industry had a macroeconomic impact. The collapse in production in the road vehicles and vehicle parts sector probably reduced GDP in the third quarter by up to 0.4 percentage points. Not least for this reason, GDP fell by 0.2% between the second and third quarters. In the final quarter, current data suggest that the new orders received by the automotive industry rose considerably, and that production bottomed out. The business climate also brightened amongst the car manufacturers at the end of 2018. The first quarter of 2019 is therefore indicative of an incipient recovery in the automotive industry. The number of newly registered car types under the new test procedure is rising steadily, and as a consequence there have been substantial increases since October 2018. However, the cyclical impact of the introduction of the new test standard is probably still being felt at the beginning of this year. In the course of the year, car manufacturing in Germany is likely to again become more oriented to global demand.

Diagram 17: New car registrations (seasonally adjusted)



Source: Federal Motor Transport Authority.

In view of the collective wage agreements already in place and increasing scarcity on the labour market, collectively agreed wages will rise significantly in 2019. Gross wages and salaries per employee (effective earnings) will rise roughly as fast as they did last year. The cuts in taxes and charges seen at the beginning of the year lessen the impact of fiscal drag, so that net wages are likely to rise even more quickly than gross wages. Monetary welfare benefits will also expand sharply in view of the measures set out in the Coalition Agreement. Overall, therefore, disposable income is likely to increase sharply again this year.

Corporate income and income from assets will expand less strongly than wages and salaries in the course of the economic slowdown. As a consequence, the macroeconomic wage ratio will rise further. There will be a sharp rise in unit wage costs. As a result of the drop in energy prices, the rise in consumer prices is likely to be marginally lower this year than last year.

In view of the expansion of real disposable income and the continuing good outlook on the labour market, private households will increase their consumer spending appreciably (cf. Overview 4). The additional income will also be used for investment in private housing.

Public consumption expenditure is set to rise more strongly in 2019 than last year. The dynamism is due to the higher rise in non-monetary welfare benefits, not least due to the Act to Strengthen Nursing Staff.

A positive financial balance for the entire public sector can be expected again this year. It will, however, be smaller than last year. In particular, the implementation of the priority measures in the Coalition Agreement and other measures will have an effect here. The structural fiscal surplus, i.e. adjusted for cyclical and one-off effects, will also be positive in 2019.

Gross fixed capital formation is likely to expand further, despite certain imponderables in the external economic environment, in view of the high level of capacity utilisation, favourable financing conditions and well-filled order books. Investment in plant and equipment and private-sector investment in construction will, however, see a rather less dynamic expansion than last year. Overall, nominal investment rises more quickly than GDP, so that the investment ratio will increase further this year.

The global economy will continue to grow, but it lost some momentum in 2018 and there are signs of a further gradual slowing in the rate of expansion this year. In line with the forecasts of international organisations, the projection for 2019 as a whole therefore assumes weaker global economic growth than last year. World trade is also likely to grow less strongly. There has also been a deterioration in the cyclical prospects for the eurozone. However, the process of cyclical recovery following the debt crisis should continue. In view of the end to the special development in the automotive sector and the depreciation of the euro against non-EU currencies, German exports should increase by slightly more than last year in both nominal and price-adjusted terms.

Due to the ongoing rise in overall demand, imports are likely to continue to rise faster than exports. This means that the current account balance is likely to see another slight drop in terms of GDP for the fourth year in succession this year.

Overview 3: Technical details of the annual projection

	2017	2018	2019
	In percent or percentage points		
Annual average GDP rate	**2.2**	**1.5**	**1.0**
Statistical overhang at the end of the previous year [1],	0.8	0.2	0.5
Rate of growth over course of year [2]	2.8	0.9	1.3
Annual average GDP rate, adjusted for working days	2.5	1.5	1.0
Calendar effects [3]	-0.3	0.0	0.0

Source: Federal Statistical Office 2019; in-house calculations.

1 Index level in Q4 of previous year adjusted for seasonal and calendar-day effects in relation to quarterly average of previous year adjusted for calendar-day effects.
2 Rate of change over year from Q4 to Q4, adjusted for seasonal and calendar-day effects.
3 In percent of GDP.

205. The 2019 annual projection is based on the following assumptions:

- The price for Brent crude oil will fall by nearly 20% to around USD57 a barrel as an average for 2019. This is derived from futures prices.

- The exchange rates in the projection period are assumed to be constant at their respective averages of the last six weeks before the production of the projection. This produces a euro rate of around USD1.14, or a depreciation of just under 4% from last year.

- The interest rate for main refinancing transactions of the European Central Bank will remain constant at 0.00% until the end of the projection period.

- There will be no negative developments during the projection period which significantly raise the level of economic uncertainty. For example, the financial sector will remain stable, and the trade disputes will not spread. The projection assumes an orderly departure of the United Kingdom from the European Union.

- All of the economic and fiscal policy measures (cf. Part I) adopted by the time of the finalisation of the Annual Economic Report have been fed into the projection.

206. In the view of the Federal Government, and given the assumptions cited above, the underlying course indicated by the annual projection is the most likely development of the German economy. Nevertheless, the estimate does involve uncertainties. There are chances for a more favourable economic development, primarily on the domestic market. For example, consumers could reduce their ongoing savings and expand consumer spending by more than expected. However, the risks are currently predominant. They are mainly to be found in the global environment. An increase in the protectionist developments in global trade which can currently be seen is a serious danger. This could impact on growth in China, but even more on German trade and the value chains, cause global uncertainty and have a negative impact on investment. Another marked risk is the withdrawal of the United Kingdom from the EU. Depending on how the withdrawal takes place, there could be a significant cyclical slowdown in the United Kingdom which would affect not only German exports to the United Kingdom, but also growth in Europe. Also, the economy could cool in the United States, for example, by more than has been assumed so far. In addition, there are other risks which are less in the spotlight at present.

Overview 4: Contributions to GDP growth

	2017	2018	2019
		In percent or percentage points	
Contributions to growth[1]:			
GDP (growth) = (1)+(2)+(3)+(4)	2.2	1.5	1.0
(1) Private consumption expenditure	**0.9**	**0.5**	**0.7**
(2) Public consumption expenditure	**0.3**	**0.2**	**0.4**
(3) Gross capital formation	**0.6**	**1.0**	**0.3**
(3a) Stockbuilding	0.1	0.4	-0.2
(3b) Gross fixed capital formation	0.6	0.6	0.5
Construction	0.3	0.3	0.3
Machinery and equipment	0.2	0.3	0.2
Other plant and equipment	0.1	0.0	0.1
Domestic demand = (1)+(2)+(3)	**1.9**	**1.7**	**1.3**
Export of goods and services	2.1	1.1	1.3
goods	1.9	1.0	1.0
services	0.3	0.1	0.2
Import of goods and services	-1.8	-1.3	-1.6
goods	-1.6	-1.3	-1.3
services	-0.2	0.0	-0.3
4) External balance of goods and services	**0.3**	**-0.2**	**-0.3**

Source: Federal Statistical Office 2019; in-house calculations.

1 Deviations in totals possible due to rounding.

Global upswing losing momentum

207. The pace of expansion in the world economy is weakening. Following growth of 3.7% in 2018, it is assumed that global economic growth will amount to around 3.5%[1] in 2019. A number of indicators show that the global upturn is slowing. Global industrial output was slower last year than the year before. The Markit global purchasing managers' index for industry softened to its lowest level for more than two years in December. Following a further drop, the ifo index on the global economic climate for the fourth quarter of 2018 is actually negative. Global trade in particular lost momentum last year. The advanced maturity of the global upswing is also indicated by the reduction in under-utilisation of capacity and increases in over-utilisation in many regions. For example, according to the OECD's output gap estimate, average capacity utilisation is rising in all the member states, but particularly also in the eurozone and the United States.

208. Growth slowed last year in the eurozone. All of the larger countries registered softer growth than in the preceding year. The cyclical dynamism is likely to lose a little momentum this year too. This is also suggested by the current indicators. The European Commission's Economic Sentiment Indicator remains at a high level, but has been pointing downwards since the beginning of 2018. The Markit purchasing managers' index for the eurozone also declined last year, both for the goods-producing industry and for services. Nevertheless, the increase in employment is continuing. Unemployment fell again last year to the lowest level since the financial crisis. Capacity utilisation in industry has also almost returned to the pre-crisis level. The improvement on the labour market and the rising level of capacity utilisation are likely to gradually exert pressure on the price level. The risks to growth in the eurozone continue to include the repercussions of Brexit and some less sustainable budget policies. For 2019, we expect an overall growth rate of 1.5%.

209. The economy in the United States accelerated substantially last year, partly due to stimulating effects of an expansionary fiscal policy. This year, the pace of growth is likely to drop to around 2.5%. The U.S. yield curve is also suggestive of this: its partial inversion in recent months has advanced, expressing less optimistic growth expectations on the part of the market players. Consumer spending has registered stable rates of growth in recent years, and is boosted by very solid developments on the labour market. Also, despite four interest rate rises in 2018, the key interest rates remain low. Pressure on prices is gradually increasing. Last year saw this reflected in a higher rate of inflation.

In the emerging economies in general, economic growth is likely to continue at a similar pace to last year. The development of the Chinese economy will lose further momentum. However, this will be offset by sharper rises in other Asian countries. Despite the clear fall at the end of the year, the average crude oil price rose last year, benefiting Russia, Brazil and other oil-exporting countries. Recent figures show an acceleration in the Brazilian economy, which is likely to grow faster again this year. India's economic output was extremely dynamic last year, and will attain a similar rate of expansion this year. The IMF expects the emerging economies to grow by 4½% this year, repeating last year's performance.

Slower expansion of world trade

210. Last year, the development in world trade entered much calmer waters. At the same time, the composition of the growth varied widely. There was a particularly softening in the foreign trade of developed economies. The trade intensity of the emerging economies continued its upward trend. Overall, growth in world trade is likely to remain slow.

German exports were affected by the WLTP issue in the second half of last year. Exports are likely to recover from this in the reference period and to move close to the level of growth in Germany's sales markets. However, the outlook has deteriorated, at least according to the export expectations of ifo and the Association of German Chambers of Industry and Commerce. The effective exchange rate of the euro fell in recent months and is not likely to have an additional negative effect on exports.

Overall, exports of goods and services are set to rise by only around 2.7% this year. Due to the dynamic domestic demand, imports will increase substantially faster, by 4.0%. The stabilisation of commodity prices and the higher increase in unit wage costs compared with other countries in Europe mean that export prices will increase somewhat

1 GDP of the global economy calculated on the basis of purchasing power parities.

faster than import prices. This means that the terms of trade will see a slight improvement.

Exports are an important pillar of growth in an open economy like Germany. Per se, they have a positive impact on GDP growth. If one deducts the concomitant rise in imports, however, this effect is more than offset. In total, German foreign trade thus reduces the increase in GDP in arithmetical terms.

The current account surplus, which peaked at 8.9% in 2015 in terms of GDP, has since fallen to 7.5% in 2018. Last year, this reflected both the surprisingly weak foreign demand for German exports and the robust domestic demand. This year, it is likely to decline further, to 7.3%.

Robust investment activity

211. The Federal Government expects gross fixed capital formation to grow appreciably again, by 2.4% in 2019, i.e. by more than the development in macroeconomic output. However, it is noticeable that commercial investments only expanded slightly more strongly than commercial gross value added.[2] The proportion of real commercial gross fixed capital formation in terms of gross value added – the ratio of commercial investment – has remained relatively constant and close to the historic average, unlike in previous economic cycles (cf. Diagram 18). This is likely to be due to the fact that the investment is caught between low costs of financing and increased external economic uncertainty, so that no strong uptick in investment has emerged.

These conflicting incentives are particularly affecting investment in plant and machinery. Major fundamentals remain positive here. The low interest-rate environment means that the cost of financing is at a historic low, and full order books and above-average capacity utilisation in industry are making investment in expansion appear more urgent. However, the stimulus from the world economy is weaker than last year. Also, the increased risks for the global economy, the concomitant uncertainty and the increasing skills shortages in the construction sector and in some service sectors are having a negative impact on the inclination to invest. This is also reflected in the findings of the latest economic survey by the Association of German Chambers of Commerce and Industry: the proportion of those surveyed wishing to expand their own capacities fell slightly in 2018 from the 2017 level. This applies to both industry and services. This means that investment in plant and equipment is likely to increase substantially in 2019, but at a rate of 2.3%, which is a slower rate than last year. Skills shortages are increasingly being seen in the construction sector in particular. In November, for example, the number of vacancies reached a new record. The full order books show that there is a demand for construction work and that it is becoming more difficult to meet it. As a result, given a historically high level of capacity utilisation, there are signs of overheating in this sector, mainly in the form of sharp rises in construction prices. Since the economic and financial crisis, the house-building sector has outperformed overall investment in construction in every single year. Against the backdrop of high construction prices, a slight increase in mortgage interest rates, and a tightening on the supply side, however, the growth in investment in housing will be somewhat slower than in previous years, at 2.7%. A further stimulus derives from public-sector construction. There has recently been a clear rise in the number of building permits for public-sector construction. The measures to further expand public transport infrastructure and to assist financially weak municipalities are likely to lead to a further sharp expansion of public-sector investment in the reference period. Overall, investment in construction is set to expand by 2.9% in 2019.

As the level of digitisation advances, investment in research and development, software and databases becomes increasingly important. Around 20% of corporate investment is accounted for by "other assets", which mainly consist of investment in intellectual property. In 2019, investment in other assets will expand at a slightly faster pace, by 1.4%.

Development on the labour market not affected by slower economy

The robust labour market continues to be the mainstay of the economy. The steady upward trend in employment has now been ongoing for twelve years; 2018 also saw an average increase in gainful activity in Germany of 1.3% or approximately 562,000 people. This meant that gainful activity reached a new all-time record at 44.8 million people; in absolute terms, most of the new jobs were created in corporate services, health and social services, but also in

2 Non-state investment excluding housing.

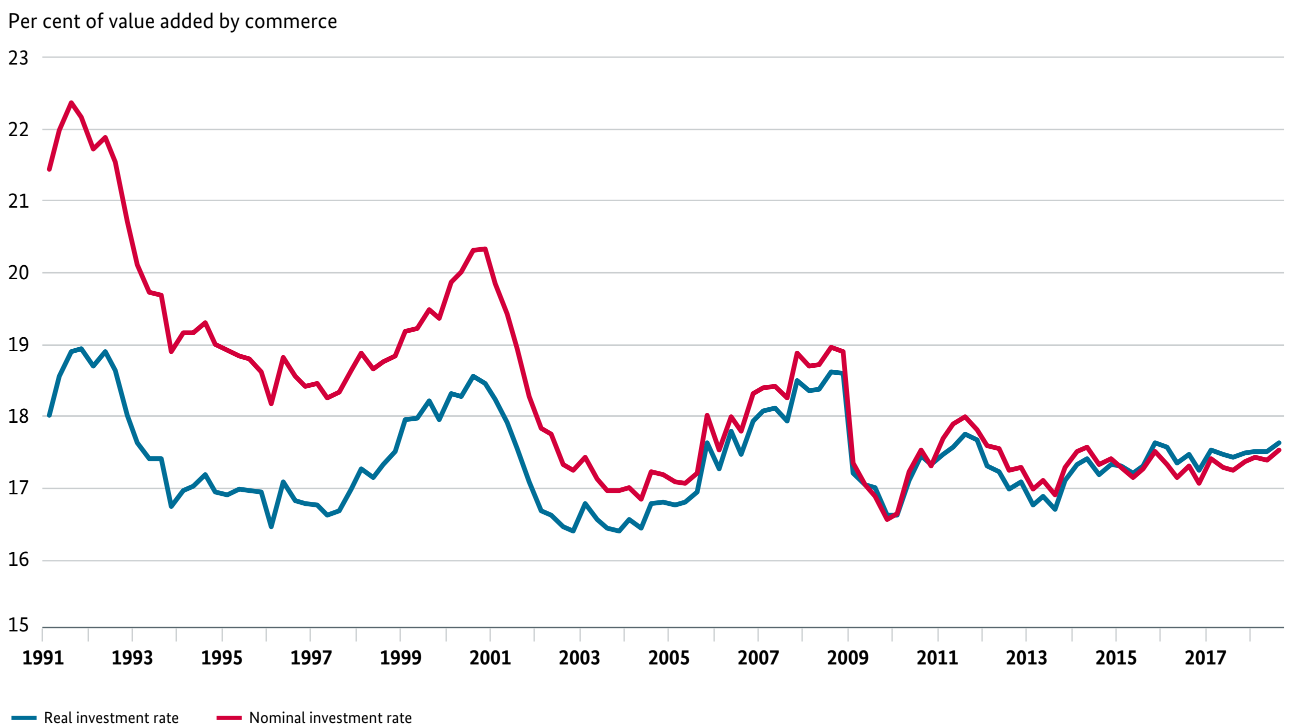
the manufacturing sector. The rise in employment was largely based on an increase in jobs subject to social security contributions; in contrast, the number of self-employed persons and people exclusively in marginal employment declined further. The volume of work also continued to increase due to rising employment, reaching the highest level for 26 years last year.

The unemployment rate dropped clearly in 2018 to an annualised figure of 5.2%. The number of registered unemployed fell by 193,000 people, reaching 2.3 million, the lowest level since German reunification. This development is rooted in declines in unemployment both amongst German and foreign unemployed persons.

Progress is being made on integrating the refugees into the labour market. The number of people from the countries of origin of the refugees in jobs subject to social security contributions rose by around 95,000, or 47%, between October 2017 and October 2018. The number of individuals in this cohort who were exclusively in marginal employment grew by a further 10,000. At the same time, roughly one-third of the people in this cohort obtaining jobs did so as temporary agency workers; other leading sectors were corporate services and the hotel, restaurant and catering industry. Unemployment amongst people from the leading countries of origin of asylum seekers actually remained fairly constant during 2018, even though many people pressed on to the labour market in the course of the year once they had completed integration and language courses. All of this suggests that the labour market integration of refugees is going better than was to be expected in the light of experience with refugees who have come to Germany in the past (Joint diagnosis, 10/2018). However, the relatively low employment ratio of just over 30% shows that much hard work will still be needed to complete the integration.

Key leading indicators like the high number of vacancies or the labour market barometer of the Institute for Employment Research remain at a high level, but most recent figures show a slight softening. This suggests that companies still have a high demand for labour, even if employment is not likely to rise as quickly this year as in the preceding years. One reason for this is the slight economic slowdown. Another is the increasing scarcity of skilled workers, which is resulting in growing recruitment difficulties for the com-

Diagram 18: Commercial investment ratio



Source: Deutsche Bundesbank.

panies. Overall, the number of people in work is set to rise by around 390,000 in 2019. This increase will again largely be driven by a rise in the number of jobs subject to social security contributions.

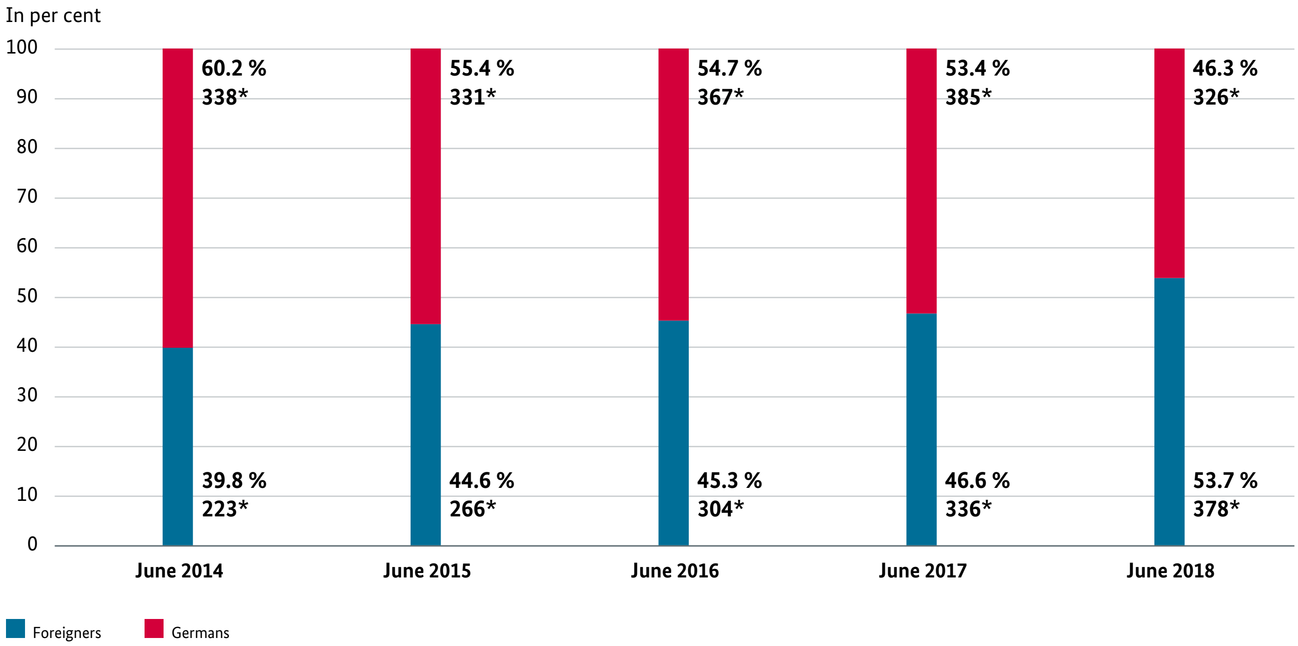
The additional jobs are being filled less by people in unemployment, and more by the rising labour force participation of women and older people, and by people coming from abroad. An outstanding role is played by labour migration, particularly from countries of the European Union (cf. Diagram 19). This year is again expected to see a further increase in the labour market participation of women and older people. However, in view of the labour force participation rate of around 80%,[3] which is already very high in the international comparison, further activation of individuals is likely to reach its limits. On the other hand, there is potential to increase the supply of labour in the volume of work, which in the case of women in Germany is below the international average, at 31 hours a week.

The Federal Government expects unemployment to continue to fall in the course of 2019. In view of the weaker economy, however, the pace of the fall is likely to slow somewhat. The annualised number of registered unemployed is likely to drop by around 140,000, with the unemployment rate falling to 4.9%.

Inflation rate drops due to falling crude oil prices

212. Last year, the rise in the consumer price level in Germany accelerated to 1.9%. This means that the inflation rate was in line with the target set by the European Central Bank. The rise in prices was largely a result of the ongoing increase in oil prices. If one excludes energy and food prices from the development (core inflation), the inflation rate stood at 1.5% as an annual average for 2018, and was thus slightly higher than the long-term average of 1.2% since 2000.

Diagram 19: Share of foreigners and Germans in growth of employment subject to social security contributions (year-on-year)



* Absolute change in 1000s year-on-year

Source: Federal Employment Agency.

3 Defined as the total of working and unemployed persons as a proportion of the total population of the 20-64-year-olds in line with the ILO concept.

Fuel prices are likely to lower the inflation rate this year. Judging by futures prices on the commodity exchanges at the beginning of the year, the oil price in 2019 is likely to be well below last year's level, at USD57. This means that the price development is likely to be driven more by domestic economic factors than last year.

Capacity utilisation in the manufacturing sector is set to remain slightly above the long-term average. This is likely to find expression in higher prices. Imported intermediate products will also become somewhat more expensive due to the depreciation of the euro. Furthermore, the companies abroad surveyed by the Markit Institute are expecting rising prices for industrial goods. The ongoing effect of last year's wage rises will also significantly increase labour costs in the manufacturing sector. Overall, the rate of price increases is therefore likely to accelerate in the case of goods apart from energy products.

The development of prices for services is likely to be the main factor driving macroeconomic inflation. Inflation had already picked up noticeably here last year. If the kindergarten fees had not been abolished in some of the Länder, the rise in prices would have been even greater. In the services sector, higher unit wage costs are also to be expected as wages pick up speed. In the field of construction services in particular, the strong rise in prices is likely to continue due to the existing capacity constraints. The ifo price expectations for industry and commerce have just reached the highest level seen in recent years.

Contributions towards macroeconomic inflation are also derived from the demand for housing, which is virtually unaffected by the economic cycle. Since these are likely to remain high, the increased rise in net rental costs excluding ancillary costs is likely to continue. Rental payments account for roughly one-fifth of the basket of goods, and are the largest item in the basket used to measure the consumer price level. This means that prices for services are likely to pick up a little speed. The price increase for net rental payments is the factor behind the slight increase in the core inflation rate to 1.6% in 2019.

All in all, at 1.5% the rise in the consumer price level this year is likely to be much lower than last year's increase. The consumer spending deflator will rise by 1.4%, a little less than consumer prices.

Disposable income is boosting consumption

213. Last year, consumer spending rose by a little less than the GDP. The clear increases in disposable income were used by private households for an above-average increase in savings, which was reflected in a rising savings ratio. However, most of the parameters this year suggest that there will be a clear increase in consumer spending. The upswing on the labour market is continuing, and this is resulting in sharp wage rises in view of the scarcities on the labour market. Net wages are likely to increase even faster than gross wages due to numerous reductions in taxes and charges. Monetary welfare benefits will also rise even more substantially than last year as the increase in benefits adopted in the Coalition Agreement is rolled out. All of this is resulting in a considerable overall rise in disposable income. Following adjustment for the expected inflation, it will also rise clearly in real terms. At the same time, consumer sentiment is still positive against the backdrop of the good environment for consumption, and the propensity to purchase on the part of private households is high.

Last year's collective agreements provided for clear increases in collective wages this year. Together with the continuing good development on the labour market, collective wages are again likely to rise clearly this year. Gross wages and salaries per employee (effective earnings) will rise by more than collectively agreed earnings, not least due to the rise in the nation-wide minimum wage. Also, the scarcity on the labour market is encouraging pay levels above the collectively agreed rates. Furthermore, mini-jobs will continue to be transformed into regular employment subject to social security payments, so that per-capita income will rise. For this reason, the wage drift is again likely to be clearly positive this year. Against this background, there will be a similar increase in effective earnings per employee to that seen last year, at 3.1% (cf. Overview 6).

The clear rise in gross wages is made even greater by reductions in taxes and charges resulting from the Coalition Agreement. It is true that the reduction in the contribution rate to unemployment insurance is offset by an equivalent rise in the contribution rate to statutory long-term care insurance. At the same time, however, the burden on employees and other people covered by statutory health insurance will be reduced as parity in contributions to the schemes is introduced and the amount of the additional contribution is reduced. At the same time, the basic allowance and the child allowance are being raised and the tax schedule adjusted. This will reduce the progression in the tax schedule. Also, the income range up to which only reduced social security contributions need to be paid is being extended. This means that low-earners have to pay lower social security contributions. Overall, 2019 is bringing tangible relief for private citizens.

As a consequence, net wages and salaries per employee will rise by 3.7% this year, by much more than the gross figure. The level of gainful activity is likely to expand a little more slowly this year than in 2017. This will slow the development of the total payroll. In view of the continuing strong dynamism of wages and the relief described above, net wages and salaries will increase just as fast as in the preceding year, at 4.8%. Since these are by far the largest component of disposable income, at 49% at present, this has a tangible impact on the overall development of disposable income.

Accounting for a share of 23.7%, monetary welfare benefits also make a substantial contribution to the development of disposable income. At the beginning of the year, the extension of the "mother's pension" increased the benefits paid out by statutory pension insurance. In view of last year's good development in wages, statutory pensions will see another significant rise from the middle of the year. Furthermore, July will see the second stage of the policy to bring eastern German pensions into line with the western level. Also, statutory child benefit will be increased by €10 per child in July. On the other hand, the fall in unemployment will result in lower payments of wage replacement benefits. Overall, monetary welfare benefits will rise more quickly than last year, at 4.5%.

Disposable income also includes entrepreneurial and property income of private households. Accounting for 27.3%, this is the second largest component of disposable income. In view of the softening of the economy, the ongoing low level of interest rates, and the increased labour costs, this will decline in 2019.

Overall, nominal disposable income of private households is likely to see a slightly smaller rise this year than last year, at 2.8%. Nevertheless, this still represents a sharp expansion in disposable income in the long-term comparison. The average annual rise over the last 15 years was only 2.2%.

Above-average rises in incomes are likely initially to mean that a higher proportion of income is saved. This happens partly to enable people to continue to increase consumption in times of lower rises in incomes. As a result, despite a continuing environment of very low interest rates, the savings ratio rose last year by 0.4 percentage points to 10.3% of disposable income. In view of the above-average rise in disposable income this year, the savings ratio is initially likely to rise slightly. Nominal consumer spending is therefore likely to rise rather less strongly than disposable income.

Overall, consumer spending will increase by 1.3% in 2019 against the backdrop of a continuing moderate rise in prices. The increase is thus set to be slightly larger than in 2018, when consumer spending rose by 1.0%.

Public-sector consumption dynamic

214. Public-sector consumption is set to rise more strongly in 2019 than last year. The public-sector budgets achieved a surplus of 1.7% of the nominal GDP. This means that the overall public-sector budgets have been in surplus in every year since 2014. 2019 and the coming years are also expected to see a positive financial balance for the state as a whole. The structural fiscal surplus, i.e. adjusted for cyclical and one-off effects, will also be positive once again in 2019. The medium-term budgetary target set for Germany in the context of the European Stability and Growth Pact, of a structural deficit of at most 0.5% in terms of nominal GDP, will continue to be met.

The implementation of the priority measures of the Coalition Agreement, which includes relief for individual citizens and additional public-sector spending on consumption and investment, is resulting this year in a drop in the overall public-sector financial balance of around 0.7 percentage points of the GDP according to the budgetary planning for 2019 (cf. Overview 5). The measures of the Coalition Agreement are thus providing a strong cyclical stimulus in uncertain external economic times.

Overview 5: Effect of fiscal policy measures from the Coalition Agreement on the overall public-sector budget in 2019[1]

	Figures in % of GDP
Priority spending in the following key areas:	
Investment in the future: education, research, higher education, digitisation	-0.1
Families, children, welfare	-0.1
Construction and housing	0.0
Equal living standards, agriculture, transport and municipalities	-0.1
International responsibility for security and development	-0.1
Other measures:	
Act to reduce the burden on families	-0.1
Act to relieve the burden on those insured (including return to parity-based financing of statutory health insurance)	-0.1
Act on opportunities to gain qualifications	-0.2
Act to improve and stabilise benefits (pensions package 1)	-0.1
Act to Strengthen Nursing Staff	0.1
Change in financial surplus	**-0.7**

Source: Draft Budgetary Plan 2019.

1 Discrepancies in the totals possible due to rounding.

Box 5: Review of the 2018 Annual Projection

According to provisional annual figures from the Federal Statistical Office, the price-adjusted gross domestic product expanded by 1.5% in 2018. This means that the German economy grew less strongly than the rate of 2.4% that had been expected in the projection in the 2018 Annual Economic Report (cf. Overview 7). A smaller stimulus was derived both from the foreign and the domestic economy than had been expected a year ago.

At the beginning of 2018, the public debate about tariffs flared up, and new tariffs were introduced and existing ones increased during the year. World trade was softer than expected in 2018, and this had a negative impact on German exports. On top of this, there was the slower export of cars which lacked the new WLTP certification. As a result, exports grew by only 2.4%, much less than had been expected.

The smaller external economic stimulus also impacted the domestic economy. For example, investment in equipment was somewhat weaker than forecast (4.5% rather than 5% increase). On the other hand, investment in construction developed somewhat better than expected, but investment in other assets was much weaker than anticipated, with a rise of 0.4%.

Real private consumer spending increased by 1.0%, or much less than was forecast a year ago (+1.9%). This sharp deviation from the forecast is very surprising, given that disposable income developed roughly in line with expectations, at +3.2% (forecast: +3.6%). The price level of consumer spending also developed precisely in line with expectations, with a rise of 1.6%. The cause of the weak development in consumer spending was a rise in the savings ratio of private households to 10.3%. In the annual projection, the Federal Government had expected a constant savings ratio of 9.7%.

Public-sector consumption grew by 3.8% in nominal terms, less than the expected rate of 4.1%. This was partly due to the smaller rise in federal spending on consumption. One reason for the smaller development in federal spending was the provisional budget in place until mid-July 2018.

Overview 6: Key figures of the 2019 annual projection

Macroeconomic trends in the Federal Republic of Germany[1]	**2018**	**Annual projection 2019**
	Percentage change on preceding year	
Gross domestic product (GDP). Output approach		
GDP (real)	**1.5**	**1.0**
Total employment	1.3	0.9
GDP per employee	0.2	0.2
GDP per hour worked	0.1	0.5
for information:		
Unemployment rate in % (ESA concept)[2a]	*3.2*	*3.0*
Unemployment rate in % (Federal Employment Agency definition)[2a]	*5.2*	*4.9*
GDP by expenditure (at current prices)		
Consumption expenditure		
Private consumption expenditure	2.6	2.7
Public consumption expenditure	3.8	4.5
Gross fixed capital formation	6.0	5.3
Change in stocks (€ billion)	*8.3*	*1.0*
Domestic demand	4.1	3.4
Foreign balance of goods and services (€ billion)	*233.7*	*231.3*
Foreign balance of goods and services (as % of GDP)[7]	*6.9*	*6.6*
Gross Domestic Product (nominal)	**3.4**	**3.1**
GDP by expenditure (real)		
Consumption expenditure		
Private consumption expenditure	1.0	1.3
Public consumption expenditure	1.1	2.1
Gross fixed capital formation	3.0	2.4
Machinery and equipment	4.5	2.3
Construction	3.0	2.9
Other plant and equipment	0.4	1.4
Stockbuilding (GDP growth contribution)[3a]	*0.4*	*-0.2*
Domestic demand	1.8	1.4
Exports	2.4	2.7
Imports	3.4	4.0
External balance of goods and services (contribution to GDP growth)[3a]	*-0.2*	*-0.3*
Gross Domestic Product (volume)	**1.5**	**1.0**
Prices (2010 = 100)		
Private consumption expenditure[4]	1.6	1.4
Domestic demand	2.2	1.9
Gross Domestic Product[5a]	1.9	2.1
Distribution of gross national income		
(resident concept)		
Compensation of employees	4.7	4.3
Income from self-employment and property	-0.3	0.2
National income	3.1	3.1
Gross national income	3.4	3.1
for information (resident concept):		
Employees	1.6	1.1
Total gross wages and salaries	4.8	4.2
Total gross wages and salaries per employee	3.2	3.1
Disposible income of private households	3.2	2.8
Savings ratio in %[6a]	*10.3*	*10.4*

1 Up to 2018 figures from the Federal Statistical Office; National Accounts Status: January 2019.
2 In relation to the total labour force.
3 Absolute change (stocks/external balance) in per cent of pre-year GDP (=contribution to change in GDP).
4 Consumer price index, percentage change on preceding year: 2018: 1.9 %; 2019: 1.5 %.
5 Unit labour costs, percentage change on preceding year: 2018: 2.9 %; 2019: 3.0 %.
6 Saving in per cent of private households' disposable income including occupational pension claims.
7 Current account balance: 2018: +7.5 %; 2019: +7.3 .

Overview 7: Comparison between the 2018 annual projection and actual outcomes

Key figures for macroeconomic trends in the Federal Republic of Germany[1]	Annual projection 2018	Actual outcomes 2018
	Percentage change on preceding year, unless otherwise stated	
Gross domestic product (GDP), output approach		
GDP (real)	**2.4**	**1.5**
Total (employment)	1.1	1.3
GDP per employee	1.2	0.2
GDP per hour worked	1.1	0.1
for information:		
Unemployment rate in % (ESA concept)[2]	*3.2*	*3.2*
Unemployment rate in % (Federal Employment Agency definition)[2]	*5.3*	*5.2*
GDP by expenditure (at current prices)		
Consumption expenditure		
Private consumption expenditure	3.6	2.6
Public consumption expenditure	4.1	3.8
Gross fixed capital formation	5.7	6.0
Change in stocks (€ billion)	*-22.1*	*8.3*
Domestic demand	4.2	4.1
Foreign balance of goods and services (€ billion)	*257.7*	*233.7*
Foreign balance of goods and services (as % of GDP)	*7.6*	*6.9*
Gross Domestic Product (nominal)	**4.1**	**3.4**
GDP by expenditure (real)		
Consumption expenditure		
Private consumption expenditure	1.9	1.0
Public consumption expenditure	1.8	1.1
Gross fixed capital formation	3.8	3.0
Machinery and equipment	5.0	4.5
Construction	2.8	3.0
Other plant and equipment	4.2	0.4
Stockbuilding (GDP growth contribution)[3]	*0.0*	*0.4*
Domestic demand	2.3	1.8
Exports	5.3	2.4
Imports	5.8	3.4
External balance of goods and services (contribution to GDP growth)[3, 7]	*0.2*	*-0.2*
Gross Domestic Product (volume)	**2.4**	**1.5**
Prices (2010 = 100)		
Private consumption expenditure[4]	1.6	1.6
Domestic demand	1.8	2.2
Gross Domestic Product[5]	1.8	1.9
Distribution of gross national income		
(resident concept)		
Compensation of employees	4.0	4.7
Income from self-employment and property	4.7	-0.3
National income	4.2	3.1
Gross national income	4.1	3.4
for information (resident concept):		
Employees	1.3	1.6
Total gross wages and salaries	4.1	4.8
Total gross wages and salaries per employee	2.9	3.2
Disposible income of private households	3.6	3.2
Savings ratio in %[6]	*9.7*	*10.3*

1 Up to 2017 figures from the Federal Statistical Office; National Accounts Status: January 2019.
2 In relation to the total labour force.
3 Absolute change (stocks/external balance) in per cent of pre-year GDP (=contribution to change in GDP).
4 Consumer price index, percentage change on preceding year: annual projection 2018: 1.8%; actual outcome 2018: 1.9%.
5 Unit labour costs, percentage change on preceding year: annual projection 2018: 1.8%; actual outcome 2018: 2.9%.
6 Saving in per cent of private households' disposable income including occupational pension claims.
7 Current account balance: Annual projection 2018: +8.1%; actual outcome 2018: +7.5%.

www.bmwi.de