



2017 Annual Economic Report

For inclusive growth in Germany and Europe

Summary

1. The German economy is in very good shape. In 2016, the gross domestic product expanded by 1.9% (price-adjusted), faster than in any year since 2011. The rise in employment is a German success story. In 2016, 43.5 million people were in gainful employment, and this figure is set to increase further in 2017 by 320,000. This means record figures not only for the number of people in work, but also for the number of those paying into social security insurance. In comparison with 2013, the number of gainfully active persons was around 1.5 million higher last year, and more than four million up on 2005. The high level of immigration onto the German labour market from the European Union will also contribute to the rise in employment. In contrast, the high level of immigration of people seeking protection will only impact gradually, in the form both of higher employment and of higher unemployment. The unemployment rate is currently at the lowest level for 25 years, and is likely to stabilise around the 6% mark. The rate of youth unemployment is the lowest in the European Union.

2. The good economic situation will continue this year. The Federal Government expects a 1.4% increase in the price-adjusted gross domestic product (cf. Overview1). The slight fall-off in growth is not a reflection of a deteriorating economic outlook, but is largely due to the effect of a smaller number of working days compared with last year. The rise in incomes which is going hand in hand with the labour market development, coupled with a moderate increase in consumer prices, offers a favourable situation for private households. These are increasing their spending on consumption at a higher rate than that seen in the recent past, and are investing strongly in residential property. In 2016, the public-sector budget achieved a surplus of 0.6% in terms of nominal gross domestic product. The good situation of the public budgets is creating scope for rising public-sector expenditure on consumption and investment. In the reference period, German companies will invest somewhat more in equipment and machinery in order to be able to meet the

slowly rising demand from abroad. In view of the slightly above-average level of capacity utilisation in industry, investment in expansion is likely to gain some significance alongside investment in replacements. In contrast, world trade will remain slow, and could also be hampered by protectionist tendencies. The risks, particularly from the external economic environment, remain considerable. This reduces the prospects for exports and thus also the propensity for companies to invest in equipment and buildings. All in all, however, there are no signs at present of an interruption to the steady upward trend.

3. The social market economy combines competition and fair reward for performance with social equity and participation in social progress. The freedom of the individual in the social market economy is inseparable from responsibility for the common good. In this way, the social market economy has always aimed to ensure “prosperity for all”. Major elements of the social market economy are also being discussed and developed in the international arena under the heading of “inclusive growth”. Here, the focus of the debate is particularly on the impact of an unequal distribution of incomes and assets on economic development. In the view of the Federal Government, inclusive growth is characterised by a rising level of prosperity which opens up opportunities for all parts of the population and ensures a fair distribution in society of the prosperity which has been generated. In addition to the restriction on market power imposed by a competitive economic system, this particularly involves equal opportunities for all members of society. It also includes a balancing of disparities in income, anchored in the tax and transfer system. If there is to be a high quality of life in society as a whole, as many people as possible must participate in the positive economic development. In view of the complexity of a globalised market economy, the ongoing pressures of immigration from crisis regions, and the rapid advance in digitalisation, this goal of the broadest possible social participation in economic growth is becoming increas-

ingly important. Not least with a view to social cohesion, there are many reasons to limit material inequality without providing false incentives. Against this background, the Federal Government is deliberately using its policies to strengthen the foundations for inclusive growth, social cohesion and a high quality of life.

4. A sustainable and forward looking economic and fiscal policy must keep its focus on laying the foundations for tomorrow's prosperity. Since 2014, the Federation has not taken on any new debt. This means that the Federal Government is continuing to make a substantial contribution to the positive overall development in public finances. With a debt-to-GDP ratio of probably 68 ¼ % of GDP in 2016, Germany is once again on course to meet the Maastricht criterion of 60 % for the total national debt towards the end of the decade. This will strengthen the state's ability to act in future, not least in view of the demographic challenges, as well as confidence in Germany as a place to do business. For example, an ageing population is generating greater fiscal burdens which are already being reflected in sharp rises in overall public spending on welfare, pensions, health and long-term care. These expenditure trends must be monitored diligently in order to ensure that public budgets remain capable of targeting expenditures at forward looking tasks.

5. Needs-oriented, efficiently implemented public investment can have a lasting impact on economic output and thus the sustainability of the public budgets. Against this background, the Federal Government is particularly

using the scope available to it to undertake additional investment. In total, federal investment has risen by well over a third since the beginning of the legislative term, to €36.1 billion in the 2017 federal budget. By comparison, the federal budget itself only rose by just under 7% in the same period.

6. Modern and efficient transport infrastructure is one of the key foundations for prosperity and economic growth in a modern economy. For this reason, the Federal Government is resolutely continuing its policy of substantially boosting investment in transport infrastructure. It has earmarked approximately €12.8 billion for this this year. This represents a 25 % rise compared with the situation at the start of the legislative term. In the 2030 Federal Transport Infrastructure Plan, which was adopted in August 2016, the Federal Government is setting priorities for the future development of the transport infrastructure. It will include around 1,000 projects over the next 15 years, with a total volume of approximately €270 billion.

7. In addition to the transport infrastructure, digital infrastructure is also a key strategic factor for Germany's economy. For this reason, the Federal Government has set itself the goal of making Germany one of the leaders in terms of digital infrastructure. The growing need for high-capacity digital data networks necessitates a rapid, nation-wide broadband roll-out. The increase in the budgetary funding for the broadband funding programme means that the Federal Government is now providing approximately €4 billion up to 2020 for the expansion of

Overview 1: Selected key figures for macroeconomic trends in the Federal Republic of Germany¹

	2015	2016	annual projection 2017
	Percentage change on preceding year		
Gross domestic product (GDP), output approach			
GDP (real)	1.7	1.9	1.4
Total employment	0.9	1.0	0.7
Unemployment rate in % (Federal Employment Agency definition) ²	6.4	6.1	6.0
GDP by expenditure (real)			
Private consumption expenditure	2.0	2.0	1.4
Machinery and Equipment	3.7	1.7	1.2
Construction	0.3	3.1	1.9
Domestic demand	1.6	2.2	1.6
Exports	5.2	2.5	2.8
Imports	5.5	3.4	3.8
External balance of goods and services (contribution to GDP growth) ³	0.2	-0.1	-0.1
Total gross wages and salaries per employee	2.7	2.5	2.5

1 Up to 2016 results of the Federal Statistical Office; National Accounts Status: January 2017.

2 In relation to the total labour force.

3 Absolute change external balance in per cent of pre-year GDP (= contribution to change in GDP).

forward looking broadband networks with a minimum download rate of 50 Mbit/s.

In order to facilitate the expansion of high-speed digital networks, the Bundestag and the Bundesrat adopted the Digital Networks Act last year. It aims to reduce the cost of the broadband roll-out by up to €20 billion by ensuring that all public transport infrastructure projects will include the laying of optical fibre cables where needed and that all newly developed areas are fitted with optical fibre networks. Furthermore, it will be possible in future to use all the public supply networks (electricity, gas, waste water, road, rail) for the roll-out.

8. The municipalities are responsible for the bulk of public investment. In order to put the trend of rising municipal investment activity on a permanent footing, the Federal Government has launched a large amount of relief for the Länder and municipalities in this legislative term. The most important relief provided by the Federal Government for municipalities and Länder amounts to a combined total of approximately €79 billion. In addition to this, the Federal Government has set up a special advisory service for municipalities in order to help them to control and implement investment projects.

9. In the decision of October 2016, the Federal Government reached agreement with the Länder on the restructuring of the national fiscal equalisation system from 2020. This includes measures to improve the distribution of responsibilities in the federal system. For example, the Federal Government has agreed with the Länder on setting up a new administrative structure for federal motorways and other federal trunk roads, and to expand the possibilities for the Federation to support investment in education by financially weak municipalities. The restructuring will help all the Länder to be able to comply with the borrowing limits in the years from 2020. A regional structural policy is still required in order to attain equal living standards across Germany. Following the expiry of the Solidarity Pact II in 2019, therefore, a nation-wide funding system is to be established as an anchor programme in the Joint Scheme "Improving the Regional Economic Structure".

10. The Federal Government has already relieved the burden on tax payers by more than €5 billion in 2015 and 2016. In 2017 and 2018, the tax burden on private households will again be lowered via the increase in the basic personal allowance and the child allowance, via a corresponding increase in child benefit, and via the adaptation of the tax brackets. On the basis of a draft act from the Federal Government, the Bundestag and the Bundesrat

have now adopted a reform of inheritance and gift tax. In future, in the case of major acquisitions of corporate assets, a review will take place as to whether relief is required in view of the asset situation of the person acquiring the assets. Also, the possibility to transfer private assets tax-free via an investment in corporate assets has been severely restricted.

11. The German government has made the fight against tax avoidance, tax evasion and tax dodging a centrepiece of its economic and fiscal policy. In the context of national legislation, it is providing measures to fight tax evasion and tax understatement which make use of foreign shell companies. At international level, the Federal Government is actively campaigning for the global enforcement of the standards developed by the OECD for the automatic exchange of information on transfer pricing between fiscal authorities (country-by-country reporting).

12. The Federal Government is revising the rules on competition in order to adapt them to the demands of advancing digitalisation, and to strengthen private and official enforcement of cartel law. The ninth amendment to the Act against Restraints on Competition addresses specific phenomena of the digital transformation in cartel law.

13. The Federal Government's reform of procurement law which entered into force last April thoroughly modernised the award of public contracts and concessions above the EU thresholds. The new procurement law makes the procedure more flexible and helps to substantially lower the costs of bureaucracy. Together with additional relief deriving from the two acts on reducing bureaucracy adopted during this legislative term, this means that the burden of bureaucracy is being cut by a total of nearly €2 billion. The Federal Government is now aiming to transfer the key procurement law reforms which apply above the EU threshold to public contracts below the thresholds; this is expected to reduce the cost of bureaucracy by a further €3.9 billion.

14. An adequate availability of venture capital is an important prerequisite for the founding and growth of innovative young companies in particular. Since the beginning of this legislative term, the Federal Government has taken numerous measures to substantially expand the availability of venture capital. In total, various funds and support instruments are offering €2 billion of additional venture capital in the coming years.

15. Also, at the end of last year, the Federal Government launched tax relief for the offsetting of corporate losses. In future tax can be claimed back against losses, even fol-

lowing a change of owner or a capital increase. For this to apply, the operations of the corporation must be maintained and no other use of the losses can be possible. This will also benefit young, companies with innovative business models which often rely on fresh capital or a change in shareholders for their finance.

16. The Federation and the Länder have – together with the business community – attained their stated goal of raising spending on research and development to 3% of gross domestic product. In order to ensure that Germany will remain in the top tier of economies in terms of the intensity of research and development, the aim is to continue to provide a stimulus for research and development. The Federal Government packages and coordinates its research and innovation measures in its High-tech Strategy. Small and medium-sized enterprises (SMEs) play a special role in terms of Germany's capacity for innovation. In view of a recent fall-off in spending on innovation by SMEs, innovation policy is placing a priority on boosting their innovative capacities.

17. Electric mobility is a key field of research both for the relevant branches of industry and for the development of sustainable, climate-neutral mobility. In order to support the roll-out of electric mobility, the Federal Government adopted a temporary market incentive package last year. Microelectronics is also an important driver of innovation. Sectors like automotive engineering and machinery and plant construction particularly benefit from the stimulus given by the new microelectronics research framework programme. The planned amendment of the eGovernment Act to promote open data also aims to strengthen innovation in the field of the digital economy. In future, data collections of the federal administration are to be provided to business and civil society for free use unless pertinent reasons argue against this.

18. The digitalisation of industry (*Industrie 4.0*) offers enormous potential for innovation and business in Germany. The best possible use should be made of this potential in order to safeguard Germany's industrial strengths and build on them. In the forward looking *Industrie 4.0* project, the Federal Government is therefore supporting applied research projects. *Plattform Industrie 4.0* brings together all the key stakeholders from business, science and the social partners. It drafts recommendations for action by government and guidelines in order to provide practical and targeted support for the digital transformation of manufacturing companies.

19. The legal framework for business activities must also keep pace with the digital transformation. In the Second

Act Amending the Telemedia Act, the Federal Government is therefore aiming to provide legal certainty for all providers of public wifi hot spots, and thus to boost participation in the opportunities of digitalisation. If innovative new business models of the digital economy are to meet with public acceptance, it will be vital to provide protection for personal data. The EU General Data Protection Regulation puts in place a largely uniform legal framework for the processing of personal data and will therefore make a significant contribution to establishing a level playing field in the EU. It delivers an appropriate balance between the right of the individual to have his data protected and the justified interests of companies in using these data.

20. The digitalisation of modern societies is also increasing the demands placed on the security of the information technology systems. The Federal Government's cybersecurity strategy aims to make the risks related to digitalisation manageable so that the opportunities and potential of digitalisation can be fully utilised to benefit the whole of society.

21. Digitalisation, a shift in social values, and demographic change are affecting the German labour market, as are international developments and the immigration of hundreds of thousands of workers. Even if the overall development on the labour market is extremely robust, numerous sectors are experiencing far-reaching change. The Federal Government is working actively on these dynamic processes.

22. The participation of more and more people on the labour market is a key precondition for inclusive growth and makes a major contribution to the rise in satisfaction with life in Germany seen in recent years (cf. 2016 Annual Economic Report Item 243). However, there is a need for further efforts, particularly in the light of the increasing ageing of the population. A modern approach which offers women and men flexible options in the way they shape their lives and their work will help to activate the potential skills pool and to permit greater social participation. The Federal Government is resolutely continuing its efforts to improve the compatibility of family life and work. In order to facilitate the transitions between part-time and full-time phases, the Federal Government is planning to update the right to part-time work. The Act for Greater Transparency on Remuneration is intended to help make wage disparities between women and men visible and to strengthen the principle of "equal pay for equal or equivalent work". In this way, greater transparency in the remuneration structures can help to reduce discrimination.

23. A current and central challenge to social cohesion is the integration of all the refugees who will be living in Germany for the foreseeable future. It is true that the rate of immigration of people seeking protection has fallen clearly, from 890,000 in 2015 to around 280,000 last year. However, the majority of these people have yet to be integrated into the labour market. The Federal Government's Integration Act has laid out further important policies for successful labour market integration. Also, the substantial additional funding for labour market integration and for social housing, integration courses and educational institutions for all people in Germany help to make the refugees part of society and to prevent social tensions.

24. Since 1 January 2015, the general minimum wage of €8.50 per hour in Germany has placed a line under the downward pressure on wages. Before the introduction of the general minimum wage, there were 5.5 million jobs paid at less than €8.50. The introduction of the minimum wage has resulted in four million of these becoming entitled to higher pay. In view of the considerable number of people affected, the introduction is a significant measure to improve the income situation of low-paid workers and thus the preconditions for inclusive growth. Following a recommendation by the independent minimum wage commission, the minimum wage has been increased for the first time, to €8.84 from 1 January 2017.

25. The instruments of work and services contracts and temporary agency workers are important for an adaptable economy based on a division of labour. At the same time, undesirable developments in these instruments need to be countered. The amendment to the Act on Temporary Employment adopted last year by the Bundestag orients the use of temporary agency workers to its core functions.

26. In order to ensure that all people have opportunities to obtain a good job in the long term, and particularly to open up more career prospects to the low-paid and to reduce the risks of poverty, additional efforts are needed in the field of education and training. The revision by the Federal Government of the Upgrading Training Assistance Act makes an important contribution to boosting the attractiveness of vocational training in Germany and thus to safeguarding the availability of a new generation of skilled workers and managers.

27. The material provision for the over-65s is currently very favourable. Never before have pensioner households had higher incomes and assets than today. In particular in view of the good wage development in recent years, 2016 saw the largest pension rise for 23 years. However,

the ageing society is placing increasing demands on the social security systems. Appropriate security against the fundamental risks of life needs to be ensured in an ageing society, and the same goes for the financial viability of the social security systems. The Federal Government's pension policy aims at balancing interests both between those paying in and those receiving pensions, and also between the generations. At the same time, the burden imposed on those paying in must not be excessive, and the level of pensions must not be reduced to an unacceptable degree. The Act to Strengthen Company Pensions, which is expected to enter into force on 1 January 2018, will put the policies in place for greater participation of low-earners and of employees in small and medium-sized enterprises in the benefits of corporate pension provision. The Act permits sectoral occupational pension systems which are more accessible for small and medium-sized enterprises and easy for them to plan in financial terms. Also, the Federal Government plans to gradually increase the added period for recipients of disability benefits who become pensioners by three years to 65 years in the period up to 2024. In this way, the Federal Government is helping to provide better security against the economic risk of disability and to strengthen social participation.

Further to this, the Federal Government is planning to align the calculation of pensions in eastern and western Germany. To this end, the current pension amount (east) – irrespective of the wage development in eastern Germany – is to be raised in annual stages to the western German level, starting on 1 July 2018. The Act to Flexibilise the Transition from Working Life to Retirement and to Strengthen Prevention and Rehabilitation in Working Life (the "flexi-pension") can help to ensure that the positive employment trend amongst older workers continues.

28. Good health not only contributes directly to people's quality of life, but also improves the opportunities for social participation. The Federal Government has made quality assurance in medical care one of the priorities of health policy in this legislative term. At the same time, it has taken further important measures to improve the efficiency of the structures and provision. For example, measures have been taken to increase the intensity of use of digital information in the health sector, and prevention has been strengthened on a lasting basis.

29. Affordable rents and decent accommodation are also important prerequisites for appropriate participation in society. In the context of the alliance for affordable housing, the Federal Government launched a house-building campaign at the beginning of the legislative term in order to counteract the increasing scarcity of housing.

30. The energy transition is one of the Federal Government's key projects. The restructuring of the energy supply helps Germany to meet its climate targets, to phase out nuclear power, and to continue to ensure security of supply and affordability. To this end, the Federal Government has thoroughly renewed its energy policy in this legislative term, putting it on a long-term basis and anchoring the energy transition in European law.

31. The 2017 Renewable Energy Sources Act, which entered into force at the beginning of January, introduces a paradigm shift which will make the funding of renewable energy more competitive: the level of the feed-in tariff for electricity from wind, solar and biomass will not be set by the state, as in the past, but will largely be set by technology-specific auctions. The Electricity Market Act makes the electricity market fit for renewable energy. The Act puts the rules in place for more competition between flexible supply, flexible demand, and storage. In order to ensure more efficient coordination between a large number of producers and consumers, the energy sector is to be increasingly digitalised. The Act on the Digitalisation of the Energy Transition has therefore put the preconditions in place for a successful digital networking of electricity generators and consumers in Germany.

32. Since the energy transition is changing the generation situation, the electricity grid needs to be optimised and expanded. By giving priority to placing new ultra-high voltage direct current powerlines underground, the legislature paved the way in December 2015 for a grid expansion that may be more expensive, but presumably will be faster and will meet with greater public acceptance.

33. If the energy transition is to succeed, energy needs both to be used more efficiently and to be conserved. Measures in the field of energy efficiency should help Germany to attain its ambitious climate targets. Investments in energy efficient technologies are also a driving force for innovations "made in Germany". For this reason, the Federal Government has made energy efficiency a top priority in the energy transition.

34. The Federal Government is sticking to Germany's climate targets. In order to attain the necessary cuts in greenhouse gas emissions by 2020, the Federal Government is banking on the additional climate change mitigation measures contained in the 2020 Climate Action Programme to close the reduction gap. The 2050 Climate Action Plan explains how climate policy needs to be shaped in general in order to attain the ambitious targets.

35. The European Union is faced with major challenges. The referendum in the United Kingdom in favour of leaving the European Union, the relatively restrained economic development which is still to be found in parts of the eurozone, and the migration of refugees represent a big test for the European Union. It is now important to keep the EU together and to regain the trust of Europe's citizens. In addition to a concentration on the main pan-European tasks, Europe must be made more attractive as a centre for investment, the labour markets must be made more accessible for young people, and the confidence of business people and consumers in our economies must be strengthened by further structural reforms. Against this background, the debate on the reform of the Economic and Monetary Union is of particular significance.

36. The Federal Government supports the investment plan by the European Commission, which has developed an innovative instrument in the shape of the European Fund for Strategic Investment (EFSI). The European Council welcomed an extension to the EFSI in December 2016. The plan is to expand its volume to such an extent that additional investment totalling €500 billion can be leveraged by the end of 2020.

37. The European banking union aims to safeguard the long-term stability of Europe's banking sector. The banking union is based on the common European rules, which have been translated by the Federal Government into national law in recent years. On the other hand, the Federal Government rejects a mutualisation of European deposit guarantees at this juncture and without any further decoupling of the risks of banks and states. The Federal Government believes that it is important to first reduce the risks in the banking sector.

38. In order to stabilise the financial sector on a long-term basis and to strengthen confidence in the financial markets, the Federal Government worked with its European and international partners to renew and improve the regulatory framework for the financial markets following the financial market crisis. In recent years, it has initiated and implemented many measures aimed at providing better protection for the overall economy against shocks from the financial sector and at maintaining financial stability. Also, it has adapted the rules to ensure that those who take risks can be better called to account for possible losses.

39. The Federal Government continues to support the goal of an ambitious and balanced trade and investment agreement between the EU and the USA. It aims to ensure that high standards of protection, particularly in

the field of protection for the environment, workers, consumers and data, as well as IT security and public services, can be maintained or put in place, and that the precautionary principle is retained. CETA, the Comprehensive Economic and Trade Agreement between the EU, the EU Member States and Canada, sets standards in terms of shaping globalisation in a fair and sustainable manner.

40. The Federal Government works towards a fair regime for international economic relations and, as the holder of the G20 Presidency, has assumed special responsibility for international cooperation on financial and economic

issues. The G20 is called on to utilise its cooperation to enhance the benefits of globalisation and global networking and to share them more widely. Under the German Presidency, the G20 will initiate a debate on the opportunities and risks of globalisation.

41. The Federal Government has committed to an ambitious implementation of the UN's 2030 Agenda for Sustainable Development at all levels and in all policy fields, and has agreed on representative indicators with specific, long-term targets in its sustainability strategy. This places the focus even more strongly on the long-term and global repercussions of national economic and fiscal policy.