

PRESS RELEASE

Strengthening potential output through investment and innovation

- The long-term growth prospects of the German economy - measured by the growth rate of potential output - will be increasingly dampened by labour shortages in the coming decades.
- Skilled immigration and stronger employment incentives, as well as substituting labour with new capital goods can mitigate the growth-dampening effects of the declining labour volume .
- Policymakers should support structural change and create the appropriate regulatory framework to enable the reallocation of capital and labour to their most productive uses.
- Investments in capital goods, new general purpose technologies, such as Artificial Intelligence (AI), and in innovation more generally can sustainably strengthen growth.

Wiesbaden, 08.11.2023 – Germany's medium-term growth prospects are at a historic low. According to the medium-term projection of the German Council of Economic Experts (GCEE), potential output will only grow by an average of 0.4 percent per year until 2028 if current dynamics continue unchanged. This would be merely one-third of the average growth rate of the 2010s and is primarily due to the declining labour volume. However, growth prospects can be decisively improved by increasing productivity growth, through higher investment and by stabilising the labour volume.

“There is an urgent need for economic policy decisions to improve growth prospects,” explains council member Veronika Grimm. “Policymakers must create a suitable framework conditions to promote the reallocation of capital and labour to their most productive use, thus supporting the process of structural change. It will not be enough to simply increase the labour volume through, for example, immigration or higher female labour force participation. Only strong investment can increase potential output.”

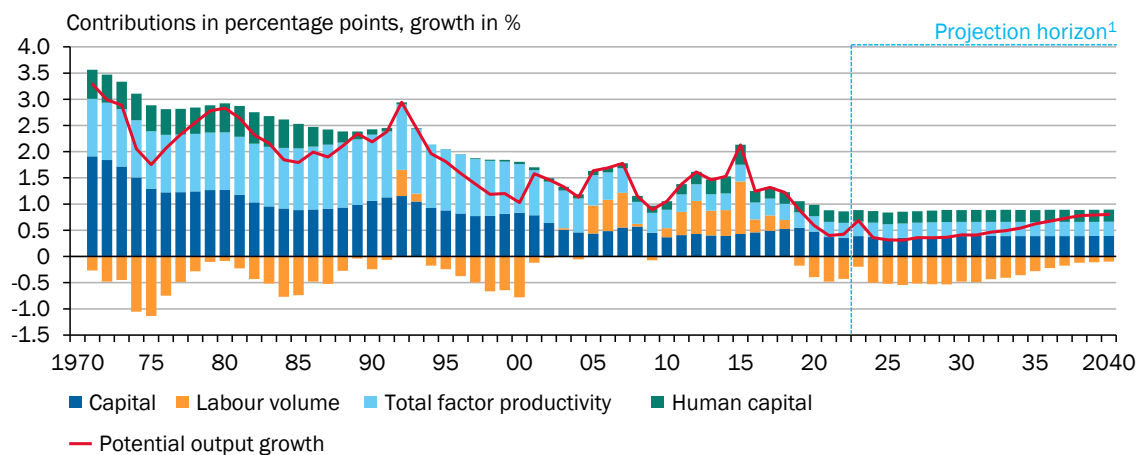
However, investment rates are currently declining in all sectors of the economy. Urgent prerequisites for making investment in Germany more attractive are a massive expansion of the digital and energy infrastructure and an acceleration of planning and approval procedures. Urgent transformational tasks are made more difficult by geopolitical developments, as trade relations have to become more resilient at the same time.

Investments in capital goods, such as machinery and equipment, software, robotization and automation systems, accelerate technological progress and can compensate for a decline in the labour volume. Artificial intelligence (AI), as a general purpose technology, can increase productivity growth across the economy. For this to succeed, AI research in Germany must be strengthened and appropriate applications must be developed. In the medium to long term, strong advances in productivity can be achieved through improving primary and

secondary education as well as strengthening universities and non-university research institutions. In addition to mobilising domestic investment, diversifying and strengthening foreign direct investment can stabilise the growth of potential output.

The higher the growth of potential output, the greater the German economy's scope will be, on the one hand, for allocating available resources for consumption and investment activities, and, on the other hand, for financing government services and redistributing income across the population.

Outlook for potential growth dampened by demographics



1 – Values for 2023 and 2024 are based on the short-term forecast by the GCEE. From 2025 projection.

Sources: Federal Statistical Office, IAB, OECD, own calculations
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The German Council of Economic Experts (GCEE) provides support to policymakers and the general public on questions and matters of economic policy. It was founded as an independent body in 1963 and currently consists of the council members: Professor Dr. Veronika Grimm, Prof. Dr. mult. Dr. h.c. Ulrike Malmendier, Professor Dr. Dr. h.c. Monika Schnitzer (chair) Professor Dr. Achim Truger, Professor Dr. Martin Werding. By publishing regular reports, the GCEE aims to help the general public and decision-makers in politics, business and society to form a reasoned opinion on economic policy developments in Germany.

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